



QUARTERLY REPORT
FOR THE PERIOD ENDED
SEPTEMBER 30, 2009

PARAGON TECHNOLOGIES, INC.

600 Kuebler Road
Easton, PA 18040
Phone: 610-252-3205
Fax: 610-252-3102

**I.R.S. Employer Identification
No.**

22-1643428

CUSIP No.

69912T108

ISSUER'S EQUITY SECURITIES

COMMON STOCK

\$1.00 Par Value

20,000,000 Common Shares Authorized

1,571,810 Shares Issued and Outstanding

PARAGON TECHNOLOGIES, INC.

Quarterly Report

For The Period Ended September 30, 2009

Item 1. The exact name of the issuer and its predecessors (if any):

Paragon Technologies, Inc., a Delaware corporation.
Formerly known as SI Handling Systems, Inc., a Pennsylvania corporation.

The Company's contact information is as follows:

Paragon Technologies, Inc.
600 Kuebler Road
Easton, PA 18040-9201
Phone:.....(610) 252-3205
Fax:.....(610) 252-3102
Internet:.....www.ptgamex.com

Item 2. Shares outstanding:

As of September 30, 2009, there were 1,571,810 shares of the Company's Common Stock issued and outstanding. As of the filing of this Quarterly Report, there were 1,571,810 shares of the Company's Common Stock issued and outstanding.

The contact information for the Company's Transfer Agent is as follows:

American Stock Transfer & Trust Company
59 Maiden Lane
New York, NY 10038
Phone:.....(718) 921-8293
Fax:.....(718) 921-8334
Internet:.....www.amstock.com

Item 3. Interim financial statements:

The Company's financial statements for the period ended September 30, 2009 are attached hereto.

Item 4. Management's discussion and analysis or plan of operation:

The Company's Management Discussion and Analysis for the period ended September 30, 2009 is attached hereto.

Item 5. Legal proceedings:

None for the period ended September 30, 2009 and through the date of this report.

Item 6. Default upon senior securities:

None for the period ended September 30, 2009 and through the date of this report.

PARAGON TECHNOLOGIES, INC.
Quarterly Report
For The Period Ended September 30, 2009 (*Continued*)

Item 7. Other information:

- a. Entry into a material definitive agreement:**
None for the period ended September 30, 2009 and through the date of this report.
- b. Termination of a material definitive agreement:**
None for the period ended September 30, 2009 and through the date of this report.
- c. Completion of acquisition or disposition of assets, including but not limited to merger:**
None for the period ended September 30, 2009 and through the date of this report.
- d. Creation of a direct financial obligation or an obligation under an off-balance sheet arrangement of an issuer:**
None for the period ended September 30, 2009 and through the date of this report.
- e. Triggering events that accelerate or increase a direct financial obligation or an obligation under an off-balance sheet arrangement:**
None for the period ended September 30, 2009 and through the date of this report.
- f. Costs associated with exit or disposal activities:**
None for the period ended September 30, 2009 and through the date of this report.
- g. Material impairments:**
None for the period ended September 30, 2009 and through the date of this report.
- h. Sales of equity securities:**
None for the period ended September 30, 2009 and through the date of this report.
- i. Material modification to rights of security holders:**
None for the period ended September 30, 2009 and through the date of this report.
- j. Changes in issuer's certifying accountant:**
None for the period ended September 30, 2009 and through the date of this report.

PARAGON TECHNOLOGIES, INC.
Quarterly Report
For The Period Ended September 30, 2009 *(Continued)*

Item 7. Other information: *(Continued)*

k. Non-reliance on previously issued financial statements or a related audit report or completed interim review:

None for the period ended September 30, 2009 and through the date of this report.

l. Changes in control of issuer:

None for the period ended September 30, 2009 and through the date of this report.

m. Departure of directors or officers; election of directors; appointment of principal officers:

None for the period ended September 30, 2009 and through the date of this report.

The current members of the Company's Board of Directors are as follows:

Theodore W. Myers, Chairman
Ronald J. Izewski
Robert J. Schwartz
Leonard S. Yurkovic

The current executive officers of the Company are as follows:

Leonard S. Yurkovic, Acting CEO
William J. Casey, Executive Vice President
Ronald J. Semanick, CFO, Vice President – Finance,
Treasurer, and Secretary

n. Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year:

None for the period ended September 30, 2009 and through the date of this report.

o. Amendments to Issuer's Code of Ethics, or Waiver of a Provision of the Code of Ethics:

None for the period ended September 30, 2009 and through the date of this report.

Item 8. Exhibits:

None for the period ended September 30, 2009 and through the date of this report.

PARAGON TECHNOLOGIES, INC.
Quarterly Report
For The Period Ended September 30, 2009 (*Continued*)

Item 9. Certifications:

I, Ronald J. Semanick, Chief Financial Officer of the issuer, certify that:

- a. I have reviewed the Quarterly Report including the financial statements for the period ended September 30, 2009 and the footnotes of Paragon Technologies, Inc.
- b. Based on my knowledge, this Quarterly 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 disclosure statement; and
- c. Based on my knowledge, the financial statements, other financial information included or incorporated by reference including the previously filed information and disclosure statement fairly present, in all material respects, the financial condition, results of operations, and cash flows of the issuer as of and for the periods presented.

November 4, 2009

/s/ Ronald J. Semanick
Ronald J. Semanick
Chief Financial Officer

I, Leonard S. Yurkovic, Acting Chief Executive Officer of the issuer, certify that:

- a. I have reviewed the Quarterly Report including the financial statements for the period ended September 30, 2009 and the footnotes of Paragon Technologies, Inc.
- b. Based on my knowledge, this Quarterly 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 disclosure statement; and
- c. Based on my knowledge, the financial statements, other financial information included or incorporated by reference including the previously filed information and disclosure statement fairly present, in all material respects, the financial condition, results of operations, and cash flows of the issuer as of and for the periods presented.

November 4, 2009

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

FINANCIAL INFORMATION

Financial Statements

Paragon Technologies, Inc.

Balance Sheets (Unaudited)

September 30, 2009 and December 31, 2008

(In Thousands, Except Share Data)

| | September 30, 2009 | December 31, 2008 |
|---|-----------------------|----------------------|
| <u>Assets</u> | | |
| Current assets: | | |
| Cash and cash equivalents..... | \$ 6,094 | 5,615 |
| Receivables: | | |
| Trade (net of allowance for doubtful accounts of \$0 as of September 30, 2009 and \$100 as of December 31, 2008)..... | 1,722 | 2,627 |
| Notes and other receivables..... | 259 | 336 |
| Total receivables | <u>1,981</u> | <u>2,963</u> |
| Costs and estimated earnings in excess of billings..... | 181 | 925 |
| Inventories: | | |
| Raw materials..... | 166 | 178 |
| Work-in-process | 2 | 11 |
| Finished goods | 528 | 516 |
| Total inventories | <u>696</u> | <u>705</u> |
| Prepaid expenses and other current assets | 220 | 123 |
| Total current assets..... | <u>9,172</u> | <u>10,331</u> |
| Machinery and Equipment, at cost: | | |
| Machinery and equipment | 1,349 | 1,371 |
| Less: accumulated depreciation | <u>1,132</u> | <u>1,084</u> |
| Net machinery and equipment..... | <u>217</u> | <u>287</u> |
| Total assets..... | <u>\$ 9,389</u> | <u>10,618</u> |

See accompanying notes to financial statements.

(Continued)

Financial Statements (Continued)
Paragon Technologies, Inc.
Balance Sheets (Unaudited) (Continued)
September 30, 2009 and December 31, 2008
(In Thousands, Except Share Data)

| | September 30, 2009 | December 31, 2008 |
|--|-----------------------|----------------------|
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable..... | \$ 1,640 | 1,262 |
| Customers' deposits and billings in excess of costs and estimated earnings | 965 | 804 |
| Accrued salaries, wages, and commissions..... | 241 | 191 |
| Accrued product warranties | 358 | 395 |
| Unearned support contract revenue | 209 | 392 |
| Accrued other liabilities..... | 287 | 312 |
| Total current liabilities..... | <u>3,700</u> | <u>3,356</u> |
| Long-term liabilities: | | |
| Income taxes payable | 188 | 257 |
| Total long-term liabilities..... | <u>188</u> | <u>257</u> |
| Commitments and contingencies (See Note 12) | | |
| Stockholders' equity: | | |
| Common stock, \$1 par value; authorized 20,000,000 shares; issued and outstanding 1,571,810 shares as of September 30, 2009 and 1,786,229 shares as of December 31, 2008 | 1,572 | 1,786 |
| Additional paid-in capital..... | 3,296 | 3,586 |
| Retained earnings | 633 | 1,633 |
| Total stockholders' equity..... | <u>5,501</u> | <u>7,005</u> |
| Total liabilities and stockholders' equity | <u>\$ 9,389</u> | <u>10,618</u> |

See accompanying notes to financial statements.

Financial Statements *(Continued)***Paragon Technologies, Inc.**

Statements of Operations (Unaudited)

For the Three and Nine Months Ended September 30, 2009 and 2008

(In Thousands, Except Share and Per Share Data)

| | Three Months Ended | | Nine Months Ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2009 | September 30, 2008 | September 30, 2009 | September 30, 2008 |
| Net sales | \$ 3,148 | 3,715 | 6,961 | 12,883 |
| Cost of sales | 2,284 | 2,540 | 5,218 | 9,217 |
| Gross profit on sales | <u>864</u> | <u>1,175</u> | <u>1,743</u> | <u>3,666</u> |
| Selling, general and administrative expenses | 788 | 1,363 | 2,794 | 3,992 |
| Product development costs..... | 43 | 3 | 114 | 109 |
| Interest income..... | (31) | (75) | (103) | (289) |
| Other expense, net..... | 3 | 1 | 12 | - |
| | <u>803</u> | <u>1,292</u> | <u>2,817</u> | <u>3,812</u> |
| Income (loss) before income taxes..... | 61 | (117) | (1,074) | (146) |
| Income tax expense (benefit)..... | 6 | 484 | (75) | 458 |
| Net income (loss) | <u>\$ 55</u> | <u>(601)</u> | <u>(999)</u> | <u>(604)</u> |
| Basic and diluted earnings (loss) per share | <u>\$.03</u> | <u>(.24)</u> | <u>(.61)</u> | <u>(.23)</u> |
| Weighted average basic and diluted shares outstanding | <u>1,571,810</u> | <u>2,516,012</u> | <u>1,632,003</u> | <u>2,638,643</u> |

See accompanying notes to financial statements.

Financial Statements *(Continued)*
Paragon Technologies, Inc.
 Statements of Cash Flows (Unaudited)
 For the Nine Months Ended September 30, 2009 and 2008
(In Thousands)

| | Nine Months Ended | |
|--|-----------------------|-----------------------|
| | September 30, 2009 | September 30, 2008 |
| Cash flows from operating activities: | | |
| Net loss | \$ (999) | (604) |
| Adjustments to reconcile net loss to net cash provided (used) by operating activities: | | |
| Depreciation of machinery and equipment.... | 70 | 94 |
| Deferred income tax expense | - | 424 |
| Provision for doubtful accounts | - | 100 |
| Amortization of deferred gain on sale- leaseback | - | (28) |
| Stock-based compensation | 12 | 18 |
| Change in operating assets and liabilities: | | |
| Receivables | 982 | 782 |
| Costs and estimated earnings in excess of billings | 744 | 741 |
| Inventories | 9 | 66 |
| Prepaid expenses and other current assets | (97) | (75) |
| Accounts payable | 378 | (537) |
| Customers' deposits and billings in excess of costs and estimated earnings..... | 161 | (1,974) |
| Accrued salaries, wages, and commissions | 50 | 124 |
| Income taxes payable | (69) | (19) |
| Accrued product warranties | (37) | 213 |
| Unearned support contract revenue | (183) | (8) |
| Accrued other liabilities | (25) | 1 |
| Net cash provided (used) by operating activities. | <u>996</u> | <u>(682)</u> |
| Cash flows from investing activities: | | |
| Proceeds from sales of short-term investments..... | - | 200 |
| Purchases of machinery and equipment | - | (103) |
| Net cash provided by investing activities | <u>-</u> | <u>97</u> |

See accompanying notes to financial statements.

(Continued)

Financial Statements (Continued)

Paragon Technologies, Inc.

Statements of Cash Flows (Unaudited) (Continued)

For the Nine Months Ended September 30, 2009 and 2008

(In Thousands)

| | Nine Months Ended | |
|--|-----------------------|-----------------------|
| | September 30, 2009 | September 30, 2008 |
| Cash flows from financing activities: | | |
| Repurchase and retirement of common stock..... | (517) | (2,665) |
| Net cash used by financing activities..... | (517) | (2,665) |
| Increase (decrease) in cash and cash equivalents..... | 479 | (3,250) |
| Cash and cash equivalents, beginning of period | 5,615 | 12,104 |
| Cash and cash equivalents, end of period..... | <u>\$ 6,094</u> | <u>8,854</u> |
| Supplemental disclosures of cash flow information: | | |
| Cash paid (received) during the period for: | | |
| Interest expense..... | <u>\$ -</u> | <u>-</u> |
| Income taxes..... | <u>\$ (140)</u> | <u>123</u> |

See accompanying notes to financial statements.

Financial Statements *(Continued)***Paragon Technologies, Inc.**

Statements of Stockholders' Equity and Comprehensive Income (Loss) *(Unaudited)*
 For the Years Ended December 31, 2007 and 2008, and for the Nine Months Ended
 September 30, 2009

(In Thousands, Except Share Data)

| | Common Shares | | Additional Paid-In Capital | Retained Earnings | Total Stockholders' Equity | Comprehensive Income (Loss) |
|---|---------------|----------|----------------------------------|----------------------|----------------------------------|--------------------------------|
| | Number | Amount | | | | |
| Balance at December 31, 2006 | 2,873,891 | \$ 2,874 | 5,720 | 3,834 | 12,428 | |
| Net income | - | - | - | 341 | 341 | 341 |
| Comprehensive income..... | - | - | - | - | - | 341 |
| Nonvested stock grants, net of amortization..... | (5,000) | (5) | 13 | - | 8 | |
| Effect of initial application of FIN 48..... | - | - | - | 37 | 37 | |
| Acquisition and retirement of common stock..... | (99,699) | (100) | (202) | (265) | (567) | |
| Other incentive plan activity | - | - | 6 | - | 6 | |
| Balance at December 31, 2007 | 2,769,192 | 2,769 | 5,537 | 3,947 | 12,253 | |
| Net loss..... | - | - | - | (687) | (687) | (687) |
| Comprehensive loss..... | - | - | - | - | - | (687) |
| Nonvested stock grants, net of amortization..... | (2,500) | (3) | 4 | - | 1 | |
| Acquisition and retirement of common stock..... | (980,463) | (980) | (1,960) | (1,627) | (4,567) | |
| Other incentive plan activity | - | - | 5 | - | 5 | |
| Balance at December 31, 2008 | 1,786,229 | 1,786 | 3,586 | 1,633 | 7,005 | |
| Net loss..... | - | - | - | (999) | (999) | (999) |
| Comprehensive loss..... | - | - | - | - | - | (999) |
| Amortization of nonvested stock grants..... | - | - | 9 | - | 9 | |
| Acquisition and retirement of common stock..... | (214,419) | (214) | (302) | (1) | (517) | |
| Other incentive plan activity | - | - | 3 | - | 3 | |
| Balance at September 30, 2009 | 1,571,810 | \$ 1,572 | 3,296 | 633 | 5,501 | |

See accompanying notes to financial statements.

Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2009 and 2008

(1) Basis of Financial Statement Presentation

In the opinion of the management of Paragon Technologies, Inc. ("Paragon" or the "Company"), the unaudited interim financial statements furnished reflect all adjustments and accruals that are necessary to present a fair statement of results for the interim periods. Results for interim periods are not necessarily indicative of results expected for the full fiscal year.

This Quarterly Report should be read in conjunction with, and is qualified in its entirety by reference to, the Financial Statements of the Company and the related Notes thereto appearing in the Company's annual report on Form 10-K for the year ended December 31, 2008 as filed with the Securities and Exchange Commission on March 30, 2009. Refer to the Company's annual report on Form 10-K for the year ended December 31, 2008 for more complete financial information.

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

(2) Allowance for Doubtful Accounts

The Company provides an allowance for doubtful accounts determined by a specific identification of individual accounts. The Company writes off receivables upon determination that no further collections are possible. The allowance for doubtful accounts as of September 30, 2009 and December 31, 2008 was \$0 and \$100,000, respectively.

(3) Accrued Product Warranties

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 one and one-half percent of the cost of the system being sold. A detailed review of products still in the warranty period is performed each quarter.

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

| | Beginning Balance January 1 | Additions (Reductions) Charged to | | Ending Balance September 30 |
|------------|--------------------------------|--------------------------------------|------------|--------------------------------|
| | | Costs and Expenses | Deductions | |
| 2009 | \$ 395 | (32) | (5) | 358 |
| 2008 | \$ 234 | 287 | (74) | 447 |

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2009 and 2008

(4) Business Operations

Company Overview

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

The Company (also referred to as "SI Systems") is a specialized systems integrator supplying SI Systems' branded automated material handling systems to manufacturing, assembly, order fulfillment, and distribution operations customers located primarily in North America, including the U.S. government. SI Systems' branded products are utilized to automate the movement or selection of products and are often integrated with other automated equipment such as conveyors and robots. SI Systems 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 SYNTHESIS[™] Software Suite. SYNTHESIS[™] 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.

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.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2009 and 2008

(5) Recently Issued Accounting Pronouncements

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. SFAS No. 157's fair value measurement requirements for non-financial assets and liabilities that are not required or permitted to be measured at fair value on a recurring basis have been deferred until fiscal years beginning after November 15, 2008. The Company has certain non-financial assets, such as long-lived assets, that may be re-measured to fair value on a non-recurring basis. The Company adopted SFAS No. 157 for financial assets and liabilities on January 1, 2008. The Company adopted SFAS No. 157 for its non-financial assets and liabilities on January 1, 2009. The adoption of SFAS No. 157 did not have a material impact on the Company's financial statements.

In February 2007, the Financial Accounting Standards Board issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115 ("SFAS No. 159"). SFAS No. 159 permits entities to elect to measure many financial instruments and certain other items at fair value. Upon adoption of SFAS No. 159, an entity may elect the fair value option for eligible items that exist at the adoption date. Subsequent to the initial adoption, the election of the fair value option should only be made at initial recognition of the asset or liability or upon a remeasurement event that gives rise to new-basis accounting. The decision about whether to elect the fair value option is applied on an instrument-by-instrument basis, is irrevocable and is applied only to an entire instrument and not only to specified risks, cash flows or portion of that instrument. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value nor does it eliminate disclosure requirements included in other accounting standards. The Company adopted SFAS No. 159 on January 1, 2008 and elected not to fair value any items under this statement. The adoption of SFAS No. 159 did not have a material impact on the Company's financial statements.

In December 2007, the Financial Accounting Standards Board issued SFAS No. 141(R), Business Combinations ("SFAS No. 141R"). SFAS No. 141R replaces SFAS No. 141, Business Combinations and applies to all transactions or other events in which an entity obtains control of one or more businesses. SFAS No. 141R requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose additional information needed to evaluate and understand the nature and financial effect of the business combination. SFAS No. 141R is effective prospectively for fiscal years beginning after December 15, 2008 and may not be applied before that date. The Company will apply the guidance of the statement to business combinations completed on or after January 1, 2009.

Financial Statements *(Continued)*

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2009 and 2008

(6) Sale-Leaseback

The Company's principal office is located in a 173,000 square foot, concrete, brick, and steel facility in Easton, Pennsylvania. In connection with the February 2003 sale of the Company's Easton, Pennsylvania facility, the Company entered into a leaseback arrangement for 25,000 square feet of office space for five years. The leasing agreement required fixed monthly rental payments of \$19,345 during the fifth year of the lease, which ran from February 21, 2007 through February 20, 2008. 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.

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 was amortized in equal amounts as a reduction in rent expense over the five-year term of the lease. The amortization of the deferred profit expired during the first quarter of 2008. During the nine months ended September 30, 2009 and 2008, \$0 and \$28,000, respectively, of the deferred gain was recognized.

On November 14, 2007, the Company amended the lease agreement to extend the term of the lease for a period of five years, commencing immediately upon the February 21, 2008 expiration date of the original term of the lease. The amended lease agreement requires fixed monthly rental payments of \$18,000 for five years through the February 20, 2013 expiration date of the lease. The amended lease agreement incorporates the terms and conditions of the original lease agreement.

(7) Line of Credit

On February 19, 2009, the Company established a \$5,000,000 line of credit facility with its principal bank to be used primarily for working capital purposes. Interest on the line of credit facility is at the LIBOR Market Index Rate plus 1.25%. As of September 30, 2009, the Company did not have any borrowings under the line of credit facility; however, the leasing agreement associated with the Company's principal office is secured with a \$200,000 letter of credit. Therefore, as of September 30, 2009, the amount of available line of credit was \$4,800,000.

The line of credit facility contains various non-financial covenants and is secured by all of the Company's accounts receivables and inventory. The Company was in compliance with all covenants as of September 30, 2009. The line of credit facility expires on November 30, 2009. The Company expects to renew the line of credit facility under similar terms and conditions during the fourth quarter of 2009.

Financial Statements (Continued)**Paragon Technologies, Inc.**

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2009 and 2008

(8) Stock Repurchase Program

The following table represents the periodic repurchases of equity securities made by the Company during the three months ended September 30, 2009:

| Issuer Purchases of Equity Securities | | | | | |
|---------------------------------------|------------------------------------|--|--|--|--|
| Fiscal Period | Total Number of Shares Repurchased | Average Price Paid Per Share (Including Brokerage Commissions) | Total Number of Shares Repurchased as Part of a Publicly Announced Program | Approximate Dollar Value of Shares Purchased Under the Program | Approximate Dollar Value of Shares That May Yet Be Purchased Under the Program |
| 07/01/09 – 07/31/09 | - | \$ - | - | \$ - | \$ 2,799,943 |
| 08/01/09 – 08/31/09 | - | \$ - | - | \$ - | \$ 2,799,943 |
| 09/01/09 – 09/30/09 | - | \$ - | - | \$ - | \$ 2,799,943 |
| | - | \$ - | - | \$ - | |

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, 2006, 2007, and 2008 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 \$22,000,000.

There were no stock repurchases during the three months ended September 30, 2009. During the nine months ended September 30, 2009, the Company repurchased 214,419 shares of common stock at a weighted average cost, including brokerage commissions, of \$2.41 per share. Cash expenditures for the stock repurchases for the three and nine months ended September 30, 2009 were \$0 and \$516,725, respectively. From the inception of the Company's stock repurchase program on August 12, 2004 through September 30, 2009, the Company repurchased 2,832,600 shares of common stock at a weighted average cost, including brokerage commissions, of \$6.78 per share. Cash expenditures for the stock repurchases since the inception of the program were \$19,200,057. As of September 30, 2009, \$2,799,943 remained available for repurchases under the stock repurchase program.

Based on market conditions and other factors, additional repurchases may be made from time to time, in compliance with SEC regulations, in the open market or through privately negotiated transactions at the discretion of the Company. There is no expiration date with regards to the stock repurchase program. 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 to additional paid-in capital. All shares of common stock that were repurchased by the Company since the inception of the program were subsequently retired.

Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2009 and 2008

(9) Unearned Support Contract Revenue

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

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

(10) Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with 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 expense associated with stock-based compensation arrangements is a non-cash charge. In the Statements of Cash Flows, stock-based compensation expense is an adjustment to reconcile net income (loss) to net cash provided (used) by operating activities.

1997 Equity Compensation Plan

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

Under the Company's ECP, officers, directors, and employees have been granted options to purchase shares of common stock at the market price at the date of grant. Options vest in four equal annual installments beginning on the first anniversary of the date of grant; thus, at the end of four years, the options are fully exercisable. Vested stock option awards may be exercised through payment of cash, exchange of mature shares, or through a broker. As of September 30, 2009, 5,000 options are outstanding under the plan, and all options have a term of seven years.

Stock-based compensation expense recognized during the three months ended September 30, 2009 and 2008 for stock-based compensation programs was \$4,000 and \$6,000, respectively. Stock-based compensation expense recognized during the three months ended September 30, 2009 and 2008 consisted of expensing \$1,000 and \$1,000, respectively, for employee stock options, and \$3,000 and \$5,000, respectively, for nonvested stock.

Financial Statements *(Continued)*

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2009 and 2008

(10) Stock-Based Compensation *(Continued)*

1997 Equity Compensation Plan *(Continued)*

Stock-based compensation expense recognized during the nine months ended September 30, 2009 and 2008 for stock-based compensation programs was \$12,000 and \$18,000, respectively. Stock-based compensation expense recognized during the nine months ended September 30, 2009 and 2008 consisted of expensing \$3,000 and \$4,000, respectively, for employee stock options, and \$9,000 and \$14,000, respectively, for nonvested stock.

All of the stock-based compensation expense recognized was a component of selling, general and administrative expenses.

Stock Options

There were no stock options exercised, forfeited, or granted during the three and nine months ended September 30, 2009, and no further grants are available under the plan.

As of September 30, 2009, there is unrecognized compensation cost of \$1,000 on the stock option awards which will be recognized over the next five months.

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.

As of September 30, 2009, there is unrecognized compensation cost of \$5,000 on the nonvested stock awards which will be recognized over the next five months.

(11) Income Taxes

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

Valuation allowances are provided to reduce the carrying amounts of deferred tax assets when it is more likely than not that some portion or all of the deferred tax assets will not be realized. When 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 in the appropriate taxing jurisdictions during the periods in which the temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, taxable income in carryback years, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income, during 2008, management concluded that the Company's deferred tax assets are more likely than not to expire before the Company can use them. During the three and nine months ended September 30, 2009, the Company's management concluded that the full valuation allowance for deferred tax assets is appropriate as the facts and circumstances have not changed since the year ended December 31, 2008.

Financial Statements *(Continued)*

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2009 and 2008

(11) Income Taxes *(Continued)*

The Company classifies interest and penalties related to unrecognized tax benefits as a component of income tax expense. To the extent interest and penalties are not assessed with respect to uncertain tax positions, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision. For the three months ended September 30, 2009 and 2008, \$3,000 and \$0, respectively, of expense (benefit) related to interest and penalties was recognized in the statements of operations. For the nine months ended September 30, 2009 and 2008, \$(14,000) and \$3,000, respectively, of expense (benefit) related to interest and penalties was recognized in the statements of operations.

The Company recognized income tax expense of \$6,000 during the three months ended September 30, 2009 compared to income tax expense of \$484,000 during the three months ended September 30, 2008. Income tax expense for the three months ended September 30, 2009 was primarily due to accruals for state income tax matters. Based on the level of historical taxable income, projections for future taxable income, and an increase in the valuation allowance offsetting deferred tax assets, income tax expense for the three months ended September 30, 2009 was lower than statutory federal and state tax rates. Income tax expense for the three months ended September 30, 2008 was higher than statutory federal and state tax rates primarily due to the establishment of a valuation allowance for deferred tax assets, the federal income tax portion of unrecognized tax benefits, and the tax benefits for the current year pre-tax loss, partially offset by a change in unrecognized tax benefits.

The Company recognized an income tax benefit of \$75,000 during the nine months ended September 30, 2009 compared to income tax expense of \$458,000 during the nine months ended September 30, 2008. The income tax benefit for the nine months ended September 30, 2009 was primarily due to the reversal of accruals for the expiration of tax return statutes. Based on the level of historical taxable income, projections for future taxable income, and an increase in the valuation allowance offsetting deferred tax assets, the income tax benefit for the nine months ended September 30, 2009 was lower than statutory federal and state tax rates. Income tax expense for the nine months ended September 30, 2008 was higher than statutory federal and state tax rates primarily due to the establishment of a valuation allowance for deferred tax assets, the federal income tax portion of unrecognized tax benefits, and the tax benefit for the current year pre-tax loss, partially offset by a change in unrecognized tax benefits.

As of September 30, 2009, the Company's net unrecognized tax benefits totaled \$188,000, all of which would impact the effective tax rate if recognized. As of December 31, 2008, the Company's net unrecognized tax benefits totaled \$257,000, all of which would impact the effective tax rate if recognized.

During the three months ended September 30, 2009, the Company accrued additional interest related to unrecognized tax benefits of \$3,000. During the nine months ended September 30, 2009, the Company reduced the amount of accrued interest related to unrecognized tax benefits by \$14,000 due to the expiration of statutes of limitations.

During the three months ended September 30, 2009, the Company increased the total unrecognized tax benefits by \$3,000 due to the accrual of additional interest. During the nine months ended September 30, 2009, the Company decreased the total unrecognized tax benefits by \$69,000 due to the expiration of statutes of limitations.

Financial Statements *(Continued)*

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Nine Months Ended September 30, 2009 and 2008

(11) Income Taxes *(Continued)*

The Company estimates that the total unrecognized tax benefits may decrease by approximately \$2,000 due to the expiration of statutes of limitations prior to September 30, 2010.

The Company is subject to U.S. federal income tax as well as income tax of multiple state and foreign jurisdictions. The Company has substantially concluded all U.S. federal income tax matters for years through 2005. The Company has operations in approximately 30 state and foreign taxing jurisdictions. The Company has substantially concluded state income tax matters for years through 2003.

(12) Legal Proceedings

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

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the unaudited financial statements and related notes thereto included in this Quarterly Report for the period ended September 30, 2009, and the cautionary statements and financial statements and related notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. The discussion and analysis contains "forward-looking statements" based on management's current expectations, assumptions, estimates, and projections. These forward-looking statements involve risks and uncertainties. The Company's actual results could differ materially from those included in these "forward-looking statements" as a result of risks and uncertainties identified in connection with those forward-looking statements, including those factors identified herein, and in the Company's other publicly filed reports.

Business Overview

Paragon Technologies, Inc. provides a variety of material handling solutions, including systems, technologies, products, and services for material flow applications. Founded in 1958, the Company's material handling solutions are based on core technologies in horizontal transportation and order fulfillment and are aimed at improving productivity for manufacturing, assembly, and distribution center operations.

(a) Results of Operations – Nine Months Ended September 30, 2009 Compared to the Nine Months Ended September 30, 2008

Earnings Summary

The Company had a net loss of \$999,000 (or \$0.61 basic loss per share) for the nine months ended September 30, 2009, compared to a net loss of \$604,000 (or \$0.23 basic loss per share) for the nine months ended September 30, 2008. The increase in the net loss was primarily due to:

- a decrease during the first nine months of 2009 in sales and gross profit of \$5,922,000 and \$1,923,000, respectively, as described below; and
- a decrease of \$186,000 in interest income attributable to the lower level of funds available for investment as the Company liquidated a portion of its short-term investments to fund the Company's stock repurchase activities and the reduced level of interest rates earned on funds available for investment.

Partially offsetting the above increase in the net loss was:

- a decrease in selling, general and administrative expenses of \$1,198,000 as described below; and
- an increase in the income tax benefit of \$533,000 as described below.

Net Sales and Gross Profit on Sales

| | 2009 | 2008 |
|--|--------------|------------|
| Net sales..... | \$ 6,961,000 | 12,883,000 |
| Cost of sales..... | 5,218,000 | 9,217,000 |
| Gross profit on sales..... | \$ 1,743,000 | 3,666,000 |
| Gross profit as a percentage of sales..... | 25.0% | 28.5% |

Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

(a) Results of Operations – Nine Months Ended September 30, 2009 Compared to the Nine Months Ended September 30, 2008 *(Continued)*

Net Sales and Gross Profit on Sales *(Continued)*

The decrease in sales was associated with a smaller backlog of orders entering fiscal 2009 when compared to the backlog of orders entering fiscal 2008 and a smaller amount of orders received during the first nine months of 2009 when compared to the amount of orders received during the first nine months of 2008.

Gross profit, as a percentage of sales, for the nine months ended September 30, 2009, when compared to the nine months ended September 30, 2008, was favorably impacted by 0.4% due to product mix, and unfavorably impacted by 3.9% due to the reduced absorption of overhead costs.

Selling, General and Administrative Expenses

Selling, general and administrative expenses of \$2,794,000 were lower by \$1,198,000 for the nine months ended September 30, 2009 than for the nine months ended September 30, 2008. The favorable variance in selling, general and administrative expenses was primarily attributable to a decrease of \$706,000 in salaries and fringe benefits, a decrease of \$111,000 in commission expenses related to the reduction in sales, a decrease of \$285,000 in marketing expenses primarily associated with product promotion and trade shows, and a decrease of \$92,000 in professional fees and consulting expenses. Also contributing to the reduction in selling, general and administrative expenses was \$105,000 of provision related to the allowance for doubtful accounts associated with uncollectible receivables that was recognized during the third quarter of the prior fiscal year. Partially offsetting the aforementioned favorable variance was \$115,000 of severance costs pertaining to a reduction of employees due to the economic slowdown.

Product Development Costs

Product development costs, including patent expense, of \$114,000 were higher by \$5,000 for the nine months ended September 30, 2009 than for the nine months ended September 30, 2008. Development programs in the nine months ended September 30, 2009 and 2008 were primarily aimed at improvements to the Company's Order Fulfillment systems technologies. Order Fulfillment development efforts during the nine months ended September 30, 2009 included DISPEN-SI-MATIC[®] hardware and software enhancements aimed at promoting workplace efficiencies for the Company's customers. Order Fulfillment development efforts during the nine months ended September 30, 2008 included voice-directed replenishment and DISPEN-SI-MATIC[®] software enhancements aimed at promoting workplace efficiencies for the Company's customers.

Interest Income

Interest income of \$103,000 was lower by \$186,000 for the nine months ended September 30, 2009 than for the nine months ended September 30, 2008. The decrease in interest income was attributable to the lower level of funds available for investment as the Company liquidated a portion of its short-term investments to fund the Company's stock repurchase activities and the reduced level of interest rates earned on funds available for investment.

Income Tax Expense (Benefit)

The Company recognized an income tax benefit of \$75,000 during the nine months ended September 30, 2009 compared to income tax expense of \$458,000 during the nine months ended September 30, 2008. The income tax benefit for the nine months ended September 30, 2009 was primarily due to the reversal of accruals for the expiration of tax return statutes. Based on the level of historical taxable income, projections for future

Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

(a) Results of Operations – Nine Months Ended September 30, 2009 Compared to the Nine Months Ended September 30, 2008 *(Continued)*

Income Tax Expense (Benefit) *(Continued)*

taxable income, and an increase in the valuation allowance offsetting deferred tax assets, the income tax benefit for the nine months ended September 30, 2009 was lower than statutory federal and state tax rates. Income tax expense for the nine months ended September 30, 2008 was higher than statutory federal and state tax rates primarily due to the establishment of a valuation allowance for deferred tax assets, the federal income tax portion of unrecognized tax benefits, and the tax benefit for the current year pre-tax loss, partially offset by a change in unrecognized tax benefits.

(b) Results of Operations – Three Months Ended September 30, 2009 Compared to the Three Months Ended September 30, 2008

Earnings Summary

The Company had net income of \$55,000 (or \$0.03 basic earnings per share) for the three months ended September 30, 2009, compared to a net loss of \$601,000 (or \$0.24 basic loss per share) for the three months ended September 30, 2008. The increase in net income was primarily due to:

- a decrease in selling, general and administrative expenses of \$575,000 as described below; and
- a decrease in income tax expense of \$478,000 as described below.

Partially offsetting the above increase in net income was:

- a decrease during the third quarter of 2009 in sales and gross profit of \$567,000 and \$311,000, respectively, as described below;
- a decrease of \$44,000 in interest income attributable to the lower level of funds available for investment as the Company liquidated a portion of its short-term investments to fund the Company's stock repurchase activities and the reduced level of interest rates earned on funds available for investment; and
- an increase in product development costs of \$40,000 as described below.

Net Sales and Gross Profit on Sales

| | <u>2009</u> | <u>2008</u> |
|--|-------------------|------------------|
| Net sales..... | \$ 3,148,000 | 3,715,000 |
| Cost of sales..... | 2,284,000 | 2,540,000 |
| Gross profit on sales..... | <u>\$ 864,000</u> | <u>1,175,000</u> |
| Gross profit as a percentage of sales..... | <u>27.4%</u> | <u>31.6%</u> |

The decrease in sales was associated with a smaller backlog of orders entering fiscal 2009 when compared to the backlog of orders entering fiscal 2008 and a smaller amount of orders received during the first nine months of 2009 when compared to the amount of orders received during the first nine months of 2008.

Gross profit, as a percentage of sales, for the three months ended September 30, 2009, when compared to the three months ended September 30, 2008, was unfavorably impacted by 9.4% due to product mix, and favorably impacted by 5.2% due to the increased absorption of overhead costs.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

(b) Results of Operations – Three Months Ended September 30, 2009 Compared to the Three Months Ended September 30, 2008 *(Continued)*

Selling, General and Administrative Expenses

Selling, general and administrative expenses of \$788,000 were lower by \$575,000 for the three months ended September 30, 2009 than for the three months ended September 30, 2008. The favorable variance in selling, general and administrative expenses was primarily attributable to a decrease of \$351,000 in salaries and fringe benefits, a decrease of \$59,000 in marketing expenses primarily associated with product promotion and trade shows, and a decrease of \$29,000 in professional fees and consulting expenses. Also contributing to the reduction in selling, general and administrative expenses was \$105,000 of provision related to the allowance for doubtful accounts associated with uncollectible receivables that was recognized during the third quarter of the prior fiscal year.

Product Development Costs

Product development costs, including patent expense, of \$43,000 was higher by \$40,000 for the three months ended September 30, 2009 than for the three months ended September 30, 2008. Development programs in the three months ended September 30, 2009 and 2008 were primarily aimed at improvements to the Company's Order Fulfillment systems technologies. Order Fulfillment development efforts during the three months ended September 30, 2009 included DISPEN-SI-MATIC[®] hardware and software enhancements aimed at promoting workplace efficiencies for the Company's customers. Order Fulfillment development efforts during the three months ended September 30, 2008 included DISPEN-SI-MATIC[®] software enhancements aimed at promoting workplace efficiencies for the Company's customers.

Interest Income

Interest income of \$31,000 was lower by \$44,000 for the three months ended September 30, 2009 than for the three months ended September 30, 2008. The decrease in interest income was attributable to the lower level of funds available for investment as the Company liquidated a portion of its short-term investments to fund the Company's stock repurchase activities and the reduced level of interest rates earned on funds available for investment.

Income Tax Expense (Benefit)

The Company recognized income tax expense of \$6,000 during the three months ended September 30, 2009 compared to income tax expense of \$484,000 during the three months ended September 30, 2008. Income tax expense for the three months ended September 30, 2009 was primarily due to accruals for state income tax matters. Based on the level of historical taxable income, projections for future taxable income, and an increase in the valuation allowance offsetting deferred tax assets, income tax expense for the three months ended September 30, 2009 was lower than statutory federal and state tax rates. Income tax expense for the three months ended September 30, 2008 was higher than statutory federal and state tax rates primarily due to the establishment of a valuation allowance for deferred tax assets, the federal income tax portion of unrecognized tax benefits, and the tax benefits for the current year pre-tax loss, partially offset by a change in unrecognized tax benefits.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

Liquidity and Capital Resources

The Company's cash and cash equivalents at September 30, 2009 were \$6,094,000, representing 64.9% of total assets, compared to \$5,615,000, or 52.9% of total assets, at December 31, 2008. The increase was primarily due to cash provided by operating activities totaling \$996,000, partially offset by the repurchase and retirement of common stock totaling \$517,000.

Cash provided by operating activities totaling \$996,000 during the nine months ended September 30, 2009 was primarily due to the following factors:

- a decrease in receivables in the amount of \$982,000 in accordance with contractual requirements;
- a decrease in costs and estimated earnings in excess of billings in the amount of \$744,000 in accordance with contractual requirements;
- an increase in accounts payable in the amount of \$378,000 associated with the purchase of goods and services rendered in accordance with job completion requirements; and
- an increase in customers' deposits and billings in excess of costs and estimated earnings in the amount of \$161,000 in accordance with contractual requirements.

Partially offset by the following factors:

- a net loss in the amount of \$999,000 for the first nine months of 2009;
- an increase in prepaid expenses and other current assets in the amount of \$97,000 primarily associated with payment of insurance premiums for the current year; and
- a decrease in unearned support contract revenue in the amount of \$183,000 relating to the recognition of revenue on support contracts on the straight-line basis.

The Company's cash and cash equivalents and short-term investments at September 30, 2008 were \$8,854,000, representing 69.0% of total assets, compared to \$12,304,000, or 67.2% of total assets, at December 31, 2007. The decrease was primarily due to the repurchase and retirement of common stock totaling \$2,665,000, purchases of capital equipment totaling \$103,000, and cash used by operating activities totaling \$682,000.

Cash used by operating activities totaling \$682,000 during the nine months ended September 30, 2008 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 \$1,974,000 in accordance with contractual requirements; and
- a decrease in accounts payable in the amount of \$537,000 associated with payments for purchases of sales and services rendered in accordance with job completion requirements.

Partially offset by the following factors:

- a decrease in receivables, net of the allowance for doubtful accounts, in the amount of \$882,000 in accordance with contractual requirements;
- a decrease in costs and estimated earnings in excess of billings in the amount of \$741,000 in accordance with contractual requirements; and
- an increase in accrued product warranties in the amount of \$213,000 primarily associated with the establishment of warranties for contracts entering the warranty period.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

Liquidity and Capital Resources *(Continued)*

The Company repurchased \$517,000 of its common stock during the nine months ended September 30, 2009 compared with \$2,665,000 of stock repurchases during the nine months ended September 30, 2008. As of September 30, 2009, the Company has \$2,799,943 authorized by the Board of Directors to use for future stock repurchases.

On February 19, 2009, the Company established a \$5,000,000 line of credit facility with its principal bank to be used primarily for working capital purposes. Interest on the line of credit facility is at the LIBOR Market Index Rate plus 1.25%. As of September 30, 2009, the Company did not have any borrowings under the line of credit facility; however, the leasing agreement associated with the Company's principal office is secured with a \$200,000 letter of credit. Therefore, as of September 30, 2009, the amount of available line of credit was \$4,800,000.

The line of credit facility contains various non-financial covenants and is secured by all of the Company's accounts receivables and inventory. The Company was in compliance with all covenants as of September 30, 2009. The line of credit facility expires on November 30, 2009. The Company expects to renew the line of credit facility under similar terms and conditions during the fourth quarter of 2009.

The Company anticipates that its financial resources, consisting of cash and cash equivalents 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 continues to review opportunities with the goal of maximizing resources, increasing stockholder value, and pursuing strategic alternatives. 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 strategic alternatives.

Contractual Obligations

The Company leases approximately 25,000 square feet in Easton, Pennsylvania for use as its principal office. The leasing agreement, as amended, requires fixed monthly rental payments of \$18,000. 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 20, 2013.

During the third quarter of 2008, the Company issued a \$638,000 letter of credit in the ordinary course of business to secure cash received from a customer in connection with the sale of an automated material handling system. During the first quarter of 2009, the Company delivered the material handling system to the customer and, in accordance with the terms of the letter of credit, the amount of the letter of credit was reduced to \$64,000. The letter of credit expired on April 15, 2009. There was no claim under the letter of credit during its existence.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

Contractual Obligations *(Continued)*

Future contractual obligations and commercial commitments at September 30, 2009 as noted above are as follows:

| | Total | Payments Due by Period | | | | | After 2013 |
|-------------------------------|-------------------------|--|---------|---------|---------|--------|------------|
| | | 2009 | 2010 | 2011 | 2012 | 2013 | |
| Contractual obligations: | | | | | | | |
| Operating leases | \$ 738,000 | 54,000 | 216,000 | 216,000 | 216,000 | 36,000 | - |
| | Total Amounts Committed | Amount of Commitment Expiration Per Period | | | | | |
| | | 2009 | 2010 | 2011 | 2012 | 2013 | After 2013 |
| Other commercial commitments: | | | | | | | |
| Letters of credit | \$ 200,000 | - | 200,000 | - | - | - | - |

As of September 30, 2009, the Company has unrecognized tax benefits of \$188,000. The timing of cash settlement cannot be reasonably estimated.

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 the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

Off-Balance Sheet Arrangements

As of September 30, 2009, 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 8 of the Notes to Financial Statements of the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

Recently Issued Accounting Pronouncements

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. SFAS No. 157's fair value measurement requirements for non-financial assets and liabilities that are not required or permitted to be measured at fair value on a recurring basis have been deferred until fiscal years beginning after November 15, 2008. The Company has certain non-financial assets, such as long-lived assets, that may be re-measured to fair value on a non-recurring basis. The Company adopted SFAS No. 157 for financial assets and liabilities on January 1, 2008. The Company adopted SFAS No. 157 for its non-financial assets and liabilities on January 1, 2009. The adoption of SFAS No. 157 did not have a material impact on the Company's financial statements.

In February 2007, the Financial Accounting Standards Board issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115 ("SFAS No. 159"). SFAS No. 159 permits entities to elect to measure many financial instruments and certain other items at fair value. Upon adoption of SFAS No. 159, an entity may elect the fair value option for eligible items that exist at the adoption date. Subsequent to the initial adoption, the election of the fair value option should only be made at initial recognition of the asset or liability or upon a remeasurement event that gives rise to new-basis accounting. The decision about whether to elect the fair value option is applied on an instrument-by-instrument basis, is irrevocable and is applied only to an entire instrument and not only to specified risks, cash flows or portion of that instrument. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value nor does it eliminate disclosure requirements included in other accounting standards. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company adopted SFAS No. 159 on January 1, 2008 and elected not to fair value any items under this statement. The adoption of SFAS No. 159 did not have a material impact on the Company's financial statements.

In December 2007, the Financial Accounting Standards Board issued SFAS No. 141(R), Business Combinations ("SFAS No. 141R"). SFAS No. 141R replaces SFAS No. 141, Business Combinations and applies to all transactions or other events in which an entity obtains control of one or more businesses. SFAS No. 141R requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose additional information needed to evaluate and understand the nature and financial effect of the business combination. SFAS No. 141R is effective prospectively for fiscal years beginning after December 15, 2008 and may not be applied before that date. The Company will apply the guidance of the statement to business combinations completed on or after January 1, 2009.

Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

Cautionary Statement

Certain statements contained herein are not based on historical fact and are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 and the Securities and Exchange Commission rules, regulations, and releases. The Company intends that such forward-looking statements be subject to the safe harbors created thereby. Among other things, the forward-looking statements regard the Company's earnings, liquidity, financial condition, review of strategic alternatives, and other matters. Words or phrases denoting the anticipated results of future events, such as "anticipate," "does not anticipate," "should help to," "believe," "estimate," "is positioned," "expects," "may," "will," "will likely," "is expected to," "will continue," "should," "project," and similar expressions that denote uncertainty, are intended to identify such forward-looking statements. The Company's actual results, performance, or achievements could differ materially from the results expressed in, or implied by, such "forward-looking statements": (1) as a result of risks and uncertainties identified in connection with those forward-looking statements, including those factors identified herein, and in the Company's other publicly filed reports; (2) as a result of factors over which the Company has no control, including the strength of domestic and foreign economies, sales growth, competition, and certain costs increases; or (3) if the factors on which the Company's conclusions are based do not conform to the Company's expectations.

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.
