

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2006

Commission file number: 1-15729

PARAGON TECHNOLOGIES, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

22-1643428

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

600 Kuebler Road

Easton, Pennsylvania

(Address of Principal Executive Offices)

18040

(Zip Code)

Registrant's Telephone Number, Including Area Code: **610-252-3205**

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, Par Value \$1.00 Per Share

(Title of Class)

American Stock Exchange

(Name of Exchange on Which Registered)

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark 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 check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark 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 12-b of the Exchange Act. (Check one:)

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

The aggregate market value of common stock held by non-affiliates of the Registrant (based on the closing price on the American Stock Exchange) on June 30, 2006, the last day of the Registrant's second fiscal quarter, was approximately \$18.4 million. For purposes of determining this amount only, Registrant has defined affiliates as including (a) the executive officers named in Part III of this 10-K report, (b) all directors of Registrant, and (c) each stockholder that has informed Registrant by June 30, 2006 that it is the beneficial owner of 10% or more of the outstanding common stock of Registrant.

The number of shares of the Registrant's Common Stock, \$1.00 par value, outstanding as of March 28, 2007 was 2,813,041.

DOCUMENTS INCORPORATED BY REFERENCE:

None



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PART I

Item 1. Business

Company Overview

Paragon Technologies, Inc. ("the Company"), 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[®] and automated order fulfillment solutions and specialized software from the SINTHESIS[™] Software Suite. SINTHESIS[™] 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[®] and CARTRAC[®] 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.

On May 20, 2005, the Company and Ermanco entered into an Asset Purchase Agreement (the "Asset Purchase Agreement") with TGW Transportgeräte GmbH, an Austrian corporation ("Buyer Parent"), and Malibu Acquisition, Inc., a Michigan corporation and wholly owned subsidiary of Buyer Parent ("Buyer"), pursuant to which Paragon agreed to sell to Buyer substantially all of the assets and liabilities of Ermanco, Paragon's conveyor and sortation subsidiary located in Spring Lake, Michigan. On August 5, 2005, the Company completed the sale of substantially all of the assets and liabilities of Ermanco. See Discontinued Operations - Sale of Ermanco in Note 2 of the Notes to Consolidated Financial Statements for further information regarding the sale of substantially all of the assets and liabilities of Ermanco.

Following the sale of Ermanco, the Company has continued 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 through a redeployment of assets from Ermanco to the Company's remaining business, 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.

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 years ended December 31, 2006, 2005, and 2004 are as follows (*in thousands*):

For the year ended December 31, 2006:

	<u>SI Systems</u>	<u>% of Total Sales</u>
Systems sales	\$ 14,576	81.9%
Aftermarket sales	3,212	18.1%
Total sales	<u>\$ 17,788</u>	<u>100.0%</u>

For the year ended December 31, 2005:

	<u>SI Systems</u>	<u>% of Total Sales</u>
Systems sales	\$ 13,614	81.6%
Aftermarket sales	3,062	18.4%
Total sales	<u>\$ 16,676</u>	<u>100.0%</u>

For the year ended December 31, 2004:

	<u>SI Systems</u>	<u>% of Total Sales</u>
Systems sales	\$ 8,375	71.6%
Aftermarket sales	3,327	28.4%
Total sales	<u>\$ 11,702</u>	<u>100.0%</u>

The Company's products are sold worldwide through its own sales personnel. Domestic and international sales during the years ended December 31, 2006, 2005, and 2004 are as follows (*in thousands*):

For the year ended December 31, 2006:

	<u>SI Systems</u>	<u>% of Total Sales</u>
Domestic sales	\$ 16,866	94.8%
International sales	922	5.2%
Total sales	<u>\$ 17,788</u>	<u>100.0%</u>

For the year ended December 31, 2005:

	<u>SI Systems</u>	<u>% of Total Sales</u>
Domestic sales.....	\$ 15,966	95.7%
International sales.....	710	4.3%
Total sales.....	<u>\$ 16,676</u>	<u>100.0%</u>

For the year ended December 31, 2004:

	<u>SI Systems</u>	<u>% of Total Sales</u>
Domestic sales.....	\$ 9,941	85.0%
International sales.....	1,761	15.0%
Total sales.....	<u>\$ 11,702</u>	<u>100.0%</u>

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 engages in sales with the U.S. government, which is one of the Company's customers. Sales to the U.S. government during the years ended December 31, 2006, 2005, and 2004 represented 4.1%, 3.2%, and 3.0% of total sales, respectively.

In the year ended December 31, 2006, one customer accounted for over 10% of sales and is listed as follows: Caterpillar - \$2,098,000 or 11.8% of total sales. In the year ended December 31, 2005, five customers accounted for over 10% of sales, and they are listed as follows: BMG Direct Marketing - \$2,492,000 or 14.9%, SI/BAKER - \$1,990,000 or 11.9%, Vistakon, a division of Johnson & Johnson Vision Care - \$1,867,000 or 11.2%, E-Z-GO Division of Textron - \$1,812,000 or 10.9%, and Honda of America Mfg. - \$1,723,000 or 10.3%. In the year ended December 31, 2004, two customers accounted for over 10% of sales, and they are listed as follows: Canadian Tire Corporation - \$1,600,000 or 13.7% and Office Depot - \$1,184,000 or 10.1%. No other customer accounted for over 10% of sales.

The Company's backlog of orders at December 31, 2006 and December 31, 2005 were \$5,932,000 and \$6,918,000, 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 contracts, fluctuations in the Company's sales and earnings occur with increases or decreases in major installations. The Company expects to fill, within its 2007 calendar year, all of the December 31, 2006 backlog of orders indicated above.

Products

SI Systems' Branded Products

SI Systems' branded products encompass the horizontal transport, manufacturing, assembly, order fulfillment, and inventory replenishment families of products.

Horizontal Transport

LO-TOW[®]. LO-TOW[®] is an in-floor towline conveyor. These conveyor systems are utilized in the automation of manufacturing, assembly, unit load handling in distribution environments, and large newspaper roll delivery systems. Industries served include the automotive, recreational and utility vehicle, distribution centers, radiation chambers, engine assembly, truck assembly, construction vehicles, newspaper facilities, farm machinery, and the U.S. government, primarily the United States Postal Service and the Defense Logistics Agency. This simple, yet reliable component design allows for a variety of configurations well suited for numerous applications. It provides reliable and efficient transportation for unit loads of all types in progressive assembly or distribution applications. Because SI Systems' LO-TOW[®] tow chain used with the system operates at a minimal depth, systems can be installed in existing one-story and multi-story buildings as well as newly constructed facilities. Controls sophistication varies depending upon the application. More complex systems include programmable logic controllers ("PLCs"), personal computers for data collection and operator interface, radio frequency identification and communication, bar code identification, and customer host computer communication interface. The Company believes that SI Systems is the largest supplier of in-floor towline systems in the United States. A typical LO-TOW[®] system requires approximately six months to engineer, manufacture, and install. LO-TOW[®] sales as a percent of total sales were 36.3%, 34.1%, and 22.7% for the years ended December 31, 2006, 2005, and 2004, respectively.

CARTRAC[®]. CARTRAC[®] spinning tube conveyor systems are used in the automation of production, and assembly operations throughout various industries. Some of the industries served are automotive, aerospace, appliance, defense, electronics, machine tools, radiation chambers, castings, transportation, and foundries. As part of a fully computerized manufacturing system, CARTRAC[®] offers zero pressure accumulation, high speeds, and smooth acceleration/deceleration capabilities for both light and heavy load capabilities that are well suited for the manufacturing environment where high volume product rate and short cycle time are critical. Some of the more sophisticated systems require a high degree of accuracy and positioning repeatability. For these applications, CARTRAC[®] carriers are positioned in workstations holding very tight tolerances.

CARTRAC[®] sales, as a percent of total sales, were 11.1%, 0.2%, and 1.8% for the years ended December 31, 2006, 2005, and 2004, respectively.

Order Fulfillment Systems

DISPEN-SI-MATIC[®], SYNTHESIS[™], and Automated Order Fulfillment Solutions

DISPEN-SI-MATIC[®] and SYNTHESIS[™] offer ideal solutions for reducing inefficiencies, labor-intensive methods, and long-time deliveries where high volume of small orders must be fulfilled. Industries served include pharmaceutical, entertainment, vision, nutritional supplements, health and beauty aids, cosmetics, and an assortment of various soft goods.

SINTHESIS™ is a proprietary intelligent order fulfillment software suite that can achieve picking accuracy of up to 99.9%, increase order throughput up to 70%, and reduce return volumes by as much as 80%. Comprised of eight software groups with 26 extendible software modules, SINTHESIS™ continuously assesses real-time needs and deploys solutions to accurately facilitate and optimize planning, warehousing, inventory, routing, and order fulfillment within the distribution process. In installations worldwide, SINTHESIS™ integrates intelligent software programming with innovative conveyance technology to perform high-volume, full-case or split-case, item-oriented distribution smarter, faster, and leaner.

SI Systems' branded products include a variety of DISPEN-SI-MATIC® models for automated order fulfillment, where volume, speed, accuracy, and efficiency are of the essence. The Pick-to-Belt, Totes Through, and Buckets Through are solutions that provide ultra-high throughput for loose-pick individual items. Additionally, the DISPEN-SI-MATIC® allows a package to be dispensed into a tote or carton, thus achieving a high degree of accuracy and efficiency in order fulfillment.

SI Systems' capabilities also include gantry picking, which involves the fulfillment of orders as well as inventory replenishment, utilizing automated gantry/robotic technology. Certain customer applications and order profiles are well suited for this solution.

SI Systems' branded technologies include automated picking and replenishment solutions that complement DISPEN-SI-MATIC®, thus offering the Company's customers a comprehensive solution in order fulfillment where volume of orders are processed with a high degree of accuracy. These highly sophisticated systems require customization tailored to each individual customer's requirements.

A typical DISPEN-SI-MATIC®, SINTHESIS™, and automated order fulfillment system requires approximately six to nine months to engineer, manufacture, and install.

DISPEN-SI-MATIC®, SINTHESIS™, and the related order fulfillment systems sales, as a percent of total sales, were 34.2%, 46.9%, and 46.8% for the years ended December 31, 2006, 2005, and 2004, respectively.

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.

Sales and Marketing

The Company goes to market with a multiple brand, multiple channel strategy under the SI Systems OFS and SI Systems PAS brands. Each brand has its own focused sales force, utilizing the products and services currently available or under development within the Company.

Sales of the Company's SI Systems branded products are made through its own internal sales personnel. The systems are sold on a fixed-price basis. Generally, contract terms provide for progress payments and a portion of the purchase price is withheld by the customer until the system has been accepted. Customers include major manufacturers, technology organizations, and distributors of a wide variety of products, as well as the U.S. government. A significant amount of business is derived from existing customers through the sale of additional systems, additions to existing systems, plus parts and service. The Company is not substantially dependent upon any one customer; however, the Company's business is dependent upon a limited number of customers.

Competition

The material handling industry includes many products, devices, and systems competitive with those of the Company. As in the case of other technically oriented companies, there is a risk that the Company's business may be adversely affected by technological advances made by its competitors. However, the Company believes that its competitive advantages include its reputation in the material handling field and proven capabilities in the markets in which it concentrates. Its disadvantages include its relatively small size as compared to certain of its larger competitors.

There are three principal competitors supplying equipment similar to the LO-TOW[®] system: FMC Technologies, Jervis B. Webb Company, and Southern Systems, Inc. Competition in this field is primarily in the areas of price, experience, systems performance, and features. SI Systems is a leading provider of LO-TOW[®] systems, based on Conveyor Equipment Manufacturers Association (CEMA) United States market statistics.

The CARTRAC[®] system competes with various alternative materials handling technologies, including automated guided vehicle systems, electrified monorail and pallet skid systems, power and free conveyor systems, and belt and roller conveyor systems, that may be obtained through a variety of suppliers. However, the Company believes that the CARTRAC[®] system's advantages, such as controlled acceleration and deceleration, high speed, individual carrier control, and right angle turning, are significant distinctive features providing competitive advantages in applications requiring these features.

The DISPEN-SI-MATIC[®] system competes primarily with manual picking methods, and it also competes with similar devices provided by two other system manufacturers, KNAPP Logistik Automation GmbH and SSI Schäfer Peem GmbH, along with various alternative picking technologies, such as general purpose "broken case" automated order fulfillment systems that have been sold for picking items of non-uniform configuration. The Company believes that the DISPEN-SI-MATIC[®] system provides greater speed and accuracy than manual methods of collection and reduces damage, pilferage, and labor costs.

Proprietary SYNTHESIS[™] software competes with other middleware that has been developed for order fulfillment logistics by a variety of software and/or hardware suppliers. The Company believes that SYNTHESIS[™] is superior to other software offerings because it is based on a proven track record of successful applications that manage distribution centers by accepting order data from the customer's host business system and efficiently optimizing the full range of order fulfillment functions down to control of individual pieces of material handling equipment.

Raw Materials

The Company has not been adversely affected by energy or raw materials shortages. The principal raw material purchased by the Company is steel, which the Company purchases from various suppliers. Steel prices have escalated in recent years; however, the Company has been able to pass these increased costs on to its customers. The Company also purchases components from various suppliers that are incorporated into the Company's finished products.

Patents, Copyrights, and Licenses

The Company seeks patents, trademarks, and other intellectual property rights to protect and preserve its proprietary technology and its rights to capitalize on the results of research and development activities. The Company seeks copyright protection for its proprietary software. The Company also relies on trade secrets, know-how, technological innovations, and licensing opportunities to provide it with competitive advantages in its market and to accelerate new product introductions.

It is the Company's policy to require its professional and technical employees and consultants to execute confidentiality agreements at the time that they enter into employment or consulting relationships with the Company. These agreements provide that all confidential information developed by, or known to, the individual during the course of the individual's relationship with the Company, is to be kept confidential and not disclosed to third parties except in specific circumstances. In the case of employees, the agreement provides that all inventions conceived by the employee during his tenure at the Company will be the exclusive property of the Company.

The Company holds seven patents, all of which have been issued in the United States, with lives that expire from June 2008 through October 2023. Significant design features of the LO-TOW[®], CARTRAC[®], DISPEN-SI-MATIC[®], and Sortation systems are covered by patents or patent applications in the United States and pertain mainly to the following areas: loading and unloading products, vehicle and carrier design, track design and assembly, and order fulfillment system designs.

CARTRAC[®], ROBOLITE[®], ROBODRIVE[®], ROBORAIL[®], SWITCH-CART[®], LO-TOW[®], DISPEN-SI-MATIC[®], DISTRIBUTION SYSTEM OPTIMIZER[®], ACCUPIC[®], ETV[®], SI[®], and Paragon Technologies[®] are registered trademarks of the Company. SYNTHESIS[™], DC XCELLERATOR[™] and SI Planograph[™] are trademarks of the Company.

The Company does not believe that the loss of any one or group of related patents, trademarks, or licenses would have a material adverse effect on the overall business of the Company.

Product Development

Total product development costs, including patent expense, were \$283,000, \$62,000, and \$176,000 for the years ended December 31, 2006, 2005, and 2004, respectively. The Company aggressively pursues continual research of new product development opportunities, with a concentrated effort to improve existing technologies that improve customer efficiency. The Company also develops new products and integration capabilities that are financed through customer projects.

Development programs in the year ended December 31, 2006 were primarily aimed at improvements to the Company's Order Fulfillment and Production & Assembly systems technologies. Development efforts during the year ended December 31, 2006 included DISPEN-SI-MATIC[®] hardware and software enhancements aimed at promoting workplace efficiencies for the Company's customers, voice-directed replenishment, and LO-TOW[®] product enhancements.

Development programs in the years ended December 31, 2005 and December 31, 2004 were primarily aimed at improvements to the Company's Order Fulfillment systems technologies. Order Fulfillment development efforts, that were essentially completed during the year ended December 31, 2004 and incorporated into the Company's Order Fulfillment product offerings, were centered on the development of an innovative computer control system, along with DISPEN-SI-MATIC[®] software and hardware enhancements aimed at promoting workplace efficiencies for the Company's customers. Order Fulfillment development efforts during the year ended December 31, 2005 were primarily additional modifications and enhancements to the Company fiscal 2004 development initiatives.

Employees

As of December 31, 2006, the Company employed four executive officers and 50 office employees, including salespersons, draftspersons, and engineers. The Company also operates as a project manager in connection with the installation, integration, and service of its products generally utilizing subcontractors. The Company provides life insurance, major medical insurance, a retirement savings plan, and paid vacation and sick leave benefits, and considers its relations with employees to be satisfactory.

Available Information

The Company files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC"). You may read and copy any document the Company files with the SEC at the SEC's public reference room at 100 F Street, NE, Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for information on the public reference room. The SEC maintains an internet site that contains annual, quarterly and current reports, proxy and information statements and other information that issuers (including Paragon Technologies, Inc.) file electronically with the SEC. The Company's electronic SEC filings are available to the public at the SEC's internet site, www.sec.gov. In addition, the Company's internet website is www.ptgamex.com, and you may find the Company's SEC filings on the "For Stockholders" page of that website. The Company provides access to all of its filings with the SEC, free of charge, as soon as reasonably practicable after filing with the SEC on such site. The Company's internet website and the information contained on that website, or accessible from its website, is not intended to be incorporated into this Annual Report on Form 10-K.

Item 1A. Risk Factors

THE FOLLOWING CAUTIONARY STATEMENTS ARE MADE TO PERMIT PARAGON TECHNOLOGIES, INC. TO TAKE ADVANTAGE OF THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995.

Investing in the Company's Common Stock will provide an investor with an equity ownership interest in the Company. Stockholders will be subject to risks inherent in the Company's business. The performance of Paragon's shares will reflect the performance of the Company's business relative to, among other things, general economic and industry conditions, market conditions, and competition. The value of the investment in the Company may increase or decline and could result in a loss. An investor should carefully consider the following factors as well as other information contained in this Form 10-K before deciding to invest in shares of the Company's Common Stock.

This Form 10-K also contains forward-looking statements that involve risks and uncertainties. The Company's actual results could differ materially from those anticipated in the forward-looking statements as a result of many factors, including the risk factors described below and the other factors described elsewhere in this Form 10-K.

The Company wishes to inform its investors of the following important factors that in some cases have affected, and in the future could affect, the Company's results of operations and that could cause such future results of operations to differ materially from those expressed in any forward-looking statements made by or on behalf of the Company. Disclosure of these factors is intended to permit the Company to take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. Many of these factors have been discussed in prior SEC filings by the Company. Though the Company has attempted to list comprehensively these important cautionary factors, the Company wishes to caution investors that other factors may in the future prove to be important in affecting the Company's results of operations.

Sales of the Company's products depend on the capital spending decisions of its customers.

Automated, integrated material handling systems using the Company's products can range in price from \$100,000 to several million dollars. Accordingly, purchases of the Company's products represent a substantial capital investment by its customers, and the Company's success depends directly on their capital expenditure budgets. The Company's future operations may be subject to substantial fluctuations as a consequence of domestic and foreign economic conditions, industry patterns, and other factors affecting capital spending.

The current domestic and international economic conditions in the Company's major markets for SI Systems' branded products, such as the electronics, telecommunications, semiconductor, appliance, pharmaceutical, food processing, and automotive components industries, have resulted in cutbacks in capital spending which has caused a direct, material adverse impact on the Company's product sales in recent years. 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. Since the Company recognizes sales on a percentage of completion basis for its systems contracts, fluctuations in the Company's sales and earnings occur with increases or decreases in major installations. 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 cannot estimate when or if a sustained revival in the markets for its products will occur. If the Company is unable to maintain an increased level of sales of its products, the Company's sales will continue to be adversely affected.

The Company is largely dependent upon a limited number of large contracts, including contracts with a federal government agency.

The Company is largely dependent upon a limited number of large contracts from large domestic corporations and a federal government agency. This dependence can cause unexpected fluctuations in sales volume and operating results from period to period. In the year ended December 31, 2006, one customer accounted for over 10% of sales and is listed as follows: Caterpillar - \$2,098,000 or 11.8% of total sales. In the year ended December 31, 2005, five customers accounted for over 10% of sales, and they are listed as follows: BMG Direct Marketing - \$2,492,000 or 14.9%, SI/BAKER - \$1,990,000 or 11.9%, Vistakon, a division of Johnson & Johnson Vision Care - \$1,867,000 or 11.2%, E-Z-GO Division of Textron - \$1,812,000 or 10.9%, and Honda of America Mfg. - \$1,723,000 or 10.3%. In the year ended December 31, 2004, two customers accounted for over 10% of sales, and they are listed as follows: Canadian Tire Corporation - \$1,600,000 or 13.7% and Office Depot - \$1,184,000 or 10.1%. No other customer accounted for over 10% of sales.

The Company received \$732,000 or 4.1% of its total sales from sales to government agencies in the fiscal year ended December 31, 2006. Accordingly, our sales have been impacted as a result of government spending cuts, general budgetary constraints, and the complex and competitive government procurement processes. If the Company is unable to attain an increased level of government-related sales, the Company's sales will continue to be adversely affected.

The Company's contracts with government agencies are subject to adjustment pursuant to federal regulations.

From time to time, the Company receives contracts from federal agencies. Each of the Company's contracts with federal agencies include various federal regulations that impose certain requirements on the Company, including the ability of the government agency or general contractor to alter the price, quantity, or delivery schedule of the Company's products. In addition, the government agency retains the right to terminate the contract at any time at its convenience. Upon alteration or termination of these contracts, the Company would normally be entitled to an equitable adjustment to the contract price so that the Company may receive the purchase price for items it has delivered and reimbursement for allowable costs it has incurred. From time to time, a portion of the Company's backlog is from government-related contracts. The Company's total backlog of orders at December 31, 2006 was \$5,932,000, of which \$0 was associated with U.S. government projects. Accordingly, because contracts with federal agencies can be terminated, the Company cannot assure you that backlog associated with government contracts will result in sales. The Company has not previously experienced material adjustments or terminations of government contracts.

The Company must accurately estimate its costs prior to entering into contracts on a fixed-price basis.

The Company frequently enters into contracts with its customers on a fixed-price basis. In order to realize a profit on these contracts, the Company must accurately estimate the costs the Company will incur in completing the contract. 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. 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.

At times, uncertainty exists with respect to the resources required to accomplish the contractual scope of work dealing with the final integration of state-of-the-art automated material handling systems. As a result of past experience with cost overruns, the Company established enhanced business controls, estimating, and procurement disciplines to attempt to reduce future cost overruns. Since the Company established these controls in 2000, it has not experienced additional significant cost overruns on new contracts; however, additional cost overruns in the future could result in reduced revenues and earnings.

The Company faces significant competition, which could result in the Company's loss of customers.

The markets in which the Company competes are highly competitive. The Company competes with a number of different manufacturers, both domestically and abroad, with respect to each of its products and services. Some of the Company's competitors have greater financial and other resources than the Company. The Company's ability to compete depends on factors both within and outside its control, including:

- product availability, performance, and price;
- product brand recognition;
- distribution and customer support;
- the timing and success of its newly developed products; and
- the timing and success of newly developed products by its competitors.

These factors could possibly limit the Company's ability to compete successfully.

The Company may lose market share if it is not able to develop new products or enhance its existing products.

The Company's ability to remain competitive and its future success depend greatly upon the technological quality of its products and processes relative to those of its competitors. The Company may need to develop new and enhanced products and to introduce these new products at competitive prices and on a timely and cost-effective basis. The Company may not be successful in selecting, developing, and manufacturing new products or in enhancing its existing products on a timely basis or at all. The Company's new or enhanced products may not achieve market acceptance. If the Company cannot successfully develop and manufacture new products, timely enhance its existing technologies, or meet customers' technical specifications for any new products, the Company's products could lose market share, its sales and profits could decline, and it could experience operating losses. New technology or product introductions by the Company's competitors could also cause a decline in sales or loss of market share for the Company's existing products or force the Company to significantly reduce the prices of its existing products.

From time to time, the Company has experienced and will likely continue to experience delays in the introduction of new products. The Company has also experienced and may continue to experience technical and manufacturing difficulties with introductions of new products and enhancements. Any failure by the Company to develop, manufacture, and sell new products in quantities sufficient to offset a decline in sales from existing products or to manage product and related inventory transitions successfully could harm the Company's business. The Company's success in developing, introducing, selling, and supporting new and enhanced products depends upon a variety of factors, including:

- timely and efficient completion of hardware and software design and development;
- timely and efficient implementation of manufacturing processes; and
- effective sales, marketing, and customer service.

The Company depends on key personnel and may not be able to retain these employees or recruit additional qualified personnel, which would harm the Company's business.

The Company is highly dependent upon the continuing contributions of its key management, sales, and product development personnel. The loss of the services of any of its senior managerial, technical, or sales personnel could have a material adverse effect on the Company's business, financial condition, and results of operations. None of the Company's executive officers have employment agreements with the Company. The Company does not maintain key man life insurance on the lives of any of its key personnel. The Company's future success also heavily depends on its continuing ability to attract, retain, and motivate highly qualified managerial, technical, and sales personnel. The Company's inability to recruit and train adequate numbers of qualified personnel on a timely basis could adversely affect its ability to design, manufacture, market, and support its products.

The Company may face costly intellectual property infringement claims.

On a few occasions, the Company has received communications from third parties asserting that it is infringing certain patents and other intellectual property rights of others, or seeking indemnification against the alleged infringement. As claims arise, the Company evaluates their merits. Any claims of infringement brought by third parties could result in protracted and costly litigation, in the Company paying damages for infringement, and in the need for the Company to obtain a license relating to one or more of its products or current or future technologies. Such a license may not be available on commercially reasonable terms or at all. Litigation, which could result in substantial cost to the Company and diversion of its resources, may be necessary to enforce its patents

or other intellectual property rights, or to defend the Company against claimed infringement of the rights of others. Any intellectual property litigation and the failure to obtain necessary licenses or other rights could have a material adverse effect on the Company's business, financial condition, and results of operations.

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

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

The Company's failure to protect its intellectual property and proprietary technology may significantly impair the Company's competitive advantage.

Third parties may infringe or misappropriate the Company's patents, copyrights, trademarks, and similar proprietary rights. The Company cannot be certain that the steps the Company has taken to prevent the misappropriation of the Company's intellectual property are adequate, particularly in foreign countries where the laws may not protect the Company's proprietary rights as fully as in the United States. The Company relies on a combination of patent, copyright, and trade secret protection and nondisclosure agreements to protect its proprietary rights. However, the Company cannot be certain that patent and copyright law and trade secret protection will be adequate to deter misappropriation of its technology, that any patents issued to the Company will not be challenged, invalidated, or circumvented, that the rights granted thereunder will provide competitive advantages to the Company, or that the claims under any patent application will be allowed. The Company may be subject to or may initiate interference proceedings in the United States Patent and Trademark Office, which can demand significant financial and management resources. The process of seeking patent protection can be time-consuming and expensive, and there can be no assurance that patents will issue from currently pending or future applications or that the Company's existing patents or any new patents that may be issued will be sufficient in scope or strength to provide meaningful protection or any commercial advantage to the Company.

The Company may in the future initiate claims or litigation against third parties for infringement of the Company's proprietary rights in order to determine the scope and validity of the Company's proprietary rights or the proprietary rights of the Company's competitors. These claims could result in costly litigation and the diversion of the Company's technical and management personnel.

New software products or enhancements may contain defects that could result in expensive and time-consuming design modifications or large warranty charges, damage customer relationships, and result in loss of market share.

New software products or enhancements may contain errors or performance problems when first introduced, when new versions or enhancements are released, or even after such products or enhancements have been used in the marketplace for a period of time. Despite the Company's testing, product defects may be discovered only after a product has been installed and used by customers. Errors and performance problems may be discovered in future shipments of the Company's products. These errors could result in expensive and time-consuming design modifications or large warranty charges, damage customer relationships, and result in loss of market share. To date, there have been no known defects in the Company's software products that materially affected the Company's operations.

The Company may be subject to product liability claims, which can be expensive, difficult to defend, and may result in large judgments or settlements against the Company.

On a few occasions, the Company has received communications from third parties asserting that the Company's products have caused bodily injury to others. Product liability claims can be expensive, difficult to defend, and may result in large judgments or settlements against the Company. In addition, third party collaborators and licensees may not protect the Company from product liability claims. Although the Company maintains product liability insurance in the amount of approximately \$26 million, claims could exceed the coverage obtained. A successful product liability claim in excess of the Company's insurance coverage could harm the Company's financial condition and results of operations. In addition, any successful claim may prevent the Company from obtaining adequate product liability insurance in the future on commercially desirable terms. Even if a claim is not successful, defending such a claim may be time-consuming and expensive.

The Company may seek to make acquisitions or joint ventures that prove unsuccessful or strain or divert resources.

The Company continues to evaluate potential acquisitions and joint ventures. However, the Company may not be able to complete any acquisitions or joint ventures at all. Acquisitions and joint ventures present risks that could materially and adversely affect the Company's business and financial performance, including:

- the diversion of management's attention from everyday business activities;
- the contingent and latent risks associated with the past operations of, and other unanticipated problems arising in, the acquired business; and
- the need to expand management, administration, and operational systems.

If the Company makes such acquisitions, it cannot predict whether:

- it will be able to successfully integrate the operations and personnel of any new businesses into its business;
- it will realize any anticipated benefits of completed acquisitions; or
- there will be substantial unanticipated costs associated with acquisitions, including potential costs associated with environmental liabilities undiscovered at the time of acquisition.

If the Company makes such joint ventures, it cannot predict whether:

- it will realize any anticipated benefits of successful joint ventures; and
- there will be substantial unanticipated costs associated with such joint ventures or investments.

In addition, future acquisitions by the Company may result in:

- potentially dilutive issuances of the Company's equity securities;
- the incurrence of additional debt;
- restructuring charges; and
- the recognition of significant charges for depreciation and amortization related to certain intangible assets.

In the future, the Company may make investments in or acquire companies or commence operations in businesses and industries that are outside of those areas that the Company has operated historically. The Company cannot assure that it will be successful in managing any new business. If these investments, acquisitions, or arrangements are not successful, the Company's earnings could be materially adversely affected by increased expenses and decreased revenues.

The Company may incur significant increased costs in order to assess its internal controls over financial reporting, and its internal controls over financial reporting may be found to be deficient.

Section 404 of the Sarbanes-Oxley Act of 2002 requires management to assess its internal controls over financial reporting and requires auditors to attest to that assessment. Current regulations of the Securities and Exchange Commission, or SEC, will require the Company to include this assessment in its Annual Report on Form 10-K, commencing with the annual report for the fiscal year ended December 31, 2007.

The Company may incur significant increased costs in implementing and responding to the new requirements. In particular, the rules governing the standards that must be met for management to assess its internal controls over financial reporting under Section 404 are complex and require significant documentation, testing, and possible remediation. The process of reviewing, documenting, and testing internal controls over financial reporting may cause a significant strain on the Company's management, information systems, and resources. The Company may have to invest in additional accounting and software systems. The Company may also be required to hire additional personnel and to use outside legal, accounting, and advisory services. In addition, the Company may incur additional fees from its auditors when they are required to perform the additional services necessary for them to provide their attestation. If the Company is unable to favorably assess the effectiveness of its internal control over financial reporting when it is required to, the Company may be required to change its internal control over financial reporting to remediate deficiencies. In addition, investors may lose confidence in the reliability of the Company's financial statements, causing the Company's stock price to decline.

The Company's presence in international markets exposes it to risk.

The Company has a limited presence in international markets and has experienced a fluctuation in international sales volume in recent years. Maintenance and continued growth of this segment of the Company's business may be affected by changes in trade, monetary and fiscal policies, laws and regulations of the United States and other trading nations and by foreign currency exchange rate fluctuations.

Availability of product components could harm the Company's profitability.

The Company obtains raw materials and certain manufactured components from third party suppliers. Although the Company deems that it maintains an adequate level of raw material inventory, even brief unanticipated delays in delivery by suppliers, including those due to capacity constraints, labor disputes, impaired financial condition of suppliers, weather emergencies, or other natural disasters, may adversely affect the Company's ability to satisfy its customers on a timely basis and thereby affect the Company's financial performance.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

The Company's principal office is located 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 \$18,781 (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.

Item 2. Properties (Continued)

The Company believes that its Easton, Pennsylvania facility is adequate for its current operations. The Company's operations experience fluctuations in workload due to the timing and receipt of new orders and customer job completion requirements. Currently, the Company's facilities are adequate to handle these fluctuations. In the event of an unusual demand in workload, the Company supplements its internal operations with outside subcontractors that perform services for the Company in order to complete contractual requirements for its customers. The Company will continue to utilize internal personnel and its own facility and, when necessary and/or cost effective, outside subcontractors to complete contracts in a timely fashion in order to address the needs of its customers.

Item 3. 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 consolidated financial position, results of operations, or liquidity.

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

No matters were submitted to a vote of security holders during the fourth quarter ended December 31, 2006.

PART II

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters

The Company's common stock trades on the American Stock Exchange (Amex) under the symbol "PTG." The high and low sales prices for the years ended December 31, 2006 and 2005 are as follows:

	For the Year Ended December 31, 2006		For the Year Ended December 31, 2005	
	High	Low	High	Low
First Quarter	10.65	9.25	10.13	7.71
Second Quarter	11.50	8.25	12.89	8.67
Third Quarter	8.95	6.00	13.79	10.19
Fourth Quarter	6.98	5.19	11.00	8.85

The Company did not pay cash dividends during the years ended December 31, 2006, 2005, and 2004, and has no present intention to declare cash dividends. Any determination to pay dividends in the future will be at the discretion of the Company's Board of Directors and will be dependent upon the Company's results of operations, financial condition, and other factors deemed relevant by the Company's Board of Directors.

The number of holders of record of the Company's common stock as of December 31, 2006, as shown by the records of the Company's transfer agent was 275. This figure does not include individual participants in security position listings.

The closing market price of the Company's common stock on March 28, 2007 was \$5.84.

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters *(Continued)*

Issuer Purchases of Equity Securities

The following table represents the periodic repurchases of equity securities made by the Company during the three months ended December 31, 2006:

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	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Program
10/01/06 – 10/31/06	89,200	\$ 5.35	89,200	\$ 477,246	\$ 1,307,496
11/01/06 – 11/30/06	60,200	\$ 5.67	60,200	\$ 341,547	\$ 965,949
12/01/06 – 12/31/06	91,800	\$ 5.61	91,800	\$ 515,360	\$ 450,589
	241,200	\$ 5.53	241,200	\$ 1,334,153	

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 August 19, 2005, the Company announced the repurchase of an aggregate of 359,200 shares (or 8.3%) of its common stock in a private sale transaction for an aggregate of approximately \$3,502,000 (or \$9.75 per share) from Leon C. Kirschner, the Company's former Chief Operating Officer, and Steven Shulman, a former director of the Company. In these transactions, the Company, with authorization from its Board of Directors, repurchased 190,091 shares from Mr. Kirschner for approximately \$1,853,000 and 169,109 shares from Mr. Shulman for approximately \$1,649,000, which represented their holdings of the Company's common stock, and retired the shares. The closing market price of the Company's common stock on August 18, 2005 was \$12.60 per share.

Mr. Kirschner, who also served as the Chief Executive Officer of the Company's former wholly owned subsidiary, Ermanco Incorporated, resigned as an officer and employee of the Company on August 5, 2005, the day on which the Company completed its sale of substantially all of the assets and liabilities of Ermanco Incorporated. Mr. Shulman resigned as a director of the Company on August 8, 2005. Mr. Shulman became a director of the Company as a result of the Company's purchase of Ermanco on September 30, 1999.

On November 15, 2005, the Company announced the repurchase of 100,000 shares (or 2.67%) of its common stock in a private sale transaction for \$975,000 (or \$9.75 per share) from L. Jack Bradt, a member of the Company's Board of Directors. The Company's non-interested Audit Committee members and the Board of Directors approved the repurchase of Mr. Bradt's shares. The closing market price of the Company's common stock on November 14, 2005 was \$10.09 per share.

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters *(Continued)*

Issuer Purchases of Equity Securities *(Continued)*

During the three months ended December 31, 2006, the Company repurchased 241,200 shares of common stock at a weighted average cost, including brokerage commissions, of \$5.53 per share. During the year ended December 31, 2006, the Company repurchased 679,219 shares of common stock at a weighted average cost, including brokerage commissions, of \$7.57 per share. Cash expenditures for the stock repurchases during the three and twelve months ended December 31, 2006 were \$1,334,153 and \$5,142,898, respectively. Through December 31, 2006, the Company had repurchased 1,538,019 shares of common stock at a weighted average cost, including brokerage commissions, of \$8.81 per share. Cash expenditures for the stock repurchases since the inception of the program were \$13,549,411. As of December 31, 2006, \$450,589 remained available for repurchases under the stock repurchase program.

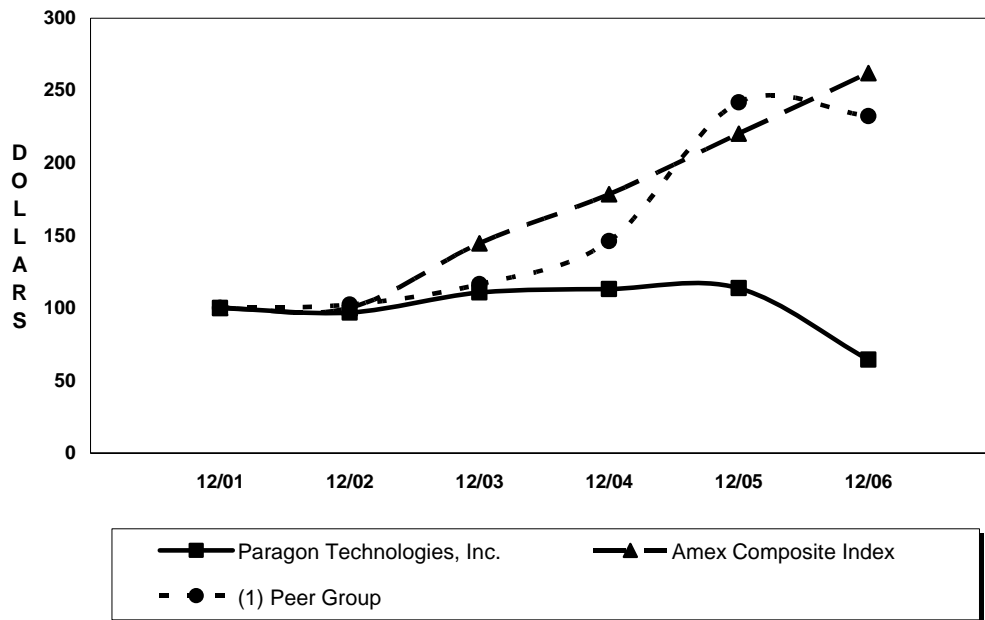
Subsequent to December 31, 2006, the Company's Board of Directors amended its existing stock repurchase program by increasing the amount it has authorized management to repurchase from up to \$14,000,000 of the Company's common stock to up to \$15,000,000.

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 5. Market for the Registrant's Common Equity and Related Stockholder Matters *(Continued)*

Stock Performance Chart

The following graph illustrates the cumulative total stockholder return on the Company's common stock during the years ended December 31, 2006, December 31, 2005, December 31, 2004, December 31, 2003, and December 31, 2002 with comparison to the cumulative total return on the Amex Composite Index, and a Peer Group of Construction and Related Machinery Companies. This comparison assumes \$100 was invested on December 31, 2001 in the Company's common stock and in each of the foregoing indexes and assumes reinvestment of dividends.



	<u>12/31/01</u>	<u>12/31/02</u>	<u>12/31/03</u>	<u>12/31/04</u>	<u>12/31/05</u>	<u>12/31/06</u>
Paragon Technologies, Inc.	100	97	111	113	114	64
(1) Peer Group	100	103	117	146	242	232
Amex Composite Index	100	100	145	178	220	262

(1) The self-constructed Peer Group of Construction and Related Machinery Companies includes: A.S.V., Inc., Bolt Technology Corporation, Columbus McKinnon Corporation, Industrial Rubber Products, Inc., Lufkin Industries, Inc., Quipp, Inc., and Tesco Corporation. The total returns of each member of the Peer Group were determined in accordance with Securities and Exchange Commission regulations; i.e., weighted according to each such issuer's stock market capitalization.

Please refer to the Company's disclosure regarding Executive Compensation information included in Item 11 of this Annual Report on Form 10-K.

Item 6. Selected Financial Data

The following table sets forth the Company's selected consolidated financial information for each of the years in the five-year period ended December 31, 2006. The selected consolidated financial data presented below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and Consolidated Financial Statements and Notes thereto included in this report. The historical results presented herein may not be indicative of future results. The information presented below is in thousands, except per share amounts.

	For the Years Ended				
	12/31/06	12/31/05	12/31/04	12/31/03	12/31/02
Net sales	\$17,788	16,676	11,702	12,083	14,906
Income (loss) from continuing operations before income taxes.....	\$ 449	301	(271)	6,034	1,376
Income tax expense (benefit).....	(19)	93	(106)	2,349	420
Income (loss) from continuing operations....	468	208	(165)	3,685	956
Income (loss) from discontinued operations, net of income taxes.....	-	990	1,638	100	(293)
Net income	<u>\$ 468</u>	<u>1,198</u>	<u>1,473</u>	<u>3,785</u>	<u>663</u>
Basic earnings (loss) per share:					
Income (loss) from continuing operations....	\$.14	.05	(.04)	.87	.23
Income (loss) from discontinued operations	-	.24	.38	.02	(.07)
Net income	<u>\$.14</u>	<u>.29</u>	<u>.34</u>	<u>.89</u>	<u>.16</u>
Diluted earnings (loss) per share:					
Income (loss) from continuing operations....	\$.14	.05	(.04)	.85	.22
Income (loss) from discontinued operations	-	.24	.38	.02	(.07)
Net income	<u>\$.14</u>	<u>.29</u>	<u>.34</u>	<u>.87</u>	<u>.15</u>
Total assets (1)	\$ 16,752	22,596	33,424	33,803	36,703
Long-term liabilities	\$ 28	193	2,761	2,159	9,402
Cash dividends per share	\$ -	-	-	-	-

See Discontinued Operations - Sale of Ermanco in Note 2 of the Notes to Consolidated Financial Statements for further information regarding the sale of substantially all of the assets and liabilities of Ermanco in the third quarter of 2005.

Item 6. Selected Financial Data *(Continued)*

(1) During the year ended December 31, 2006, the Company repurchased 679,219 shares of common stock at a weighted average cost, including brokerage commissions, of \$7.57 per share. Cash expenditures for the stock repurchases during the year ended December 31, 2006 were \$5,142,898. During the year ended December 31, 2005, the Company repurchased 824,100 shares of common stock at a weighted average cost, including brokerage commissions, of \$9.81 per share. Cash expenditures for the stock repurchases during the year ended December 31, 2005 were \$8,080,882. See Stock Repurchase Program in Note 12 of the Notes to Consolidated Financial Statements regarding the repurchase of shares of the Company's common stock.

Item 7. 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 consolidated financial statements and related notes thereto included in this 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 as more fully discussed in Item 1A, Risk Factors.

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.

On August 5, 2005, the Company completed the sale of substantially all of the assets and liabilities of Ermanco, and received cash consideration of \$23,055,000 (subject to a working capital adjustment and an accounts receivable adjustment). Transaction costs associated with the sale of the assets and liabilities of Ermanco were approximately \$1,038,000. During the fourth quarter of 2005, the Company paid \$448,000 to the Buyer in connection with the working capital adjustment and \$61,000 in connection with the accounts receivable adjustment. Therefore, the Company received cash consideration of \$21,508,000, net of transaction costs and the working capital and the accounts receivable adjustments in connection with the sale of the assets and liabilities of Ermanco, thereby resulting in a pre-tax loss of approximately \$964,000. See Note 2 of the Notes to Consolidated Financial Statements for further information regarding the sale of substantially all of the assets and liabilities of Ermanco. The discussion that follows reflects the operations of the Company following the sale of substantially all of the assets and liabilities of Ermanco.

Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations *(Continued)*

Key Performance Metrics Relevant to the Company

Capacity Utilization

Capacity Utilization, as documented in the Federal Reserve Statistical Release⁽¹⁾, is a key economic indicator that the Company follows as a barometer that may lead to capital spending for material handling systems. Capacity Utilization attempts to measure what percent of available capacity is actually being utilized. Management believes that when Capacity Utilization rises 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 years ended December 31, 2006, 2005, 2004, 2003, 2002, and 2001:

<i>(Dollars in Thousands)</i>	2006	2005	2004	2003	2002	2001
Backlog of orders —						
Beginning	\$ 6,918	5,514	4,052	4,834	7,666	16,353
Add: orders.....	16,802	18,080	13,164	11,301	12,074	10,321
Less: sales	17,788	16,676	11,702	12,083	14,906	19,008
Backlog of orders —						
Ending	\$ 5,932	6,918	5,514	4,052	4,834	7,666
Capacity Utilization ⁽¹⁾	81.8%	80.2%	78.1%	76.1%	74.8%	76.1%

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 for the years ended December 31, 2006, 2005, 2004, 2003, 2002, and 2001:

<i>(Dollars in Thousands)</i>	2006	2005	2004	2003	2002	2001
Current assets	\$16,370	22,134	14,249	14,720	15,444	19,200
Current liabilities.....	\$ 4,296	5,337	7,355	9,583	9,416	13,357
Current ratio	3.81	4.15	1.94	1.54	1.64	1.44

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 for the years ended December 31, 2006, 2005, 2004, 2003, 2002, and 2001 and also includes the number of shares outstanding at each fiscal year end:

Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations *(Continued)*

Key Performance Metrics Relevant to the Company *(Continued)*

Debt to Equity Ratio *(Continued)*

<i>(Dollars in Thousands)</i>	2006	2005	2004	2003	2002	2001
Current installments of long-term debt.....	\$ -	-	-	-	1,437	2,305
Long-term debt	-	-	-	-	7,263	9,900
Total debt.....	-	-	-	-	8,700	12,205
Total stockholders' equity (1).....	\$ 12,428	17,066	23,308	22,061	17,885	16,912
Debt to equity ratio.....	-	-	-	-	.49	.72
Number of shares outstanding at year end	2,873,891	3,539,019	4,265,310	4,277,595	4,256,098	4,221,635

(1) During the year ended December 31, 2006, the Company repurchased 679,219 shares of common stock at a weighted average cost, including brokerage commissions, of \$7.57 per share. Cash expenditures for the stock repurchases during the year ended December 31, 2006 were \$5,142,898. During the year ended December 31, 2005, the Company repurchased 824,100 shares of common stock at a weighted average cost, including brokerage commissions, of \$9.81 per share. Cash expenditures for the stock repurchases during the year ended December 31, 2005 were \$8,080,882. See Stock Repurchase Program in Note 12 of the Notes to Consolidated Financial Statements regarding the repurchase of shares of the Company's common stock.

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 consolidated 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 recognition on systems 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 December 31, 2006, there are no contracts that are anticipated to result in a loss.

Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations *(Continued)*

Critical Accounting Policies and Estimates *(Continued)*

Revenue Recognition on Systems Sales *(Continued)*

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 past three years.

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 December 31, 2006 is \$192,000.

Inventories

Inventories are valued at the lower of average cost or market. The Company provides an inventory reserve determined by a specific identification of individual slow moving items and other inventory items based on historical experience. The reserve is considered to be a write-down of inventory to a new cost basis. Upon disposal of inventory, the new cost basis is removed from the accounts.

Results of Operations – Year Ended December 31, 2006 Compared to the Year Ended December 31, 2005

Earnings Summary

The Company had net income of \$468,000 (or \$0.14 basic earnings per share) for the year ended December 31, 2006, compared to net income of \$1,198,000 (or \$0.29 basic earnings per share) for the year ended December 31, 2005. There was no income from discontinued operations, net of income taxes, for the year ended December 31, 2006, compared to income from discontinued operations, net of income taxes of \$990,000 (or \$0.24 basic earnings per share) for the year ended December 31, 2005. Income from continuing operations was \$468,000 (or \$0.14 basic earnings per share) for the year ended December 31, 2006, compared to income from continuing operations of \$208,000 (or \$0.05 basic earnings per share) for the year ended December 31, 2005. The increase in income from continuing operations was primarily due to:

Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations (Continued)

Results of Operations – Year Ended December 31, 2006 Compared to the Year Ended December 31, 2005 (Continued)

Earnings Summary (Continued)

- an increase during 2006 in total revenues and gross profit of \$1,112,000 and \$760,000, respectively, as described below; and
- an increase of \$203,000 in interest income attributable to the higher level of funds available for investment as a result of the cash proceeds from the August 5, 2005 sale of substantially all of the assets and liabilities of Ermanco and the increased level of interest rates earned on funds available for investment.

Partially offsetting the above increase in income from continuing operations for the year ended December 31, 2006 was an increase in selling, general and administrative expenses of \$606,000 and an increase in product development costs of \$221,000 as mentioned below.

Net Sales and Gross Profit on Sales

	2006	2005
Net sales	\$ 17,788,000	16,676,000
Cost of sales	12,492,000	12,140,000
Gross profit on sales	<u>\$ 5,296,000</u>	<u>4,536,000</u>
Gross profit as a percentage of sales	<u>29.8%</u>	<u>27.2%</u>

The increase in sales was associated with a larger backlog of orders entering fiscal 2006 when compared to the backlog of orders entering fiscal 2005. Contributing to the increase in sales was progress made on contracts received prior to the start of the year and during 2006 in accordance with contract completion requirements associated with certain customers.

Gross profit, as a percentage of sales, for the year ended December 31, 2006, when compared to the year ended December 31, 2005, was favorably impacted by approximately 1.3% due to product mix and the impact of the favorable performance on the Company's contracts that were completed or nearing completion in the year ended December 31, 2006 as compared to the year ended December 31, 2005. Also contributing to the aforementioned favorable variance was a 1.3% reduction in overhead costs as a percentage of sales due to the higher sales volume to cover fixed overhead costs in the year ended December 31, 2006.

Selling, General and Administrative Expenses

Selling, general and administrative expenses of \$5,252,000 were higher by \$606,000 for the year ended December 31, 2006 than for the year ended December 31, 2005. The increase was attributable to the addition of resources aimed at expanding the customer base and an increase in salaries and fringe benefits totaling \$227,000, an increase of \$34,000 in commission expenses related to the Company's enhanced revenue performance, and an increase of \$285,000 in marketing expenses primarily associated with product promotion and participation in trade shows.

Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations *(Continued)*

Results of Operations – Year Ended December 31, 2006 Compared to the Year Ended December 31, 2005 *(Continued)*

Product Development Costs

Product development costs, including patent expense, of \$283,000 were higher by \$221,000 for the year ended December 31, 2006 than for the year ended December 31, 2005. Development programs in the year ended December 31, 2006 were primarily aimed at improvements to the Company's Order Fulfillment and Production & Assembly systems technologies. Development efforts during the year ended December 31, 2006 included DISPEN-SI-MATIC[®] hardware and software enhancements aimed at promoting workplace efficiencies for the Company's customers, voice-directed replenishment, and LO-TOW[®] product enhancements. Development programs in the years ended December 31, 2005 and December 31, 2004 were primarily aimed at improvements to the Company's Order Fulfillment systems technologies. Order Fulfillment development efforts, that were essentially completed during the year ended December 31, 2004 and incorporated into the Company's Order Fulfillment product offerings, were centered on the development of an innovative computer control system, along with DISPEN-SI-MATIC[®] software and hardware enhancements aimed at promoting workplace efficiencies for the Company's customers. Order Fulfillment development efforts during the year ended December 31, 2005 were primarily additional modifications and enhancements to the Company's fiscal 2004 development initiatives.

Interest Income

Interest income of \$527,000 was higher by \$203,000 for the year ended December 31, 2006 than for the year ended December 31, 2005. The increase in interest income was attributable to the higher level of funds available for investment as a result of the cash proceeds from the August 5, 2005 sale of substantially all of the assets and liabilities of Ermanco and the increased level of interest rates earned on funds available for investment.

Income Tax Expense (Benefit)

The Company recognized an income tax benefit of \$19,000 during the year ended December 31, 2006 compared to income tax expense of \$93,000 during the year ended December 31, 2005. The income tax benefit for the year ended December 31, 2006 was primarily due to the reversal of accruals for the expiration of tax return statutes and tax-exempt interest on certain investments. Income tax expense for the year ended December 31, 2005 was lower than statutory federal and state tax rates primarily due to tax-exempt interest on certain investments.

Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations *(Continued)*

Results of Operations – Year Ended December 31, 2005 Compared to the Year Ended December 31, 2004

Earnings Summary

The Company had net income of \$1,198,000 (or \$0.29 basic earnings per share) for the year ended December 31, 2005, compared to net income of \$1,473,000 (or \$0.34 basic earnings per share) for the year ended December 31, 2004. Income from discontinued operations, net of income taxes, was \$990,000 (or \$0.24 basic earnings per share) for the year ended December 31, 2005, compared to income from discontinued operations, net of income taxes, of \$1,638,000 (or \$0.38 basic earnings per share) for the year ended December 31, 2004. Income from continuing operations was \$208,000 (or \$0.05 basic earnings per share) for the year ended December 31, 2005, compared to a loss from continuing operations of \$165,000 (or \$0.04 basic loss per share) for the year ended December 31, 2004. The increase in income from continuing operations was primarily due to:

- an increase during 2005 in total revenues and gross profit of \$4,974,000 and \$649,000, respectively, as described below; and
- an increase of \$248,000 in interest income attributable to the higher level of funds available for investment as a result of the cash proceeds from the August 5, 2005 sale of substantially all of the assets and liabilities of Ermanco.

Partially offsetting the above increase in income from continuing operations for the year ended December 31, 2005 was an increase in selling, general and administrative expenses of \$486,000 as mentioned below.

Net Sales and Gross Profit on Sales

	<u>2005</u>	<u>2004</u>
Net sales	\$ 16,676,000	11,702,000
Cost of sales	<u>12,140,000</u>	<u>7,815,000</u>
Gross profit on sales	<u>\$ 4,536,000</u>	<u>3,887,000</u>
Gross profit as a percentage of sales	<u>27.2%</u>	<u>33.2%</u>

The increase in sales was associated with a larger backlog of orders entering fiscal 2005 when compared to the backlog of orders entering fiscal 2004. Contributing to the increase in sales was progress made on contracts received prior to the start of the year and during 2005 in accordance with contract completion requirements associated with certain customers.

Gross profit, as a percentage of sales, for the year ended December 31, 2005, when compared to the year ended December 31, 2004, was unfavorably impacted by approximately 8.2% due to competitive pricing pressures and product mix, along with the impact of the favorable performance on the Company's contracts that were completed or nearing completion in the year ended December 31, 2004 as compared to the year ended December 31, 2005. Partially offsetting the aforementioned unfavorable variance was a 2.2% reduction in overhead costs as a percentage of sales due to the higher sales volume to cover fixed overhead costs in the year ended December 31, 2005.

Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations *(Continued)*

Results of Operations – Year Ended December 31, 2005 Compared to the Year Ended December 31, 2004 *(Continued)*

Selling, General and Administrative Expenses

Selling, general and administrative expenses of \$4,646,000 were higher by \$486,000 for the year ended December 31, 2005 than for the year ended December 31, 2004. The increase was attributable to the addition of resources aimed at expanding the customer base and an increase in salaries and fringe benefits totaling \$305,000, an increase of \$64,000 in commission expenses related to the Company's enhanced revenue performance, and an increase of \$204,000 in professional fees and consulting expenses. Partially offsetting the aforementioned unfavorable variance was a decrease of \$84,000 in marketing expenses primarily associated with product promotion.

Product Development Costs

Product development costs, including patent expense, of \$62,000 were lower by \$114,000 for the year ended December 31, 2005 than for the year ended December 31, 2004. Development programs in the years ended December 31, 2005 and December 31, 2004 were primarily aimed at improvements to the Company's Order Fulfillment systems technologies. Order Fulfillment development efforts, that were essentially completed during the year ended December 31, 2004 and incorporated into the Company's Order Fulfillment product offerings, were centered on the development of an innovative computer control system, along with DISPEN-SI-MATIC[®] software and hardware enhancements aimed at promoting workplace efficiencies for the Company's customers. Order Fulfillment development efforts during the year ended December 31, 2005 were primarily additional modifications and enhancements to the Company's fiscal 2004 development initiatives.

Interest Income

Interest income of \$324,000 was higher by \$248,000 for the year ended December 31, 2005 than for the year ended December 31, 2004. The increase in interest income was attributable to the higher level of funds available for investment as a result of the cash proceeds from the August 5, 2005 sale of substantially all of the assets and liabilities of Ermanco.

Other Income, Net

The favorable variance of \$44,000 in other income, net for the year ended December 31, 2005 as compared to the year ended December 31, 2004 was primarily attributable to an increase in royalty income from a license agreement related to material handling equipment sales.

Income Tax Expense (Benefit)

The Company recognized income tax expense of \$93,000 during the year ended December 31, 2005 compared to an income tax benefit of \$106,000 during the year ended December 31, 2004. Income tax expense for the year ended December 31, 2005 was lower than statutory federal and state tax rates primarily due to tax-exempt interest on certain investments. The income tax benefit for the year ended December 31, 2004 was generally recorded at statutory federal and state tax rates.

Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations *(Continued)*

Liquidity and Capital Resources

The Company's cash and cash equivalents and short-term investments at December 31, 2006 were \$12,072,000, representing 72.1% 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 \$5,143,000 and purchases of capital equipment of \$131,000.

Cash used by operating activities totaling \$51,000 during the year ended December 31, 2006 was primarily due to the following factors:

- a decrease in customers' deposits and billings in excess of costs and estimated earnings in the amount of \$650,000 in accordance with contractual requirements.

Partially offset by the following factors:

- a decrease in receivables in the amount of \$110,000 primarily associated with the collection of an income tax refund which was partially offset by an increase in customer billings in accordance with contractual requirements;
- a decrease in costs and estimated earnings in excess of billings in the amount of \$172,000 in accordance with contractual requirements; and
- a decrease in prepaid expenses and other current assets of \$217,000 primarily associated with the amortization of insurance premiums in accordance with policy expiration dates.

The Company's cash and cash equivalents and short-term investments at December 31, 2005 were \$17,397,000, representing 77.0% of total assets, up from \$3,602,000, or 10.8% of total assets, at December 31, 2004. The increase was primarily due to cash proceeds of \$21,508,000 from the sale of Ermanco, net of transaction costs and the working capital and accounts receivable adjustments, and proceeds of \$623,000 from the sale of common stock in connection with the Company's stock option plan, partially offset by the repurchase and retirement of common stock of \$8,081,000.

Cash provided by operating activities totaling \$149,000 during the year ended December 31, 2005 was primarily due to the following factors:

- an increase in customers' deposits and billings in excess of costs and estimated earnings in the amount of \$802,000 in accordance with contractual requirements; and
- an increase in net cash provided by operating activities of discontinued operations of \$601,000.

Partially offset by the following factors:

- an increase in trade receivables in the amount of \$393,000 in accordance with contractual requirements;
- an increase in costs and estimated earnings in excess of billings in the amount of \$524,000 in accordance with contractual requirements; and
- a decrease in accrued product warranty in the amount of \$301,000 primarily associated with the reversal of unused, expired accrued product warranties for contracts that were no longer in the warranty period.

Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations *(Continued)*

Liquidity and Capital Resources *(Continued)*

On August 5, 2005, the Company completed the sale of substantially all of the assets and liabilities of Ermanco, and received cash consideration of \$23,055,000 (subject to a working capital adjustment and an accounts receivable adjustment). Transaction costs associated with the sale of the assets and liabilities of Ermanco were approximately \$1,038,000. During the fourth quarter of 2005, the Company paid approximately \$448,000 to the Buyer in connection with the working capital adjustment and \$61,000 in connection with the accounts receivable adjustment. Therefore, the Company received cash consideration of \$21,508,000, net of transactions costs and the working capital and accounts receivable adjustments in connection with the sale of the assets and liabilities of Ermanco, thereby resulting in a pre-tax loss on the sale of approximately \$964,000.

The Company's line of credit facility may not exceed \$5,000,000 and is to be used primarily for working capital purposes. Effective August 5, 2005, the Company issued a \$2,000,000 letter of credit in connection with the sale of substantially all of the assets and liabilities of Ermanco, thereby reducing the amount of available line of credit to \$2,800,000. The letter of credit remained in place to August 5, 2006, the one-year anniversary of the closing of the asset sale. There was no claim under the letter of credit during its existence. As of December 31, 2006, 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. As of December 31, 2006, the Company did not have any borrowings under the line of credit facility, and the line of credit facility expires effective June 30, 2007. The Company expects to renew the line of credit facility under similar terms and conditions during 2007.

The Company anticipates that its financial resources, consisting of cash generated from the sale of Ermanco 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 businesses. The Company may not be able to effect any of these strategic options.

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 \$18,781 (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.

Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations *(Continued)*

Contractual Obligations *(Continued)*

Future contractual obligations and commercial commitments at December 31, 2006 as noted above are as follows:

	Payments Due by Period					
	Total	2007	2008	2009	2010	2011
Contractual obligations:						
Operating leases	\$ 265,000	231,000	34,000	-	-	-
Total	\$ 265,000	231,000	34,000	-	-	-

	Total Amounts Committed	Amount of Commitment Expiration Per Period				
		2007	2008	2009	2010	2011
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 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 this Annual Report on Form 10-K.

Off-Balance Sheet Arrangements

As of December 31, 2006, 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.

Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations *(Continued)*

Recently Issued Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board issued SFAS No. 151, "Inventory Costs an Amendment of ARB No. 43, Chapter 4" ("SFAS No. 151"). SFAS No. 151 provides for certain fixed production overhead cost to be reflected as a period cost and not capitalized as inventory. The Company adopted SFAS No. 151 on January 1, 2006. The adoption of SFAS No. 151 did not have a material impact on the Company's financial statements.

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised) "Share-Based Payment" ("SFAS No. 123R"). SFAS No. 123R addresses all forms of share-based payment awards, including shares issued under employee stock purchase plans, stock options, restricted and nonvested stock, and stock appreciation rights. It requires companies to recognize in the statement of operations the grant-date fair value of stock options and other equity-based compensation issued to employees. The statement eliminates the intrinsic value-based method prescribed by APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, that the Company used prior to January 1, 2006. The Company adopted SFAS No. 123R on January 1, 2006.

In May 2005, the Financial Accounting Standard Board issued SFAS No. 154, "Accounting Changes and Error Corrections – A Replacement of APB Opinion No. 20 and FASB Statement No. 3" ("SFAS No. 154"). SFAS No. 154 requires retrospective application to prior periods' financial statements for changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This statement also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle, such as a change in non-discretionary profit-sharing payments resulting from an accounting change, should be recognized in the period of the accounting change. SFAS No. 154 also requires that a change in depreciation, amortization, or depletion method for long-lived non-financial assets be accounted for as a change in accounting estimate affected by a change in accounting principle. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company adopted the provisions of this statement, as applicable, on January 1, 2006, and there was no impact of the adoption.

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 provisions of FIN 48 are effective beginning January 1, 2007 with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is currently evaluating the impact of adopting FIN 48 on the financial statements.

Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations *(Continued)*

Recently Issued Accounting Pronouncements *(Continued)*

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB No. 108") to provide guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. Under SAB No. 108, companies should evaluate a misstatement based on its impact on the current year income statement, as well as the cumulative effect of correcting such misstatements that existed in prior years existing in the current year's ending balance sheet. The Company adopted the provisions of SAB No. 108 on January 1, 2006, and there was no impact of the adoption.

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.

Item 7a. 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 8. Consolidated Financial Statements and Supplementary Data

I N D E X

- Report of Independent Registered Public Accounting Firm.

- Consolidated Financial Statements:
 - Consolidated Balance Sheets, December 31, 2006 and 2005.

 - Consolidated Statements of Operations for the years ended December 31, 2006, 2005, and 2004.

 - Consolidated Statements of Stockholders' Equity and Comprehensive Income for the years ended December 31, 2006, 2005, and 2004.

 - Consolidated Statements of Cash Flows for the years ended December 31, 2006, 2005, and 2004.

 - Notes to Consolidated Financial Statements.

- All schedules are omitted as the required information is inapplicable or the information is presented in the consolidated financial statements or related notes.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Paragon Technologies, Inc.:

We have audited the accompanying consolidated balance sheets of Paragon Technologies, Inc. and subsidiary as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Paragon Technologies, Inc. and subsidiary as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment, using the modified prospective approach, effective January 1, 2006.

KPMG LLP

Philadelphia, PA
March 30, 2007

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY

Consolidated Balance Sheets

December 31, 2006 and 2005

(In Thousands, Except Share Data)

	December 31, 2006	December 31, 2005
<u>Assets</u>		
Current assets:		
Cash and cash equivalents.....	\$ 2,447	687
Short-term investments.....	9,625	16,710
Total cash and cash equivalents and short-term investments.....	<u>12,072</u>	<u>17,397</u>
Receivables:		
Trade	2,557	2,029
Notes and other receivables.....	428	1,066
Total receivables	<u>2,985</u>	<u>3,095</u>
Costs and estimated earnings in excess of billings.....	444	616
Inventories:		
Raw materials.....	100	108
Work-in-process	29	26
Finished goods	340	210
Total inventories	<u>469</u>	<u>344</u>
Deferred income tax benefits.....	288	353
Prepaid expenses and other current assets ..	112	329
Total current assets	<u>16,370</u>	<u>22,134</u>
Property, plant and equipment, at cost:		
Machinery and equipment	1,195	1,160
Less: accumulated depreciation	919	911
Net property, plant and equipment	<u>276</u>	<u>249</u>
Deferred income tax benefits	96	203
Other assets.....	10	10
Total assets	<u>\$ 16,752</u>	<u>22,596</u>

*See accompanying notes to consolidated financial statements.**(Continued)*

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARYConsolidated Balance Sheets *(Continued)*

December 31, 2006 and 2005

(In Thousands, Except Share Data)

	December 31, 2006	December 31, 2005
<u>Liabilities and Stockholders' Equity</u>		
Current liabilities:		
Accounts payable.....	\$ 1,177	1,391
Customers' deposits and billings in excess of costs and estimated earnings.....	1,394	2,044
Accrued salaries, wages, and commissions.....	132	102
Income taxes payable.....	541	650
Accrued product warranty.....	192	189
Deferred gain on sale-leaseback.....	165	165
Unearned support contract revenue.....	270	239
Accrued other liabilities.....	425	557
Total current liabilities.....	<u>4,296</u>	<u>5,337</u>
Long-term liabilities:		
Deferred gain on sale-leaseback.....	28	193
Total long-term liabilities.....	<u>28</u>	<u>193</u>
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$1 par value; authorized 20,000,000 shares; issued and outstanding 2,873,891 shares as of December 31, 2006 and 3,539,019 shares as of December 31, 2005.....	2,874	3,539
Additional paid-in capital.....	5,720	7,004
Retained earnings.....	3,834	6,523
Total stockholders' equity.....	<u>12,428</u>	<u>17,066</u>
Total liabilities and stockholders' equity.....	<u>\$ 16,752</u>	<u>22,596</u>

See accompanying notes to consolidated financial statements.

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY

Consolidated Statements of Operations

For the Years Ended December 31, 2006, 2005, and 2004

(In Thousands, Except Share and Per Share Data)

	December 31, 2006	December 31, 2005	December 31, 2004
Net sales	\$ 17,788	16,676	11,702
Cost of sales	12,492	12,140	7,815
Gross profit on sales	<u>5,296</u>	<u>4,536</u>	<u>3,887</u>
Selling, general and administrative expenses.....	5,252	4,646	4,160
Product development costs.....	283	62	176
Interest expense.....	1	1	4
Interest income.....	(527)	(324)	(76)
Other income, net.....	(162)	(150)	(106)
	<u>4,847</u>	<u>4,235</u>	<u>4,158</u>
Income (loss) from continuing operations before income taxes.....	449	301	(271)
Income tax expense (benefit).....	(19)	93	(106)
Income (loss) from continuing operations	468	208	(165)
Income from discontinued operations, net of income taxes	-	990	1,638
Net income	<u>\$ 468</u>	<u>1,198</u>	<u>1,473</u>
Basic earnings (loss) per share: Income (loss) from continuing operations.....	\$.14	.05	(.04)
Income from discontinued operations.....	-	.24	.38
Net income	<u>\$.14</u>	<u>.29</u>	<u>.34</u>
Diluted earnings (loss) per share: Income (loss) from continuing operations.....	\$.14	.05	(.04)
Income from discontinued operations.....	-	.24	.38
Net income	<u>\$.14</u>	<u>.29</u>	<u>.34</u>
Weighted average shares outstanding	3,307,382	4,073,252	4,278,065
Dilutive effect of stock options	4,373	45,342	72,232
Weighted average shares outstanding assuming dilution	<u>3,311,755</u>	<u>4,118,594</u>	<u>4,350,297</u>

See accompanying notes to consolidated financial statements.

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY

Consolidated Statements of Stockholders' Equity and Comprehensive Income

For the Years Ended December 31, 2006, 2005, and 2004

(In Thousands, Except Share Data)

	Common Shares		Additional Paid-In Capital	Retained Earnings	Total Stockholders' Equity	Comprehensive Income
	Number	Amount				
Balance at December 31, 2003	4,277,595	\$ 4,278	7,678	10,105	22,061	
Net income	-	-	-	1,473	1,473	1,473
Comprehensive income	-	-	-	-	-	1,473
Stock options exercised	22,415	22	353	(305)	70	
Acquisition and retirement of common stock	(34,700)	(35)	(64)	(226)	(325)	
Other incentive plan activity	-	-	29	-	29	
Balance at December 31, 2004	4,265,310	4,265	7,996	11,047	23,308	
Net income	-	-	-	1,198	1,198	1,198
Comprehensive income	-	-	-	-	-	1,198
Stock options exercised	97,809	98	602	(77)	623	
Acquisition and retirement of common stock	(824,100)	(824)	(1,612)	(5,645)	(8,081)	
Other incentive plan activity	-	-	18	-	18	
Balance at December 31, 2005	3,539,019	3,539	7,004	6,523	17,066	
Net income	-	-	-	468	468	468
Comprehensive income	-	-	-	-	-	468
Nonvested stock grants, net of amortization	12,500	12	14	-	26	
Stock options exercised	1,591	2	59	(61)	-	
Acquisition and retirement of common stock	(679,219)	(679)	(1,368)	(3,096)	(5,143)	
Other incentive plan activity	-	-	11	-	11	
Balance at December 31, 2006	2,873,891	\$ 2,874	5,720	3,834	12,428	

See accompanying notes to consolidated financial statements.

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows

For the Years Ended December 31, 2006, 2005, and 2004

(In Thousands)

	December 31, 2006	December 31, 2005	December 31, 2004
Cash flows from operating activities:			
Net income	\$ 468	1,198	1,473
Less: income from discontinued operations.....	-	990	1,638
Income (loss) from continuing operations.....	468	208	(165)
Adjustments to reconcile net income to net cash provided (used) by operating activities:			
Depreciation of plant and equipment.....	104	90	104
Amortization of deferred gain on sale-leaseback.....	(165)	(165)	(165)
Other non-cash items affecting earnings	37	18	29
Change in operating assets and liabilities:			
Receivables	110	(768)	(1,432)
Costs and estimated earnings in excess of billings.....	172	(524)	358
Inventories	(125)	8	(128)
Deferred tax expenses	172	343	310
Prepaid expenses and other current assets	217	(97)	(20)
Accounts payable	(214)	(55)	77
Customers' deposits and billings in excess of costs and estimated earnings	(650)	802	249
Accrued salaries, wages, and commissions	30	2	8
Income taxes payable.....	(109)	145	(417)
Accrued product warranty.....	3	(301)	(224)
Unearned support contract revenue.....	31	54	(89)
Accrued other liabilities.....	(132)	(212)	(40)
Deferred compensation	-	-	(42)
Net cash provided by operating activities of discontinued operations.....	-	601	114
Net cash provided (used) by operating activities.....	(51)	149	(1,473)

(Continued)

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY
Consolidated Statements of Cash Flows *(Continued)*
For the Years Ended December 31, 2006, 2005, and 2004
(In Thousands)

	<u>December 31,</u> <u>2006</u>	<u>December 31,</u> <u>2005</u>	<u>December 31,</u> <u>2004</u>
Cash flows from investing activities:			
Proceeds from the sale of Ermanco, net of transaction costs and post closing adjustments	-	21,508	-
Proceeds from sales of short-term investments.....	7,585	10,875	-
Purchases of short-term investments.....	(500)	(25,685)	(1,900)
Additions to property, plant and equipment.....	(131)	(150)	(63)
Net cash used by investing activities of discontinued operations.....	-	(254)	(198)
Net cash provided (used) by investing activities	<u>6,954</u>	<u>6,294</u>	<u>(2,161)</u>
Cash flows from financing activities:			
Sale of common shares in connection with employee incentive stock option plan.....	-	623	70
Repurchase and retirement of common stock.....	(5,143)	(8,081)	(325)
Net cash used by financing activities.....	<u>(5,143)</u>	<u>(7,458)</u>	<u>(255)</u>
Increase (decrease) in cash and cash equivalents	1,760	(1,015)	(3,889)
Cash and cash equivalents, beginning of period	687	1,702	5,591
Cash and cash equivalents, end of period	<u>\$ 2,447</u>	<u>687</u>	<u>1,702</u>

See accompanying notes to consolidated financial statements.

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY

Notes To Consolidated Financial Statements

(1) Description of Business and Summary of Significant Accounting Policies

Description of Business and Concentration of Credit Risk

The Company, based out of Easton, Pennsylvania, (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. 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. SI Systems' branded products are utilized to automate the movement or selection of products and are often integrated with other automated equipment such as conveyors and robots. The Company's integrated material handling solutions involve both standard and specially designed components and include integration of non-proprietary automated handling technologies so as to provide turnkey solutions for its customers' unique material handling needs. The 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.

In the year ended December 31, 2006, one customer accounted for over 10% of sales and is listed as follows: Caterpillar - \$2,098,000 or 11.8% of total sales. In the year ended December 31, 2005, five customers accounted for over 10% of sales, and they are listed as follows: BMG Direct Marketing - \$2,492,000 or 14.9%, SI/BAKER - \$1,990,000 or 11.9%, Vistakon, a division of Johnson & Johnson Vision Care - \$1,867,000 or 11.2%, E-Z-GO Division of Textron - \$1,812,000 or 10.9%, and Honda of America Mfg. - \$1,723,000 or 10.3%. In the year ended December 31, 2004, two customers accounted for over 10% of sales, and they are listed as follows: Canadian Tire Corporation - \$1,600,000 or 13.7%, and Office Depot - \$1,184,000 or 10.1%. No other customer accounted for over 10% of sales.

The Company's products are sold on a fixed-price basis. Generally, contract terms provide for progress payments and a portion of the purchase price is withheld by the buyer until the system has been accepted. Generally, contract terms are net 30 days for product and parts sales, with progress payments for system-type projects. As of December 31, 2006, three customers owed the Company in excess of 10% of trade receivables, and they are listed as follows: Krauss-Maffei Corporation - \$508,000 or 19.9%, Caterpillar - \$492,000 or 19.2%, and DPI Material Handling Systems - \$256,000 or 10.0%. No other customer owed the Company in excess of 10% of trade receivables. The Company believes that the concentration of credit risk in its trade receivables is substantially mitigated by the Company's ongoing credit evaluation process as well as the general creditworthiness of its customer base.

Principles of Consolidation

The consolidated financial statements for the fiscal years ended prior to 2006 include the accounts of SI Systems and Ermanco, a wholly owned subsidiary, after elimination of intercompany balances and transactions.

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY
Notes To Consolidated Financial Statements

(1) Description of Business and Summary of Significant Accounting Policies
(Continued)

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 reserve, warranty reserve, and revenue recognition.

Financial Instruments

The Company believes the market values of its assets and liabilities, which are financial instruments, approximate their carrying values due to the short-term nature of the instruments.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, cash on deposit, amounts invested on an overnight basis with a bank, and other highly liquid investments purchased with an original maturity of three months or less. The Company does not believe it is exposed to any significant credit risk on cash and cash equivalents.

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. These 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.

Allowance for Doubtful Accounts

The Company provides an allowance for doubtful accounts determined by a specific identification of individual accounts and other accounts based on historical experience. The Company writes off receivables upon determination that no further collections are probable. The allowance for doubtful accounts was \$0 at December 31, 2006 and 2005.

Inventories

Inventories are valued at the lower of average cost or market. Inventories primarily consist of materials purchased or manufactured for stock.

Property, Plant and Equipment

Plant and equipment are recorded at cost and generally are depreciated on the straight-line method over the estimated useful lives of individual assets. The ranges of lives used in determining depreciation rates for machinery and equipment is generally 3 - 7 years. Maintenance and repairs are charged to operations; betterments and renewals are capitalized. Upon sale or retirement of plant and equipment, the cost and related accumulated depreciation are removed from the accounts and the resultant gain or loss, if any, is credited or charged to earnings.

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY
Notes To Consolidated Financial Statements (*Continued*)

(1) Description of Business and Summary of Significant Accounting Policies
(*Continued*)

Asset Impairment

The Company reviews the recovery of the net book value of long-lived assets whenever events and circumstances indicate that the net book value of an asset may not be recoverable from the estimated undiscounted future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the net book value, an impairment loss is recognized equal to an amount by which the net book value exceeds the fair value of assets.

Revenue Recognition

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.

Revenues on other sales of parts or equipment are recognized when title transfers pursuant to shipping terms. There are no installation or customer acceptance aspects of these sales.

Product Development Costs

The Company expenses product development costs as incurred.

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.

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

	Beginning Balance	Additions (Reductions) Charged to Costs and Expenses	Deductions	Ending Balance
2006.....	\$ 189	71	(68)	192
2005.....	\$ 490	(242)	(59)	189
2004.....	\$ 714	(70)	(154)	490

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.

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY
Notes To Consolidated Financial Statements (*Continued*)

(1) Description of Business and Summary of Significant Accounting Policies
(*Continued*)

Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised) "Share-Based Payment" ("SFAS No. 123R"). SFAS No. 123R addresses all forms of share-based payment awards, including shares issued under employee stock purchase plans, stock options, restricted and nonvested stock, and stock appreciation rights. It requires companies to recognize in the statement of operations the grant-date fair value of stock options and other equity-based compensation issued to employees. The statement eliminates the intrinsic value-based method prescribed by APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, that the Company used prior to January 1, 2006.

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. Prior to January 1, 2006, the Company applied Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its stock option plans. Accordingly, no compensation expense was recognized in net income for employee stock options, as options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. The Company recognized compensation expense on options granted to non-employee directors. The estimated impact of adopting SFAS No. 123R in 2006 was approximately \$7,000 and did not have a significant impact on basic and diluted earnings per share for the year. The pro forma impact of expensing employee stock options in 2005 would have been \$27,000 or a reduction of diluted earnings per share by approximately \$.01 for the year, while the pro forma impact of expensing employee stock options in 2004 would have been \$91,000 or a reduction of basic and diluted earnings per share by approximately \$.02 for the year based on the disclosures required by SFAS No. 123.

The Company adopted SFAS No. 123R using the modified prospective transition method and therefore has not restated prior periods. Under this transition method, compensation cost associated with employee stock options recognized in 2006 includes attribution of the fair value related to the remaining unvested portion of stock option awards granted prior to January 1, 2006, 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 Consolidated Statements of Cash Flows, stock-based compensation expense is an adjustment to reconcile net income to cash provided (used) by operating activities.

Prior to the adoption of SFAS No. 123R, the Company presented tax benefits, if any, resulting from stock-based compensation as operating cash flows in the Consolidated Statements of Cash Flows. 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 year ended December 31, 2006, no excess tax benefits were generated.

SFAS No. 123R modified the disclosure requirements related to stock-based compensation. Accordingly, the disclosures prescribed by SFAS No. 123R are included below.

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY
Notes To Consolidated Financial Statements (*Continued*)

(1) Description of Business and Summary of Significant Accounting Policies
(*Continued*)

Stock-Based Compensation (*Continued*)

For stock options granted prior to the adoption of SFAS No. 123R, the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," to its stock option plan would have been as follows:

	For the Year Ended December 31, 2005	For the Year Ended December 31, 2004
Net income, as reported	\$ 1,198	1,473
Deduct: total stock-based employee compensation expense determined under fair value based method, net of related tax effects	(27)	(91)
Pro forma net income	<u>\$ 1,171</u>	<u>1,382</u>
Basic earnings per share:		
As reported	\$.29	.34
Pro forma	\$.29	.32
Diluted earnings per share:		
As reported	\$.29	.34
Pro forma	\$.28	.32

Earnings Per Share

Basic and diluted earnings per share for the years ended December 31, 2006, 2005, and 2004 are based on the weighted average number of shares outstanding. In addition, diluted earnings per share reflect the effect of dilutive securities which include the shares that would be outstanding assuming the exercise of dilutive stock options. The number of shares that would be issued from the exercise has been reduced by the number of shares that could have been purchased from the proceeds at the average market price of the Company's common stock.

Recently Issued Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board issued SFAS No. 151, "Inventory Costs an Amendment of ARB No. 43, Chapter 4" ("SFAS No. 151"). SFAS No. 151 provides for certain fixed production overhead cost to be reflected as a period cost and not capitalized as inventory. The Company adopted SFAS No. 151 on January 1, 2006. The adoption of SFAS No. 151 did not have a material impact on the Company's financial statements.

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised) "Share-Based Payment" ("SFAS No. 123R"). SFAS No. 123R addresses all forms of share-based payment awards, including shares issued under employee stock purchase plans, stock options, restricted and nonvested stock, and stock appreciation rights. It requires companies to recognize in the statement of operations the grant-date fair value of stock options and other equity-based compensation issued to employees. The statement eliminates the intrinsic value-based method prescribed by APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, that the Company used prior to January 1, 2006. The Company adopted SFAS No. 123R on January 1, 2006.

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY
Notes To Consolidated Financial Statements (*Continued*)

(1) Description of Business and Summary of Significant Accounting Policies
(*Continued*)

Recently Issued Accounting Pronouncements (*Continued*)

In May 2005, the Financial Accounting Standard Board issued SFAS No. 154, "Accounting Changes and Error Corrections – A Replacement of APB Opinion No. 20 and FASB Statement No. 3" ("SFAS No. 154"). SFAS No. 154 requires retrospective application to prior periods' financial statements for changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This statement also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle, such as a change in non-discretionary profit-sharing payments resulting from an accounting change, should be recognized in the period of the accounting change. SFAS No. 154 also requires that a change in depreciation, amortization, or depletion method for long-lived non-financial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company adopted the provisions of this statement, as applicable, on January 1, 2006, and there was no impact of the adoption.

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 provisions of FIN 48 are effective beginning January 1, 2007 with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is currently evaluating the impact of adopting FIN 48 on the financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB No. 108") to provide guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. Under SAB No. 108, companies should evaluate a misstatement based on its impact on the current year income statement, as well as the cumulative effect of correcting such misstatements that existed in prior years existing in the current year's ending balance sheet. The Company adopted the provisions of SAB No. 108 on January 1, 2006, and there was no impact of the adoption.

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.

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY
Notes To Consolidated Financial Statements (*Continued*)

(2) Discontinued Operations — Sale of Ermanco

On May 20, 2005, the Company and Ermanco entered into an Asset Purchase Agreement (the "Asset Purchase Agreement") with TGW Transportgeräte GmbH, an Austrian corporation ("Buyer Parent"), and Malibu Acquisition, Inc., a Michigan corporation and wholly owned subsidiary of Buyer Parent ("Buyer"), pursuant to which Paragon agreed to sell to Buyer substantially all of the assets and liabilities of Ermanco, Paragon's conveyor and sortation subsidiary located in Spring Lake, Michigan. The terms of the Asset Purchase Agreement provided that Buyer pay cash in the amount of \$23 million (subject to a working capital adjustment and an accounts receivable adjustment) and assume certain liabilities of Ermanco, as more fully described in the Asset Purchase Agreement, a copy of which was filed as an attachment to the Company's definitive proxy statement with the Securities and Exchange Commission on July 1, 2005. At a Special Meeting of Stockholders held on August 3, 2005, the Company received approval from its stockholders to sell substantially all of the assets and liabilities of Ermanco.

On August 5, 2005, the Company completed the sale of substantially all of the assets and liabilities of Ermanco, and received cash consideration of \$23,055,000 (subject to a working capital adjustment and an accounts receivable adjustment). Transaction costs associated with the sale of the assets and liabilities of Ermanco were approximately \$1,038,000. During the fourth quarter of 2005, the Company paid approximately \$448,000 to the Buyer in connection with the working capital adjustment and \$61,000 in connection with the accounts receivable adjustment. Therefore, the Company received cash consideration of \$21,508,000, net of transactions costs and the working capital and the accounts receivable adjustments in connection with the sale of the assets and liabilities of Ermanco, thereby resulting in a pre-tax loss on the sale of approximately \$964,000.

Ermanco and Paragon indemnified the Buyer and Buyer Parent for, among other things, a breach of any representation, warranty, covenant, or agreement set forth under the terms of the Asset Purchase Agreement. Paragon and Ermanco will have no liability to Buyer or Buyer Parent with respect to claims for breaches of representations and/or warranties until the aggregate amount of loss relating to such breaches exceeds \$230,000, and then only for such amount that exceeds \$230,000. The overall aggregate indemnification liability of Paragon and Ermanco shall not exceed \$5,750,000. At the closing of the asset sale, Paragon delivered to the Buyer an irrevocable letter of credit in the amount of \$2 million as security for its indemnification obligations. The letter of credit remained in place to August 5, 2006, the one-year anniversary of the closing sale of the asset sale. There was no claim under the letter of credit during its existence.

Ermanco and Paragon agreed that for a period of 3 years following the closing of the transaction, each will not solicit any employee, customer, or supplier of Buyer to leave Buyer's employment or alter its business dealings with the Buyer.

In accordance with Financial Accounting Standards Board ("FASB") Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the results of operations for Ermanco's business activities are reported as a discontinued operation and accordingly, the accompanying consolidated financial statements have been reclassified to report separately the assets, liabilities, and operating results of this discontinued operation.

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY
Notes To Consolidated Financial Statements (*Continued*)

(2) Discontinued Operations — Sale of Ermanco (*Continued*)

The following are the condensed results of operations for Ermanco (in thousands):

	<u>December 31, 2005</u>	<u>December 31, 2004</u>
Net sales.....	\$ 28,132	30,553
Income from operations before income taxes ..	\$ 2,523	2,487
Income tax expense	916	849
Income from operations after income taxes	1,607	1,638
Loss on sale before income taxes.....	(964)	-
Income tax benefit	(347)	-
Loss on sale after income tax benefit.....	(617)	-
Income from discontinued operations	\$ 990	1,638

(3) Uncompleted Contracts

Costs and estimated earnings on uncompleted contracts are as follows (*in thousands*):

	<u>December 31, 2006</u>	<u>December 31, 2005</u>
Costs and estimated earnings on uncompleted contracts	\$ 14,672	11,592
Less: billings to date.....	(15,622)	(13,020)
	<u>\$ (950)</u>	<u>(1,428)</u>
Included in accompanying balance sheets under the following captions:		
Costs and estimated earnings in excess of billings	\$ 444	616
Customers' deposits and billings in excess of costs and estimated earnings	(1,394)	(2,044)
	<u>\$ (950)</u>	<u>(1,428)</u>

(4) 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%. Effective August 5, 2005, the Company issued a \$2,000,000 letter of credit in connection with the sale of substantially all of the assets and liabilities of Ermanco, thereby reducing the amount of available line of credit to \$2,800,000. The letter of credit remained in place to August 5, 2006, the one-year anniversary of the closing of the asset sale. There was no claim under the letter of credit during its existence. As of December 31, 2006, 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 receivable and inventory. The Company was in compliance with all covenants as of December 31, 2006. As of December 31, 2006, the Company did not have any borrowings under the line of credit facility, and the line of credit facility expires effective June 30, 2007. The Company expects to renew the line of credit facility under similar terms and conditions during 2007.

(5) Stock Options and Nonvested Stock

1997 Equity Compensation Plan

The Company has a stock-based compensation program, the 1997 Equity Compensation Plan ("ECP"), which will expire in July 2007. The ECP provides for grants of stock options, restricted and nonvested stock, and stock appreciation rights to selected employees, key advisors who perform valuable services, and directors of the Company. In addition, the ECP provides for grants of performance units to employees and key advisors. The ECP, as amended by stockholders in August 2000 and June 2001, authorizes up to 1,012,500 shares of common stock for issuance pursuant to the terms of the plan. 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 December 31, 2006, 32,500 options are outstanding under the plan, and all options have a term of five or seven years.

The compensation cost charged against income during the year ended December 31, 2006 for stock-based compensation programs was \$37,000. Stock-based compensation costs during year ended December 31, 2006 consisted of expensing \$7,000 for employee stock options, \$4,000 for directors' stock options, and \$26,000 for nonvested stock. Stock-based compensation costs during the years ended December 31, 2005 and 2004 consisted of expensing \$18,000 and \$29,000, respectively, for directors' stock options. All of the compensation cost recognized was a component of selling, general and administrative expenses.

Stock Options

On March 8, 2006, the Board of Directors of the Company granted 12,500 stock options to its executive officers. The fair value of options granted was estimated using the Black Scholes option valuation model that used the assumptions noted in the table below. Expected volatility and expected dividend yield are based on actual historical experience of the Company's stock and dividends over the historical period equal to the option term. The dividend yield on the Company's common stock is assumed to be zero since the Company has not paid any cash dividends since 1999 and has no present intention to declare cash dividends. The expected life represents the period of time that options granted are expected to be outstanding and was calculated using the simplified method. The assumptions given below results from certain groups of employees exhibiting different behavior. The Company does not expect to have any forfeitures of its recent stock option awards based on the historical experience of the group of employees that received the stock option awards. The risk-free rate is based on the U. S. Treasury Securities with terms equal to the expected time of exercise as of the grant date.

Expected volatility	18.0%
Expected dividend yield	0.0%
Expected life (in years).....	4.75
Risk-free interest rate.....	4.75%

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY
Notes To Consolidated Financial Statements (Continued)

(5) Stock Options and Nonvested Stock (Continued)

Stock Options (Continued)

The grant-date fair value of options granted on March 8, 2006 was \$2.60 per option.

A summary of stock option activity is presented below:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2006.....	38,535	\$ 7.86		
Granted	12,500	10.01		
Exercised	(12,535)	7.50		
Forfeited	(6,000)	7.50		
Outstanding at December 31, 2006...	<u>32,500</u>	<u>\$ 8.89</u>	2.6	\$ 81,800
Exercisable at December 31, 2006....	20,000	\$ 8.20	.4	\$ 49,300

During the year ended December 31, 2006, the Company received 10,944 shares of its common stock as payment for the exercise of 12,535 stock options in accordance with the ECP. The total intrinsic value of stock options exercised during the year ended December 31, 2006 was \$13,663. Upon the exercise of stock options under the 1997 ECP, the Company issues new common stock from its authorized shares.

The compensation cost charged against income during the year ended December 31, 2006 for stock options was \$11,000 (or \$7,000, net of income taxes). The total compensation cost of \$33,000 is expected to be recognized on the straight-line basis over the stated vesting period consistent with the terms of the arrangement. As of December 31, 2006, there is unrecognized compensation cost of \$22,000 on the stock option awards which will be recognized over the next 3.2 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.

A summary of nonvested stock activity is presented below:

	Nonvested Shares	Grant Date Fair Value
Nonvested at January 1, 2006.....	-	\$ -
Granted	12,500	10.01
Vested	-	-
Forfeited	-	-
Nonvested at December 31, 2006	<u>12,500</u>	<u>\$ 10.01</u>

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY
Notes To Consolidated Financial Statements (*Continued*)

(5) Stock Options and Nonvested Stock (*Continued*)

Nonvested Stock (*Continued*)

The compensation cost charged against income during the year ended December 31, 2006 for nonvested stock awards was \$26,000. The total compensation cost of \$125,000 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 December 31, 2006, there is unrecognized compensation cost of \$99,000 on the nonvested stock awards which will be recognized over the next 3.2 years.

(6) Employee Benefit Plans

The Company has a defined contribution Retirement Savings Plan for its employees. Employees age 21 and above, with at least 90 days of service, are eligible to participate in the Plan. Under the 401(k) feature of the Plan, the Company matches 100% of the first 3% of pay which the employee contributes to the Plan and 50% of the next 2% of pay which the employee contributes to the Plan. The Plan also contains provisions for profit sharing contributions in the form of cash as determined annually by the Company's Board of Directors; however, there were no profit sharing contributions for the years ended December 31, 2006, 2005, and 2004. Total expense for the Retirement Savings Plan was \$147,000, \$129,000, and \$132,000 for the years ended December 31, 2006, 2005, and 2004, respectively.

(7) Income Taxes

The provision for income tax expense (benefit) associated with continuing operations consists of the following (*in thousands*):

	For the Year Ended December 31, 2006	For the Year Ended December 31, 2005	For the Year Ended December 31, 2004
Federal - current.....	\$ (168)	(251)	(418)
- deferred.....	152	338	330
	<u>(16)</u>	<u>87</u>	<u>(88)</u>
State - current.....	(23)	1	2
- deferred.....	20	5	(20)
	<u>(3)</u>	<u>6</u>	<u>(18)</u>
Foreign - current.....	-	-	-
	<u>\$ (19)</u>	<u>93</u>	<u>(106)</u>

The income tax expense (benefit) was allocated as follows (*in thousands*):

	For the Year Ended December 31, 2006	For the Year Ended December 31, 2005	For the Year Ended December 31, 2004
Continuing operations	\$ (19)	93	(106)
Discontinued operations.....	-	569	849
	<u>\$ (19)</u>	<u>662</u>	<u>743</u>

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY
Notes To Consolidated Financial Statements (*Continued*)

(7) Income Taxes (*Continued*)

The reconciliation between the U.S. federal statutory rate and the Company's effective income tax rate associated with continuing operations is (*in thousands*):

	For the Year Ended December 31, 2006	For the Year Ended December 31, 2005	For the Year Ended December 31, 2004
Computed tax expense (benefit) at statutory rate of 34%.....	\$ 153	102	(92)
Increase (reduction) in taxes resulting from:			
State income taxes, net of federal benefit.....	(2)	4	(12)
Tax-exempt interest.....	(151)	(86)	(2)
Miscellaneous items	(19)	73	-
	<u>\$ (19)</u>	<u>93</u>	<u>(106)</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities associated with continuing operations at December 31, 2006 and 2005 are presented below (*in thousands*):

	December 31, 2006	December 31, 2005
Deferred tax assets:		
Net operating and built-in loss carryforward	\$ 89	190
Inventories	99	148
Accrued restructuring costs	22	24
Accrued warranty costs	74	73
Accruals for other expenses, not yet deductible for tax purposes.....	158	265
Total gross deferred tax assets.....	<u>442</u>	<u>700</u>
Deferred tax liabilities:		
Plant and equipment, principally due to differences in depreciation.....	(24)	(29)
Prepaid expenses	(34)	(115)
Total gross deferred tax liabilities.....	<u>(58)</u>	<u>(144)</u>
Net deferred tax assets	<u>\$ 384</u>	<u>556</u>

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences at December 31, 2006.

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY
Notes To Consolidated Financial Statements (*Continued*)

(8) Contingencies

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 consolidated financial position, results of operations, or liquidity.

(9) Commitments and Related Party Transactions

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 \$18,781 (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.

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. During the years ended December 31, 2006, 2005, and 2004, \$165,000, \$165,000, and \$165,000, respectively, of the deferred gain was recognized.

Total rental expense in the years ended December 31, 2006, 2005, and 2004 approximated \$259,000, \$231,000, and \$222,000, respectively.

Future minimum rental commitments at December 31, 2005 are as follows (*in thousands*):

	<u>Operating Leases</u>
2007	\$ 231
2008	34
2009	-
2010	-
2011	-
Total	<u>\$ 265</u>

On September 20, 2005, the Board of Directors of the Company, upon the recommendation of the Board's Nominating Committee, unanimously voted to elect Mr. Joel L. Hoffner as a Director of the Company to fill the vacancy created by the resignation of Mr. Steven Shulman on August 8, 2005. Mr. Hoffner had been a consultant to SI Handling Systems, Inc. and Paragon Technologies for various marketing and business evaluation assignments during the last ten years. From September 1, 2005 through December 31, 2005, Mr. Hoffner provided consulting services related to the Company's corporate development pursuant to the terms of a consulting agreement by and between

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY
Notes To Consolidated Financial Statements (*Continued*)

(9) Commitments and Related Party Transactions (*Continued*)

the Company and The QTX Group dated September 1, 2005. In consideration for their services, The QTX Group received \$7,500 per month and reimbursement for all reasonable and necessary out-of-pocket expenses directly incurred by Mr. Hoffner during the term of his engagement with the Company. The parties terminated the consulting agreement with The QTX Group on January 1, 2006, the time Mr. Hoffner's appointment as President and Chief Executive Officer of the Company became effective. Consulting expenses associated with The QTX Group in the years ended December 31, 2005 and 2004 approximated \$44,000 and \$10,000, respectively. Mr. Hoffner resigned from his positions as President and CEO and as a director of the Company effective March 1, 2007.

On November 15, 2005, the Company announced the repurchase of 100,000 shares (or 2.67%) of its common stock in a private sale transaction for \$975,000 (or \$9.75 per share) from L. Jack Bradt, a member of the Company's Board of Directors. The Company's non-interested Audit Committee members and the Board of Directors approved the repurchase of Mr. Bradt's shares. The closing market price of the Company's common stock on November 14, 2005 was \$10.09 per share.

(10) Cash Flow Information

Supplemental disclosures of cash flow information for the years ended December 31, 2006, 2005, and 2004 are as follows (*in thousands*):

	For the Year Ended December 31, 2006	For the Year Ended December 31, 2005	For the Year Ended December 31, 2004
Supplemental disclosures of cash flow information:			
Cash paid (received) during the period for:			
Interest	\$ 1	1	4
Income taxes	\$ (738)	2,718	512

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY
Notes To Consolidated Financial Statements (Continued)

(11) Quarterly Financial Information (Unaudited)

Selected Quarterly Financial Data

(In thousands, except per share amounts)

For the Year Ended December 31, 2006	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net sales	\$ 4,220	4,823	5,209	3,536
Gross profit on sales	\$ 1,287	1,508	1,401	1,100
Income (loss) from continuing operations	\$ 1	171	239	57
Income (loss) from discontinued operations, net of income taxes	-	-	-	-
Net income	<u>\$ 1</u>	<u>171</u>	<u>239</u>	<u>57</u>
Basic earnings (loss) per share:				
Income (loss) from continuing operations	\$ -	.05	.07	.02
Income (loss) from discontinued operations	-	-	-	-
Net income	<u>\$ -</u>	<u>.05</u>	<u>.07</u>	<u>.02</u>
Diluted earnings (loss) per share:				
Income (loss) from continuing operations	\$ -	.05	.07	.02
Income (loss) from discontinued operations	-	-	-	-
Net income	<u>\$ -</u>	<u>.05</u>	<u>.07</u>	<u>.02</u>
For the Year Ended December 31, 2005				
Net sales	\$ 3,866	3,729	4,101	4,980
Gross profit on sales	\$ 1,092	890	1,127	1,427
Income (loss) from continuing operations	\$ 64	(110)	61	193
Income (loss) from discontinued operations, net of income taxes	130	819	80	(39)
Net income	<u>\$ 194</u>	<u>709</u>	<u>141</u>	<u>154</u>
Basic earnings (loss) per share:				
Income (loss) from continuing operations	\$.02	(.03)	.01	.05
Income (loss) from discontinued operations03	.20	.02	(.01)
Net income	<u>\$.05</u>	<u>.17</u>	<u>.03</u>	<u>.04</u>
Diluted earnings (loss) per share:				
Income (loss) from continuing operations	\$.02	(.03)	.01	.05
Income (loss) from discontinued operations03	.20	.02	(.01)
Net income	<u>\$.05</u>	<u>.17</u>	<u>.03</u>	<u>.04</u>

PARAGON TECHNOLOGIES, INC. AND SUBSIDIARY
Notes To Consolidated Financial Statements (*Continued*)

(11) Quarterly Financial Information (*Unaudited*) (*Continued*)

See Discontinued Operations – Sale of Ermanco in Note 2 of the Notes to Consolidated Financial Statements for further information regarding the sale of substantially all of the assets and liabilities of Ermanco in the third quarter of 2005.

(12) 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 August 19, 2005, the Company announced the repurchase of an aggregate of 359,200 shares (or 8.3%) of its common stock in a private sale transaction for an aggregate of approximately \$3,502,000 (or \$9.75 per share) from Leon C. Kirschner, the Company's former Chief Operating Officer, and Steven Shulman, a former director of the Company. In these transactions, the Company, with authorization from its Board of Directors, repurchased 190,091 shares from Mr. Kirschner for approximately \$1,853,000 and 169,109 shares from Mr. Shulman for approximately \$1,649,000, which represented their holdings of the Company's common stock, and retired the shares. The closing market price of the Company's common stock on August 18, 2005 was \$12.60 per share.

Mr. Kirschner, who also served as the Chief Executive Officer of the Company's former wholly owned subsidiary, Ermanco Incorporated, resigned as an officer and employee of the Company on August 5, 2005, the day on which the Company completed its sale of substantially all of the assets and liabilities of Ermanco Incorporated. Mr. Shulman resigned as a director of the Company on August 8, 2005. Mr. Shulman became a director of the Company as a result of the Company's purchase of Ermanco on September 30, 1999.

On November 15, 2005, the Company announced the repurchase of 100,000 shares (or 2.67%) of its common stock in a private sale transaction for \$975,000 (or \$9.75 per share) from L. Jack Bradt, a member of the Company's Board of Directors. The Company's non-interested Audit Committee members and the Board of Directors approved the repurchase of Mr. Bradt's shares. The closing market price of the Company's common stock on November 14, 2005 was \$10.09 per share.

During the year ended December 31, 2006, the Company repurchased 679,219 shares of common stock at a weighted average cost, including brokerage commissions, of \$7.57 per share. Cash expenditures for the stock repurchases during the year ended December 31, 2006 were \$5,142,898. Through December 31, 2006, the Company repurchased 1,538,019 shares of common stock at a weighted average cost, including brokerage commissions, of \$8.81 per share. Cash expenditures for the stock repurchases since the inception of the program were \$13,549,411. As of December 31, 2006, \$450,589 remained available for repurchases under the stock repurchase program.

Subsequent to December 31, 2006, 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.

(12) 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 regard 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.

(13) Subsequent Events

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.

Robert J. Blyskal and Samuel L. Torrence were elected to the Board of Directors of the Company effective February 1, 2007.

Mr. Hoffner resigned from his positions as President and CEO and as a director of the Company effective March 1, 2007.

Leonard S. Yurkovic returned to the Company as Acting CEO on March 1, 2007.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. 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 December 31, 2006. 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.

Item 9A. Controls and Procedures *(Continued)*

(b) Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting identified in connection with the evaluation of such controls that occurred during the Company's most recent fiscal year that has materially affected, or that is reasonably likely to materially affect the Company's internal control over financial reporting.

Item 9B. Other Information

Not applicable.

PART III

Item 10. Directors and Executive Officers of the Registrant

Information concerning the Company's directors is as follows:

Name, Other Positions or Offices With The Company and Principal Occupation for Past Five Years	Director Since	Age
Robert J. Blyskal	2007	52
Mr. Blyskal is a private investor who from 2004 through his retirement in 2005 served as President and Chief Operating Officer of GSI Commerce, Inc., an e-commerce solutions provider that enables various organizations to operate e-commerce businesses. From 2003 to 2004, Mr. Blyskal was a consultant to NeighborCare Pharmacies Inc., a provider of pharmacy services, infusion, medical supplies and equipment, and oxygen and respiratory medications to the long-term care marketplace. From 1993 to 2003, Mr. Blyskal held several executive-level positions, including Executive Vice President of Operations and Technology, Senior Vice President of Pharmacy Operations, and Vice President and General Manager, at Medco Health Solutions, Inc., a pharmacy benefits manager with mail order pharmacy operations.		
L. Jack Bradt	1958	78
L. Jack Bradt was the founder in 1958, and for 30 years until his retirement in 1987, President and CEO of SI Handling Systems, Inc., renamed Paragon Technologies, Inc. in 2000. Mr. Bradt has continued as a director of the Company since its inception. He is active as a director in a number of local, state, and national organizations involved in business, education, human services, and government.		
Theodore W. Myers	2002	63
Theodore W. Myers is the Chairman of the Board of the Company, a position he has held since June 2002. Mr. Myers retired from Tucker Anthony Sutro, an investment banking firm, where he was First Vice President and Branch Manager of the Phillipsburg, New Jersey satellite office, where he served from 1991 to 2000.		
Anthony W. Schweiger	2001	65
Anthony W. Schweiger is President and CEO of The Tomorrow Group, LLC, a governance and management consultancy. He is also Chairman and Managing Principal of e-brilliance, LLC, a software and IT education consultancy. Mr. Schweiger's business experience includes governance oversight, capital market management, risk management, technology, and strategic planning.		
Since 1992, he has been a director and Governance Chair of Radian Group Inc., a NYSE traded global provider of credit enhancement products. He also serves on Radian's Compensation and Investment & Finance Committees. Between 2004 and 2005, Mr. Schweiger was a director and Audit Chair and Governance Chair of United Financial Mortgage Corp. In his capacity as a consultant, Mr. Schweiger advises various service and technology businesses on governance, operational, and strategic issues.		

Item 10. Directors and Executive Officers of the Registrant *(Continued)*

Name, Other Positions or Offices With The Company and Principal Occupation for Past Five Years	Director Since	Age
Samuel L. Torrence	2007	56

Samuel L. Torrence currently serves as the President and Chief Operating Officer of Just Born, Inc., a privately owned confectionery manufacturer of hard candy, jellybeans, marshmallows, and other candy products, a position he has held since 2005. Mr. Torrence joined Just Born in 2002 as Executive Vice President. From 1993 to 2001, Mr. Torrence held several executive-level positions, including Executive Vice President of Human Resources and Administration, Executive Vice President of Administration & Parts Operations, Senior Vice President of Total Quality Management, and Vice President of Human Resources and Total Quality Management, at Mack Trucks, Inc., a manufacturer of heavy- and medium-duty trucks for use in a variety of industries.

Leonard S. Yurkovic.....	2002	69
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Leonard S. Yurkovic returned to the Company as Acting CEO on March 1, 2007. Mr. Yurkovic started with the Company in 1979 as Vice President – Finance. Throughout the 1980s, Mr. Yurkovic was appointed to several executive-level positions at the Company, having been named President and Chief Operating Officer in 1985, Managing Director of European Operations in 1987, and then President and CEO in 1988. Mr. Yurkovic initially retired from the Company as CEO and a member of the Board of Directors in 1999. Mr. Yurkovic returned to the Company as President and CEO in October 2003 and retired from the Company as President and CEO on December 31, 2005.

The aforementioned directors of the Company hold their positions as directors until the next Annual Meeting of Stockholders.

The names, ages, and offices with the Company of its executive officers are as follows:

<u>Name</u>	<u>Age</u>	<u>Office</u>
Leonard S. Yurkovic	69	Acting Chief Executive Officer, effective March 1, 2007, Director
Joel L. Hoffner	62	President and Chief Executive Officer, Director until his resignation on March 1, 2007
William J. Casey	63	Executive Vice President of the Company and President and Chief Operating Officer of SI Systems
John F. Lehr	46	Vice President of the Company and Managing Director of Order Fulfillment
Ronald J. Semanick	45	Vice President - Finance, Chief Financial Officer, Treasurer, and Secretary

Item 10. Directors and Executive Officers of the Registrant *(Continued)*

Information regarding Mr. Yurkovic is provided above.

Mr. Hoffner became President and CEO of the Company on January 1, 2006, and a director of the Company on September 20, 2005. Mr. Hoffner previously served as Vice President of Product Management (June 1992 – June 1995), Vice President of Engineering (May 1987 – January 1988), and Director of Engineering (July 1985 – May 1987) at SI Handling Systems, Inc., renamed Paragon Technologies, Inc. in 2000. In 1993, Mr. Hoffner also served as CEO and founder of SI/BAKER, INC., a joint venture between the Company and Automated Prescription Systems, Inc. that provided order fulfillment systems to the mail order pharmacy market. In 1995, Mr. Hoffner became the President of E&E Corporation, and through December 31, 2005 he was the Managing Director of The QTX Group. Both companies provided consultative due diligence and enterprise evaluation services to investment banking institutions worldwide, to process and manufacturing industries, and to warehousing and distribution operations. Mr. Hoffner had been a consultant to SI Handling Systems, Inc. and Paragon Technologies for various marketing and business evaluation assignments from 1995 through 2005. Mr. Hoffner resigned from his positions as President and CEO and as a director of the Company effective March 1, 2007.

Mr. Casey whose career with the Company spans 39 years, rejoined the Company on December 29, 2003 as Vice President of SI Systems Production & Assembly after a two and a half year absence. Mr. Casey was appointed Executive Vice President of the Company and President of SI Systems Production & Assembly on October 14, 2005. Mr. Casey was appointed President and Chief Operating Officer of SI Systems effective March 1, 2007. From July 2001 to December 2003 Mr. Casey held an executive position with The Casey Group, an information technology firm specializing in providing Enterprise Services in IT management, integration, and outsourcing. Previously (1965-2001), Mr. Casey held a variety of senior management positions at Paragon Technologies including Executive Vice President, Vice President Sales and Marketing, and Director of Sales. Mr. Casey is a well known leader in the material handling industry. A member of the Conveyor Equipment Manufacturers Association (CEMA) for over 25 years, acting as Board President in 2002-2003, Mr. Casey has served on its Board of Directors since 1997 and chaired numerous committees. Mr. Casey received a Bachelor's Degree in Business and Commerce from Rider University.

Mr. Lehr joined the Company as the Director of Sales and Marketing of SI Systems Order Fulfillment on April 18, 2005. Mr. Lehr was appointed Vice President of the Company and Managing Director of Order Fulfillment on October 14, 2005. With over 23 years of experience in the material handling systems integration industry, Mr. Lehr has specific expertise in the design, sale and implementation of highly automated distribution centers. Mr. Lehr has managed facilities projects in North America, South America, and Europe across a wide range of wholesale and retail distribution markets. From 2000 through 2004, Mr. Lehr focused on the development of industry specific analytical processes and tools that assisted clients in the resolution of complex distribution problems. These processes have contributed to the success of over \$100 million dollars of automated systems projects. From 2003 to 2005 Mr. Lehr was President of Genesys Systems. Mr. Lehr served as Managing Partner of Novare-Solutions from 2000 to 2003 and from 1999 to 2000 he held various positions at W&H Systems, a systems integrator, ranging from Project Manager to Vice President. Mr. Lehr received a Bachelor's Degree in Industrial Design from the University of Bridgeport.

Item 10. Directors and Executive Officers of the Registrant *(Continued)*

Mr. Semanick was appointed Vice President - Finance, Chief Financial Officer, and Treasurer of the Company on May 10, 2000, and was appointed Secretary of the Company on July 13, 1994. Previously, Mr. Semanick held the positions of Controller, Manager of Financial Accounting, Senior Financial Accountant, and Financial Accountant. Prior to joining the Company in 1985, Mr. Semanick was employed as a Certified Public Accountant by Arthur Andersen & Company of Philadelphia, Pennsylvania. Mr. Semanick received a Bachelor's Degree in Accounting from Moravian College and his MBA in Finance from Wilkes University. Mr. Semanick is a Certified Public Accountant in Pennsylvania, and is a member of the Pennsylvania and American Institutes of Certified Public Accountants.

SECTION 16(a) — BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires our directors and executive officers and persons who beneficially own more than 10% of our common stock (collectively, the "reporting persons") to file reports of ownership and changes in ownership with the Securities and Exchange Commission and to furnish the Company with copies of these reports. Based on our records and other information, we believe that in 2006 all of our directors and executive officers met all applicable Section 16(a) filing requirements.

Audit Committee

The Audit Committee consists of four directors, Messrs. Blyskal, Bradt, Myers, and Schweiger, all of whom are considered "independent" within the meaning of the rules of the Securities and Exchange Commission and the American Stock Exchange. The Board of Directors has further determined that all of the Audit Committee members are "financially literate," and that based on Mr. Schweiger's education, his previous experience as a chief financial officer and chief executive officer, his participation on other audit committees, and his professional experience, Mr. Schweiger is an "audit committee financial expert" within the meaning of the rules of the Securities and Exchange Commission and, therefore, Mr. Schweiger qualifies as a financially sophisticated audit committee member within the meaning of the rules of the American Stock Exchange. No member of the Audit Committee simultaneously serves on the audit committees of more than three public companies.

Code of Conduct

The Company has a Code of Business Conduct and Ethics, which is attached as Exhibit 14 to this annual report and can be viewed on the Company's website at www.ptgamex.com. The Company requires all employees, officers, and directors to adhere to this Code in addressing the legal and ethical issues encountered in conducting their work. The Code of Business Conduct and Ethics requires that the Company's employees avoid conflicts of interest, comply with all laws and other legal requirements, conduct business in an honest and ethical manner, and otherwise act with integrity and in the Company's best interest. The Company's Code of Business Conduct and Ethics is intended to comply with Item 406 of the SEC's Regulation S-K and the rules of the American Stock Exchange.

The Code of Business Conduct and Ethics includes procedures for reporting violations of the Code, which are applicable to all employees. The Sarbanes-Oxley Act of 2002 requires companies to have procedures to receive, retain, and treat complaints received regarding accounting, internal accounting controls, or auditing matters and to allow for the confidential and anonymous submission by employees of concerns regarding questionable accounting or auditing matters. The Code of Business Conduct and Ethics also includes these required procedures.

Item 11. Executive Compensation

**EXECUTIVE COMPENSATION
Compensation Discussion and Analysis**

1. Executive Compensation Program Philosophies and Objectives

Paragon's executive compensation program is based on the following philosophies and objectives:

- The Compensation Committee (for purposes of this Executive Compensation section, the "Committee") of the Board of Directors is responsible for establishing the Company's executive compensation program, subject to final approval by the Company's Board of Directors;
- The executive compensation program should enable Paragon to attract, retain, and motivate individuals with the skills and talent necessary to provide a meaningful contribution to Paragon while reinforcing Paragon's culture and desired behaviors;
- The executive compensation program should remain competitive with industry and similar sized company compensation programs. To that end, the program should provide "median rewards for median performance" and "superior rewards for superior performance" when measured against appropriate Company targets and comparative groups;
- Accountability for performance is essential in aligning an executive's interest with those of Paragon's stockholders. Therefore, an executive's compensation package should be largely based on the Company's achievement of specified financial and stockholder return objectives as well as the executive's achievement of specified individual objectives;
- The executive compensation program should take into account internal equity among the executive officer group;
- Executive compensation should be delivered in a mixture of base salary, cash incentive, equity, and health and welfare programs that are effective in retaining high performing executive officers while motivating them to achieve current year business objectives as well as to deliver long-term goals. Equity ownership is viewed as a critical component to assure that the executives' Company financial interests are closely aligned with those of the Company stockholders; and
- The executive compensation program should promote collaboration and teamwork across the Company.

The Committee selects compensation elements for its executive compensation program with these philosophies and objectives in mind. The executive compensation program reflects that the Company operates with a small team of executives. The executives are given significant and extensive responsibilities that encompass both the Company's strategic plan and direct day-to-day activities in sales, finance, customer communications, product development, marketing, manufacturing, and other similar activities. Additionally, the Committee regularly reviews overall Company performance and individual executive contributions, performance, leadership traits, and representation of the Company.

Item 11. Executive Compensation *(Continued)*

Although the Committee believes that employment contracts do not ensure or guarantee that executives' efforts, attention, and commitment are aligned with maximizing the success of the Company and stockholder value, it is recognized that under certain circumstances these contracts are necessary. Currently, there are no employment contracts with any of the executives. The Committee continues to be diligent in considering when employment contracts are necessary and in the best interest of the Company and the Company's stockholders.

2. Executive Compensation Program Process and Oversight

The Committee provides advice, direction, and oversight responsibility for the compensation and human resources programs, processes, and functions of Paragon, including establishing a mandatory retirement age for executives and directors. The Committee has the sole authority at the Company's expense, to engage and terminate consulting firms and legal counsel, as the Committee deems advisable, to advise the Committee with respect to executive compensation and human resource matters, including the sole authority to approve the consultant's fees and other engagement terms.

Paragon's Board of Directors has delegated to the Committee the following responsibilities and authority:

- The Committee is responsible for developing and endorsing the executive compensation program philosophies and objectives discussed above;
- With respect to Paragon's Chief Executive Officer ("CEO"), the Committee:
 - Reviews and approves corporate goals and objectives relevant to the compensation of the CEO, annually evaluates the CEO's performance in light of these goals and objectives, and communicates the results to the CEO and the full Board;
 - Recommends (for approval by the independent directors) the CEO's compensation levels (including base salary, cash incentive and equity compensation, and other direct and indirect benefits) based on its evaluation of the CEO; and
 - Considers, among other items, Paragon's performance and relative stockholder return and the value of total compensation to CEO's at comparable companies.
- The Committee approves compensation for all executives below the level of CEO, including, if applicable, new and amended employment and severance agreements for these executives;
- The Committee assists the Board of Directors in establishing and periodically updating appropriate base salary, cash incentive, and equity compensation plans;
- The Committee administers these plans in order to attract, retain, and motivate skilled and talented executives and to align such plans with Paragon's financial performance, business strategies, and growth in stockholder value;
- The Committee provides necessary determinations in connection with executive compensation to qualify for tax deductions in excess of limitations under applicable regulations, including section 162(m) of the Internal Revenue Code as applicable; and

Item 11. Executive Compensation *(Continued)*

- The Committee guides the Board of Directors regarding all elements of appropriate director compensation and human resource matters, including establishing appropriate retirement policies.

The Committee recognizes the importance of maintaining sound principles for the development and administration of executive compensation and benefit programs and has taken steps that significantly enhance the Committee's ability to effectively carry out its responsibilities and ensure that Paragon's compensation and benefit programs further the philosophies and objectives set forth above. Among other things, the Committee has taken the following actions:

- (1) retained Aon Consulting ("Aon"), independent compensation consultant, in 2005 to advise the Committee on executive compensation and reward issues; and
- (2) implemented a more robust executive performance management process, including annual management-based objectives ("MBOs"), which are reviewed and approved by the Committee, to strengthen the link between executive pay and performance.

Management's participation in the compensation process is critical in creating an equitably tailored program that is both effective in motivating the executive team and in ensuring that the process appropriately reflects Paragon's culture and current strategies. Each year, Paragon's executives are required to develop a new set of MBOs for themselves and their respective areas of responsibility, consisting of both qualitative and quantitative goals. They are also required to review them with Paragon's CEO. These MBOs must be approved by the CEO and serve as a basis for measuring the amount of cash and equity incentive awards to which each executive is entitled. The process and timing for setting these objectives and assessing performance against these objectives are discussed in detail below.

The Committee uses the following resources, processes, and procedures to help it effectively perform its responsibilities:

- Executive sessions, without management present, to discuss various compensation matters, including the compensation of the CEO;
- Executive sessions with the CEO present to discuss recommendations of the CEO pertaining to executive compensation;
- An independent executive compensation consultant who advises the Committee from time to time on compensation matters; and
- A periodic review of all executive compensation and benefit programs for competitiveness, reasonableness, and cost-effectiveness.

The Committee believes that the total compensation provided to the Company's executives is reasonable and meets the philosophies and objectives of the compensation program for the Company's executives.

Compensation Surveys and Benchmarking

From time to time, the Committee periodically reviews surveys and benchmarking data consisting of total compensation and each of its three elements: base salary, cash incentive, and equity compensation. In determining 2006 executive compensation, the Committee targeted executive compensation for executives, at the lower end of the competitive range of survey data of companies from nationally recognized executive compensation surveys.

Item 11. Executive Compensation *(Continued)*

Principal Components of Executive Compensation

In the past, executives have been primarily compensated by a combination of base salary and discretionary incentives. The Company is deliberately moving to a managed program more consistent with the stated compensation philosophies and objectives. In the future, executives' total compensation will be more heavily weighted towards performance-based, variable compensation, with annual base salary ranging from 50% to 75% of a Named Executive's total compensation package. Equity compensation grants, currently consisting of stock options and nonvested stock, are awarded as part of a long-term incentive plan, which aligns the equity compensation component with the returns delivered to stockholders over time.

Although the Committee has not established specific ratios for each of the principal compensation components, it strives to maintain a reasonable and competitive balance between cash and equity compensation components. For compensation setting purposes, each executive is considered individually; however, the same considerations apply to all executives. In setting base salary, the primary factors are the scope of the executive's duties and responsibilities, the executive's performance of those duties and responsibilities, and a general evaluation of the competitive market conditions for similar executives with each of the Company's respective executive's experience.

The Company also compensates its executives with other customary benefits such as medical coverage, group life insurance, travel accident insurance, disability coverage, and a defined contribution retirement savings plan. The Company does not provide significant perquisites or post-retirement benefits to its executives, such as a defined benefit pension plan.

Base Salary

The Committee provides base salaries to executive officers to attract and retain talent, provide competitive compensation for the performance of the executives' basic job duties and responsibilities, and recognize individual contributions to the Company's financial performance. The Committee generally targets base salary levels to be at the lower end of the competitive range and, therefore, base salaries are not intended to exceed the median of market data provided by the Company's compensation consultant. Base salaries may be adjusted at the discretion of the Board of Directors based on the recommendation of the Committee. Based on recommendations of the CEO and the Committee's review of the applicable compensation survey data, as discussed above, base salaries of all executive officers for 2006 were set at levels at the lower end of the competitive range. The Committee typically recommends and the Board of Directors sets base salaries at these levels due to differences in revenue size among the companies included in the published survey sources. The Committee believes that the base salaries paid to the Company's executive officers are reasonable and are the primary component of the Company's compensation program.

On January 1, 2006, Mr. Hoffner was hired as the Company's President and CEO at a salary of \$200,000 per annum and subsequently reduced to \$155,000. The salary paid to Mr. Hoffner was arrived at through negotiations with Mr. Hoffner and was subsequently adjusted to be equal to the salary paid to each of Messrs. Casey and Lehr, two of the Company's principal executives. On March 1, 2007, Mr. Hoffner resigned from his positions as President and CEO and as a director of the Company. Mr. Yurkovic returned to the Company as Acting CEO on March 1, 2007 at a base salary of \$10,500 per month and is not eligible for director compensation while in this position. The salary paid to Mr. Yurkovic was arrived at through negotiations with Mr. Yurkovic.

Item 11. Executive Compensation *(Continued)*

Changes, if any, to base salaries for all employees generally will take effect on March 1; however, base salaries of executives are also reviewed at the time of a promotion or other change in responsibilities. In connection with his change in responsibilities and promotion to Vice President of the Company, effective November 14, 2005, Mr. Lehr received an increase of \$5,000 in base salary, bringing his base salary to \$155,000. In connection with his change in responsibilities and promotion to Executive Vice President of the Company, effective November 14, 2005, Mr. Casey received an increase of \$15,000 in base salary, bringing his base salary to \$155,000. Also, effective March 1, 2007, in connection with his change in responsibilities and promotion to President and Chief Operating Officer ("COO") of SI Systems, Mr. Casey received an increase of \$20,000 in base salary, bringing his base salary to \$175,000. During 2006, Mr. Semanick received no increase in base salary and his base salary remains at \$124,373, the per annum rate of pay that was set on March 1, 2005.

Bonus Awards

While the Company implements a more managed program for executive compensation, it has utilized discretionary cash bonus awards to recognize the contributions of selected executives based on the Board of Directors' judgment of the executive's overall performance. When appropriate, the Committee recommends the recipients and amounts of these discretionary cash bonus awards each year for approval by the Board of Directors. Discretionary cash bonuses may vary among executives, with no one executive guaranteed a minimum cash bonus amount. On December 19, 2006, discretionary cash bonus awards were recommended by the Committee and, subsequently approved by the Board of Directors, for Messrs. Casey and Semanick in the amounts of \$10,000 and \$5,000, respectively, for their overall personal performance and contributions to the business during 2006. This cash bonus was relevant to the particular executive's job responsibilities and duties, including but not limited to leadership, long-term performance, mentoring skills, and other intangible qualities that contribute to corporate and individual success.

Equity Awards

The Committee believes that equity awards are an important component of the Company's compensation program because they have the effect of retaining executives and aligning executives' financial interests with the interests of stockholders. The Company's current policy is to grant equity awards to executives and directors and, if applicable, other key employees. The Board of Directors does not look specifically at stock ownership or equity awards granted in prior years in setting equity awards for the current year.

During 2006, the two types of equity awards granted to executives were stock options and nonvested stock. These types of equity awards were selected to provide a program that focuses on aspects of performance such as stock price appreciation, total return to stockholders, and financial performance. The total number of stock options and nonvested shares granted to each executive were delivered equally by each type. However, the grant date fair value of the awards granted to each executive was weighted differently for the two types, with approximately 20% of the grant date fair value of the total equity awards in medium-term compensation such as stock options which vest in four equal annual installments beginning on the first anniversary of the date of grant, and approximately 80% of the grant date fair value of the total equity awards in longer-term compensation such as nonvested stock which vest on the four-year anniversary of the date of grant. During 2006, equity awards were granted to executives based on position rate whereby the President and CEO received 40% of the equity awards and each of the other three executives received 20% of the equity awards. The Committee and the Board of Directors has discretionary authority to adjust the relative type and mix of equity awards.

Item 11. Executive Compensation *(Continued)*

Stock Options

Stock options provide the Company's executives with the opportunity to purchase and maintain an equity interest in the Company and to share in the appreciation of the value of the Company's common stock. All stock options granted to executives in 2006 were granted from the Company's 1997 Equity Compensation Plan. Some of the features of the stock options granted during 2006 include:

- The term of each grant does not exceed seven years;
- Options vest in four equal annual installments beginning on the first anniversary of the date of grant; and
- The exercise price is equal to the closing market price on the date of grant.

The Company uses stock options as a long-term incentive because stock options focus the executive team on increasing longer-term value for stockholders. For additional information concerning the timing of grants of stock options, please see "The Company's Practices with Respect to the Granting of Equity Awards" below. On March 8, 2006, stock options were awarded to each of the executives named in the Summary Compensation Table: Mr. Hoffner (5,000 stock options), Mr. Semanick (2,500 stock options), Mr. Casey (2,500 stock options), and Mr. Lehr (2,500 stock options). No directors or other employees of the Company received any stock option grants during 2006.

Stock Awards

Nonvested stock awards provide the Company's executives with the opportunity to maintain an equity interest in the Company and to share in the appreciation of the value of the Company's common stock. All nonvested shares granted to executives in 2006 were granted from the Company's 1997 Equity Compensation Plan. Nonvested stock awards are "time-based" and vest on the four-year anniversary of the date of grant. In order for the nonvested stock to vest and, thus be earned, the executive must remain employed by the Company at the time of vesting.

The Company uses nonvested stock as a long-term incentive because stock ownership focuses the executive team on increasing longer-term value for stockholders. For additional information concerning the timing of grants of nonvested stock, please see "The Company's Practices with Respect to the Granting of Equity Awards" below. On March 8, 2006, nonvested stock was awarded to each of the executives named in the Summary Compensation Table: Mr. Hoffner (5,000 shares), Mr. Semanick (2,500 shares), Mr. Casey (2,500 shares), and Mr. Lehr (2,500 shares). No directors or other employees of the Company received any nonvested stock grants during 2006.

Other Compensation

In addition to the compensation described above, executives named in the Summary Compensation Table receive certain other benefits. Such benefits include a monthly auto allowance for executives of \$800 for the business usage of personal automobiles and Company contributions under the Company's 401(k) retirement savings plan. Participation in the Company's 401(k) retirement savings plan and Company contributions and benefits related to the retirement savings plan are made available to all of the Company's employees. The costs to the Company associated with providing these benefits for executives named in the Summary Compensation Table are reflected in the "All Other Compensation" column of the Summary Compensation Table.

Item 11. Executive Compensation (Continued)

The Company also provides other benefits, such as medical coverage, group life insurance, travel accident insurance, and disability coverage, to each executive named in the Summary Compensation Table, which are also provided to all of the Company's employees. The value of these benefits is not required to be included in the Summary Compensation Table because such benefits are made available to all employees. The Company also provides vacation and other paid holidays to all employees, including the executives named in the Summary Compensation Table, which are comparable to those provided by other companies.

Severance

The Company has an Executive Officer Severance Policy (the "Severance Policy") for an executive without an employment agreement, which applies in the event that an executive is terminated by the Company for reasons other than "cause," as such term is defined in the Severance Policy. The Severance Policy was established to provide a competitive benefit in order to motivate qualified individuals to accept executive positions with the Company. Under the Severance Policy, the CEO will receive 52 week's regular straight-time pay while the other executives will receive one week's regular straight-time pay based on their years of service with the Company in accordance with the following schedule:

Years of Service	Severance Pay (Weeks)
1 year of service or less	13 Weeks
Greater than 1 year of service, but less than 7 years of service	26 Weeks
Greater than 7 years of service, but less than 14 years of service	39 Weeks
Greater than 14 years of service or CEO of the Company	52 Weeks

During the aforementioned severance payout period, the Company will provide the executive continued medical coverage in accordance with the same terms offered during employment. The Company will also provide executive outplacement services for terminated executives. For additional information concerning the Severance Policy, see "Potential Payments upon Termination or Change in Control" below.

Change in Control

The Company does not have change-in-control agreements with its executives named in the Summary Compensation Table. However, the provisions of the 1997 Equity Compensation Plan applicable to change in control apply to nonvested stock and stock option grants issued under the Company's 1997 Equity Compensation Plan. Upon a change in control, all nonvested shares subject to forfeiture immediately prior to the change in control will become non-forfeitable and the restrictions and conditions on all outstanding nonvested stock shall immediately lapse, and all outstanding stock options shall automatically accelerate and become fully exercisable. For additional information concerning change in control provisions applicable to nonvested stock and stock option grants issued under the Company's 1997 Equity Compensation Plan, see "Potential Payments upon Termination or Change in Control" below.

Financial Restatement

The Company does not have a formal policy regarding the effects of a financial restatement on incentive compensation. The Company may, to the extent permitted by applicable law, seek recoupment of incentive compensation, if applicable, paid to any executive where the payment was predicated upon the achievement of certain financial results that were subsequently the subject of a restatement, the executive is found to have engaged in fraud or misconduct that caused or partially caused the need for the restatement, and a lower payment would have been made to the executive based upon

Item 11. Executive Compensation (Continued)

the restated financial results. In each such instance, the Company, to the extent practicable, may seek to recover the amount by which the individual executive's incentive compensation for the relevant period exceeded the payment that would have been made based on the restated financial results.

The Company's Practices with Respect to the Granting of Equity Awards

Equity awards are granted by the Board of Directors and are based upon the recommendations of the Committee.

- **Timing of Grants.** Regularly scheduled meetings of the Board of Directors generally occur in the month of the dissemination of the Company's earnings release for the immediately preceding fiscal quarter. Equity awards are typically granted at one of these regularly scheduled meetings and, as a rule, further grants are not made for the remainder of the year. On limited occasions, grants may occur at other regularly scheduled meetings of the Board of Directors during the year, primarily for approving a compensation package for a newly hired or promoted executive. The timing of such grants is driven solely by the activity related to the need for the hiring or promotion; not the price of the Company's common stock or the timing of any news release of Company information.
- **Option Exercise Price.** The exercise price of a newly granted stock option is the closing price on the American Stock Exchange on the date of grant.

Stockholding Guidelines

The Committee also believes that it is in the best interests of stockholders for the Company's directors and executives to own a minimum required amount of the Company's common stock, thereby aligning their interests with the interests of stockholders. Accordingly, on March 8, 2006, the Board of Directors implemented stock ownership guidelines applicable for all of the Company's directors and executives. The current stock ownership guidelines are as follows:

- The CEO of the Company is required to own at least 15,000 shares of the Company's common stock and all other executives and directors of the Company are required to own at least 10,000 shares of the Company's common stock.
- The common stock ownership requirement may be reached over a time period not exceeding the later of (1) five years from the March 8, 2006 policy inception date, or (2) five years from the date the director or executive begins his or her tenure as a director or executive with the Company.
- Directors of the Company are required to make an investment in the Company's common stock prior to or at the time of their election or appointment to the Company's Board of Directors, as long as such purchases do not violate the Company's insider trading policy.

Securities Trading Policy

Directors, executives, and employees of the Company may not engage in any transaction in which they may profit from short-term speculative swings in the value of the Company's securities. This prohibition includes "short sales" (selling borrowed securities which the seller hopes can be purchased at a lower price in the future) or "short sales against the box" (selling owned, but not delivered securities), and other hedging transactions designed to minimize an individual's risk inherent in owning the Company's common stock. In addition, the securities trading policy is designed to ensure compliance with all insider trading rules.

Item 11. Executive Compensation *(Continued)*

Perquisites

The Company does not provide significant perquisites to its executives, nor does it have an executive perquisite program. The Board of Directors and the Committee believe that providing significant perquisites to executives would not be consistent with the Company's overall compensation philosophies and objectives because awarding such perquisites do not necessary align an executive's interest with long-term stockholder value.

Tax Implications of Executive Compensation

Section 162(m) of the Internal Revenue Code places a limit of \$1,000,000 in compensation per year on the amount that the Company may deduct with respect to each of its Named Executives. The limitation does not apply to compensation that qualifies as "performance-based compensation" or falls within other exceptions provided in the statute. Awards under the Company's 1997 Equity Compensation Plan may be made on terms that will qualify for exception from the deductibility limit. However, the Committee retains the discretion to approve elements of compensation for specific executives in the future that may not be fully deductible when the Committee deems the compensation appropriate in light of its philosophies and objectives. The Committee believes that all compensation paid to the executives in 2006 did not exceed the deductible limit and will be deductible for federal income tax purposes.

3. Report of the Compensation Committee

The Committee has reviewed and discussed the Compensation Discussion and Analysis for the year ended December 31, 2006 required by Item 402(b) of Regulation S-K with management, and based on such review and discussions, the Committee recommended to the Board that the Compensation Discussion and Analysis for the year ended December 31, 2006 be included in this Annual Report on Form 10-K.

The Members of the Compensation Committee:

Anthony W. Schweiger, Chairman

L. Jack Bradt

Theodore W. Myers

Samuel L. Torrence

Item 11. Executive Compensation *(Continued)*

Set forth below is certain information relating to compensation received by the Company's Principal Executive Officer or PEO (its CEO), Principal Financial Officer or PFO (its Chief Financial Officer), and other most highly compensated executives of the Company in 2006 (collectively, the "Named Executives"). No executive has an employment agreement with the Company.

SUMMARY COMPENSATION TABLE

Name and Principal Positions	Year	Salary (\$ (1))	Bonus (\$)	Stock Awards (\$ (2))	Option Awards (\$ (3))	All Other Compensation (\$ (4))	Total (\$)
<u>Principal Executive Officer</u>							
Joel L. Hoffner President and CEO (5)	2006	155,000	-	10,427	2,709	13,800	181,936
<u>Principal Financial Officer</u>							
Ronald J. Semanick Vice President – Finance, Chief Financial Officer, and Treasurer	2006	124,373	5,000	5,214	1,354	14,575	150,516
William J. Casey Executive Vice President (6)	2006	155,000	10,000	5,214	1,354	15,800	187,368
John F. Lehr Vice President	2006	155,000	-	5,214	1,354	9,600	171,168

- (1) This column includes employee pre-tax contributions to the Company's 401(k) retirement savings plan.
- (2) This column reflects the dollar amount recognized for financial accounting reporting purposes for the fiscal year ended December 31, 2006, in accordance with SFAS No. 123(R) pursuant to the Company's 1997 Equity Compensation Plan and, therefore, includes amounts from awards granted in and, if applicable, prior to 2006. See the "Grants of Plan-Based Awards Table" for information on nonvested stock granted to the Company's Named Executives in 2006. These amounts reflect the Company's accounting expense for these awards, and do not correspond to the actual value that will be recognized by the Named Executive.
- (3) This column reflects the dollar amount recognized for financial accounting reporting purposes for the fiscal year ended December 31, 2006, in accordance with SFAS No. 123(R) pursuant to the Company's 1997 Equity Compensation Plan and, therefore, includes amounts from awards granted in and, if applicable, prior to 2006. See the "Grants of Plan-Based Awards Table" for information on stock options granted to the Company's Named Executives in 2006. These amounts reflect the Company's accounting expense for these awards, and do not correspond to the actual value that will be recognized by the Named Executives. The assumptions used in the calculation of these amounts are described in Note 5 of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10-K.

Item 11. Executive Compensation (Continued)

(4) This column includes the following additional compensation:

Name	Year	Auto Allowance (\$ (a))	Company Contributions to 401(k) Plan (\$ (b))	All Other Compensation Total (\$)
Joel L. Hoffner	2006	9,600	4,200	13,800
Ronald J. Semanick	2006	9,600	4,975	14,575
William J. Casey	2006	9,600	6,200	15,800
John F. Lehr	2006	9,600	-	9,600

(a) This column includes monthly auto allowance of \$800 for the business usage of personal automobiles.

(b) This column includes the amounts expensed for financial reporting purposes for Company contributions to the Company's 401(k) retirement savings plan pertaining to basic, matching, and profit sharing contributions. For further information, please refer to the Company's "Employee Benefit Plans" in Note 6 of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10-K.

(5) Mr. Hoffner became President and CEO of the Company on January 1, 2006 and resigned from his positions as President and CEO and as a director of the Company effective March 1, 2007.

(6) Mr. Casey rejoined the Company on December 29, 2003 and became Executive Vice President of the Company on October 14, 2005. Mr. Casey was appointed President and COO of SI Systems effective March 1, 2007, at which time his base salary was increased to \$175,000.

Item 11. Executive Compensation (Continued)

**GRANTS OF PLAN-BASED AWARDS DURING THE YEAR ENDED
DECEMBER 31, 2006**

Name	Grant Date	Approval Date	All Other Stock Awards: Number of Shares of Stock or Units (#) (1)	All Other Option Awards: Number of Securities Underlying Options (#) (2)	Exercise or Base Price of Option Awards (\$/Sh) (3)	Closing Price on Grant Date (\$/Sh) (4)	Grant Date Fair Value of Stock and Option Awards (\$) (5)
Joel L. Hoffner	3/8/2006	3/8/2006	5,000	-	-	10.01	50,050
	3/8/2006	3/8/2006	-	5,000	10.01	10.01	13,000
Ronald J. Semanick	3/8/2006	3/8/2006	2,500	-	-	10.01	25,025
	3/8/2006	3/8/2006	-	2,500	10.01	10.01	6,500
William J. Casey	3/8/2006	3/8/2006	2,500	-	-	10.01	25,025
	3/8/2006	3/8/2006	-	2,500	10.01	10.01	6,500
John F. Lehr	3/8/2006	3/8/2006	2,500	-	-	10.01	25,025
	3/8/2006	3/8/2006	-	2,500	10.01	10.01	6,500

(1) This column shows the number of nonvested shares granted to the Named Executives in 2006 under the Company's 1997 Equity Compensation Plan. The nonvested stock grants vest on March 8, 2010, the four-year anniversary of the date of grant.

(2) This column shows the number of options granted to the Named Executives in 2006 under the Company's 1997 Equity Compensation Plan. The options have a term of seven years and 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.

(3) This column shows the exercise price for the stock options granted on March 8, 2006, which was the closing price of the Company's common stock on that day.

(4) This column shows the closing market price of the Company's common stock on March 8, 2006.

(5) This column shows the full grant date fair value of nonvested shares and options under SFAS No. 123R granted to the Named Executives in 2006. Generally, the full grant date fair value is the amount that the Company would expense in its financial statements over the award's vesting schedule. For nonvested shares, fair value is calculated using the closing price of the Company's common stock on the grant date of \$10.01. For stock options, fair value is calculated using the Black Scholes value on the grant date of \$2.60. The fair value shown for option awards are accounted for in accordance with SFAS No. 123R. For additional information on the assumptions used in the calculation of this amount, please refer to Note 5 of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10-K. These amounts reflect the Company's accounting expense for these awards, and do not correspond to the actual value that will be recognized by the Named Executives.

Item 11. Executive Compensation (Continued)**OUTSTANDING EQUITY AWARDS AT DECEMBER 31, 2006**

Name	Number of Securities Underlying Unexercised Options (#)	Number of Securities Underlying Unexercised Options (#)	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#) (2)	Market Value of Shares or Units of Stock That Have Not Vested (\$)
	Exercisable	Unexercisable (1)				
Joel L. Hoffner	-	5,000	10.01	3/8/13	5,000	28,150
Ronald J. Semanick	-	2,500	10.01	3/8/13	2,500	14,075
William J. Casey	-	2,500	10.01	3/8/13	2,500	14,075
John F. Lehr	-	2,500	10.01	3/8/13	2,500	14,075

- (1) This column includes the stock options awarded on March 8, 2006 under the Company's 1997 Equity Compensation Plan. The options have a term of seven years and 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.
- (2) This column includes the nonvested stock awarded on March 8, 2006 under the Company's 1997 Equity Compensation Plan. The nonvested stock grants vest on March 8, 2010, the four-year anniversary of the date of grant. Due to his resignation from the Company effective March 1, 2007, Mr. Hoffner forfeited his 5,000 shares of nonvested stock.
- (3) The market value of shares of stock that have not vested was based on the closing market price of the Company's common stock on December 31, 2006 of \$5.63 per share.

OPTION EXERCISES AND STOCK VESTED IN THE YEAR ENDED DECEMBER 31, 2006

Name	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting (\$)
Joel L. Hoffner	-	-	-	-
Ronald J. Semanick	2,535 (1)	2,763	-	-
William J. Casey	-	-	-	-
John F. Lehr	-	-	-	-

- (1) On August 1, 2006, the Company received 2,213 shares of its common stock with a market price of \$8.59 per share as payment by Mr. Semanick for the exercise of 2,535 options with an exercise price of \$7.50. The transaction was made in connection with the Company's 1997 Equity Compensation Plan and was approved by the Board of Directors on August 1, 2006.

Item 11. Executive Compensation *(Continued)*

PENSION BENEFITS TABLE

Name	Plan Name	Number of Years Credited Service (#)	Present Value of Accumulated Benefit (\$)	Payments During Last Fiscal Year (\$)
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This table has been omitted because it is not applicable to the Company and its Named Executives.

NONQUALIFIED DEFERRED COMPENSATION TABLE

Name	Executive Contributions in Last Fiscal Year (\$)	Registrant Contributions in Last Fiscal Year (\$)	Aggregate Earnings in Last Fiscal Year (\$)	Aggregate Withdrawals/Distributions (\$)	Aggregate Balance at Last Fiscal Year-End (\$)
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This table has been omitted because it is not applicable to the Company and its Named Executives.

Item 11. Executive Compensation (Continued)

**POTENTIAL PAYMENTS UPON TERMINATION OR CHANGE IN CONTROL TABLE
AS OF DECEMBER 31, 2006**

The information below describes and estimates certain compensation that would become payable under existing plans and arrangements if the Named Executive's employment had terminated on December 31, 2006, given the Named Executive's compensation and, if applicable, based on the Company's closing stock price on that date. These benefits are in addition to benefits available generally to non-executive employees such as Company contributions under the Company's 401(k) retirement savings plan and accrued vacation pay.

Name	Benefit	Before Change	After Change	Change in
		in Control	in Control	
		Termination	Termination	
		w/o Cause or	w/o Cause or	
		for Good	for Good	
		Reason	Reason	
Joel L. Hoffner (3)	Severance pay	\$155,000	\$155,000	\$ -
	Outplacement services	10,000	10,000	-
	Health care benefits continuation	8,616	8,616	-
	Value of nonvested stock subject to acceleration	-	-	28,150 (1)
	Value of stock options subject to acceleration	-	-	- (2)
Ronald J. Semanick	Severance pay	124,373	124,373	-
	Outplacement services	10,000	10,000	-
	Health care benefits continuation	5,661	5,661	-
	Value of nonvested stock subject to acceleration	-	-	14,075 (1)
	Value of stock options subject to acceleration	-	-	- (2)
William J. Casey (4)	Severance pay	155,000	155,000	-
	Outplacement services	10,000	10,000	-
	Health care benefits continuation	12,924	12,924	-
	Value of nonvested stock subject to acceleration	-	-	14,075 (1)
	Value of stock options subject to acceleration	-	-	- (2)
John F. Lehr	Severance pay	77,500	77,500	-
	Outplacement services	10,000	10,000	-
	Health care benefits continuation	5,516	5,516	-
	Value of nonvested stock subject to acceleration	-	-	14,075 (1)
	Value of stock options subject to acceleration	-	-	- (2)

- (1) On March 8, 2006, the Compensation Committee awarded nonvested stock under the 1997 Equity Compensation Plan to Messrs. Hoffner (5,000 shares), Semanick (2,500 shares), Casey (2,500 shares), and Lehr (2,500 shares). The value associated with the accelerated vesting of nonvested stock has been determined based on the closing market price of the Company's common stock on December 31, 2006 of \$5.63 per share.

Item 11. Executive Compensation *(Continued)*

- (2) The closing market price of the Company's common stock on December 31, 2006 was \$5.63 per share, while the exercise price of outstanding stock options is \$10.01 per share. Therefore, the stock options are not-in-the-money at December 31, 2006 and would not provide any additional value to the Named Executives.
- (3) Mr. Hoffner resigned from his positions as President and CEO and as a director of the Company effective March 1, 2007 and is no longer eligible for the aforementioned benefits noted in this table.
- (4) Mr. Casey was appointed President and COO of SI Systems effective March 1, 2007 at which time his base salary was increased to \$175,000. As a result of the March 1, 2007 increase in Mr. Casey's base salary, the benefit associated with severance pay in this table would amount to \$175,000.

COMPENSATION OF DIRECTORS

Directors who are also employees of the Company receive no additional remuneration for their services as directors. The Chairman of the Board of Directors and other non-employee directors receive an annual retainer of \$24,000 and \$12,000, respectively; a fee of \$1,500 for each Board meeting attended; a fee of \$600 per day for all Company-related activities undertaken at the request of the Chairman of the Board or the Chief Executive Officer of the Company; and a fee of \$300 per interview for all Company-related activities undertaken in connection with interviewing qualified candidates to fill vacancies in key positions within the Company.

The Chairman of the Audit Committee receives an annual retainer of \$5,000, and directors are paid for serving on Committees of the Board of Directors. Non-employee directors serving on Committees of the Board of Directors receive meeting fees of \$1,500 for Audit Committee Meetings and \$1,000 for all other Committee Meetings of the Board of Directors. Directors are also reimbursed for their customary and usual expenses incurred in attending Board and Committee Meetings including those for travel, food, and lodging.

Under the Company's 1997 Equity Compensation Plan, directors are eligible to receive grants of stock options at the discretion of the Company's Board of Directors. No grants of stock options were made to any directors in 2006. However, in September 2006 the Board of Directors approved a change in director compensation under which non-employee directors will receive an annual grant of phantom stock beginning in 2007, providing the stockholders approve a revised equity compensation plan at the forthcoming annual meeting of stockholders, equal to \$7,500 based on the closing price of the Company's common stock on the date of the annual grant. It is the intent of the Board of Directors to make the phantom stock award grants on the date of the Board of Director's first regular meeting each year.

Item 11. Executive Compensation (Continued)

**DIRECTOR COMPENSATION TABLE
FOR THE YEAR ENDED DECEMBER 31, 2006**

Name	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)	Option Awards (\$ (1))	Non-Equity Incentive Plan Compensation (\$)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	Total (\$)
L. Jack Bradt	\$ 42,000	-	-	-	-	-	\$ 42,000
Theodore W. Myers	54,000	-	1,711	-	-	-	55,711
Anthony W. Schweiger	47,000	-	-	-	-	-	47,000
Leonard S. Yurkovic	34,000	-	2,862	-	-	-	36,862
Total	\$ 177,000	-	4,573	-	-	-	\$ 181,573

(1) This column includes the expense recognized during the year ended December 31, 2006 associated with the grant date fair value of stock options awarded during the second quarter of 2002.

Options outstanding at December 31, 2006, all of which are exercisable, pertaining to the Company's directors are as follows:

Name	Grant Date	Number of Securities Underlying Unexercised Options (#) Exercisable (1)	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price (\$)	Option Expiration Date
L. Jack Bradt	-	-	-	-	-
Theodore W. Myers	4/10/02	10,000	-	8.27	4/10/07
Anthony W. Schweiger	-	-	-	-	-
Leonard S. Yurkovic	6/20/02	10,000	-	8.12	6/20/07

(1) This column includes the stock options awarded during 2002 under the Company's 1997 Equity Compensation Plan. The options have a term of five years and 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. The option exercise price is based on the closing market price of the Company's common stock on the grant date. The grant date fair value of the options awarded during 2002 to Messrs. Myers and Yurkovic were \$25,000 and \$24,300, respectively.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The Committee is currently comprised of Mr. Schweiger, Chairman, and Messrs. Bradt, Myers, and Torrence. Mr. Bradt was formerly the CEO of the Company until 1987. No Named Executive of the Company serves as a member of the Board of Directors or Committee of any entity that has one or more Named Executives serving as a member of the Company's Board of Directors or Committee.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table sets forth certain information as of March 28, 2007 (unless otherwise noted) regarding the ownership of common stock (i) by each person known by the Company to be the beneficial owner of more than five percent (5%) of the outstanding common stock, (ii) by each director or nominee for election as a director of the Company, (iii) by the executives of the Company named in the Summary Compensation Table, and (iv) by all current executives and directors of the Company as a group. Unless otherwise stated, the beneficial owners exercise sole voting and/or investment power over their shares.

Title of Class	Name and Address of Beneficial Owner (1)	Amount and Nature of Beneficial Ownership	Right to Acquire Under Options Exercisable Within 60 Days	Percent of Class (2)
Common Stock, Par Value \$1.00 Per Share	Emerald Advisers, Inc. (3) 1703 Oregon Pike Suite 101 Lancaster, PA 17601	329,647	-	11.7%
Common Stock, Par Value \$1.00 Per Share	Robert J. Blyskal (4)	-	-	*
Common Stock, Par Value \$1.00 Per Share	L. Jack Bradt (5) 580 Riverwoods Way Bethlehem, PA 18018	220,324	-	7.8%
Common Stock, Par Value \$1.00 Per Share	Theodore W. Myers (6)	26,200	10,000	1.3%
Common Stock, Par Value \$1.00 Per Share	Anthony W. Schweiger	11,319	-	*
Common Stock, Par Value \$1.00 Per Share	Samuel L. Torrence (4)	-	-	*
Common Stock, Par Value \$1.00 Per Share	Leonard S. Yurkovic	19,000	10,000	1.0%
Common Stock, Par Value \$1.00 Per Share	Ronald J. Semanick (7)	17,370	625	*
Common Stock, Par Value \$1.00 Per Share	William J. Casey (7)	2,500	625	*
Common Stock, Par Value \$1.00 Per Share	John F. Lehr (7)	2,500	625	*
Common Stock, Par Value \$1.00 Per Share	All current directors and executive officers as a group (9 persons) (4) (5) (6) (7)	299,213	21,875	11.3%

*Represents less than 1%.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters *(Continued)*

- (1) Unless otherwise indicated, the address for each stockholder listed on the table is c/o Paragon Technologies, Inc., 600 Kuebler Road, Easton, Pennsylvania 18040.
- (2) The percentage for each individual, entity or group is based on the aggregate number of shares outstanding as of March 28, 2007 (2,813,041) and all shares issuable upon the exercise of outstanding stock options held by each individual or group that are presently exercisable or exercisable within 60 days after March 28, 2007.
- (3) This information is presented in reliance on information disclosed in a Schedule 13G/A filed with the Securities and Exchange Commission on February 14, 2007.
- (4) Messrs. Blyskal and Torrence were elected to the Board of Director's of the Company effective February 1, 2007. Messrs. Blyskal and Torrence joined the Company's Board of Director's during a time when the Company's insider trading policy precluded them from acquiring or selling shares of the Company's common stock.
- (5) Includes 51,262 shares held by members of Mr. Bradt's immediate family. Mr. Bradt disclaims beneficial ownership of such shares. Mr. Bradt has 211,000 shares pledged as security for loans.
- (6) Includes 2,800 shares held by members of Mr. Myers' immediate family. Mr. Myers disclaims beneficial ownership of such shares.
- (7) Includes nonvested shares awarded on March 8, 2006 under the Company's 1997 Equity Compensation Plan to Messrs. Semanick (2,500 shares), Casey (2,500 shares), and Lehr (2,500 shares). The nonvested stock grants vest on March 8, 2010, the four-year anniversary of the date of grant.

Equity Compensation Plan Information

The Company maintains the 1997 Equity Compensation Plan (the "1997 Plan") pursuant to which it may grant equity awards to eligible persons.

The following table gives information about equity awards under the Company's 1997 Plan.

Plan Category	(a)	(b)	(c)
	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by security holders	32,500	\$ 8.89	715,947
Equity compensation plans not approved by security holders	-	-	-
Total	32,500	\$ 8.89	715,947

Item 13. Certain Relationships and Related Transactions

On September 20, 2005, the Board of Directors of the Company, upon the recommendation of the Board's Nominating Committee, unanimously voted to elect Mr. Joel L. Hoffner as a Director of the Company to fill the vacancy created by the resignation of Mr. Steven Shulman on August 8, 2005. Mr. Hoffner had been a consultant to SI Handling Systems, Inc. and Paragon Technologies for various marketing and business evaluation assignments from 1995 through 2005. From September 1, 2005 through December 31, 2005, Mr. Hoffner provided consulting services related to the Company's corporate development pursuant to the terms of a consulting agreement by and between the Company and The QTX Group dated September 1, 2005. In consideration for their services, The QTX Group received \$7,500 per month and reimbursement for all reasonable and necessary out-of-pocket expenses directly incurred by Mr. Hoffner during the term of his engagement with the Company. The parties terminated the consulting agreement with The QTX Group on January 1, 2006, the time Mr. Hoffner's appointment as President and Chief Executive Officer of the Company became effective. Consulting expenses associated with The QTX Group in the years ended December 31, 2005 and 2004 approximated \$44,000 and \$10,000, respectively. Mr. Hoffner resigned from his positions as President and CEO and a director of the Company effective March 1, 2007.

On November 15, 2005, the Company announced the repurchase of 100,000 shares (or 2.67%) of its common stock in a private sale transaction for \$975,000 (or \$9.75 per share) from L. Jack Bradt, a member of the Company's Board of Directors. The Company's non-interested Audit Committee members and the Board of Directors approved the repurchase of Mr. Bradt's shares. The closing market price of the Company's common stock on November 14, 2005 was \$10.09 per share.

With the exception of Mr. Yurkovic, the Company's Acting CEO, each of the members of the Company's Board of Directors is considered "independent" within the meaning of the rules of the American Stock Exchange and the Securities and Exchange Commission.

Item 14. Principal Accountant Fees and Services

Selection of the independent registered public accountants is made solely by the Audit Committee. KPMG LLP ("KPMG") served as the Company's independent registered public accountants for 2006 and 2005. Fees for all services provided by KPMG for the fiscal years ended December 31, 2006 and 2005 were as follows:

Audit Fees

KPMG's fees for professional services rendered in connection with the audit of financial statements included in the Company's Form 10-K and review of financial statements included in the Company's Forms 10-Q and all other SEC regulatory filings were \$129,800 for 2006 and \$142,400 for 2005.

Audit-Related Fees

KPMG's fees for audit-related services were \$0 for 2006 and \$23,000 for 2005. The services rendered in 2005 were in connection with due diligence related to the sale of substantially all of the assets and liabilities of Ermanco.

Item 14. Principal Accountant Fees and Services *(Continued)*

Tax Fees

KPMG's fees for tax services were \$68,150 for 2006 and \$92,910 for 2005. The services rendered in 2006 were in connection with tax compliance and tax consultation services related to the Company's annual federal and state tax returns. The services rendered in 2005 were in connection with tax compliance and tax consultation services totaling \$52,460 related to the Company's annual federal and state tax returns and due diligence totaling \$40,450 related to the sale of substantially all of the assets and liabilities of Ermanco.

All Other Fees

No other fees were charged by KPMG to the Company in 2006 and 2005 other than those referenced above.

Fee Approval Policy

In accordance with our Audit Committee Charter, the Audit Committee approves in advance any and all audit services, including audit engagement fees and terms, and non-audit services provided to the Company by our independent registered public accountants (subject to the de minimus exception for non-audit services contained in Section 10A(i)(1)(B) of the Securities Exchange Act of 1934, as amended), all as required by applicable law or listing standards. The independent registered public accountants and our management are required to periodically report to the Audit Committee the extent of services provided by the independent registered public accountants and the fees associated with these services. Specific services being provided by the Company's independent registered public accountants are regularly reviewed in accordance with the pre-approval policy. All services rendered by KPMG are permissible under applicable laws and regulations, and the Audit Committee pre-approved all audit, audit-related, and non-audit services performed by KPMG during 2006.

PART IV

Item 15. Exhibits and Financial Statement Schedules

- (a) 1. Index to Consolidated Financial Statements
Report of Independent Registered Public Accounting Firm
Consolidated Financial Statements:
Consolidated Balance Sheets, December 31, 2006 and 2005
Consolidated Statements of Operations for the years ended December 31, 2006, 2005, and 2004
Consolidated Statements of Stockholders' Equity and Comprehensive Income for the years ended December 31, 2006, 2005, and 2004
Consolidated Statements of Cash Flows for the years ended December 31, 2006, 2005, and 2004
Notes to Consolidated Financial Statements

2. Index to Financial Statement Schedule

All schedules are omitted as the required information is inapplicable or the information is presented in the consolidated financial statements or related notes.

3. Exhibits:

- 2.1 Stock Purchase Agreement dated as of August 6, 1999 among SI Handling Systems, Inc., Ermanco Incorporated, and the stockholders of Ermanco Incorporated (incorporated by reference to Exhibit 2.1 to Form 10-Q for the quarterly period ended August 29, 1999).
- 2.2 Stock Purchase Agreement by and among McKesson Automation Systems, Inc., Paragon Technologies, Inc., and SI/BAKER, INC. dated September 19, 2003 (incorporated by reference to Exhibit 2.2 on Form 8-K, filed on October 1, 2003).
- 3.1 Articles of Incorporation of Paragon Technologies, Inc., a Delaware corporation (incorporated by reference to Exhibit 3.1 on Form 8-K, filed on December 11, 2001).
- 3.2 Bylaws of Paragon Technologies, Inc., a Delaware corporation (incorporated by reference to Exhibit 3.2 on Form 8-K, filed on December 11, 2001).
- 3.3 Certificate of Amendment to the Articles of Incorporation of Ermanco Incorporated as filed with the Michigan Secretary of State on August 5, 2005 (incorporated by reference to Exhibit 3.1 to Form 8-K, filed on August 9, 2005).
- 10.1 Executive Officer Incentive Plan* (incorporated by reference to Exhibit 10.5 to Annual Report on Form 10-K for the fiscal year ended February 26, 1995).
- 10.2 Directors' Deferred Compensation Plan* (incorporated by reference to Exhibit 10.6 to the Company's Registration Statement on Form S-8 [No. 333-10181]).
- 10.3 1997 Equity Compensation Plan* (incorporated by reference to Exhibit 10.7 to the Company's Registration Statement on Form S-8 [No. 333-36397]).

PART IV (Continued)

Item 15. Exhibits and Financial Statement Schedules (Continued)

- 10.4 Executive Employment Agreement with William R. Johnson dated March 29, 1999* (incorporated by reference to Exhibit 10.10 to Form 10-Q for the quarterly period ended May 30, 1999).
- 10.5 Employment Agreement with Leon C. Kirschner* (incorporated by reference to Exhibit 10.11 to Form 8-K, filed on October 15, 1999).
- 10.6 Line of Credit Loan Agreement entered into September 30, 1999 by and between SI Handling Systems, Inc., Ermanco Incorporated, and First Union National Bank (incorporated by reference to Exhibit 10.12 to Form 8-K, filed on October 15, 1999).
- 10.7 Promissory Note related to the Line of Credit Loan Agreement entered into September 30, 1999 by and between SI Handling Systems, Inc., Ermanco Incorporated, and First Union National Bank (incorporated by reference to Exhibit 10.13 to Form 8-K, filed on October 15, 1999).
- 10.8 First Amendment to Term Note and Loan Agreement dated March 30, 2000 (incorporated by reference to Exhibit 10.17 to Form 10-Q, filed on May 15, 2000).
- 10.9 Registration Rights Agreement (incorporated by reference to Exhibit 10.1 to Form S-3, filed on July 5, 2000).
- 10.10 Amended and Restated Executive Employment Agreement with William R. Johnson dated October 1, 2001* (incorporated by reference to Exhibit 10.22 to Amendment No. 1 to Annual Report on Form 10-K for the year ended December 31, 2001).
- 10.11 Amended and Restated Executive Employment Agreement with Leon C. Kirschner dated August 28, 2002* (incorporated by reference to Exhibit 10.23 to Form 10-Q, filed on November 14, 2002).
- 10.12 Sixth Amendment to Line of Credit Note and Loan Agreement dated August 9, 2002 (incorporated by reference to Exhibit 10.24 to Form 10-Q, filed on November 14, 2002).
- 10.13 Sixth Amendment to Promissory Note and Loan Agreement (Term Loan) dated November 13, 2002 (incorporated by reference to Exhibit 10.25 to Annual Report on Form 10-K for the year ended December 31, 2002).
- 10.14 Seventh Amendment to Line of Credit Note and Loan Agreement (Line of Credit) dated November 13, 2002 (incorporated by reference to Exhibit 10.26 to Annual Report on Form 10-K for the year ended December 31, 2002).
- 10.15 Agreement of Sale between J. G. Petrucci Company, Inc. or its Assigns and Paragon Technologies, Inc. dated November 8, 2002 (incorporated by reference to Exhibit 10.27 to Form 10-Q, filed on May 14, 2003).
- 10.16 Amendment I to Agreement of Sale between J. G. Petrucci Company, Inc. and Paragon Technologies, Inc. dated January 2, 2003 (incorporated by reference to Exhibit 10.28 to Form 10-Q, filed on May 14, 2003).

PART IV (Continued)

Item 15. Exhibits and Financial Statement Schedules (Continued)

- 10.17 Amendment II to Agreement of Sale between Triple Net Investments XIII, L.P. and Paragon Technologies, Inc. dated January 13, 2003 (incorporated by reference to Exhibit 10.29 to Form 10-Q, filed on May 14, 2003).
- 10.18 Amendment III to Agreement of Sale between Triple Net Investments, XIII, L.P. and Paragon Technologies, Inc. dated January 17, 2003 (incorporated by reference to Exhibit 10.30 to Form 10-Q, filed on May 14, 2003).
- 10.19 Lease Agreement between Triple Net Investments XIII, L.P. and Paragon Technologies, Inc. dated February 21, 2003 (incorporated by reference to Exhibit 10.31 to Form 10-Q, filed on May 14, 2003).
- 10.20 Eighth Amendment to Line of Credit Note and Loan Agreement (Line of Credit) dated June 5, 2003 (incorporated by reference to Exhibit 10.32 to Form 10-Q, filed on August 14, 2003).
- 10.21 Loan Agreement (Term Loan A and Term Loan B) entered into June 5, 2003 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.33 to Form 10-Q, filed on August 14, 2003).
- 10.22 Promissory Note related to Term Loan A entered into June 5, 2003 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.34 to Form 10-Q, filed on August 14, 2003).
- 10.23 Promissory Note related to Term Loan B entered into June 5, 2003 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.35 to Form 10-Q, filed on August 14, 2003).
- 10.24 Security Agreement related to Term Loan A dated June 5, 2003 by and between Paragon Technologies, Inc. and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.36 to Form 10-Q, filed on August 14, 2003).
- 10.25 First Amendment to Term Loan A and B Agreement dated August 4, 2003 by and between Paragon Technologies, Inc. and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.37 to Form 10-Q, filed on November 13, 2003).
- 10.26 Ninth Amendment to Line of Credit Note and Loan Agreement dated August 4, 2003 by and between Paragon Technologies, Inc. and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.38 to Form 10-Q, filed on November 13, 2003).
- 10.27 Amendment to Lease Agreement by and between Spring Lake Properties Holdings, L.C. and Ermanco Incorporated dated April 1, 2004 (incorporated by reference to Exhibit 10.27 to Form 10-Q, filed on August 12, 2004).

PART IV (Continued)

Item 15. Exhibits and Financial Statement Schedules (Continued)

- 10.28 Lease Agreement related to the Line of Credit entered into August 6, 2004 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.28 to Form 10-Q, filed on November 12, 2004).
- 10.29 Promissory Note related to the Line of Credit entered into August 6, 2004 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.29 to Form 10-Q, filed on November 12, 2004).
- 10.30 Security Agreement related to the Line of Credit dated August 6, 2004 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.30 to Form 10-Q, filed on November 12, 2004).
- 10.31 Asset Purchase Agreement by and among TGW Transportgeräte GmbH, Malibu Acquisition, Inc., Ermanco Incorporated, and Paragon Technologies, Inc. dated May 20, 2005 (incorporated by reference to Exhibit 10.1 to Form 8-K, filed on May 23, 2005).
- 10.32 Loan Agreement (Line of Credit) entered into June 20, 2005 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.31 to Form 10-Q, filed on August 12, 2005).
- 10.33 Promissory Note related to the Line of Credit entered into June 20, 2005 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.32 to Form 10-Q, filed on August 12, 2005).
- 10.34 Consulting Agreement dated September 1, 2005 by and between Paragon Technologies, Inc. and The QTX Group (incorporated by reference to Exhibit 10.1 to Form 8-K, filed on September 21, 2005).
- 10.35 Termination Agreement dated January 1, 2006 by and between Paragon Technologies, Inc. and The QTX Group (filed herewith).
- 10.36 Loan Agreement (Line of Credit) entered into June 20, 2006 by and between Paragon Technologies, Inc. and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.36 to Form 10-Q, filed on August 10, 2006).
- 10.37 Promissory Note related to the Line of Credit entered into June 20, 2006 by and between Paragon Technologies, Inc. and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.37 to Form 10-Q, filed on August 10, 2006).
- 10.38 Security Agreement related to the Line of Credit entered into June 20, 2006 by and between Paragon Technologies, Inc. and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.38 to Form 10-Q, filed on August 10, 2006).
- 14 Code of Business Conduct and Ethics (filed herewith).
- 21 Subsidiaries of the Registrant (filed herewith).

PART IV (Continued)

Item 15. Exhibits and Financial Statement Schedules (Continued)

- 23.1 Consent of Independent Registered Public Accounting Firm (filed herewith).
- 31.1 Certification by Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed by Leonard S. Yurkovic, 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).

* Management contract or compensatory plan or arrangement required to be filed as an Exhibit pursuant to Item 15(c) of this report.

(b) Exhibits 14, 21, 23.1, 31.1, 31.2, 32.1, and 32.2 are filed with this report.

(c) Not applicable.

SIGNATURES

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

PARAGON TECHNOLOGIES, INC.

Dated: March 30, 2007

By /s/ Theodore W. Myers
Theodore W. Myers
Chairman of the Board of Directors

Dated: March 30, 2007

By /s/ Leonard S. Yurkovic
Leonard S. Yurkovic
Acting Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated. This Annual Report may be signed in multiple identical counterparts, all of which taken together, shall constitute a single document.

Dated: March 30, 2007 /s/ Theodore W. Myers
Theodore W. Myers
Chairman of the Board of Directors

Dated: March 30, 2007 /s/ Leonard S. Yurkovic
Leonard S. Yurkovic
Acting Chief Executive Officer, Director

Dated: March 30, 2007 /s/ Ronald J. Semanick
Ronald J. Semanick
Vice President-Finance, Chief Financial
Officer, Treasurer, and Secretary
(Principal Accounting and Financial Officer)

Dated: March 30, 2007 /s/ Robert J. Blyskal
Robert J. Blyskal
Director

Dated: March 30, 2007 /s/ L. Jack Bradt
L. Jack Bradt
Director

Dated: March 30, 2007 /s/ Anthony W. Schweiger
Anthony W. Schweiger
Director

Dated: March 30, 2007 /s/ Samuel L. Torrence
Samuel L. Torrence
Director

EXHIBIT INDEX

- 2.1 Stock Purchase Agreement dated as of August 6, 1999 among SI Handling Systems, Inc., Ermanco Incorporated, and the stockholders of Ermanco Incorporated (incorporated by reference to Exhibit 2.1 to Form 10-Q for the quarterly period ended August 29, 1999).
- 2.2 Stock Purchase Agreement by and among McKesson Automation Systems, Inc., Paragon Technologies, Inc., and SI/BAKER, INC. dated September 19, 2003 (incorporated by reference to Exhibit 2.2 on Form 8-K, filed on October 1, 2003).
- 3.1 Articles of Incorporation of Paragon Technologies, Inc., a Delaware corporation (incorporated by reference to Exhibit 3.1 on Form 8-K, filed on December 11, 2001).
- 3.2 Bylaws of Paragon Technologies, Inc., a Delaware corporation (incorporated by reference to Exhibit 3.2 on Form 8-K, filed on December 11, 2001).
- 3.3 Certificate of Amendment to the Articles of Incorporation of Ermanco Incorporated as filed with the Michigan Secretary of State on August 5, 2005 (incorporated by reference to Exhibit 3.1 to Form 8-K, filed on August 9, 2005).
- 10.1 Executive Officer Incentive Plan* (incorporated by reference to Exhibit 10.5 to Annual Report on Form 10-K for the fiscal year ended February 26, 1995).
- 10.2 Directors' Deferred Compensation Plan* (incorporated by reference to Exhibit 10.6 to the Company's Registration Statement on Form S-8 [No. 333-10181]).
- 10.3 1997 Equity Compensation Plan* (incorporated by reference to Exhibit 10.7 to the Company's Registration Statement on Form S-8 [No. 333-36397]).
- 10.4 Executive Employment Agreement with William R. Johnson dated March 29, 1999* (incorporated by reference to Exhibit 10.10 to Form 10-Q for the quarterly period ended May 30, 1999).
- 10.5 Employment Agreement with Leon C. Kirschner* (incorporated by reference to Exhibit 10.11 to Form 8-K, filed on October 15, 1999).
- 10.6 Line of Credit Loan Agreement entered into September 30, 1999 by and between SI Handling Systems, Inc., Ermanco Incorporated, and First Union National Bank (incorporated by reference to Exhibit 10.12 to Form 8-K, filed on October 15, 1999).
- 10.7 Promissory Note related to the Line of Credit Loan Agreement entered into September 30, 1999 by and between SI Handling Systems, Inc., Ermanco Incorporated, and First Union National Bank (incorporated by reference to Exhibit 10.13 to Form 8-K, filed on October 15, 1999).
- 10.8 First Amendment to Term Note and Loan Agreement dated March 30, 2000 (incorporated by reference to Exhibit 10.17 to Form 10-Q, filed on May 15, 2000).
- 10.9 Registration Rights Agreement (incorporated by reference to Exhibit 10.1 to Form S-3, filed on July 5, 2000).
- 10.10 Amended and Restated Executive Employment Agreement with William R. Johnson dated October 1, 2001* (incorporated by reference to Exhibit 10.22 to Amendment No. 1 to Annual Report on Form 10-K for the year ended December 31, 2001).

EXHIBIT INDEX *(Continued)*

- 10.11 Amended and Restated Executive Employment Agreement with Leon C. Kirschner dated August 28, 2002* (incorporated by reference to Exhibit 10.23 to Form 10-Q, filed on November 14, 2002).
- 10.12 Sixth Amendment to Line of Credit Note and Loan Agreement dated August 9, 2002 (incorporated by reference to Exhibit 10.24 to Form 10-Q, filed on November 14, 2002).
- 10.13 Sixth Amendment to Promissory Note and Loan Agreement (Term Loan) dated November 13, 2002 (incorporated by reference to Exhibit 10.25 to Annual Report on Form 10-K for the year ended December 31, 2002).
- 10.14 Seventh Amendment to Line of Credit Note and Loan Agreement (Line of Credit) dated November 13, 2002 (incorporated by reference to Exhibit 10.26 to Annual Report on Form 10-K for the year ended December 31, 2002).
- 10.15 Agreement of Sale between J. G. Petrucci Company, Inc. or its Assigns and Paragon Technologies, Inc. dated November 8, 2002 (incorporated by reference to Exhibit 10.27 to Form 10-Q, filed on May 14, 2003).
- 10.16 Amendment I to Agreement of Sale between J. G. Petrucci Company, Inc. and Paragon Technologies, Inc. dated January 2, 2003 (incorporated by reference to Exhibit 10.28 to Form 10-Q, filed on May 14, 2003).
- 10.17 Amendment II to Agreement of Sale between Triple Net Investments XIII, L.P. and Paragon Technologies, Inc. dated January 13, 2003 (incorporated by reference to Exhibit 10.29 to Form 10-Q, filed on May 14, 2003).
- 10.18 Amendment III to Agreement of Sale between Triple Net Investments, XIII, L.P. and Paragon Technologies, Inc. dated January 17, 2003 (incorporated by reference to Exhibit 10.30 to Form 10-Q, filed on May 14, 2003).
- 10.19 Lease Agreement between Triple Net Investments XIII, L.P. and Paragon Technologies, Inc. dated February 21, 2003 (incorporated by reference to Exhibit 10.31 to Form 10-Q, filed on May 14, 2003).
- 10.20 Eighth Amendment to Line of Credit Note and Loan Agreement (Line of Credit) dated June 5, 2003 (incorporated by reference to Exhibit 10.32 to Form 10-Q, filed on August 14, 2003).
- 10.21 Loan Agreement (Term Loan A and Term Loan B) entered into June 5, 2003 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.33 to Form 10-Q, filed on August 14, 2003).
- 10.22 Promissory Note related to Term Loan A entered into June 5, 2003 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.34 to Form 10-Q, filed on August 14, 2003).
- 10.23 Promissory Note related to Term Loan B entered into June 5, 2003 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.35 to Form 10-Q, filed on August 14, 2003).

EXHIBIT INDEX *(Continued)*

- 10.24 Security Agreement related to Term Loan A dated June 5, 2003 by and between Paragon Technologies, Inc. and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.36 to Form 10-Q, filed on August 14, 2003).
- 10.25 First Amendment to Term Loan A and B Agreement dated August 4, 2003 by and between Paragon Technologies, Inc. and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.37 to Form 10-Q, filed on November 13, 2003).
- 10.26 Ninth Amendment to Line of Credit Note and Loan Agreement dated August 4, 2003 by and between Paragon Technologies, Inc. and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.38 to Form 10-Q, filed on November 13, 2003).
- 10.27 Amendment to Lease Agreement by and between Spring Lake Properties Holdings, L.C. and Ermanco Incorporated dated April 1, 2004 (incorporated by reference to Exhibit 10.27 to Form 10-Q, filed on August 12, 2004).
- 10.28 Lease Agreement related to the Line of Credit entered into August 6, 2004 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.28 to Form 10-Q, filed on November 12, 2004).
- 10.29 Promissory Note related to the Line of Credit entered into August 6, 2004 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.29 to Form 10-Q, filed on November 12, 2004).
- 10.30 Security Agreement related to the Line of Credit dated August 6, 2004 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.30 to Form 10-Q, filed on November 12, 2004).
- 10.31 Asset Purchase Agreement by and among TGW Transportgeräte GmbH, Malibu Acquisition, Inc., Ermanco Incorporated, and Paragon Technologies, Inc. dated May 20, 2005 (incorporated by reference to Exhibit 10.1 to Form 8-K, filed on May 23, 2005).
- 10.32 Loan Agreement (Line of Credit) entered into June 20, 2005 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.31 to Form 10-Q, filed on August 12, 2005).
- 10.33 Promissory Note related to the Line of Credit entered into June 20, 2005 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.32 to Form 10-Q, filed on August 12, 2005).
- 10.34 Consulting Agreement dated September 1, 2005 by and between Paragon Technologies, Inc. and The QTX Group (incorporated by reference to Exhibit 10.1 to Form 8-K, filed on September 21, 2005).
- 10.35 Termination Agreement dated January 1, 2006 by and between Paragon Technologies, Inc. and The QTX Group (filed herewith).

EXHIBIT INDEX *(Continued)*

- 10.36 Loan Agreement (Line of Credit) entered into June 20, 2006 by and between Paragon Technologies, Inc. and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.36 to Form 10-Q, filed on August 10, 2006).
- 10.37 Promissory Note related to the Line of Credit entered into June 20, 2006 by and between Paragon Technologies, Inc. and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.37 to Form 10-Q, filed on August 10, 2006).
- 10.38 Security Agreement related to the Line of Credit entered into June 20, 2006 by and between Paragon Technologies, Inc. and Wachovia Bank, National Association (incorporated by reference to Exhibit 10.38 to Form 10-Q, filed on August 10, 2006).
- 14 Code of Business Conduct and Ethics (filed herewith).
- 21 Subsidiaries of the Registrant (filed herewith).
- 23.1 Consent of Independent Registered Public Accounting Firm (filed herewith).
- 31.1 Certification by Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed by Leonard S. Yurkovic, 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).

*Management contract or compensatory plan or arrangement required to be filed as an Exhibit pursuant to Item 14(c) of this report.

PARAGON TECHNOLOGIES, INC.
CODE OF BUSINESS CONDUCT AND ETHICS

Introduction

This Code of Business Conduct and Ethics (“Code”) provides a general statement of the expectations of Paragon Technologies, Inc. (“Company”) regarding the ethical standards that each director, officer, and employee should adhere to while acting on behalf of the Company. It does not cover every issue that may arise, but it sets out basic principles to guide all employees, officers, and directors of the Company. All of our employees, officers, and directors must conduct themselves accordingly and seek to avoid even the appearance of improper behavior. This Code may also be provided to the Company’s agents and representatives, including consultants, who are expected to follow the same basic principles when providing services for the Company.

The Company’s Board of Directors is responsible for setting the standards of business conduct contained in this Code and updating these standards as it deems appropriate to reflect changes in the legal and regulatory framework applicable to the Company, the business practices within the Company’s industry, the Company’s own business practices, and the prevailing ethical standards of the communities in which the Company operates. While the Company’s Chief Executive Officer will oversee the procedures designed to implement this Code to ensure that they are operating effectively, it is the individual responsibility of each director, officer, and employee of the Company to comply with this Code. Each director, officer, and employee is expected to read and become familiar with the ethical standards described in this Code and may be required, from time to time, to affirm in writing his or her agreement to adhere to such standards.

If a law conflicts with a policy in this Code, you must comply with the law; however, if a local custom or policy conflicts with this Code, you must comply with the Code. If you have any questions about these conflicts, you should ask your supervisor how to handle the situation.

Those who violate the standards in this Code will be subject to disciplinary action. *If you are in a situation which you believe may violate or lead to a violation of this Code, follow the guidelines described in Section 14 of this Code.*

1. Compliance with Laws, Rules and Regulations

Obeying the law, both in letter and in spirit, is the foundation on which this Company’s ethical standards are built. The Company expects that all directors, officers, and employees acting on behalf of the Company will obey the laws of the cities, states, and countries in which we operate. Although you may not know the details of these laws, it is important to know enough to determine when to seek advice from supervisors, managers, or other appropriate advisors.

The Company publishes policies and holds information and training sessions to promote compliance with applicable laws, rules and regulations.

2. Conflicts of Interest

A “conflict of interest” exists when a person’s private interest interferes in any way with the interests of the Company. A conflict situation can arise when an employee, officer, or director takes actions or has interests that may make it difficult to perform his or her Company work objectively and effectively. Conflicts of interest may also arise when

an employee, officer, or director, or a member of his or her family, receives improper personal benefits as a result of his or her position in the Company. Loans to, or guarantees of obligations of, employees and their family members may create conflicts of interest.

It is almost always a conflict of interest for a Company employee to work simultaneously for a competitor, customer, or supplier. You are not allowed to work for a competitor as a consultant or board member. The best policy is to avoid any direct or indirect business connection with our customers, suppliers, or competitors, except on the Company's behalf.

Conflicts of interest are prohibited as a matter of Company policy, except under guidelines approved by the Board of Directors. Conflicts of interest may not always be clear-cut, so if you have a question, you should consult with higher levels of management. Any employee, officer, or director who becomes aware of a conflict or potential conflict should bring it to the attention of a supervisor, or consult the procedures described in Section 14 of this Code.

3. Insider Trading

Employees who have access to confidential information are not permitted to use or share that information for stock trading purposes or for any other purpose except the conduct of our business. All non-public information about the Company should be considered confidential information. To use non-public information for personal financial benefit or to "tip" others who might make an investment decision on the basis of this information is not only unethical but also illegal. If you have any questions, please consult the Company's Policy Statement on Dealing with Company Information, including Inside Information, Prohibition of Insider Trading and Conflicts of Interest.

4. Corporate Opportunities

Employees, officers, and directors are prohibited from taking for themselves personally any opportunities that are discovered through the use of Company property, information, or position, except with the consent of the Board of Directors. No employee may use Company property, information, or position for improper personal gain, and no employee may compete with the Company directly or indirectly. Employees, officers, and directors owe a duty to the Company to advance its legitimate interests when the opportunity to do so arises.

5. Competition and Fair Dealing

We seek to outperform our competition fairly and honestly. We seek competitive advantages through superior performance, never through unethical or illegal business practices. Stealing proprietary information, possessing trade secret information that was obtained without the owner's consent, or inducing such disclosures by past or present employees of other companies is prohibited. Each employee should endeavor to respect the rights of and deal fairly with the Company's customers, suppliers, competitors, and employees. No employee should take unfair advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or any other intentional unfair-dealing practice.

To maintain the Company's valuable reputation, compliance with our quality processes and safety requirements is essential. In the context of ethics, quality requires that our products and services be designed and manufactured to meet our obligations to customers. All inspection and testing documents must be handled in accordance with all applicable regulations.

The purpose of business entertainment and gifts in a commercial setting is to create good will and sound working relationships, not to gain unfair advantage with customers. No gift or entertainment should ever be offered, given, provided or accepted by any Company employee, or family member of an employee, or agent unless it: (1) is not a cash gift, (2) is consistent with customary business practices, (3) is not excessive in value, (4) cannot be construed as a bribe or payoff, and (5) does not violate any laws or regulations. Please discuss with your supervisor any gifts or proposed gifts that you believe may be, or may appear to be, inappropriate.

6. Discrimination and Harassment

The diversity of the Company's employees is a tremendous asset. We are firmly committed to providing equal opportunity in all aspects of employment and will not tolerate any illegal discrimination or harassment or any kind. Examples include derogatory comments based on racial or ethnic characteristics and unwelcome sexual advances.

7. Health and Safety

The Company strives to provide each employee with a safe and healthful work environment. Each employee has the responsibility for maintaining a safe and healthy workplace for all employees by following safety and health rules and practices and reporting accidents, injuries, and unsafe equipment, practices, or conditions.

Violence and threatening behavior are not permitted. Employees should report to work in condition to perform their duties, free from the influence of illegal drugs or alcohol. The use of illegal drugs in the workplace will not be tolerated.

8. Record-Keeping

The Company requires honest and accurate recording and reporting of information in order to make responsible business decisions. For example, only the true and actual number of hours worked should be reported.

Many employees regularly use business expense accounts, which must be documented and recorded accurately. If you are not sure whether a certain expense is legitimate, ask your supervisor, the CFO, Accounting Manager, or another member of the Finance/Accounting Department.

All of the Company's books, records, accounts, and financial statements must be maintained in reasonable detail, must appropriately reflect the Company's transactions, and must conform both to applicable legal requirements and to the Company's system of internal controls. The Company's internal controls system is designed to ensure that the process of gathering and processing financial data results in the accurate preparation of the Company's financial statements. It is the Company's policy that no employee may take any action that is not consistent with those accounting controls.

The Company's outside auditors play a large role in ensuring the accuracy of our financial statements and their involvement in that process must not be compromised through conflicts of interest or other improper pressure or coercion. The provisions of this Code concerning business entertainment of customers and suppliers also apply to dealings with the Company's independent registered public accountants. In addition, it is prohibited under federal law and Company policy to fraudulently influence, coerce, manipulate, or mislead the Company's independent registered public accountants for the purpose of rendering the Company's financial statements materially misleading.

Business records and communications often become public, and we should avoid exaggeration, derogatory remarks, guesswork, or inappropriate characterizations of people and companies that can be misunderstood. This applies equally to e-mail, eRooms, internal memos, and formal reports. Records should be retained or destroyed according to the Company's record retention policies, including any specific instructions in the event of any litigation or governmental investigation affecting the Company.

9. Accurate and Timely Periodic Reports

The Company is committed to providing its stockholders and the investment community with full, fair, accurate, timely, and understandable disclosure in its press releases and filings made with the Securities and Exchange Commission.

The Company must maintain a system of disclosure controls and procedures that will provide reasonable assurances to management that material information about the Company is made known to management, particularly during the periods in which the Company's periodic reports are being prepared. All employees, officers, and directors are responsible for providing prompt, accurate, and complete information in connection with implementation of these procedures and preparation of these reports.

10. Confidentiality; Protection and Proper Use of the Company's Assets

Directors, officers, and employees must maintain the confidentiality of confidential information entrusted to them by the Company or its suppliers, customers, or other business partners, except when disclosure is authorized by the CEO or legally required. Confidential information includes all non-public information that might be of use to competitors, or harmful to the Company or its suppliers, customers, or other business partners, if disclosed. It also includes information that suppliers, customers, and other business partners have entrusted to us. The obligation to preserve confidential information continues even after employment or service to the Company ends.

Directors, officers, and employees are personally responsible for protecting those Company assets that are entrusted to them and for helping to protect the Company's assets in general. Company equipment should not be used for non-Company business, though incidental personal use may be permitted.

The obligation of employees, officers, and directors to protect the Company's assets includes its intellectual property, such as trade secrets, patents, trademarks, and copyrights, as well as business, marketing, and service plans, engineering and manufacturing ideas, designs, databases, records, salary information, and any unpublished financial data and reports. Unauthorized use or distribution of this information is prohibited.

11. Payments to Government Personnel

The U.S. Foreign Corrupt Practices Act prohibits giving anything of value, directly or indirectly, to officials of foreign governments or foreign political candidates in order to obtain or retain business. It is strictly prohibited to make illegal payments to government officials of any country.

In addition, the U.S. government has a number of laws and regulations regarding business gratuities which may be accepted by U.S. government personnel. The promise, offer, or delivery to an official or employee of the U.S. government of a gift, favor, or other gratuity in violation of these rules would not only violate Company policy but could also be a criminal offense. State and local governments, as well as foreign governments, may have similar rules. The CEO can provide guidance to you in this area.

12. Waivers of the Code of Business Conduct and Ethics

The provisions of this Code may be waived for directors or executive officers only by a resolution of the Company's independent directors. The provisions of this Code may be waived for employees who are not directors or executive officers by the Company's CEO. Any waiver of this Code granted to an executive officer or director will be publicly disclosed as required by the securities exchange or association on which the Company's securities are listed for trading. Any change in or waiver of this Code for senior financial officers will be publicly disclosed as required by the Securities and Exchange Commission.

13. Reporting and Effect of Violations

Directors and officers should report, in person or in writing, any known or suspected violations of laws, governmental regulations, or this Code to the CEO. Employees who are not directors or officers are encouraged to report such violations, initially, to their immediate supervisor. If in doubt about the best course of action in a particular situation, contact your supervisor. It is the policy of the Company not to allow any retaliation for reports of misconduct by others that are made in good faith by directors, officers, or employees. Allowing retaliation for such reports is a violation of Federal law.

The Supervisor-Cost Estimating of the Company will oversee an investigation of any reported violations and the implementation of an appropriate response. All directors, officers, and employees are expected to cooperate in internal investigations of misconduct.

14. Compliance Procedures

We must all work to ensure prompt and consistent action against violations of this Code. However, in some situations it is difficult to know right from wrong. Since we cannot anticipate every situation that will arise, it is important that we have a way to approach a new question or problem. These are the steps to keep in mind:

- Make sure you have all the facts. In order to reach the right solutions, we must be as fully informed as possible.
- Ask yourself: What, specifically, am I being asked to do? Does it seem unethical or improper? This will enable you to focus on the specific question you are faced with, and the alternatives you have. Use your judgment and common sense; if something seems unethical or improper, it probably is.
- Clarify your responsibility and role. In most situations, there is shared responsibility. Are your colleagues informed? It may help to get others involved and discuss the problem.
- Discuss the problem with your supervisor. This is the basic guidance for all situations. In many cases, your supervisor will be more knowledgeable about the question, and will appreciate being brought into the decision-making process. Remember that it is your supervisor's responsibility to help solve problems.
- Seek help from other Company resources. In any case where it may not be appropriate to discuss an issue with your supervisor, or where you do not feel comfortable approaching your supervisor with your question, you should promptly discuss it with other appropriate Company resources. If you are concerned about general compliance matters, you may consult the CEO, or,

if you prefer to write, address your concerns to the CEO. If you are concerned about the Company's accounting or financial reporting practices, you may submit your concerns to the Chairman of the Audit Committee on a confidential and anonymous basis. You may obtain the current contact information for the Chairman of the Audit Committee from the Supervisor-Cost Estimating of the Company.

- You may report ethical violations in confidence and without fear of retaliation. If your situation requires that your identity be kept secret, your anonymity will be protected to the fullest extent possible. The Company does not permit retaliation of any kind against employees for good faith reports of ethical violations.
- Always ask first, act later: If you are unsure of what to do in any situation, seek guidance before you act.

15. Protection of Whistleblowers

The Company strives to conduct its business at all times with integrity and in an ethical manner. The Company has a strong practice of compliance with all applicable laws, adherence to all contractual requirements, conduct of ethical Company practices, and observance of Company guidelines. The Company encourages its employees to report any incident inconsistent with these guidelines to the Company and specifically avoids discouraging employees from reporting violations of law to governmental agencies responsible for enforcement of such laws.

It is the practice of the Company to provide unconditional protection to employees involved in identifying and reporting incidents of non-compliance with law, breach of contract requirements, or unethical Company practices. This employee protection policy is based on the following:

The Company will maintain a reporting process that is intended to achieve maximum individual or group anonymity. Any employee who becomes aware of an incident involving non-compliance with law, contractual obligations, ethical requirements, or Company guidelines should immediately report the incident (anonymously or otherwise) to the Supervisor-Cost Estimating of the Company.

No employee who reports a possible ethical violation or other violation of law or statute will be discharged, demoted, suspended, harassed, or discriminated against in any manner as a result of the employee's reporting of a possible violation.

Voluntary disclosure by employees of incidents involving non-compliance with law, contractual obligations, ethical requirements, or Company guidelines is encouraged.

Any employee who believes he or she has been discriminated against on the basis of making a voluntary disclosure in accordance with this guideline should immediately bring the problem to the attention of the Supervisor-Cost Estimating of the Company.

Any employee who reasonably believes that there has been a material violation of this Code of Ethics and Business Conduct caused by questionable accounting or auditing matters has the right to submit a confidential, anonymous complaint to the Supervisor-Cost Estimating. The complaint should be made in written form and provide sufficient information so that a reasonable investigation can be conducted. The complaint should be addressed to the Supervisor-Cost Estimating of the Company.

SUBSIDIARIES OF THE REGISTRANT

None.

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Paragon Technologies, Inc.:

We consent to the incorporation by reference in the registration statements (No. 333-25555, No. 333-36397, No. 333-59226, and No. 333-65870) on Form S-8 and No. 333-40834 on Form S-3 of Paragon Technologies, Inc. of our report dated March 30, 2007, with respect to the consolidated balance sheets of Paragon Technologies, Inc. and subsidiary as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity and comprehensive income and cash flows for each of the years in the three-year period ended December 31, 2006, which report appears in the December 31, 2006 annual report on Form 10-K of Paragon Technologies, Inc. Our audit report on the consolidated financial statements refers to the accounting change as a result of the adoption of Statement of Financial Accounting Standard No. 123(R), Share-Based Payment.

KPMG LLP

Philadelphia, Pennsylvania
March 30, 2007

SECTION 302 CERTIFICATION

I, Leonard S. Yurkovic, certify that:

1. I have reviewed this annual report on Form 10-K of Paragon Technologies, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: /s/ March 30, 2007
/s/ Leonard S. Yurkovic
Leonard S. Yurkovic
Acting CEO

SECTION 302 CERTIFICATION

I, Ronald J. Semanick, certify that:

1. I have reviewed this annual report on Form 10-K of Paragon Technologies, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: /s/ March 30, 2007

/s/ Ronald J. Semanick
Ronald J. Semanick
Chief Financial Officer, and Vice President – Finance and Treasurer

**CERTIFICATION OF CEO PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Paragon Technologies, Inc. (the "Company") Annual Report on Form 10-K for the year ended December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Leonard S. Yurkovic, Acting CEO of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Leonard S. Yurkovic
Leonard S. Yurkovic
Acting Chief Executive Officer
March 30, 2007

**CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Paragon Technologies, Inc. (the "Company") Annual Report on Form 10-K for the year ended December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Ronald J. Semanick, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Ronald J. Semanick

Ronald J. Semanick
Chief Financial Officer and Vice President - Finance
and Treasurer
March 30, 2007