To The Shareholders of Paragon Technologies:

Paragon's per share book value decreased by 4% in 2012 to $3.14 per share compared with $3.26 per share in 2011. Paragon's total net worth increased to $5.2 million in 2012, up 4% from $5 million in 2011. The decline in per share book value was a result of an increase in shares outstanding of approximately 7% to 1.66 million shares versus 1.55 million shares. The increase in shares outstanding was primarily a result of a private placement sale of Paragon shares to two investors in 2012. The shares were sold at a price of $2.50 per share, the current share price at the time. Since the market price was below per share book value, the mathematics results in a decline in per share book value.

Don't expect me to make a habit of selling shares at unattractive prices. My primary responsibility is to ensure that our Company's capital is allocated in a manner that provides the greatest bang for the buck. The Board of Directors and I felt that the benefits of the additional capital to the long-term per share net worth of our Company far outweighed the short-term dilutive effects on per share book value. In the future, were we to consider another capital raise, it will be precisely for the same reason.

2012 In Review

Last year was a transformative year for Paragon, a year in which many significant changes took place that we believe creates the framework for significant growth and progress in the years to come. I'd like to share those changes and what they mean for our Company going forward.

- Paragon was reorganized as a holding company. Our material handlings and order fulfillment operations, SI Systems, became our wholly owned subsidiary. With over $5 million in cash, the holding company structure ensures that this significant cash asset is prudently managed while our operating company gets a greater degree of autonomy and flexibility in building its business (later in this letter, I will go into more detail about our cash management activities).

- In August, Paragon hired Larry Strayhorn as our CEO and Jacob Cherian as our CFO. Larry and Jacob both possess tremendous business experience as well as the key ingredients that define managerial excellence: energy, intelligence, and integrity. Larry has been in the material handling and fulfillment business for over 30 years and currently holds the Chair of the Material Handling Industry of America. Jacob is a highly accomplished financial and business executive with over 30 years of financial and operational service to both private and public companies. Already, both Larry and Jacob have made their contributions felt at Paragon.

- When I was elected Chairman in March, we reduced the Board count from five to three. This reduction in bodies, however, did not reduce business talent or experience on the Board; on the contrary, it magnified it. Our other two directors, Samuel Weiser and Jack Jacobs are simply the best of the best when it comes to corporate stewardship, business experience, and character.

- Paragon shareholders should also note the following operational occurrences in 2012:

    1. I renegotiated our corporate lease for our building in Easton, PA, which was set to expire at the end of January 2013. Starting with February 2013, our monthly lease payments – inclusive of all occupancy costs - were reduced to $12,750 compared with over $22,000 per month previously. In addition, we also negotiated a reduction in our warehouse storage expense to a fixed monthly sum of $3,800 compared with the over $6,000 per month that we were previously paying.

    2. We signed up McGladrey, one of the nation's most highly regarded accounting firms, as our corporate auditor. Our partnership with McGladrey confirms Paragon's commitment to the highest level of corporate stewardship and transparency. Our senior partners at McGladrey, Mike Dubin and Susan Roeder, are first rate professionals and we are looking forward to many years of a mutually beneficial relationship. The transition to a holding company structure required a one-time double filing of tax returns in the 20 or so states in which we conduct significant business operations, and we will incur approximately $30,000 to $50,000 in additional audit related fees for the 2012 year that we do not expect to incur again in 2013.

Operating Performance

In 2012, Paragon's wholly owned subsidiary, SI Systems, generated revenues of $8.9 million and an operating loss of $340,000. This compares with 2011 revenues of $8.5 million and operating income of $136,000. In 2012, overall gross margins were 24% versus 31% in 2011. Selling, general and administrative expense was $2.38 million, or 27% of sales, compared with $2.44 million, or 29% of sales, in 2011. In 2010, SG&A expense was $2.8 million, or 36% of sales.

Paragon is off to a good start thus far in 2013 as the Company earned $653,000 in operating income from revenues of $6.5 million during the six month period ending June 30, 2013. These results compare with an operating loss of $209,000 and revenues of $4.4 million in the six month period ended June 30, 2012, respectively. Shareholders may take a modest degree of comfort that Paragon's new Board and executive management team are effectuating a turnaround only inasmuch as six months' worth of results can provide.

Shareholders may take greater comfort, however, in knowing that we won't exhibit the slightest degree of complacency just because our results are moving in the right direction. Complacency is persona non grata at Paragon. Our goal is to build a sustainable business enterprise where continued success and profitability instills growing levels of discipline and efficiency throughout the entire organization. Our objectives are crystal clear: sustainability and sales growth, specifically profitable sales growth.

After the sale of the Ermanco business in 2005, Paragon and SI Systems pursued a reactive business approach versus a proactive one. Poorly reasoned share buybacks proved disastrous: From the inception of the Company's stock repurchase program on August 12, 2004 through December 31, 2012, the Company repurchased 2,850,100 shares of common stock at a weighted average cost, including brokerage commissions, of $6.75 per share. Cash expenditures for the stock repurchases since the inception of the program were $19,239,194. All these shares, except for 10,000 shares purchased in 2010, were effectuated between 2004 and 2009, well before any present director or executive joined Paragon. In May 2013, the Board terminated the 2004 repurchase program.

SI Systems has been a provider of logistics solutions for over 50 years – for years SI was one of the leading innovators in the industry. Our customers and competitors still recognize our brand, an intangible asset we expect to capitalize on. As we look to the future at Paragon, our endeavors will be focused on creating sustainable value through a rigorous and disciplined approach geared towards reestablishing our brand, growing our customer base by providing superior service and quality to our customers, attracting talented and dedicated associates motivated by an exciting turnaround plan, maintaining an efficient operation, and placing significant emphasis on the process of capital allocation.

Capital Allocation

My primary responsibility is the allocation of capital at Paragon. Capital allocation is the process of deciding how to deploy a company's assets to earn the highest possible return for shareholders. The yardstick by which to measure the success of a company's capital allocation decisions is the *change in per share intrinsic value.* The process of capital allocation is, without question, the most important variable in growing the per share intrinsic value of any company over time.

Capital allocation is simple in definition, but not easy in implementation. Deploying capital successfully does not require above average intelligence but rather rational behavior, which usually means behaving in stark contrast to the status quo. Two companies with identical operating results but different approaches to allocating capital will produce two very different long-term results for shareholders.

One of the greatest capital allocators of all time was Henry Singleton, a name perhaps known to only a small group of investors today. Starting in the 1960's and for nearly 30 years, Singleton's conglomerate Teledyne delivered an annualized compound return of 20.4%, cementing Singleton as the greatest capital allocator of his time.

Although Singleton was extraordinarily intelligent – a world-class mathematician – his secret sauce at Teledyne was simple: Singleton was an independent thinker and gave little consideration to the "investment crowd." Singleton aggressively bought back shares (he ultimately came to purchase over

90% of Teledyne's shares) rather than pay dividends, focused on cash flow as opposed to reported earnings, avoided conference calls and analysts, and ran an unusually decentralized organization that allowed him to singularly focus on allocating Teledyne's excess capital.

Capital allocation, at its essence, is investment. Capital can be deployed in five primary ways: investing in existing operations, acquiring other business (wholly or through partial equity ownership), dividend payments, debt payments, and share repurchases.

In determining the best capital allocation direction, three questions must be addressed:

1) Should capital be kept at the company or paid out to shareholders?
2) If the capital is to be paid out, should that be done via share repurchases or a dividend?
3) If we decide to retain the capital and invest it on behalf of all shareholders, will the allocation of capital create more than $1 of value for every dollar we retain, giving consideration to the cost of capital?

Our decision is to retain and allocate our capital believing that Paragon's overall intrinsic value is significantly enhanced through the retention and deployment of Paragon's excess capital into opportunities that generate an attractive return on investment.

On the acquisition front, our strong preference is to buy entire businesses. Absent such opportunities, we will seek partial ownership interests in businesses that we deem attractively valued. Regardless of whether we are buying 100% of a business or a partial interest therein, my litmus test remains the same: Is Paragon getting more than $1 worth of value for every dollar allocated? Since the precise answer to this question is unknown at the time of capital commitment, we demand a substantial gap between the price we pay and the value we are receiving.

So that shareholders can better understand what moves the engine at Paragon, we plan to operate under the following framework:

1. Intelligent capital allocation is the most important driver of long-term intrinsic value creation; therefore, we will structure incentives and responsibilities in accordance with that philosophy.
2. What matters most in the long run is growth in per share value, not overall growth: we don't want to become the longest train, but the one that can travel the furthest on the least amount of fuel.
3. We favor a decentralized organizational structure which serves to maximize business output and minimize costs.
4. Independent, rational thinking is paramount to long-term success. The short-term focus behind Wall Street's modus operandi – reflected in the attention given to earning's guidance and quarterly results – is a distraction that we will strive to avoid.
5. Patience is a tremendous asset in business and the allocation of capital. We will act only inasmuch as fertile opportunities present themselves, and not because everyone else is

buying or selling. We will not hesitate to bet big or act boldly when presented with opportunities to do so.

My responsibility as the capital allocator at Paragon means that shareholders are, to a great extent, relying on my ability to effectuate value creating decisions that result in an increase in Paragon's intrinsic value. While tomorrow's outcome is always uncertain, where certainty must exist is in the alignment of incentives between management and shareholders.

Through Gad Capital and my personal holdings, I beneficially own 28% - worth approximately $1.3 million - of the outstanding shares of Paragon. I haven't taken a single stock option nor do I plan to. In rare occasions we will utilize stock options when we believe that doing so (in order to attract a uniquely talented individual, for example) is for the greater good of the entire company.

Simply put, I stand to benefit tremendously when Paragon's per share value is increased. More importantly, I will experience the greatest financial pain as a result of any deterioration in Paragon's value.

Capital Allocation in 2012

In 2012, Paragon deployed approximately $2 million of its excess capital into opportunities that satisfy our disciplined and rational capital allocation process. The following chart lists our investments with an aggregate market value of $100,000 or more as of June 28, 2013:

Security	Cost Basis	Market Value (as of 6/28/13)
Common Stock		
1,040,970 sh SED International	$2,440,350	$2,263,168
Preferred Stock		
12,000 sh Meritage Hospitality 8% Series B	$128,037	$136,500

Meritage Hospitality is the largest publicly traded franchisor of Wendy's restaurants in the United States with over 110 restaurants. The company has a "150 by 2015" growth plan to get to 150 restaurants by 2015. CEO Bob Schermer is a class act: when I first called him a year ago and introduced myself as a shareholder (at the time, Gad Partners Fund was the owner of Meritage shares) and asked him about his company, he spent an hour educating me not only on his business, but the restaurant industry, as well the economics of doing business in the company's home state of Michigan. Bob didn't know if I owned 100 shares or 100,000 shares, but his passion for his company was evident in the care and pride he took in explaining his business. Over the course of the year, I kept up to speed with Meritage and remained impressed with what I saw. So when months later Bob informed me that an investor was interested in potentially selling a block of Meritage preferred stock, it didn't take me long to decide I should look into the opportunity.

The preferred stock was purchased at an average cost of $9.15 against par value of $10. The 8% stated yield means our actual annual yield is 9%. Meritage has made uninterrupted dividend payments on the Series B for 38 consecutive quarters. The preferred is perpetual with cumulative dividends although Meritage reserves the right to redeem the securities at par plus any accrued but unpaid dividends (we hope not – Bob, we are looking forward to another 38 consecutive quarterly payout streak!).

Meritage is the type of investment I love to make: a good simple business run by competent management who align their interests with shareholders – not to worry at Meritage: the Schermer family owns nearly 50% of the shares.

SED International

SED, formerly known as Southern Electronics Distribution Corporation, was founded in 1980 by Gerald and Jean Diamond and is headquartered in Lawrenceville, Georgia. SED's offerings consist of approximately 17,000 products purchased from approximately 200 vendors. Vendors consist of names such as Dell, Microsoft, Panasonic, and Black and Decker. SED sells its products to a non-exclusive customer base of over 10,000 customers via 425 full time employees.

Our investment in SED International was purely on the merits of its valuation. Our capital commitment of $2.4 million is significant, but we were compelled to act boldly in light of the then significant price to value discrepancy we observed. Per our most recent filing with the Securities and Exchange Commission, Paragon owns approximately 20.9% of the outstanding stock of SED.

We have made it public via our filings with the SEC that we are seeking to join the Board of SED. We have also made it public that we harbor some concerns as it relates to the company's recent deteriorating financial performance and its Board. We continue to pursue board representation at SED as it relates to our significant investment in the company.

We remain committed in our responsibility to maximize the per share intrinsic value of Paragon in both our operating subsidiary and investee businesses. Our fiduciary obligation to our shareholders demands nothing less.

The 2012 year was a significant year for Paragon characterized by many changes that we believe laid the groundwork for many years of successful value enhancing growth. Paragon's accomplishments in 2012 are a by-product of a collective effort that begins with the Company's 25 associates, many of whom have been employed with SI Systems before your Chairman knew what a share of stock was. Our management team continues to reinvigorate every facet of our business and my fellow directors Sam Weiser and Jack Jacobs are individuals that any company would be privileged to have serve shareholders. Paragon has surrounded itself with the best of the best – you won't find a company our size with our level of talent – and all stakeholders are surely to benefit from the collective wisdom of our team.

One person in particular whose name won't show up on our press releases or annual report, but deserves a copious dose of recognition is Derek Bork of Thompson Hine, LLP, corporate counsel to Paragon. Paragon shareholders can't overestimate the value Derek has given to Paragon over the past couple of years. In Corporate America where the supply of corporate attorneys is plentiful, one has to search far and wide to find counsel like Derek. Putting aside the fact that Derek provides Paragon with double the output at literally half the cost (I know firsthand because I approve the legal bills), what shareholders need to truly appreciate is that Derek *constantly thinks about Paragon*. In a nine month period in 2012, Paragon replaced its major key executive positions without a single dollar of severance or any threat of litigation and reorganized itself into a holding company. All this and Paragon's legal tab in 2012 was still 30% less than our legal expenses in 2011. I've challenged Derek to now beat his own hurdles each and every year! This level of intensity, efficiency, and dedication is quite rare; then again Derek is rare in his field. And as I've come to quickly learn, this standard of service is par for the course at Thompson Hine. At our next annual meeting, Derek has agreed to stick around to sign autographs. I'll be the first in line.

The Annual Meeting

The Annual Meeting/Shareholder Presentation will be held on Wednesday, September 18, at 9 a.m. EST at the Atlanta offices of our corporate counsel, **Thompson Hine LLP, Two Alliance Center, 3560 Lenox Road, Suite 1600, Atlanta, GA 30326.** The meeting there last year ran smoothly thanks to all the wonderful folks at Thompson Hine. Please follow the signs to the meeting.

Our desire to hold the meeting in Atlanta was that it would make for easier same day travel for our shareholders and Company associates. We encourage all shareholders to attend.

Sincerely,

Sham Gad

Chairman

August 2013