



QUARTERLY REPORT
FOR THE PERIOD ENDED
June 30, 2010

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

1,554,310 Shares Issued and Outstanding

PARAGON TECHNOLOGIES, INC.

Quarterly Report

For The Period Ended June 30, 2010

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 June 30, 2010, there were 1,554,310 shares of the Company's Common Stock issued and outstanding. As of the filing of this Quarterly Report, there were 1,554,310 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 June 30, 2010 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 June 30, 2010 is attached hereto.

Item 5. Legal proceedings:

None for the period ended June 30, 2010 and through the date of this report.

Item 6. Default upon senior securities:

None for the period ended June 30, 2010 and through the date of this report.

PARAGON TECHNOLOGIES, INC.
Quarterly Report
For The Period Ended June 30, 2010 (*Continued*)

Item 7. Other information:

- a. Entry into a material definitive agreement:**
None for the period ended June 30, 2010 and through the date of this report.
- b. Termination of a material definitive agreement:**
None for the period ended June 30, 2010 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 June 30, 2010 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 June 30, 2010 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 June 30, 2010 and through the date of this report.
- f. Costs associated with exit or disposal activities:**
None for the period ended June 30, 2010 and through the date of this report.
- g. Material impairments:**
None for the period ended June 30, 2010 and through the date of this report.
- h. Sales of equity securities:**
None for the period ended June 30, 2010 and through the date of this report.
- i. Material modification to rights of security holders:**
None for the period ended June 30, 2010 and through the date of this report.
- j. Changes in issuer's certifying accountant:**
None for the period ended June 30, 2010 and through the date of this report.

PARAGON TECHNOLOGIES, INC.
Quarterly Report
For The Period Ended June 30, 2010 *(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 June 30, 2010 and through the date of this report.

l. Changes in control of issuer:

None for the period ended June 30, 2010 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 June 30, 2010 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 June 30, 2010 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 June 30, 2010 and through the date of this report.

Item 8. Exhibits:

None for the period ended June 30, 2010 and through the date of this report.

PARAGON TECHNOLOGIES, INC.
Quarterly Report
For The Period Ended June 30, 2010 (*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 June 30, 2010 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.

July 30, 2010

/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 June 30, 2010 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.

July 30, 2010

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

FINANCIAL INFORMATION

Financial Statements

Paragon Technologies, Inc.

Balance Sheets (Unaudited)

June 30, 2010 and December 31, 2009

(In Thousands, Except Share Data)

	June 30, 2010	December 31, 2009
<u>Assets</u>		
Current assets:		
Cash and cash equivalents.....	\$ 5,407	6,198
Receivables:		
Trade	746	876
Other receivables	31	457
Total receivables	<u>777</u>	<u>1,333</u>
Costs and estimated earnings in excess of billings.....	1	11
Inventories:		
Raw materials	161	151
Work-in-process	165	5
Finished goods	322	408
Total inventories	<u>648</u>	<u>564</u>
Prepaid expenses and other current assets	187	110
Total current assets.....	<u>7,020</u>	<u>8,216</u>
Machinery and equipment, at cost:		
Machinery and equipment	1,261	1,338
Less: accumulated depreciation	<u>1,083</u>	<u>1,141</u>
Net machinery and equipment.....	<u>178</u>	<u>197</u>
Total assets.....	<u>\$ 7,198</u>	<u>8,413</u>

See accompanying notes to financial statements.

(Continued)

Financial Statements (Continued)
Paragon Technologies, Inc.
Balance Sheets (Unaudited) (Continued)
June 30, 2010 and December 31, 2009
(In Thousands, Except Share Data)

	June 30, 2010	December 31, 2009
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable.....	\$ 762	732
Customers' deposits and billings in excess of costs and estimated earnings	389	630
Accrued salaries, wages, and commissions.....	112	154
Accrued product warranties	102	130
Unearned support contract revenue	259	344
Accrued other liabilities.....	242	279
Total current liabilities.....	<u>1,866</u>	<u>2,269</u>
Long-term liabilities:		
Income taxes payable	189	185
Total long-term liabilities.....	<u>189</u>	<u>185</u>
Commitments and contingencies (See Note 11)		
Stockholders' equity:		
Common stock, \$1 par value; authorized 20,000,000 shares; issued and outstanding 1,554,310 shares as of June 30, 2010 and 1,564,310 shares as of December 31, 2009	1,554	1,564
Additional paid-in capital.....	3,281	3,293
Retained earnings	308	1,102
Total stockholders' equity.....	<u>5,143</u>	<u>5,959</u>
Total liabilities and stockholders' equity	<u>\$ 7,198</u>	<u>8,413</u>

See accompanying notes to financial statements.

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

Statements of Operations (Unaudited)

For the Three and Six Months Ended June 30, 2010 and 2009

(In Thousands, Except Share and Per Share Data)

	Three Months Ended		Six Months Ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
Net sales	\$ 1,761	1,895	3,428	3,813
Cost of sales	1,336	1,528	2,611	2,934
Gross profit on sales	<u>425</u>	<u>367</u>	<u>817</u>	<u>879</u>
Selling, general and administrative expenses	805	875	1,534	2,006
Product development costs.....	54	44	81	71
Interest income.....	(15)	(33)	(31)	(72)
Other expense, net.....	8	2	13	9
	<u>852</u>	<u>888</u>	<u>1,597</u>	<u>2,014</u>
Loss before income taxes	(427)	(521)	(780)	(1,135)
Income tax expense (benefit).....	10	(78)	14	(81)
Net loss	<u>\$ (437)</u>	<u>(443)</u>	<u>(794)</u>	<u>(1,054)</u>
Basic and diluted loss per share	<u>\$ (.28)</u>	<u>(.28)</u>	<u>(.51)</u>	<u>(.64)</u>
Weighted average basic and diluted shares outstanding	<u>1,554,310</u>	<u>1,610,361</u>	<u>1,555,738</u>	<u>1,657,800</u>

See accompanying notes to financial statements.

Financial Statements *(Continued)*
Paragon Technologies, Inc.
 Statements of Cash Flows (Unaudited)
 For the Six Months Ended June 30, 2010 and 2009
(In Thousands)

	Six Months Ended	
	June 30, 2010	June 30, 2009
Cash flows from operating activities:		
Net loss	\$ (794)	(1,054)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Depreciation of machinery and equipment....	40	49
Stock-based compensation	-	8
Change in operating assets and liabilities:		
Receivables	556	1,808
Costs and estimated earnings in excess of billings	10	827
Inventories	(84)	(168)
Prepaid expenses and other current assets	(77)	(148)
Accounts payable	30	(588)
Customers' deposits and billings in excess of costs and estimated earnings.....	(241)	487
Accrued salaries, wages, and commissions.....	(42)	(44)
Income taxes payable	4	(72)
Accrued product warranties	(28)	(40)
Unearned support contract revenue	(85)	(114)
Accrued other liabilities.....	(37)	(79)
Net cash provided (used) by operating activities.	<u>(748)</u>	<u>872</u>
Cash flows from investing activities:		
Purchases of machinery and equipment	<u>(21)</u>	<u>-</u>
Net cash used by investing activities	<u>(21)</u>	<u>-</u>

See accompanying notes to financial statements.

(Continued)

Financial Statements *(Continued)*
Paragon Technologies, Inc.
 Statements of Cash Flows (Unaudited) *(Continued)*
 For the Six Months Ended June 30, 2010 and 2009
(In Thousands)

	Six Months Ended	
	June 30, 2010	June 30, 2009
Cash flows from financing activities:		
Repurchase and retirement of common stock.....	(22)	(517)
Net cash used by financing activities	<u>(22)</u>	<u>(517)</u>
Increase (decrease) in cash and cash equivalents.....	(791)	355
Cash and cash equivalents, beginning of period	6,198	5,615
Cash and cash equivalents, end of period	<u>\$ 5,407</u>	<u>5,970</u>
Supplemental disclosures of cash flow information:		
Cash paid (received) during the period for:		
Interest expense.....	\$ -	-
Income taxes.....	<u>\$ (401)</u>	<u>(147)</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, 2008 and 2009, and for the

Six Months Ended June 30, 2010

(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, 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	
Repurchase 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.....	-	-	-	(531)	(531)	(531)
Comprehensive loss.....	-	-	-	-	-	(531)
Amortization of nonvested stock grants.....	-	-	15	-	15	
Repurchase and retirement of common stock.....	(221,919)	(222)	(312)	-	(534)	
Other incentive plan activity	-	-	4	-	4	
Balance at December 31, 2009	1,564,310	1,564	3,293	1,102	5,959	
Net loss.....	-	-	-	(794)	(794)	(794)
Comprehensive loss.....	-	-	-	-	-	(794)
Repurchase and retirement of common stock.....	(10,000)	(10)	(12)	-	(22)	
Balance at June 30, 2010	1,554,310	\$ 1,554	3,281	308	5,143	

See accompanying notes to financial statements.

Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2010 and 2009

(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 for the year ended December 31, 2009 as filed with the Pink Sheets on March 18, 2010. Refer to the Company's Annual Report for the year ended December 31, 2009 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) 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) Included in		Ending Balance June 30
		Costs and Expenses	Claims	
2010	\$ 130	47	(75)	102
2009	\$ 395	(35)	(5)	355

(3) 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

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2010 and 2009

(3) Business Operations (Continued)

Company Overview (Continued)

conveyor systems, and aftermarket services. The Company is a Delaware corporation, incorporated on November 21, 2001. The Company was originally incorporated in Pennsylvania on June 18, 1958. The Company changed its state of incorporation from Pennsylvania to Delaware on November 21, 2001.

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 DISPENSIMATIC[®] 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 LO-TOW[®], CARTRAC[®], and Simon[™] 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 Six Months Ended June 30, 2010 and 2009

(4) Recently Issued Accounting Pronouncements

Fair Value Measurements

In September 2006, the Financial Accounting Standards Board (“FASB”) issued authoritative guidance that defines fair value, establishes a market-based framework or hierarchy for measuring fair value, and expands disclosures about fair value measurements, which is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. Effective January 1, 2008, the Company adopted this guidance for financial assets and liabilities and other assets and liabilities that are recognized and disclosed at fair value on a recurring basis. Effective January 1, 2009, the Company adopted this guidance for nonfinancial assets and liabilities. The adoption of this guidance did not impact the Company’s financial statements.

Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued authoritative guidance that permits companies to elect to measure certain financial instruments at fair value on an instrument-by-instrument basis, with changes in fair value recognized in earnings each reporting period. It also establishes financial statement presentation and disclosure requirements for assets and liabilities reported at fair value under the election. The Company adopted this guidance on January 1, 2009 and elected not to fair value any items under this guidance.

Business Combinations

In December 2007, FASB issued authoritative guidance to affirm that the acquisition method of accounting (previously referred to the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This guidance 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. The Company adopted this guidance on January 1, 2009 and it will be applied prospectively to any business combination on or after January 1, 2009.

The FASB Accounting Standards Codification

In June 2009, the FASB issued authoritative guidance that establishes the Accounting Standards Codification (Codification) as the source of authoritative U.S. generally accepted accounting principles (GAAP). The Codification is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Codification does not change current U.S. GAAP but reorganizes all authoritative literature in one place. On December 31, 2009, the Company adopted the Codification and changed the way it references U.S. GAAP. Accordingly, the Company’s Notes to Financial Statements will explain accounting concepts rather than cite the topics of specific U.S. GAAP. There was no impact on the Company’s financial statements.

Disclosures about Subsequent Events

In May 2009, the FASB established the authoritative guidance on accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. Entities are also required to disclose the date through which subsequent events have been evaluated. The Company adopted this guidance beginning in the fourth quarter of 2009. Adoption of this guidance did not have a material impact on the Company’s financial statements. Subsequent events have been evaluated through July 30, 2010.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2010 and 2009

(5) Sale-Leaseback

The Company's principal office is located in Easton, Pennsylvania. In connection with the February 21, 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.

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.

(6) 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 June 30, 2010, 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 June 30, 2010, the amount available under the 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 June 30, 2010. The line of credit expires on November 30, 2010.

(7) Stock Repurchase Program

The following table represents the periodic repurchases of equity securities made by the Company during the three months ended June 30, 2010:

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
04/01/10 – 04/30/10	-	\$ -	-	\$ -	\$ 2,760,806
05/01/10 – 05/31/10	-	\$ -	-	\$ -	\$ 2,760,806
06/01/10 – 06/30/10	-	\$ -	-	\$ -	\$ 2,760,806
	-	\$ -	-	\$ -	

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2010 and 2009

(7) Stock Repurchase Program (Continued)

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 June 30, 2010. During the six months ended June 30, 2010, the Company repurchased 10,000 shares of common stock at a weighted average cost, including brokerage commissions, of \$2.23 per share. Cash expenditures for the stock repurchases for the three and six months ended June 30, 2010 were \$0 and \$22,256, respectively.

From the inception of the Company's stock repurchase program on August 12, 2004 through June 30, 2010, the Company repurchased 2,850,100 shares of common stock at a weighted average cost, including brokerage commissions, of \$6.75 per share. Cash expenditures for the stock repurchases since the inception of the program were \$19,239,194. As of June 30, 2010, \$2,760,806 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 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.

(8) 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.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2010 and 2009

(9) Stock-Based Compensation (Continued)

The Company accounts for stock-based compensation in accordance with FASB authoritative guidance that 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.

1997 Equity Compensation 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 June 30, 2010, 5,000 options are outstanding under the plan, and all options have a term of seven years. The exercise price of the options outstanding under the plan is \$10.01.

Stock-based compensation expense recognized during the three months ended June 30, 2010 and 2009 for stock-based compensation programs was \$0 and \$4,000, respectively. Stock-based compensation expense recognized during the three months ended June 30, 2010 and 2009 consisted of expensing \$0 and \$1,000, respectively, for employee stock options, and \$0 and \$3,000, respectively, for nonvested stock.

Stock-based compensation expense recognized during the six months ended June 30, 2010 and 2009 for stock-based compensation programs was \$0 and \$8,000, respectively. Stock-based compensation expense recognized during the six months ended June 30, 2010 and 2009 consisted of expensing \$0 and \$2,000, respectively, for employee stock options, and \$0 and \$6,000, respectively, for nonvested stock.

On December 16, 2009, with the approval of the Compensation Committee, the Board of Directors accelerated the vesting of the 5,000 shares of nonvested stock and 5,000 stock options from the original date of full vesting of March 8, 2010 to December 16, 2009. All of the unrecognized compensation cost associated with the acceleration of vesting of the nonvested stock and stock options was recognized during the fourth quarter of 2009. There is no further compensation cost to be recognized on nonvested stock and stock options. The closing market price of the Company's common stock on December 16, 2009 was \$2.30.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2010 and 2009

(9) Stock-Based Compensation (Continued)

1997 Equity Compensation Plan (Continued)

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 six months ended June 30, 2010, and no further grants are available under the plan.

As of June 30, 2010, there is no further compensation cost to be recognized on the stock option awards.

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 June 30, 2010, there are no nonvested shares outstanding under the plan.

Also, as of June 30, 2010, there is no further compensation cost to be recognized on the nonvested stock awards.

(10) 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 amount 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 six months ended June 30, 2010, the Company's management concluded that the full valuation allowance for deferred tax assets is appropriate as the facts and circumstances have not changed the conclusion that a full valuation allowance is necessary.

Financial Statements *(Continued)*

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2010 and 2009

(10) Income Taxes *(Continued)*

The valuation allowance of \$406,000 as of June 30, 2010 was primarily related to \$348,000 of deferred tax assets and \$58,000 of the federal income tax effect of state unrecognized tax benefits. The valuation allowance for deferred tax assets primarily relates to inventory, warranty, net operating loss carryforwards, and other temporary differences.

The valuation allowance of \$393,000 as of December 31, 2009 was primarily related to \$337,000 of deferred tax assets and \$56,000 of the federal income tax effect of state unrecognized tax benefits. The valuation allowance for deferred tax assets primarily relates to inventory, warranty, net operating loss carryforwards, and other temporary differences.

Effective January 1, 2007, the Company adopted the FASB authoritative guidance on the accounting for uncertainty in income taxes. Based on this guidance, a tax benefit for an uncertain tax position is recognized when it is more likely than not that the position will be sustained upon examination based on its technical merits. This position also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure.

As of June 30, 2010, the Company's unrecognized tax benefits totaled \$189,000, all of which would impact the effective tax rate if recognized. As of December 31, 2009, the Company's unrecognized tax benefits totaled \$185,000, all of which would impact the effective tax rate if recognized.

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 June 30, 2010 and 2009, \$2,000 and \$(20,000), respectively, of expense (benefit) related to interest and penalties, net of federal benefit, was recognized in the statements of operations. For the six months ended June 30, 2010 and 2009, \$4,000 and \$(17,000), respectively, of expense (benefit) related to interest and penalties, net of federal benefit, was recognized in the statements of operations.

During the three and six months ended June 30, 2010, the Company increased the total unrecognized tax benefits by \$2,000 and \$4,000, respectively, due to the accrual of additional interest. During the three and six months ended June 30, 2009, the Company decreased the total unrecognized tax benefits by \$75,000 and \$72,000, respectively, due to the expiration of statutes of limitations.

The Company estimates that the total unrecognized tax benefits may decrease by \$189,000 due to the expiration of statutes of limitations prior to December 31, 2010.

The Company recognized income tax expense of \$10,000 during the three months ended June 30, 2010 compared to the recognition of an income tax benefit of \$78,000 during the three months ended June 30, 2009. Income tax expense for the three months ended June 30, 2010 was primarily related to accruals for state income tax matters. There was no income tax benefit recognized for the loss for the three months ended June 30, 2010 as a result of the valuation allowance offsetting deferred tax assets. The income tax benefit for the three months ended June 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 three months ended June 30, 2009 was lower than statutory federal and state tax rates.

Financial Statements *(Continued)*

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2010 and 2009

(10) Income Taxes *(Continued)*

The Company recognized income tax expense of \$14,000 during the six months ended June 30, 2010 compared to the recognition of an income tax benefit of \$81,000 during the six months ended June 30, 2009. Income tax expense for the six months ended June 30, 2010 was primarily related to accruals for state income tax matters. There was no income tax benefit recognized for the loss for the six months ended June 30, 2010 as a result of the valuation allowance offsetting deferred tax assets. The income tax benefit for the six months ended June 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 six months ended June 30, 2009 was lower than statutory federal and state tax rates.

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 files tax returns in approximately 30 state taxing jurisdictions. The Company has substantially concluded state income tax matters for years through 2003.

(11) 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 June 30, 2010, and the cautionary statements and financial statements and related notes thereto included in the Company's Annual Report for the year ended December 31, 2009. 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.

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

(a) Results of Operations – Six Months Ended June 30, 2010 Compared to the Six Months Ended June 30, 2009

Earnings Summary

The Company had a net loss of \$794,000 (or \$0.51 basic loss per share) for the six months ended June 30, 2010, compared to a net loss of \$1,054,000 (or \$0.64 basic loss per share) for the six months ended June 30, 2009. The decrease in the net loss was primarily due to:

- a decrease in selling, general and administrative expenses of \$472,000 as described below.

Partially offsetting the above decrease in the net loss was:

- a decrease during the first half of 2010 in sales and gross profit of \$385,000 and \$62,000, respectively, as described below;
- an increase in product development costs of \$10,000 as described below;
- a decrease of \$41,000 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 income tax expense of \$95,000 as described below.

Net Sales and Gross Profit on Sales

	<u>2010</u>	<u>2009</u>
Net sales.....	\$ 3,428,000	3,813,000
Cost of sales.....	2,611,000	2,934,000
Gross profit on sales.....	<u>\$ 817,000</u>	<u>879,000</u>
Gross profit as a percentage of sales.....	<u>23.8%</u>	<u>23.1%</u>

The decrease in sales was associated with a smaller backlog of orders entering fiscal 2010 when compared to the backlog of orders entering fiscal 2009.

Gross profit, as a percentage of sales, for the six months ended June 30, 2010, when compared to the six months ended June 30, 2009, was unfavorably impacted by 3.0% due to product mix, and favorably impacted by 3.7% due to the increased absorption of overhead costs.

Selling, General and Administrative Expenses

Selling, general and administrative expenses of \$1,534,000 were lower by \$472,000 for the six months ended June 30, 2010 than for the six months ended June 30, 2009. The favorable variance in selling, general and administrative expenses was primarily attributable to a decrease of \$263,000 in salaries and fringe benefits, and a decrease of \$67,000 in professional fees. Also contributing to the reduction in selling, general and administrative expenses was \$147,000 of severance costs pertaining to a reduction of employees due to the economic slowdown that was recognized during the first quarter of 2009.

Product Development Costs

Product development costs, including patent expense, of \$81,000 were higher by \$10,000 for the six months ended June 30, 2010 than for the six months ended June 30, 2009. Development programs in the six months ended June 30, 2010 and 2009 were primarily aimed at improvements to the Company's Order Fulfillment systems technologies. Order Fulfillment development efforts during the six months ended June

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

(a) Results of Operations – Six Months Ended June 30, 2010 Compared to the Six Months Ended June 30, 2009 *(Continued)*

Product Development Costs *(Continued)*

30, 2010 included voice picking and DISPENSIMATIC[®] hardware and software enhancements aimed at promoting workplace efficiencies for the Company's customers. Order Fulfillment development efforts during the six months ended June 30, 2009 included DISPENSIMATIC[®] hardware and software enhancements aimed at promoting workplace efficiencies for the Company's customers.

Interest Income

Interest income of \$31,000 was lower by \$41,000 for the six months ended June 30, 2010 than for the six months ended June 30, 2009. 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 \$14,000 during the six months ended June 30, 2010 compared to the recognition of an income tax benefit of \$81,000 during the six months ended June 30, 2009. Income tax expense for the six months ended June 30, 2010 was primarily related to accruals for state income tax matters. There was no income tax benefit recognized for the loss for the six months ended June 30, 2010 as a result of the valuation allowance offsetting deferred tax assets. The income tax benefit for the six months ended June 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 six months ended June 30, 2009 was lower than statutory federal and state tax rates.

(b) Results of Operations – Three Months Ended June 30, 2010 Compared to the Three Months Ended June 30, 2009

Earnings Summary

The Company had a net loss of \$437,000 (or \$0.28 basic loss per share) for the three months ended June 30, 2010, compared to a net loss of \$443,000 (or \$0.28 basic loss per share) for the three months ended June 30, 2009. The decrease in the net loss was primarily due to:

- an increase during the second quarter of 2010 in gross profit of \$58,000 as described below; and
- a decrease in selling, general and administrative expenses of \$70,000 as described below.

Partially offsetting the above decrease in the net loss was:

- an increase in product development costs of \$10,000 as described below;
- a decrease of \$18,000 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 income tax expense of \$88,000 as described below.

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

(b) Results of Operations – Three Months Ended June 30, 2010 Compared to the Three Months Ended June 30, 2009 *(Continued)*

Net Sales and Gross Profit on Sales

	2010	2009
Net sales.....	\$ 1,761,000	1,895,000
Cost of sales.....	1,336,000	1,528,000
Gross profit on sales.....	<u>\$ 425,000</u>	<u>367,000</u>
Gross profit as a percentage of sales.....	<u>24.1%</u>	<u>19.4%</u>

The decrease in sales was associated with a smaller backlog of orders entering fiscal 2010 when compared to the backlog of orders entering fiscal 2009.

Gross profit, as a percentage of sales, for the three months ended June 30, 2010, when compared to the three months ended June 30, 2009, was unfavorably impacted by 0.8% due to product mix, and favorably impacted by 5.5% due to the increased absorption of overhead costs.

Selling, General and Administrative Expenses

Selling, general and administrative expenses of \$805,000 were lower by \$70,000 for the three months ended June 30, 2010 than for the three months ended June 30, 2009. The favorable variance in selling, general and administrative expenses was primarily attributable to a decrease of \$62,000 in salaries and fringe benefits, and a decrease of \$44,000 in professional fees. Partially offsetting the aforementioned favorable variance was an increase of \$28,000 in marketing expenses primarily associated with product promotion.

Product Development Costs

Product development costs, including patent expense, of \$54,000 were higher by \$10,000 for the three months ended June 30, 2010 than for the three months ended June 30, 2009. Development programs in the three months ended June 30, 2010 and 2009 were primarily aimed at improvements to the Company's Order Fulfillment systems technologies. Order Fulfillment development efforts during the three months ended June 30, 2010 included voice picking and DISPENSIMATIC[®] hardware and software enhancements aimed at promoting workplace efficiencies for the Company's customers. Order Fulfillment development efforts during the three months ended June 30, 2009 included DISPENSIMATIC[®] hardware and software enhancements aimed at promoting workplace efficiencies for the Company's customers.

Interest Income

Interest income of \$15,000 was lower by \$18,000 for the three months ended June 30, 2010 than for the three months ended June 30, 2009. 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 \$10,000 during the three months ended June 30, 2010 compared to the recognition of an income tax benefit of \$78,000 during the three months ended June 30, 2009. Income tax expense for the three months ended June 30, 2010 was primarily related to accruals for state income tax matters.

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

(b) Results of Operations – Three Months Ended June 30, 2010 Compared to the Three Months Ended June 30, 2009 *(Continued)*

Income Tax Expense (Benefit) *(Continued)*

There was no income tax benefit recognized for the loss for the three months ended June 30, 2010 as a result of the valuation allowance offsetting deferred tax assets. The income tax benefit for the three months ended June 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 three months ended June 30, 2009 was lower than statutory federal and state tax rates.

Liquidity and Capital Resources

The Company's cash and cash equivalents at June 30, 2010 were \$5,407,000 representing 75.1% of total assets, compared to \$6,198,000, or 73.7% of total assets, at December 31, 2009. The decrease was primarily due to cash used by operating activities totaling \$748,000, the repurchase and retirement of common stock totaling \$22,000, and purchases of capital equipment totaling \$21,000.

Cash used by operating activities totaling \$748,000 during the six months ended June 30, 2010 was primarily due to the following factors:

- a net loss in the amount of \$794,000 for the first half of 2010;
- an increase in prepaid expenses and other current assets in the amount of \$77,000 primarily associated with payment of insurance premiums for the current year;
- a decrease in customers' deposits and billings in excess of costs and estimated earnings in the amount of \$241,000 in accordance with contractual requirements;
- an increase in inventories in the amount of \$84,000 relating to the purchase of safety stock and long-lead time items; and
- a decrease in unearned support contract revenue in the amount of \$85,000 relating to the recognition of revenue on support contracts on the straight-line basis.

Partially offset by the following factor:

- a decrease in receivables in the amount of \$556,000 in accordance with contractual requirements.

The Company's cash and cash equivalents at June 30, 2009 were \$5,970,000, representing 69.4% 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 \$872,000, partially offset by the repurchase and retirement of common stock totaling \$517,000.

Cash provided by operating activities totaling \$872,000 during the six months ended June 30, 2009 was primarily due to the following factors:

- a decrease in receivables in the amount of \$1,808,000 in accordance with contractual requirements;
- a decrease in costs and estimated earnings in excess of billings in the amount of \$827,000 in accordance with contractual requirements; and
- an increase in customers' deposits and billings in excess of costs and estimated earnings in the amount of \$487,000 in accordance with contractual requirements.

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

Liquidity and Capital Resources *(Continued)*

Partially offset by the following factors:

- a net loss in the amount of \$1,054,000 for the first half of 2009;
- a decrease in accounts payable in the amount of \$588,000 associated with payments for purchases of goods and services rendered in accordance with job completion requirements;
- an increase in prepaid expenses and other current assets in the amount of \$148,000 primarily associated with payment of insurance premiums for the current year;
- a decrease in unearned support contract revenue in the amount of \$114,000 relating to the recognition of revenue on support contracts on the straight-line basis;
- an increase in inventories in the amount of \$168,000 relating to the purchase of safety stock and long-lead time items;
- a decrease in accrued product warranties in the amount of \$40,000 primarily associated with the reversal of unused, expired accrued product warranties for contracts that were no longer in the warranty period; and
- a decrease in income taxes payable of \$72,000 primarily due to the reversal of accruals for the expiration of tax return statutes.

The Company repurchased \$22,000 of its common stock during the six months ended June 30, 2010 compared with \$541,000 of stock repurchases during the six months ended June 30, 2009. As of June 30, 2010, the Company has \$2,760,806 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 June 30, 2010, 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 June 30, 2010, the amount available under the 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 June 30, 2010. The line of credit facility expires on November 30, 2010.

The Company does not have any material commitments for capital expenditures as of June 30, 2010.

The Company anticipates that its financial resources, consisting of cash and cash equivalents and its line of credit facility, 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. 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.

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

Liquidity and Capital Resources *(Continued)*

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 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.

Future contractual obligations and commercial commitments at June 30, 2010 as noted above are as follows:

	Total	Payments Due by Period					After 2014
		2010	2011	2012	2013	2014	
Contractual obligations:							
Operating leases....	\$ 576,000	108,000	216,000	216,000	36,000	-	-
	Total Amounts Committed	Amount of Commitment Expiration Per Period					
		2010	2011	2012	2013	2014	After 2014
Other commercial commitments:							
Letters of credit	\$ 200,000	-	200,000	-	-	-	-

As of June 30, 2010, the Company has unrecognized tax benefits of \$189,000. The timing of cash settlement cannot be reasonably estimated.

Severance

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. The Severance Policy was established to provide a competitive benefit in order to motivate qualified individuals to accept executive officer positions with the Company. Under the Severance Policy, the CEO will receive 52 week's regular straight-time pay while the other executive officers 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 officer continued medical coverage up to a maximum of 18 months in accordance with the same terms offered during employment. The Company will also provide executive outplacement services for terminated executive officers.

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

Off-Balance Sheet Arrangements

As of June 30, 2010, 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. During the six months ended June 30, 2010 and during the year ended December 31, 2009, there were no related party transactions.

Recently Issued Accounting Pronouncements

Fair Value Measurements

In September 2006, the FASB issued authoritative guidance that defines fair value, establishes a market-based framework or hierarchy for measuring fair value, and expands disclosures about fair value measurements, which is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. Effective January 1, 2008, the Company adopted this guidance for financial assets and liabilities and other assets and liabilities that are recognized and disclosed at fair value on a recurring basis. Effective January 1, 2009, the Company adopted this guidance for nonfinancial assets and liabilities. The adoption of this guidance did not impact the Company's financial statements.

Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued authoritative guidance that permits companies to elect to measure certain financial instruments at fair value on an instrument-by-instrument basis, with changes in fair value recognized in earnings each reporting period. It also establishes financial statement presentation and disclosure requirements for assets and liabilities reported at fair value under the election. The Company adopted this guidance as of January 1, 2009 and elected not to fair value any items under this guidance.

Business Combinations

In December 2007, the FASB issued authoritative guidance to affirm that the acquisition method of accounting (previously referred to as the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This guidance 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. The Company adopted this guidance on January 1, 2009 and it will be applied prospectively to any business combination on or after January 1, 2009.

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

The FASB Accounting Standards Codification

In June 2009, the FASB issued authoritative guidance that establishes the Accounting Standards Codification (Codification) as the source of authoritative U.S. generally accepted accounting principles (GAAP). The Codification is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Codification does not change current U.S. GAAP but reorganizes all authoritative literature in one place. On December 31, 2009, the Company adopted the Codification and changed the way it references U.S. GAAP. Accordingly, the Company's Notes to Financial Statements will explain accounting concepts rather than cite the topics of specific U.S. GAAP. There was no impact on the Company's financial statements.

Disclosures about Subsequent Events

In May 2009, the FASB established the authoritative guidance on accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. Entities are also required to disclose the date through which subsequent events have been evaluated. The Company adopted this guidance beginning in the fourth quarter of 2009. Adoption of this guidance did not have a material impact on the Company's financial statements. Subsequent events have been evaluated through July 30, 2010.

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.
