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PARAGON TECHNOLOGIES INC
Form 10-Q
November 13, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 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, 2007

Commission File Number: 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, Pennsylvania	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 No

Indicate by checkmark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check

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one):

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by checkmark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of the Registrant's Common Stock, \$1.00 par value, outstanding as of November 6, 2007 was 2,769,192.

[PARAGON TECHNOLOGIES, INC. LOGO]

Paragon Technologies, Inc.
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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

 Paragon Technologies, Inc.
 Balance Sheets (Unaudited)
 September 30, 2007 and December 31, 2006
 (In Thousands, Except Share Data)

	September 30, 2007	December 31, 2006
	-----	-----
Assets		

Current assets:		
Cash and cash equivalents.....	\$ 3,671	2,447
Short-term investments.....	6,780	9,625
	-----	-----
Total cash and cash equivalents and short-term investments.....	10,451	12,072
	-----	-----
Receivables:		
Trade.....	4,098	2,557
Notes and other receivables.....	455	428
	-----	-----
Total receivables.....	4,553	2,985
	-----	-----
Costs and estimated earnings in excess of billings.....	1,591	444
Inventories:		
Raw materials.....	127	100
Work-in-process.....	46	29
Finished goods.....	506	340
	-----	-----

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Total inventories.....	679	469
Deferred income tax benefits.....	338	288
Prepaid expenses and other current assets.....	184	112
Total current assets.....	17,796	16,370
Property, plant and equipment, at cost:		
Machinery and equipment.....	1,291	1,195
Less: accumulated depreciation.....	990	919
Net property, plant and equipment.....	301	276
Deferred income tax benefits.....	77	96
Other assets.....	6	10
Total assets.....	\$ 18,180	16,752

See accompanying notes to financial statements.

(Continued)

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Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.
 Balance Sheets (Unaudited) (Continued)
 September 30, 2007 and December 31, 2006
 (In Thousands, Except Share Data)

	September 30, 2007	December 31, 2006
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable.....	\$ 3,514	1,177
Customers' deposits and billings in excess of costs and estimated earnings	992	1,394
Accrued salaries, wages, and commissions.....	230	132
Income taxes payable.....	-	541
Accrued product warranty.....	240	192

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Deferred gain on sale-leaseback.....	69	165
Unearned support contract revenue.....	220	270
Accrued other liabilities.....	353	425
	-----	-----
Total current liabilities.....	5,618	4,296
	-----	-----
Long-term liabilities:		
Income taxes payable.....	257	-
Deferred gain on sale-leaseback.....	-	28
	-----	-----
Total long-term liabilities.....	257	28
	-----	-----
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$1 par value; authorized 20,000,000 shares; issued and outstanding 2,769,192 shares as of September 30, 2007 and 2,873,891 shares as of December 31, 2006.....	2,769	2,874
Additional paid-in capital.....	5,531	5,720
Retained earnings.....	4,005	3,834
	-----	-----
Total stockholders' equity.....	12,305	12,428
	-----	-----
Total liabilities and stockholders' equity..	\$ 18,180	16,752
	=====	=====

See accompanying notes to financial statements.

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Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Statements of Operations (Unaudited)

For the Three and Nine Months Ended September 30, 2007 and 2006

(In Thousands, Except Share and Per Share Data)

	Three Months Ended		Nine Months
	September 30, 2007	September 30, 2006	September 30, 2007
	-----	-----	-----
Net sales.....	\$ 7,298	5,209	16,924
Cost of sales.....	5,559	3,808	12,780
	-----	-----	-----
Gross profit on sales.....	1,739	1,401	4,144
	-----	-----	-----

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Selling, general and administrative expenses...	1,382	1,299	4,322
Product development costs....	27	4	95
Interest expense.....	1	-	1
Interest income.....	(108)	(133)	(337)
Other income, net.....	(2)	(52)	(21)
	-----	-----	-----
	1,300	1,118	4,060
	-----	-----	-----
Income before income taxes.....	439	283	84
Income tax expense (benefit).....	(217)	44	(315)
	-----	-----	-----
Net income.....	\$ 656	239	399
	=====	=====	=====
Basic earnings per share.....	\$.24	.07	.14
	=====	=====	=====
Diluted earnings per share.....	\$.24	.07	.14
	=====	=====	=====
Weighted average shares outstanding.....	2,769,192	3,193,746	2,798,772
Dilutive effect of stock options.....	-	2,809	-
	-----	-----	-----
Weighted average shares outstanding assuming dilution.....	2,769,192	3,196,555	2,798,772
	=====	=====	=====

See accompanying notes to financial statements.

Item 1. Financial Statements (Continued)

 Paragon Technologies, Inc.
 Statements of Cash Flows (Unaudited)
 For the Nine Months Ended September 30, 2007 and 2006
 (In Thousands, Except Share Data)

Nine Months Ended	
September 30, 2007	September 30, 2006
-----	-----
-----	-----

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Cash flows from operating activities:		
Net income.....	\$ 399	411
Adjustments to reconcile net income to net cash used by operating activities:		
Depreciation of plant and equipment.....	82	73
Loss on disposition of equipment.....	-	2
Deferred tax expense.....	36	55
Amortization of deferred gain on sale- leaseback.....	(124)	(124)
Stock-based compensation.....	8	28
Change in operating assets and liabilities:		
Receivables.....	(1,568)	305
Costs and estimated earnings in excess of billings.....	(1,147)	(149)
Inventories.....	(210)	(149)
Prepaid expenses and other current assets.....	(72)	103
Other assets.....	4	-
Accounts payable.....	2,337	(380)
Customers' deposits and billings in excess of costs and estimated earnings.....	(402)	(984)
Accrued salaries, wages, and commissions.....	98	147
Income taxes payable.....	(314)	(59)
Accrued product warranty.....	48	92
Unearned support contract revenue.....	(50)	(32)
Accrued other liabilities.....	(72)	(116)
Net cash used by operating activities.....	(947)	(777)
Cash flows from investing activities:		
Proceeds from sales of short-term investments.....	3,345	5,995
Purchases of short-term investments.....	(500)	(500)
Purchases of property, plant and equipment.....	(107)	(127)
Net cash provided by investing activities.....	2,738	5,368

See accompanying notes to financial statements.

(Continued)

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.
Statements of Cash Flows (Unaudited) (Continued)
For the Nine Months Ended September 30, 2007 and 2006
(In Thousands, Except Share Data)

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	Nine Months Ended	
	September 30, 2007	September 30, 2006
Cash flows from financing activities:		
Repurchase and retirement of common stock.....	(567)	(3,809)
Net cash used by financing activities.....	(567)	(3,809)
Increase in cash and cash equivalents.....	1,224	782
Cash and cash equivalents, beginning of period.....	2,447	687
Cash and cash equivalents, end of period.....	\$ 3,671	1,469
Supplemental disclosures of cash flow information:		
Cash paid (received) during the period for:		
Interest expense.....	\$ 1	1
Income taxes.....	\$ (36)	(371)

See accompanying notes to financial statements.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2007 and 2006

(1) Basis of Financial Statement Presentation

The accompanying unaudited financial statements have been prepared in accordance with the requirements for Form 10-Q and Article 10 of Regulation S-X and, accordingly, certain information and footnote disclosures have been condensed or omitted. 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. Certain prior year amounts have been reclassified to conform to the current year's presentation. Results for interim periods are not necessarily indicative of results expected for the full fiscal year.

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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 the Company's annual report on Form 10-K for the year ended December 31, 2006 as filed with the Securities and Exchange Commission on March 30, 2007. Refer to the Company's annual report on Form 10-K for the year ended December 31, 2006 for more complete financial information.

Use of Estimates

The preparation of the financial statements, in conformity with U.S. generally accepted accounting principles, requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The judgments made in assessing the appropriateness of the estimates and assumptions utilized by management in the preparation of the financial statements are based on historical and empirical data and other factors germane to the nature of the risk being analyzed. Materially different results may occur if different assumptions or conditions were to prevail. Estimates and assumptions are mainly utilized to establish the appropriateness of the inventory valuation, warranty reserve, and revenue recognition.

(2) Short-Term Investments

The Company's short-term investments are comprised of debt securities, all classified as available for sale, that are carried at cost, which approximates fair value of the investments at period end. The debt securities include state and municipal bonds. The short-term investments are on deposit with a major financial institution and are supported by letters of credit.

(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, typically two percent of the cost of the system being sold, and a detailed review of products still in the warranty period is performed each quarter.

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

	Beginning Balance January 1	Additions (Reductions) Charged to Costs and Expenses	Deductions	En Ba Septe
2007.....	\$ 192	127	(79)	
2006.....	\$ 189	135	(43)	

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Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2007 and 2006

(4) Business Operations

----- Company Overview

Paragon, based out of Easton, Pennsylvania, provides a variety of material handling solutions, including systems, technologies, products, and services for material flow applications. The Company's capabilities include horizontal transportation, rapid dispensing, order fulfillment, computer software, sortation, integrating conveyors and conveyor systems, and aftermarket services. The Company is a Delaware corporation, originally incorporated in 1958.

The Company (also referred to as "SI Systems") is a specialized systems integrator supplying SI Systems' branded automated material handling systems to manufacturing, assembly, order fulfillment, and distribution operations customers located primarily in North America, including the U.S. government. SI Systems is brought to market as two individual brands, SI Systems' Order Fulfillment Systems (hereafter referred to as "SI Systems OFS") and SI Systems' Production & Assembly Systems (hereafter referred to as "SI Systems PAS"). Each brand has its own focused sales force, utilizing the products and services currently available or under development within the Company.

The SI Systems OFS sales force focuses on providing order fulfillment systems to order processing and distribution operations, which may incorporate the Company's proprietary DISPEN-SI-MATIC(R) and automated order fulfillment solutions and specialized software from the SYNTHESIS(TM) Software Suite. SYNTHESIS(TM) is comprised of eight proprietary software groups, with 26 extendible software modules that continually assess real-time needs and deploy solutions to accurately facilitate and optimize planning, warehousing, inventory, routing, and order fulfillment within the distribution process. The SI Systems PAS sales force focuses on providing automated material handling systems to manufacturing and assembly operations and the U.S. government, which may incorporate the Company's proprietary LO-TOW(R) and CARTRAC(R) horizontal transportation technologies.

The Company's 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. The Company's integrated material handling solutions involve both standard and specially designed components and include integration of non-proprietary automated handling technologies to provide turnkey solutions for its customers' unique material handling needs. The Company's engineering staff develops and designs computer control programs required for the efficient operation of the systems and for optimizing manufacturing, assembly, and fulfillment operations.

The Company continues to review opportunities with the goal of maximizing resources, increasing stockholder value, and considering strategies and transactions intended to provide liquidity. At this time, the Company believes that an increase in stockholder value will be best obtained

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through increases in the Company's internal technology base, strengthening the Company's sales and marketing capabilities, growth of the Company's continuing operations and other higher growth markets, by the enhancement of the Company's products with advanced proprietary software capabilities through research and development efforts and/or possible acquisitions, mergers, and joint ventures. Although the Company enters into preliminary discussions and non-disclosure agreements from time to time, the Company does not have any material definitive agreements in place. There is no assurance that the Company will be able to consummate any such acquisition.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.
Notes To Financial Statements (Unaudited)
For the Three and Nine Months Ended September 30, 2007 and 2006

(4) Business Operations (Continued)

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 during the three and nine months ended September 30, 2007 and 2006 are as follows (in thousands):

For the three months ended September 30, 2007 and 2006:

	September 30, 2007		September 30, 2006	
	Sales	% of Total Sales	Sales	% of Total Sales
Systems sales.....	\$ 6,352	87.0%	\$ 4,414	84.3%
Aftermarket sales.....	946	13.0%	795	15.7%
Total sales.....	\$ 7,298	100.0%	\$ 5,209	100.0%

For the nine months ended September 30, 2007 and 2006:

	September 30, 2007		September 30, 2006	
	Sales	% of Total Sales	Sales	% of Total Sales
Systems sales.....	\$ 14,275	84.3%	\$ 11,845	83.3%
Aftermarket sales.....	2,649	15.7%	2,407	16.7%

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Total sales.....	\$ 16,924	100.0%	\$ 14,252	100
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The Company's products are sold worldwide through its own sales personnel. Domestic and international sales during the three and nine months ended September 30, 2007 and 2006 are as follows (in thousands):

For the three months ended September 30, 2007 and 2006:

	September 30, 2007		September 30, 2006	
	Sales	% of Total Sales	Sales	% of Total Sales
Domestic sales.....	\$ 4,793	65.7%	\$ 4,787	91
International sales.....	2,505	34.3%	422	8
Total sales.....	\$ 7,298	100.0%	\$ 5,209	100

For the nine months ended September 30, 2007 and 2006:

	September 30, 2007		September 30, 2006	
	Sales	% of Total Sales	Sales	% of Total Sales
Domestic sales.....	\$ 12,111	71.6%	\$ 13,688	96
International sales.....	4,813	28.4%	564	4
Total sales.....	\$ 16,924	100.0%	\$ 14,252	100

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2007 and 2006

(4) Business Operations (Continued)

Sales from external customers for each of the Company's products during the three and nine months ended September 30, 2007 and 2006 are as follows (in thousands):

For the three months ended September 30, 2007 and 2006:

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	September 30, 2007		September 30, 2006	
	Sales	% of Total Sales	Sales	% of Total Sales
LO-TOW(R) sales.....	\$ 2,287	31.3%	\$ 1,968	37.1%
CARTRAC(R) sales.....	64	.9%	1,012	19.2%
DISPEN-SI-MATIC(TM), SINTHESIS(TM), and related order fulfillment sales.....	4,001	54.8%	1,434	27.3%
Other sales.....	-	-	-	-
Aftermarket sales.....	946	13.0%	795	15.0%
Total sales.....	\$ 7,298	100.0%	\$ 5,209	100.0%

For the nine months ended September 30, 2007 and 2006:

	September 30, 2007		September 30, 2006	
	Sales	% of Total Sales	Sales	% of Total Sales
LO-TOW(R) sales.....	\$ 5,693	33.6%	\$ 4,539	31.3%
CARTRAC(R) sales.....	119	.7%	1,924	13.3%
DISPEN-SI-MATIC(TM), SINTHESIS(TM), and related order fulfillment sales.....	8,428	49.8%	5,382	37.3%
Other sales.....	35	.2%	-	-
Aftermarket sales.....	2,649	15.7%	2,407	16.5%
Total sales.....	\$ 16,924	100.0%	\$ 14,252	100.0%

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

The Company's backlog of orders at September 30, 2007 and September 30, 2006 were \$7,172,000 and \$4,879,000, respectively.

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 or upgrading their current production or distribution sites. The customers' timing and placement of new orders is often affected by factors such as the current economy, current interest rates, and future expectations. The Company believes that its business is not subject to seasonality, although the rate of new orders can vary substantially from month to month. Since the Company recognizes sales on a percentage of completion basis for its systems

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contracts, fluctuations in the Company's sales and earnings occur with increases or decreases in major installations.

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Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2007 and 2006

(5) Recently Issued Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board issued Interpretation No. 48 ("FIN 48"), Accounting for Uncertainty in Income Taxes--an interpretation of FASB Statement No. 109, Accounting for Income Taxes, which clarifies the accounting for uncertainty in income taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation requires that the Company recognize in the financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. The Company adopted the provisions of FIN 48 on January 1, 2007 as described in Note 11 of the Notes to Financial Statements.

In September 2006, the Financial Accounting Standards Board issued SFAS No. 157, Fair Value Measurements ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a market-based framework or hierarchy for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. SFAS No. 157 does not expand or require any new fair value measures. The provisions of SFAS No. 157 are to be applied prospectively and are effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact, if any, the adoption of SFAS No. 157 will have on the Company's financial statements.

In February 2007, the Financial Accounting Standards Board issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115" ("SFAS No. 159"). SFAS No. 159 permits entities to elect to measure many financial instruments and certain other items at fair value. Upon adoption of SFAS No. 159, an entity may elect the fair value option for eligible items that exist at the adoption date. Subsequent to the initial adoption, the election of the fair value option should only be made at initial recognition of the asset or liability or upon a remeasurement event that gives rise to new-basis accounting. The decision about whether to elect the fair value option is applied on an instrument-by-instrument basis, is irrevocable and is applied only to an entire instrument and not only to specified risks, cash flows or portion of that instrument. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value nor does it eliminate disclosure requirements included in other accounting standards. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently

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evaluating the impact, if any, the adoption of SFAS No. 159 will have on the Company's financial statements.

(6) Sale-Leaseback

The Company's principal office is located in a 173,000 square foot, concrete, brick, and steel facility in Easton, Pennsylvania. 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 \$19,345 (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 leasing agreement is secured with a \$200,000 letter of credit. The lease expires on February 21, 2008.

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Item 1. Financial Statements (Continued)
Paragon Technologies, Inc.
Notes To Financial Statements (Unaudited)
For the Three and Nine Months Ended September 30, 2007 and 2006

(6) Sale-Leaseback (Continued)

In accordance with SFAS No. 13 and SFAS No. 28, the leaseback does not meet the criteria for classification as a capital lease; hence, it is classified as an operating lease. The sale-leaseback resulted in a total gain of \$2,189,000, of which \$1,363,000 was recorded as a gain in 2003. The seller-lessee (Company) retained more than a minor part (25,000 square feet) but less than substantially all of the use of the property (173,000 square feet) through the leaseback and realized a profit on the sale in excess of the present value of the minimum lease payments over the lease term. The present value of the stream of lease payments utilizing the Company's incremental borrowing rate of 10.0% was \$826,000. The \$826,000 of deferred profit is amortized in equal amounts as a reduction in rent expense over the five-year term of the lease. The amortization of the deferred profit will expire during the first quarter of 2008. During the three months ended September 30, 2007 and 2006, \$41,000 and \$41,000, respectively, of the deferred gain was recognized. During the nine months ended September 30, 2007 and 2006, \$124,000 and \$124,000, respectively, of the deferred gain was recognized.

(7) Line of Credit

The Company has a line of credit facility which may not exceed \$5,000,000 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%. As of September 30, 2007, the Company did not have any borrowings under the line of credit facility; however, the leasing agreement associated with the Company's principal office is secured with a \$200,000 letter of credit. Therefore, as of September 30, 2007, the amount of available line of credit was \$4,800,000.

The line of credit facility contains various non-financial covenants and is secured by all of the Company's accounts receivables and inventory. The

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Company was in compliance with all covenants as of September 30, 2007. The line of credit facility expires effective June 30, 2008.

(8) Stock Repurchase Program

On August 12, 2004, the Company's Board of Directors approved a program to repurchase up to \$1,000,000 of its outstanding common stock. The Company's Board of Directors amended its existing stock repurchase program on several occasions during 2005 and 2006 by increasing the amount it has authorized management to repurchase from up to \$1,000,000 of the Company's common stock to up to \$14,000,000.

On January 7, 2007, the Company's Board of Directors amended its existing stock repurchase program by increasing the amount it has authorized management to repurchase from up to \$14,000,000 of the Company's common stock to up to \$15,000,000.

There were no repurchases during the three months ended September 30, 2007. During the nine months ended September 30, 2007, the Company repurchased 99,699 shares of common stock at a weighted average cost, including brokerage commissions, of \$5.68 per share. Cash expenditures for the stock repurchases during the nine months ended September 30, 2007 were \$566,732. Through September 30, 2007, the Company repurchased 1,637,718 shares of common stock at a weighted average cost, including brokerage commissions, of \$8.62 per share. Cash expenditures for the stock repurchases since the inception of the program were \$14,116,143. As of September 30, 2007, \$883,857 remained available for repurchases under the stock repurchase program.

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Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2007 and 2006

(8) Stock Repurchase Program (Continued)

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. The purchase price for the shares of the Company's common stock repurchased was reflected as a reduction to stockholders' equity. The Company allocates the purchase price of the repurchased shares as a reduction to common stock for the par value of the shares repurchased, with the excess of the purchase price over par value being allocated between additional paid-in capital and retained earnings. All shares of common stock that were repurchased by the Company since the inception of the program were subsequently retired.

(9) Unearned Support Contract Revenue

The Company offers its Order Fulfillment customers one-year support

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

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

(10) Stock-Based Compensation

Effective January 1, 2006, the Company adopted SFAS No. 123R and began expensing the grant-date fair value of employee stock options over the related requisite service period.

The Company adopted SFAS No. 123R using the modified prospective transition method. Under this transition method, compensation cost associated with employee stock options recognized after December 31, 2005 includes attribution of the fair value related to the remaining unvested portion of stock option awards granted prior to January 1, 2006, if any, and attribution related to new awards granted after January 1, 2006.

The expense associated with stock-based compensation arrangements is a non-cash charge. In the Statements of Cash Flows, stock-based compensation expense is an adjustment to reconcile net income to net cash provided (used) by operating activities. SFAS No. 123R requires that certain cash flows resulting from tax deductions in excess of compensation cost recognized in the financial statements be classified as financing cash flows. For the nine months ended September 30, 2007 and for the year ended December 31, 2006, no excess tax benefits were generated.

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Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2007 and 2006

(10) Stock-Based Compensation (Continued)

1997 Equity Compensation Plan

The Company's stock-based compensation program, the 1997 Equity Compensation Plan ("ECP"), expired in July 2007. Prior to the expiration, the ECP provided for grants of stock options, restricted and nonvested stock, and stock appreciation rights to selected key employees, key advisors who performed valuable services, and directors of the Company. In addition, the ECP provided for grants of performance units to employees and key advisors. Prior to the expiration, the ECP, as amended by stockholders in August 2000 and June 2001, authorized up to 1,012,500 shares of common stock for issuance pursuant to the terms of the plan. No further grants are available under the plan.

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Under the Company's ECP, officers, directors, and key employees have been granted options to purchase shares of common stock at the market price at the date of grant. Options vest in four equal annual installments beginning on the first anniversary of the date of grant; thus, at the end of four years, the options are fully exercisable. Vested stock option awards may be exercised through payment of cash, exchange of mature shares, or through a broker. As of September 30, 2007, 7,500 options are outstanding under the plan, and all options have a term of seven years.

Stock-based compensation expense recognized during the three months ended September 30, 2007 and 2006 for stock-based compensation programs was \$6,000 and \$10,000, respectively. Stock-based compensation expense recognized during the three months ended September 30, 2007 and 2006 consisted of expensing \$1,000 and \$2,000, respectively, for employee stock options, and \$0 and \$0, respectively, for directors' stock options, and \$5,000 and \$8,000, respectively, for nonvested stock.

Stock-based compensation expense recognized during the nine months ended September 30, 2007 and 2006 for stock-based compensation programs was \$8,000 and \$28,000, respectively. Stock-based compensation expense recognized during the nine months ended September 30, 2007 and 2006 consisted of expensing \$4,000 and \$5,000, respectively, for employee stock options, and \$0 and \$5,000, respectively, for directors' stock options, and \$4,000 and \$18,000 respectively, for nonvested stock.

All of the stock-based compensation expense recognized was a component of selling, general and administrative expenses. Income was recognized during the three months ended March 31, 2007 as a result of the forfeiture of 5,000 shares of nonvested stock due to the resignation of Mr. Hoffner from the Company effective March 1, 2007.

Item 1. Financial Statements (Continued)

 Paragon Technologies, Inc.
 Notes To Financial Statements (Unaudited)
 For the Three and Nine Months Ended September 30, 2007 and 2006

(10) Stock-Based Compensation (Continued)

 Stock Options
 A summary of stock option activity is presented below:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In Years)
	-----	-----	-----
Outstanding at January 1, 2007.....	32,500	\$ 8.89	

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Granted.....	-	-	
Exercised.....	-	-	
Forfeited.....	(25,000)	8.56	
	-----	-----	
Outstanding at September 30, 2007.....	7,500	\$ 10.01	5.4
	=====	=====	
Exercisable at September 30, 2007.....	1,875	\$ 10.01	5.4

There were no stock options granted during the nine months ended September 30, 2007.

The compensation expense charged against income during the three months ended September 30, 2007 and 2006 for stock options was \$1,000 and \$2,000, respectively. The compensation expense charged against income during the nine months ended September 30, 2007 and 2006 for stock options was \$4,000 and \$10,000, respectively. The total compensation expense of \$23,000 is expected to be recognized on the straight-line basis over the stated vesting period consistent with the terms of the arrangement. As of September 30, 2007, there is unrecognized compensation cost of \$12,000 on the stock option awards which will be recognized over the next 2.4 years.

As of December 31, 2005, there were no unvested employee stock options. Therefore, no compensation cost related to stock options granted to employees prior to January 1, 2006 was recognized.

Nonvested Stock

The grant-date fair value of nonvested stock is determined on the date of grant based on the market price of the stock, and compensation cost is generally amortized to expense on a straight-line basis over the vesting period during which employees perform related services.

On March 8, 2006, the Company issued 12,500 shares of nonvested stock to its executive officers. Participants are entitled to cash dividends and to vote their respective shares. The shares are subject to forfeiture if employment is terminated prior to March 8, 2010.

On March 1, 2007, Mr. Hoffner resigned from his positions as President and CEO and as a director of the Company. Due to his resignation from the Company, Mr. Hoffner forfeited his 5,000 shares of nonvested stock.

Item 1. Financial Statements (Continued)

 Paragon Technologies, Inc.
 Notes To Financial Statements (Unaudited)
 For the Three and Nine Months Ended September 30, 2007 and 2006

(10) Stock-Based Compensation (Continued)

 A summary of nonvested stock activity is presented below:

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	Nonvested Shares	Grant Date Fair Value
	-----	-----
Nonvested at January 1, 2007.....	12,500	\$ 10.01
Granted.....	-	-
Vested.....	-	-
Forfeited.....	(5,000)	10.01
	-----	-----
Nonvested at September 30, 2007.....	7,500	\$ 10.01
	=====	=====

The compensation expense recognized during the three months ended September 30, 2007 and 2006 for nonvested stock awards was \$5,000 and \$8,000, respectively. The compensation expense recognized during the nine months ended September 30, 2007 and 2006 for nonvested stock awards was \$4,000 and \$18,000, respectively. The total compensation cost of \$75,000 is expected to be recognized on the straight-line basis over the four-year vesting period consistent with the terms of the arrangement. As of September 30, 2007, there is unrecognized compensation cost of \$45,000 on the nonvested stock awards which will be recognized over the next 2.4 years.

(11) Income Taxes

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

On January 1, 2007, the Company adopted the Financial Accounting Standards Board Interpretation No. 48 ("FIN 48"), Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109, Accounting for Income Taxes, which clarifies the accounting for uncertainty in income taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation requires that the Company recognize in the financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure.

As a result of the implementation of FIN 48, the Company recognized a decrease of \$37,000 in the liability for unrecognized tax benefits, which was accounted for as an increase to the January 1, 2007 balance of retained earnings. As of the date of adoption and after the impact of recognizing the decrease in liability noted above, the Company's unrecognized tax benefits totaled \$692,000, of which \$590,000 would impact the effective tax rate if recognized.

The Company recognizes interest and penalties to income tax matters in income tax expense. In conjunction with the adoption of FIN 48, the Company recognized approximately \$117,000 (\$80,000, net of federal benefit) for potential interest and

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2007 and 2006

(11) Income Taxes (Continued)

penalties at January 1, 2007 which is included as a component of the \$692,000 unrecognized tax benefit noted above. To the extent interest and penalties are not assessed with respect to uncertain tax positions, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision.

During the three and nine months ended September 30, 2007, unrecognized tax benefits decreased by approximately \$315,000 due to the expiration of statutes of limitations. As of September 30, 2007, the Company's unrecognized tax benefits totaled \$358,000, of which \$275,000 would impact the effective tax rate if recognized.

During the three and nine months ended September 30, 2007, the Company recognized approximately \$69,000 (\$53,000, net of federal benefit) for potential interest and penalties, which is a component of the \$358,000 unrecognized tax benefit noted above.

The Company estimates that the total unrecognized tax benefits may decrease by approximately \$30,000 due to the expiration of statutes of limitations prior to September 30, 2008.

With few exceptions, the Company is no longer subject to examination by major taxing authorities and jurisdictions (including U.S. Federal) for years prior to 2004.

The Company recognized an income tax benefit of \$217,000 during the three months ended September 30, 2007 compared to income tax expense of \$44,000 during the three months ended September 30, 2006. The income tax benefit for the three months ended September 30, 2007 was higher than statutory federal and state tax rates primarily due to the reversal of accruals for the expiration of tax return statutes, the effect of tax-exempt interest on certain investments on the annualized effective rate, and an adjustment in the effective income tax rate expected to apply based on the projected profitability of the Company for 2007. Income tax expense for the three months ended September 30, 2006 was lower than statutory federal and state tax rates primarily due to the effect of tax-exempt interest on certain investments on the annualized effective rate.

The Company recognized an income tax benefit of \$315,000 during the nine months ended September 30, 2007 compared to income tax expense of \$1,000 during the nine months ended September 30, 2006. The income tax benefit for the nine months ended September 30, 2007 was higher than statutory federal and state tax rates primarily due to the reversal of accruals for the expiration of tax return statutes, the effect of tax-exempt interest on certain investments on the annualized effective rate, and an adjustment in the effective income tax rate expected to apply based on the projected profitability of the Company for 2007. Income tax expense for the nine

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months ended September 30, 2006 was lower than statutory federal and state tax rates primarily due to the reversal of accruals for the expiration of tax return statutes and the effect of tax-exempt interest on certain investments on the annualized effective rate.

(12) Legal Proceedings

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

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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 financial statements and related notes thereto included in this Quarterly Report on Form 10-Q for the period ended September 30, 2007, 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, 2006. 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. Founded in 1958, the Company's 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.

----- Key Performance Metrics Relevant to the Company -----

Capacity Utilization -----

Capacity Utilization, as documented in the Federal Reserve Statistical

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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 and falls, the Company may see a corresponding change in the rate of new orders, and therefore, a corresponding change 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, the 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, 2007, and for the years ended December 31, 2006, 2005, 2004, 2003, and 2002:

(Dollars in Thousands)	Nine Months Ended September 30, 2007	Year Ended December 31			
		2006	2005	2004	2003
Backlog of orders - Beginning.....	\$ 5,932	6,918	5,514	4,052	4,052
Add: orders.....	18,164	16,802	18,080	13,164	11,702
Less: sales.....	16,924	17,788	16,676	11,702	12,164
Backlog of orders - Ending.....	\$ 7,172	5,932	6,918	5,514	4,052
Capacity Utilization (1).....	81.7%	81.7%	80.2%	78.1%	76.1%

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

 Results of Operations (Continued)

Current Ratio

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, 2007 and as of December 31, 2006, 2005, 2004, 2003, and 2002:

(Dollars in Thousands)	As of September 30, 2007	As of December 31		
		2006	2005	2004

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Current assets.....	\$ 17,796	16,370	22,134	14,249
Current liabilities.....	\$ 5,618	4,296	5,337	7,355
Current ratio.....	3.17	3.81	4.15	1.94

Debt to Equity Ratio

With an emphasis on generating cash flows to eliminate the Company's senior and subordinated debt, the Company eliminated its financial leverage in 2003 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 stockholders 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, 2007 and as of December 31, 2006, 2005, 2004, 2003, and 2002 and also includes the number of shares outstanding at the end of each fiscal period:

(Dollars in Thousands)	As of September 30,	As of December 31,		
	2007	2006	2005	2004
Current installments of long-term debt.....	\$ -	-	-	-
Long-term debt.....	-	-	-	-
Total debt.....	-	-	-	-
Total stockholders' equity (1).....	\$ 12,305	12,428	17,066	23,308
Debt to equity ratio.....	-	-	-	-
Number of shares outstanding at the end of the fiscal period.....	2,769,192	2,873,891	3,539,019	4,265,310

Critical Accounting Policies and Estimates

The discussion and analysis of the Company's financial condition and results of operations are based upon the Company's financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires the Company 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 the Company's financial statements. Actual results may, under different assumptions and conditions, differ significantly from the Company's estimates.

The Company believes that its accounting policies related to revenue

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recognition on system sales, warranty, and inventories are its "critical accounting policies." These policies have been reviewed with the Audit Committee of the Board of Directors and are discussed in greater detail below.

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, 2007, there are 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 nine months ended September 30, 2007.

Accrued Product Warranty

The Company's products are warranted against defects in materials and workmanship for varying periods of time depending on customer requirements and the type of system sold, with a typical warranty period of one year. The Company provides an accrual for estimated future warranty costs and potential product liability claims based upon a percentage of cost of sales, typically two percent of the cost of the system being 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 warranty reserve as of September 30, 2007 was \$240,000.

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

Results of Operations (Continued)

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 new cost basis is removed from the accounts.

(a) Results of Operations - Nine Months Ended September 30, 2007 Compared to the

Nine Months Ended September 30, 2006

Earnings Summary

The Company had a net income of \$399,000 (or \$0.14 basic earnings per share) for the nine months ended September 30, 2007, compared to net income of \$411,000 (or \$0.12 basic earnings per share) for the nine months ended September 30, 2006. The decrease in net income was primarily due to:

- o a decrease during the nine months of 2007 in gross profit of \$52,000 as described below;
- o an increase in selling, general and administrative expenses of \$222,000 as described below;
- o a decrease of \$72,000 in interest income attributable to the lower level of funds available for investment as the Company liquidated a portion of its short-term investments to fund the Company's stock repurchase activities; and
- o a decrease of \$107,000 in other income, net attributable to a decrease in royalty income from a license agreement related to material handling equipment sales.

Partially offsetting the above decrease in net income was:

- o a decrease in product development costs of \$125,000 as described below; and
- o an income tax benefit of \$315,000, primarily due to the reversal of accruals for the expiration of tax return statutes, the effect of tax-exempt interest on certain investments on the annualized effective rate, and an adjustment in the effective income tax rate expected to apply based on the projected profitability of the Company for 2007.

Net Sales and Gross Profit on Sales

	2007	2006
	-----	-----
Net sales.....	\$ 16,924,000	14,252,000
Cost of sales.....	12,780,000	10,056,000
	-----	-----
Gross profit on sales.....	\$ 4,144,000	4,196,000
	=====	=====
Gross profit as a percentage of sales.....	24.5%	29.4%
	=====	=====

The increase in sales was associated with a larger amount of orders received during the first nine months of 2007 when compared to the amount of orders received during the first nine months of 2006. Contributing to the increase in sales was progress made on contracts received during the first nine months of 2007 in accordance with contract completion requirements.

Gross profit, as a percentage of sales, for the nine months ended September 30, 2007, when compared to the nine months ended September 30, 2006, was unfavorably impacted by 3.2% due to product mix, and by 1.7% due to the reduced

absorption of overhead costs.

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

Results of Operations (Continued)

(a) Results of Operations - Nine Months Ended September 30, 2007 Compared to the

Nine Months Ended September 30, 2006 (Continued)

Selling, General and Administrative Expenses

Selling, general and administrative expenses of \$4,322,000 were higher by \$222,000 for the nine months ended September 30, 2007 than for the nine months ended September 30, 2006. The increase was attributable to the addition of resources aimed at expanding the customer base and costs associated with sales efforts in response to quoting and sales activities totaling \$144,000, and an increase of \$229,000 in commission expenses related to the Company's enhanced revenue performance. Partially offsetting the aforementioned unfavorable variance was a decrease of \$153,000 in marketing expenses primarily associated with product promotion and trade shows.

Product Development Costs

Product development costs, including patent expense, of \$95,000 were lower by \$125,000 for the nine months ended September 30, 2007 than for the nine months ended September 30, 2006. Development programs in the nine months ended September 30, 2007 were primarily aimed at improvements to the Company's Order Fulfillment systems technologies. Order Fulfillment development efforts during the nine months ended September 30, 2007 included voice-directed replenishment and DISPEN-SI-MATIC(R) software enhancements aimed at promoting workplace efficiencies for the Company's customers.

Development programs in the nine months ended September 30, 2006 were primarily aimed at improvements to the Company's Order Fulfillment and Production & Assembly systems technologies. Development efforts during the nine months ended September 30, 2006 included DISPEN-SI-MATIC(R) hardware and software enhancements aimed at promoting workplace efficiencies for the Company's customers and LO-TOW(R) product enhancements.

Interest Income

Interest income of \$337,000 was lower by \$72,000 for the nine months ended September 30, 2007 than for the nine months ended September 30, 2006. The decrease in interest income was attributable to the lower level of funds available for investment, as the Company liquidated a portion of its short-term investments to fund the Company's stock repurchase activities.

Other Income, Net

The unfavorable variance of \$107,000 in other income, net for the nine months ended September 30, 2007 as compared to the nine months ended September 30, 2006 was primarily attributable to a decrease in royalty income from a

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license agreement related to material handling equipment sales.

Income Tax Expense (Benefit)

The Company recognized an income tax benefit of \$315,000 during the nine months ended September 30, 2007 compared to income tax expense of \$1,000 during the nine months ended September 30, 2006. The income tax benefit for the nine months ended September 30, 2007 was higher than statutory federal and state tax rates primarily due to the reversal of accruals for the expiration of tax return statutes, the effect of tax-exempt interest on certain investments on the annualized effective rate, and an adjustment in the effective income tax rate expected to apply based on the projected profitability of the Company for 2007. Income tax expense for the nine months ended September 30, 2006 was lower than statutory federal and state tax rates primarily due to the reversal of accruals for the expiration of tax return statutes and the effect of tax-exempt interest on certain investments on the annualized effective rate.

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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, 2007 Compared to ----- the Three Months Ended September 30, 2006 -----

Earnings Summary -----

The Company had net income of \$656,000 (or \$0.24 basic earnings per share) for the three months ended September 30, 2007, compared to net income of \$239,000 (or \$0.07 basic earnings per share) for the three months ended September 30, 2006. The increase in net income was primarily due to:

- o an increase in sales and gross profit of \$2,089,000 and \$338,000, respectively, as described below; and
- o an income tax benefit of \$217,000, primarily due to the reversal of accruals for the expiration of tax return statutes, the effect of tax-exempt interest on certain investments on the annualized effective rate, and an adjustment in the effective income tax rate expected to apply based on the projected profitability of the Company for 2007.

Partially offsetting the above increase in net income was:

- o an increase in selling, general and administrative expenses of \$83,000 as described below;
- o an increase in product development costs of \$23,000 as described below;
- o a decrease of \$25,000 in interest income attributable to the lower level of funds available for investment as the Company liquidated a portion of its short-term investments to fund the Company's stock repurchase activities; and
- o a decrease of \$50,000 in other income, net attributable to a decrease in royalty income from a license agreement related to material handling equipment sales.

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Net Sales and Gross Profit on Sales

	2007	2006
	-----	-----
Net sales.....	\$ 7,298,000	5,209,000
Cost of sales.....	5,559,000	3,808,000
	-----	-----
Gross profit on sales.....	\$ 1,739,000	1,401,000
	=====	=====
Gross profit as a percentage of sales.....	23.8%	26.9%
	=====	=====

The increase in sales was associated with a larger amount of orders received during the first nine months of 2007 when compared to the amount of orders received during the first nine months of 2006. Contributing to the increase in sales was progress made on contracts received during the first nine months of 2007 in accordance with contract completion requirements.

Gross profit, as a percentage of sales, for the three months ended September 30, 2007, when compared to the three months ended September 30, 2006, was unfavorably impacted by 4.1% due to product mix and favorably impacted by 1.0% due to the increased absorption of overhead costs.

Selling, General and Administrative Expenses

Selling, general and administrative expenses of \$1,382,000 were higher by \$83,000 for the three months ended September 30, 2007 than for the three months ended September 30, 2006. The increase was attributable to the addition of resources aimed at expanding the customer base and costs associated with sales efforts in response to quoting and sales activities totaling \$25,000, and an increase of \$92,000 in commission expenses related to the Company's enhanced revenue performance. Partially offsetting the aforementioned unfavorable variance was a decrease of \$25,000 in marketing expenses primarily associated with product promotion and trade shows.

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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, 2007 Compared to

the Three Months Ended September 30, 2006 (Continued)

Product Development Costs

Product development costs, including patent expense, of \$27,000 were higher

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by \$23,000 for the three months ended September 30, 2007 than for the three months ended September 30, 2006. Development programs in the three months ended September 30, 2007 were primarily aimed at improvements to the Company's Order Fulfillment systems technologies. Order Fulfillment development efforts during the three months ended September 30, 2007 included DISPEN-SI-MATIC(R) software enhancements aimed at promoting workplace efficiencies for the Company's customers.

Development programs in the three months ended September 30, 2006 were primarily aimed at improvements to the Company's Order Fulfillment systems technologies. Development efforts during the three months ended September 30, 2006 included DISPEN-SI-MATIC(R) software enhancements aimed at promoting workplace efficiencies for the Company's customers.

Interest Income

Interest income of \$108,000 was lower by \$25,000 for the three months ended September 30, 2007 than for the three months ended September 30, 2006. The decrease in interest income was attributable to the lower level of funds available for investment, as the Company liquidated a portion of its short-term investments to fund the Company's stock repurchase activities.

Other Income, Net

The unfavorable variance of \$50,000 in other income, net for the three months ended September 30, 2007 as compared to the three months ended September 30, 2006 was primarily attributable to a decrease in royalty income from a license agreement related to material handling equipment sales.

Income Tax Expense (Benefit)

The Company recognized an income tax benefit of \$217,000 during the three months ended September 30, 2007 compared to income tax expense of \$44,000 during the three months ended September 30, 2006. The income tax benefit for the three months ended September 30, 2007 was higher than statutory federal and state tax rates primarily due to the reversal of accruals for the expiration of tax return statutes, the effect of tax-exempt interest on certain investments on the annualized effective rate, and an adjustment in the effective income tax rate expected to apply based on the projected profitability of the Company for 2007. Income tax expense for the three months ended September 30, 2006 was lower than statutory federal and state tax rates primarily due to the effect of tax-exempt interest on certain investments on the annualized effective rate.

Liquidity and Capital Resources

The Company's cash and cash equivalents and short-term investments at September 30, 2007 were \$10,451,000, representing 57.5% of total assets, down from \$12,072,000, or 72.1% of total assets, at December 31, 2006. The decrease was primarily due to the repurchase and retirement of common stock totaling \$567,000, and cash used by operating activities totaling \$947,000.

The Company's cash and cash equivalents and short-term investments at September 30, 2006 were \$12,684,000, representing 71.4% of total assets, down from \$17,397,000, or 77.0% of total assets, at December 31, 2005. The decrease was primarily due to the repurchase and retirement of common stock of \$3,809,000, and cash used by operating activities totaling \$777,000.

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

Results of Operations (Continued)

Liquidity and Capital Resources (Continued)

Cash used by operating activities totaling \$947,000 during the nine months ended September 30, 2007 was primarily due to the following factors:

- o an increase in receivables in the amount of \$1,568,000 in accordance with contractual requirements;
- o an increase in costs and estimated earnings in excess of billings in the amount of \$1,147,000 in accordance with contractual requirements;
- o an increase in inventories in the amount of \$210,000 relating to the purchase of safety stock and long-lead time items; and
- o a decrease in customers' deposits and billings in excess of costs and estimated earnings in the amount of \$402,000 in accordance with contractual requirements.

Partially offset by an increase in accounts payable in the amount of \$2,337,000 associated with the purchase of goods and services rendered in accordance with job completion requirements.

Cash used by operating activities totaling \$777,000 during the nine months ended September 30, 2006 was primarily due to the following factors:

- o a decrease in customers' deposits and billings in excess of costs and estimated earnings in the amount of \$984,000 in accordance with contractual requirements; and
- o an increase in costs and estimated earnings in excess of billings in the amount of \$149,000 in accordance with contractual requirements.

Partially offset by a decrease in receivables in the amount of \$305,000 primarily associated with the collection of an income tax refund.

The Company has a line of credit facility which may not exceed \$5,000,000 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%. As of September 30, 2007, the Company did not have any borrowings under the line of credit facility; however, the leasing agreement associated with the Company's principal office is secured with a \$200,000 letter of credit. Therefore, as of September 30, 2007, the amount of available line of credit was \$4,800,000.

The line of credit facility contains various non-financial covenants and is secured by all of the Company's accounts receivables and inventory. The Company was in compliance with all covenants as of September 30, 2007. The line of credit facility expires effective June 30, 2008.

The Company anticipates that its financial resources, consisting of cash and cash equivalents and short-term investments, 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 is currently exploring various business strategies designed to enhance the value of the Company's assets for its stockholders. The Company is continuing to evaluate and actively explore a range of possible options, including transactions intended to provide liquidity and maximize stockholder value, and consideration of the acquisition of complementary assets and/or

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businesses. The Company may not be able to effect any of these strategic options.

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

 Results of Operations (Continued)

Contractual Obligations

The Company leases 25,000 square feet in Easton, Pennsylvania for use as its principal office. The leasing agreement requires fixed monthly rentals of \$19,345 (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 leasing agreement is secured with a \$200,000 letter of credit. The lease expires on February 21, 2008.

Future contractual obligations and commercial commitments at September 30, 2007 as noted above are as follows:

	Total	Payments Due by Period			
		2007	2008	2009	2010
Contractual obligations:					
Operating leases.....	\$ 97,000	58,000	39,000	-	
Unrecognized tax benefits.....	257,000	-	31,000	68,000	158,000
Total.....	\$ 354,000	58,000	70,000	68,000	158,000

	Total Amounts Committed	Amount of Commitment Expiration Per Period			
		2007	2008	2009	2010
Other commercial commitments:					
Letters of credit.....	\$ 200,000	-	200,000	-	

The Company has an Executive Officer Severance Policy (the "Severance Policy") for executive officers without an employment agreement, which applies

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in the event that an executive officer is terminated by the Company for reasons other than "cause," as such term is defined in the Severance Policy. Under the Severance Policy, executive officers will receive a portion of their regular straight-time pay based on their position and length of service with the Company, medical coverage, and executive outplacement services. For further information, please refer to the Company's disclosure regarding the "Executive Officer Severance Policy" in Item 11 of the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Off-Balance Sheet Arrangements

As of September 30, 2007 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), obligations (including contingent obligations) under a contract that would be accounted for as a derivative instrument, 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.

Related Party Transactions

From time to time, the Company enters into transactions with related parties. For further information, please refer to the Company's disclosure regarding "Commitments and Related Party Transactions" in Note 9 of the Notes to Consolidated Financial Statements of the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

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

Results of Operations (Continued)

Recently Issued Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board issued Interpretation No. 48 ("FIN 48"), Accounting for Uncertainty in Income Taxes -- an interpretation of FASB Statement No. 109, Accounting for Income Taxes, which clarifies the accounting for uncertainty in income taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation requires that the Company recognize in the financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. The Company adopted the provisions of FIN 48 on January 1, 2007 as described in Note 11 of the Notes to Financial Statements.

In September 2006, the Financial Accounting Standards Board issued SFAS No. 157, Fair Value Measurements ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a market-based framework or hierarchy for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 is applicable

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whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. SFAS No. 157 does not expand or require any new fair value measures. The provisions of SFAS No. 157 are to be applied prospectively and are effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact, if any, the adoption of SFAS No. 157 will have on the Company's financial statements.

In February 2007, the Financial Accounting Standards Board issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115" ("SFAS No. 159"). SFAS No. 159 permits entities to elect to measure many financial instruments and certain other items at fair value. Upon adoption of SFAS No. 159, an entity may elect the fair value option for eligible items that exist at the adoption date. Subsequent to the initial adoption, the election of the fair value option should only be made at initial recognition of the asset or liability or upon a remeasurement event that gives rise to new-basis accounting. The decision about whether to elect the fair value option is applied on an instrument-by-instrument basis, is irrevocable and is applied only to an entire instrument and not only to specified risks, cash flows or portion of that instrument. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value nor does it eliminate disclosure requirements included in other accounting standards. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact, if any, the adoption of SFAS No. 159 will have on the Company's financial statements.

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

Results of Operations (Continued)

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 and 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, the forward-looking statements 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," "does not anticipate," "should help to," "believe," "estimate," "is positioned," "expects," "may," "will," "will likely," "is expected to,"

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"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, 2007. 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 accumulated and communicated to the Company's management, including the Company's CEO and CFO, to allow timely decisions regarding required disclosure, and 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 fiscal quarter ended September 30, 2007 that has materially affected, or is reasonably likely to materially affect the Company's internal control over financial reporting.

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PART II -- OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

Item 1A, "Risk Factors," of our 2006 Form 10-K includes a detailed discussion of our risk factors. There have been no material changes in our Risk Factors from those disclosed in our annual report on Form 10-K for the year ended December 31, 2006.

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, 2007:

Issuer Purchases of Equity Securities					
Fiscal Period	Total Number of Shares Repurchased	Average Price Paid Per Share (Including Brokerage Commissions)	Total Number of Shares Repurchased as Part of a Publicly Announced Program	Approximate Dollar Value of Shares Purchased Under the Program	U
7/01/07 - 7/31/07	-	\$ -	-	\$ -	
8/01/07 - 8/31/07	-	\$ -	-	\$ -	
9/01/07 - 9/30/07	-	\$ -	-	\$ -	
	-	\$ -	-	\$ -	

On August 12, 2004, the Company's Board of Directors approved a program to repurchase up to \$1,000,000 of its outstanding common stock. The Company's Board of Directors amended its existing stock repurchase program on several occasions during 2005 and 2006 by increasing the amount it has authorized management to repurchase from up to \$1,000,000 of the Company's common stock to up to \$14,000,000.

On January 7, 2007, the Company's Board of Directors amended its existing stock repurchase program by increasing the amount it has authorized management to repurchase from up to \$14,000,000 of the Company's common stock to up to \$15,000,000.

There were no repurchases during the three months ended September 30, 2007. During the nine months ended September 30, 2007, the Company repurchased 99,699 shares of common stock at a weighted average cost, including brokerage commissions, of \$5.68 per share. Cash expenditures for the stock repurchases

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during the nine months ended September 30, 2007 were \$566,732. Through September 30, 2007, the Company repurchased 1,637,718 shares of common stock at a weighted average cost, including brokerage commissions, of \$8.62 per share. Cash expenditures for the stock repurchases since the inception of the program were \$14,116,143. As of September 30, 2007, \$883,857 remained available for repurchases under the stock repurchase program.

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

(Continued)

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. The purchase price for the shares of the Company's common stock repurchased was reflected as a reduction to stockholders' equity. The Company allocates the purchase price of the repurchased shares as a reduction to common stock for the par value of the shares repurchased, with the excess of the purchase price over par value being allocated between additional paid-in capital and retained earnings. All shares of common stock that were repurchased by the Company since the inception of the program were subsequently retired.

Item 3. Defaults Upon Senior Securities

Not applicable.

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

The Company's Annual Meeting of Stockholders was held on August 1, 2007 with the following items being submitted to a vote of stockholders:

1. The election of five directors to the Board of Directors.
2. The approval of the proposed 2007 Equity Incentive Plan.

Details of the proposals noted above were provided to stockholders in the form of a Notice of Annual Meeting and Proxy Statement dated and mailed on June 26, 2007, with such solicitation being in accordance with Section 14 of the Securities and Exchange Act of 1934, as amended, and the regulations promulgated thereunder.

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

Proposal Number 2 for the approval of the proposed 2007 Equity Incentive Plan was not approved by the stockholders.

The voting results on the two matters noted above are set forth as follows:

1. Election of Directors:

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Name of Nominee -----	Votes For -----	Votes Withheld -----	Non-Voting -----
Robert J. Blyskal	2,504,588	73,471	191,133
Theodore W. Myers	2,449,088	128,971	191,133
Anthony W. Schweiger	2,147,908	430,151	191,133
Samuel L. Torrence	2,449,088	128,971	191,133
Leonard S. Yurkovic	2,504,288	73,771	191,133

2. Approval of the proposed 2007 Equity Incentive Plan:

Votes For -----	Votes Against -----	Abstentions -----	Non-Voting -----
596,860	791,537	2,010	1,378,785

Item 5. Other Information

Not applicable.

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Item 6. Exhibits

Exhibit No. -----	Description -----
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, Acting 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, Acting 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).

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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
Acting CEO

/s/ Ronald J. Semanick

Ronald J. Semanick
Chief Financial Officer

Dated: November 13, 2007

EXHIBIT INDEX

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