

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2008

Commission file number: 1-15729

PARAGON TECHNOLOGIES, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

22-1643428
(I.R.S. Employer
Identification No.)

600 Kuebler Road, Easton, Pennsylvania
(Address of Principal Executive Offices)

18040
(Zip Code)

Registrant's Telephone Number, Including Area Code:

610-252-3205

Indicate by checkmark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer
Smaller Reporting Company

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

The number of shares of the Registrant's Common Stock, \$1.00 par value, outstanding as of July 30, 2008 was 2,639,894.



PARAGON
TECHNOLOGIES

Paragon Technologies, Inc.
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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Paragon Technologies, Inc.

Balance Sheets (Unaudited)

June 30, 2008 and December 31, 2007

(In Thousands, Except Share Data)

	June 30, 2008	December 31, 2007
<u>Assets</u>		
Current assets:		
Cash and cash equivalents.....	\$ 10,890	12,104
Short-term investments.....	180	200
Total cash and cash equivalents and short-term investments	<u>11,070</u>	<u>12,304</u>
Receivables:		
Trade	1,481	2,640
Notes and other receivables.....	402	310
Total receivables	<u>1,883</u>	<u>2,950</u>
Costs and estimated earnings in excess of billings.....	525	1,353
Inventories:		
Raw materials.....	199	160
Work-in-process	29	224
Finished goods	549	475
Total inventories	<u>777</u>	<u>859</u>
Deferred income tax benefits.....	332	263
Prepaid expenses and other current assets .	306	113
Total current assets.....	<u>14,893</u>	<u>17,842</u>
Machinery and equipment, at cost:		
Machinery and equipment	1,380	1,313
Less: accumulated depreciation	<u>1,030</u>	<u>1,000</u>
Net machinery and equipment.....	<u>350</u>	<u>313</u>
Deferred income tax benefits	86	161
Total assets.....	<u>\$ 15,329</u>	<u>18,316</u>

See accompanying notes to financial statements.

(Continued)

Item 1. Financial Statements (Continued)
Paragon Technologies, Inc.
Balance Sheets (Unaudited) (Continued)
June 30, 2008 and December 31, 2007
(In Thousands, Except Share Data)

	June 30, 2008	December 31, 2007
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable.....	\$ 1,407	1,726
Customers' deposits and billings in excess of costs and estimated earnings	791	3,063
Accrued salaries, wages, and commissions.....	173	173
Accrued product warranties	431	234
Deferred gain on sale-leaseback.....	-	28
Unearned support contract revenue	313	254
Accrued other liabilities	249	324
Total current liabilities.....	<u>3,364</u>	<u>5,802</u>
Long-term liabilities:		
Income taxes payable	244	261
Total long-term liabilities.....	<u>244</u>	<u>261</u>
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$1 par value; authorized 20,000,000 shares; issued and outstanding 2,670,244 shares as of June 30, 2008 and 2,769,192 shares as of December 31, 2007	2,670	2,769
Additional paid-in capital.....	5,381	5,537
Retained earnings	3,670	3,947
Total stockholders' equity.....	<u>11,721</u>	<u>12,253</u>
Total liabilities and stockholders' equity	<u>\$ 15,329</u>	<u>18,316</u>

See accompanying notes to financial statements.

Item 1. Financial Statements (Continued)**Paragon Technologies, Inc.**

Statements of Operations (Unaudited)

For the Three and Six Months Ended June 30, 2008 and 2007

(In Thousands, Except Share and Per Share Data)

	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Net sales	\$ 4,123	6,019	9,168	9,626
Cost of sales	3,158	4,544	6,677	7,221
Gross profit on sales	965	1,475	2,491	2,405
Selling, general and administrative expenses	1,260	1,536	2,629	2,940
Product development costs.....	11	18	106	68
Interest income.....	(93)	(117)	(214)	(229)
Other income, net.....	(1)	(3)	(1)	(19)
	<u>1,177</u>	<u>1,434</u>	<u>2,520</u>	<u>2,760</u>
Income (loss) before income taxes.....	(212)	41	(29)	(355)
Income tax expense (benefit).....	(103)	30	(26)	(98)
Net income (loss)	<u>\$ (109)</u>	<u>11</u>	<u>(3)</u>	<u>(257)</u>
Basic earnings (loss) per share.....	<u>\$ (.04)</u>	<u>.00</u>	<u>.00</u>	<u>(.09)</u>
Diluted earnings (loss) per share.....	<u>\$ (.04)</u>	<u>.00</u>	<u>.00</u>	<u>(.09)</u>
Weighted average basic and diluted shares outstanding	<u>2,685,664</u>	<u>2,780,154</u>	<u>2,713,233</u>	<u>2,811,448</u>

See accompanying notes to financial statements.

Item 1. Financial Statements (Continued)
Paragon Technologies, Inc.
 Statements of Cash Flows (Unaudited)
 For the Six Months Ended June 30, 2008 and 2007
 (In Thousands, Except Share Data)

	Six Months Ended	
	June 30, 2008	June 30, 2007
Cash flows from operating activities:		
Net loss	\$ (3)	(257)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Depreciation of machinery and equipment....	63	55
Deferred income tax expense (benefit)	6	(4)
Amortization of deferred gain on sale- leaseback	(28)	(83)
Stock-based compensation	12	3
Change in operating assets and liabilities:		
Receivables	1,067	84
Costs and estimated earnings in excess of billings	828	(1,843)
Inventories	82	(327)
Prepaid expenses and other current assets	(193)	(192)
Accounts payable	(319)	1,840
Customers' deposits and billings in excess of costs and estimated earnings.....	(2,272)	892
Accrued salaries, wages, and commissions	-	(51)
Income taxes payable	(17)	72
Accrued product warranties	197	(2)
Unearned support contract revenue	59	(6)
Accrued other liabilities	(75)	(92)
Net cash provided (used) by operating activities	(593)	89
Cash flows from investing activities:		
Proceeds from sales of short-term investments.....	20	870
Purchases of short-term investments	-	(500)
Purchases of machinery and equipment	(100)	(43)
Net cash provided (used) by investing activities.....	(80)	327

See accompanying notes to financial statements.

(Continued)

Item 1. Financial Statements *(Continued)*
Paragon Technologies, Inc.
 Statements of Cash Flows (Unaudited) *(Continued)*
 For the Six Months Ended June 30, 2008 and 2007
(In Thousands, Except Share Data)

	Six Months Ended	
	June 30, 2008	June 30, 2007
Cash flows from financing activities:		
Repurchase and retirement of common stock.....	(541)	(567)
Net cash used by financing activities.....	(541)	(567)
Decrease in cash and cash equivalents	(1,214)	(151)
Cash and cash equivalents, beginning of period	12,104	2,447
Cash and cash equivalents, end of period.....	<u>\$ 10,890</u>	<u>2,296</u>
Supplemental disclosures of cash flow information:		
Cash paid (received) during the period for:		
Interest expense.....	\$ -	-
Income taxes.....	<u>\$ 79</u>	<u>(24)</u>

See accompanying notes to financial statements.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2008 and 2007

(1) Basis of Financial Statement Presentation

The accompanying unaudited financial statements have been prepared in accordance with the requirements for Form 10-Q and Article 10 of Regulation S-X and, accordingly, certain information and footnote disclosures have been condensed or omitted. In the opinion of the management of Paragon Technologies, Inc. ("Paragon" or the "Company"), the unaudited interim financial statements furnished reflect all adjustments and accruals that are necessary to present a fair statement of results for the interim periods. 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 Consolidated Financial Statements of the Company and the related Notes thereto appearing in the Company's annual report on Form 10-K for the year ended December 31, 2007 as filed with the Securities and Exchange Commission on March 28, 2008. Refer to the Company's annual report on Form 10-K for the year ended December 31, 2007 for more complete financial information.

Use of Estimates

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

(2) Short-Term Investments

The Company's short-term investments are comprised of debt securities, all classified as available for sale, that are carried at cost, which approximates fair value of the investments at period end. These debt securities include state and municipal bonds. The short-term investments are on deposit with a major financial institution and are supported by letters of credit. The fair value of the short-term investments of \$180,000 at June 30, 2008 is based on quoted prices from active markets.

(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 two 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):

	<u>Beginning Balance</u> <u>January 1</u>	<u>Additions Charged to</u> <u>Costs and Expenses</u>	<u>Deductions</u>	<u>Ending Balance</u> <u>June 30</u>
2008	\$ 234	249	(52)	431
2007	\$ 192	60	(62)	190

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2008 and 2007

(4) Business Operations

Company Overview

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

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

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

The Company's automated material handling systems are marketed, designed, sold, installed, and serviced by its own staff or subcontractors as labor-saving devices to improve productivity, quality, and reduce costs. The Company's integrated material handling solutions involve both standard and specially designed components and include integration of non-proprietary automated handling technologies to provide turnkey solutions for its customers' unique material handling needs. The Company's engineering staff develops and designs computer control programs required for the efficient operation of the systems and for optimizing manufacturing, assembly, and fulfillment operations.

Item 1. Financial Statements (Continued)**Paragon Technologies, Inc.**

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2008 and 2007

(4) **Business Operations** (Continued)

The Company's systems vary in configuration and capacity. Historically, system prices across the Company's product lines have ranged from \$100,000 to several million dollars per system. Systems and aftermarket sales during the three and six months ended June 30, 2008 and 2007 are as follows (*in thousands*):

For the three months ended June 30, 2008 and 2007:

	June 30, 2008		June 30, 2007	
	Sales	% of Total Sales	Sales	% of Total Sales
Systems sales	\$ 3,497	84.8%	5,061	84.1%
Aftermarket sales	626	15.2%	958	15.9%
Total sales.....	<u>\$ 4,123</u>	<u>100.0%</u>	<u>6,019</u>	<u>100.0%</u>

For the six months ended June 30, 2008 and 2007:

	June 30, 2008		June 30, 2007	
	Sales	% of Total Sales	Sales	% of Total Sales
Systems sales	\$ 7,719	84.2%	7,922	82.3%
Aftermarket sales	1,449	15.8%	1,704	17.7%
Total sales.....	<u>\$ 9,168</u>	<u>100.0%</u>	<u>9,626</u>	<u>100.0%</u>

The Company's products are sold worldwide through its own sales personnel. Domestic and international sales during the three and six months ended June 30, 2008 and 2007 are as follows: (*in thousands*):

For the three months ended June 30, 2008 and 2007:

	June 30, 2008		June 30, 2007	
	Sales	% of Total Sales	Sales	% of Total Sales
Domestic sales	\$ 3,062	74.3%	\$ 5,889	97.8%
International sales	1,061	25.7%	130	2.2%
Total sales.....	<u>\$ 4,123</u>	<u>100.0%</u>	<u>\$ 6,019</u>	<u>100.0%</u>

For the six months ended June 30, 2008 and 2007:

	June 30, 2008		June 30, 2007	
	Sales	% of Total Sales	Sales	% of Total Sales
Domestic sales	\$ 6,655	72.6%	\$ 8,945	92.9%
International sales	2,513	27.4%	681	7.1%
Total sales.....	<u>\$ 9,168</u>	<u>100.0%</u>	<u>\$ 9,626</u>	<u>100.0%</u>

Sales from external customers for each of the Company's products during the three and six months ended June 30, 2008 and 2007 are as follows (*in thousands*):

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2008 and 2007

(4) Business Operations

For the three months ended June 30, 2008 and 2007:

	June 30, 2008		June 30, 2007	
	Sales	% of Total Sales	Sales	% of Total Sales
LO-TOW [®] sales	\$ 2,442	59.2%	\$ 2,129	35.4%
DISPEN-SI-MATIC [®] , SINTHESIS [®] , and related order fulfillment sales.....	1,055	25.6%	2,931	48.7%
Aftermarket sales	626	15.2%	959	15.9%
Total sales.....	<u>\$ 4,123</u>	<u>100.0%</u>	<u>\$ 6,019</u>	<u>100.0%</u>

For the six months ended June 30, 2008 and 2007:

	June 30, 2008		June 30, 2007	
	Sales	% of Total Sales	Sales	% of Total Sales
LO-TOW [®] sales	\$ 4,230	46.1%	\$ 3,407	35.4%
CARTRAC [®] sales	-	-	54	.5%
DISPEN-SI-MATIC [®] , SINTHESIS [®] , and related order fulfillment sales.....	3,489	38.1%	4,427	46.0%
Other sales.....	-	-	34	.4%
Aftermarket sales	1,449	15.8%	1,704	17.7%
Total sales.....	<u>\$ 9,168</u>	<u>100.0%</u>	<u>\$ 9,626</u>	<u>100.0%</u>

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

The Company engages in sales with the U.S. government. Sales to the U.S. government during the three months ended June 30, 2008 and 2007 were \$45,000 and \$67,000, respectively. Sales to the U.S. government during the six months ended June 30, 2008 and 2007 were \$69,000 and \$194,000, respectively.

The Company's backlog of orders at June 30, 2008 and June 30, 2007 was \$5,259,000 and \$10,730,000, respectively.

The Company's business is largely dependent upon a limited number of large contracts with a limited number of customers. This dependence can cause unexpected fluctuations in sales volume. Various external factors affect the customers' decision-making process on expanding or upgrading their current production or distribution sites. The customers' timing and placement of new orders is often affected by factors such as the current economy, current interest rates, and future expectations. The Company believes that its business is not subject to seasonality, although the rate of new orders can vary substantially from month to month. Since the Company recognizes sales on a percentage of completion basis for its systems contracts, fluctuations in the Company's sales and earnings occur with increases or decreases in major installations. The Company expects to fill, within the next twelve months, all of the June 30, 2008 backlog of orders indicated above.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2008 and 2007

(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 on January 1, 2008. 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. 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 is currently evaluating the impact, if any, the adoption of SFAS No. 141R will have on the Company's financial statements.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2008 and 2007

(5) Recently Issued Accounting Pronouncements (Continued)

In December 2007, the Financial Accounting Standards Board issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51 (“SFAS No. 160”). SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, with earlier adoption prohibited. SFAS No. 160 requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent’s equity. The amount of net earnings attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. SFAS No. 160 also amends certain of ARB No. 51’s consolidation procedures for consistency with the requirements of SFAS No. 141R. SFAS No. 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. The Company is currently evaluating the impact, if any, the adoption of SFAS No. 160 will have on the Company’s financial statements.

In May 2008, the Financial Accounting Standards Board issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles (“SFAS No. 162”). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. This Statement will become effective 60 days following the SEC’s approval of the Public Company Accounting Oversight Board (PCAOB) amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The Company does not anticipate a material impact on its financial statements from the adoption of SFAS No. 162.

(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 initial five-year term of the lease. The amortization of the deferred profit expired

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2008 and 2007

(6) Sale-Leaseback (Continued)

during the first quarter of 2008. During the three months ended June 30, 2008 and 2007, \$0 and \$42,000, respectively, of the deferred gain was recognized. During the six months ended June 30, 2008 and 2007, \$28,000 and \$83,000, 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

The Company has a line of credit facility which may not exceed \$5,000,000 and is to be used primarily for working capital purposes. Interest on the line of credit facility is at the LIBOR Market Index Rate plus 1.4%. As of June 30, 2008, 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, 2008, 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 June 30, 2008. The line of credit facility expires effective September 30, 2008. The Company expects to renew the line of credit facility under similar terms and conditions during 2008.

(8) Stock Repurchase Program

On August 12, 2004, the Company's Board of Directors approved a program to repurchase up to \$1,000,000 of its outstanding common stock. The Company's Board of Directors amended its existing stock repurchase program on several occasions during 2005, 2006, and 2007 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 \$15,000,000.

On January 9, 2008, the Company's Board of Directors amended its existing stock repurchase program by increasing the amount it has authorized management to repurchase from up to \$15,000,000 of the Company's common stock to up to \$17,000,000.

During the three months ended June 30, 2008, the Company repurchased 55,348 shares of common stock at a weighted average cost, including brokerage commissions, of \$5.31 per share. During the six months ended June 30, 2008, the Company repurchased 98,948 shares of common stock at a weighted average cost, including brokerage commissions, of \$5.47 per share. Cash expenditures for the stock repurchases during the three and six months ended June 30, 2008 were \$293,763 and \$540,787, respectively. From the inception of the Company's stock repurchase program on August 12, 2004 through June 30, 2008, the Company

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2008 and 2007

(8) Stock Repurchase Program (Continued)

repurchased 1,736,666 shares of common stock at a weighted average cost, including brokerage commissions, of \$8.44 per share. Cash expenditures for the stock repurchases since the inception of the program were \$14,656,930. As of June 30, 2008, \$2,343,070 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 between additional paid-in capital and retained earnings. All shares of common stock that were repurchased by the Company since the inception of the program were subsequently retired.

(9) Unearned Support Contract Revenue

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

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2008 and 2007

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

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.

SFAS No. 123R requires that cash flows resulting from excess tax benefits be classified as financing cash flows. For the three and six months ended June 30, 2008 and for the year ended December 31, 2007, no excess tax benefits were generated.

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 June 30, 2008, 7,500 options are outstanding under the plan, and all options have a term of seven years.

Stock-based compensation expense recognized during the three months ended June 30, 2008 and 2007 for stock-based compensation programs was \$6,000 and \$6,000, respectively. Stock-based compensation expense recognized during the three months ended June 30, 2008 and 2007 consisted of expensing \$1,000 and \$1,000, respectively, for employee stock options, and \$5,000 and \$5,000, respectively, for nonvested stock.

Stock-based compensation expense recognized during the six months ended June 30, 2008 and 2007 for stock-based compensation programs was \$12,000 and \$3,000, respectively. Stock-based compensation expense recognized during the six months ended June 30, 2008 and 2007 consisted of expensing \$3,000 and \$3,000, respectively, for employee stock options, and \$9,000 and \$0 respectively, for nonvested stock.

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

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2008 and 2007

(10) Stock-Based Compensation (Continued)

Stock Options

There were no stock options exercised, forfeited, or granted during the three and six months ended June 30, 2008, and no further grants are available under the plan.

The total compensation expense of \$23,000 is expected to be recognized on the straight-line basis over the stated vesting period consistent with the terms of the arrangement. As of June 30, 2008, there is unrecognized compensation cost of \$8,000 on the stock option awards which will be recognized over the next 1.7 years.

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

Nonvested Stock

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

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

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

The total compensation cost of \$75,000 is expected to be recognized on the straight-line basis over the four-year vesting period consistent with the terms of the arrangement. As of June 30, 2008, there is unrecognized compensation cost of \$31,000 on the nonvested stock awards which will be recognized over the next 1.7 years.

(11) Income Taxes

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

Item 1. Financial Statements *(Continued)*

Paragon Technologies, Inc.

Notes To Financial Statements (Unaudited)

For the Three and Six Months Ended June 30, 2008 and 2007

(11) Income Taxes *(Continued)*

The Company recognized an income tax benefit of \$103,000 during the three months ended June 30, 2008 compared to income tax expense of \$30,000 during the three months ended June 30, 2007. The income tax benefit for the three months ended June 30, 2008 was higher than statutory federal and state tax rates primarily due to an adjustment in the effective income tax rate expected to apply based on the projected profitability of the Company for 2008 and a change in unrecognized tax benefits. Income tax expense for the three months ended June 30, 2007 was higher than statutory federal and state tax rates primarily due to tax-exempt interest, a change in unrecognized tax benefits, and an adjustment in the effective income tax rate expected to apply based on the projected profitability of the Company for 2007.

The Company recognized an income tax benefit of \$26,000 during the six months ended June 30, 2008 compared to an income tax benefit of \$98,000 during the six months ended June 30, 2007. The income tax benefit for the six months ended June 30, 2008 was higher than statutory federal and state tax rates primarily due to a change in unrecognized tax benefits and an adjustment in the effective income tax rate expected to apply based on the projected profitability of the Company for 2008. The income tax benefit for the six months ended June 30, 2007 was lower than statutory federal and state tax rates primarily due to the effect of tax-exempt interest on certain investments on the annualized effective rate.

During the three months ended June 30, 2008, the Company reduced the amount of accrued interest related to unrecognized tax benefits by \$2,000 due to the expiration of statutes of limitations. During the six months ended June 30, 2008, the Company accrued additional interest related to unrecognized tax benefits of \$1,000.

During the three and six months ended June 30, 2008, the Company decreased the total unrecognized tax benefits by \$11,000 due to the expiration of statutes of limitations.

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 2003. The Company has operations in approximately 30 state and foreign taxing jurisdictions. The Company has substantially concluded state income tax matters for years through 2002.

(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.

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

The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the unaudited financial statements and related notes thereto included in this Quarterly Report on Form 10-Q for the period ended June 30, 2008, and the cautionary statements and consolidated financial statements and related notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007. The discussion and analysis contains "forward-looking statements" based on management's current expectations, assumptions, estimates, and projections. These forward-looking statements involve risks and uncertainties. The Company's actual results could differ materially from those included in these "forward-looking statements" as a result of risks and uncertainties identified in connection with those forward-looking statements, including those factors identified herein, and in the Company's other publicly filed reports.

Business Overview

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

Key Performance Metrics Relevant to the Company

Capacity Utilization

Capacity Utilization, as documented in the Federal Reserve Statistical Release⁽¹⁾, is a key economic indicator that the Company follows as a barometer that may lead to capital spending for material handling systems. Capacity Utilization attempts to measure what percent of available capacity is actually being utilized. Management believes that when Capacity Utilization rises and falls, the Company may see a corresponding change in the rate of new orders, and therefore, a corresponding change in the backlog of orders and sales may also occur. The backlog of orders represents the uncompleted portion of systems contracts along with the value of parts and services from customer purchase orders related to goods that have not been shipped or services that have not been rendered. Backlog of orders is generally indicative of customer demand for the Company's products. As the demand for the Company's products increases, the backlog of orders, the rate of new orders, and sales also typically increases. The following table depicts the Company's backlog of orders, orders, sales, and Capacity Utilization for the six months ended June 30, 2008, and for the years ended December 31, 2007, 2006, 2005, 2004, and 2003:

<i>(Dollars in Thousands)</i>	Six Months Ended June 30, 2008	Year Ended December 31,				
		2007	2006	2005	2004	2003
Backlog of orders - Beginning.....	\$ 7,934	5,932	6,918	5,514	4,052	4,834
Add: orders	6,493	23,450	16,802	18,080	13,164	11,301
Less: sales	9,168	21,448	17,788	16,676	11,702	12,083
Backlog of orders - Ending.....	\$ 5,259	7,934	5,932	6,918	5,514	4,052
Capacity Utilization ⁽¹⁾	80.2%	81.0%	80.9%	80.2%	78.0%	76.0%

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

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

Current Ratio

Management of the Company monitors the current ratio as a measure of determining liquidity and believes the current ratio illustrates that the Company's financial resources are adequate to satisfy its future cash requirements through the next year. The following table depicts the Company's current assets, current liabilities, and current ratio as of June 30, 2008 and as of December 31, 2007, 2006, 2005, 2004, and 2003:

<i>(Dollars in Thousands)</i>	As of June 30,	As of December 31,				
	2008	2007	2006	2005	2004	2003
Current assets	\$ 14,893	17,842	16,370	22,134	14,249	14,720
Current liabilities	\$ 3,364	5,802	4,296	5,337	7,355	9,583
Current ratio	4.43	3.08	3.81	4.15	1.94	1.54

Critical Accounting Policies and Estimates

The discussion and analysis of the Company's financial condition and results of operations are based upon the Company's financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and other financial information, including the related disclosure of commitments and contingencies at the date of the Company's financial statements. Actual results may, under different assumptions and conditions, differ significantly from the Company's estimates.

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

Revenue Recognition on Systems Sales

Revenues on systems contracts, accounted for in accordance with SOP 81-1 of the American Institute of Certified Public Accountants, are recorded on the basis of the Company's estimates of the percentage of completion of individual contracts. Gross margin is recognized on the basis of the ratio of aggregate costs incurred to date to the most recent estimate of total costs. As contracts may extend over one or more years, revisions in cost and profit estimates during the course of the work are reflected in the accounting periods in which the facts requiring revisions become known. At the time a loss on a contract becomes known, the entire amount of the estimated ultimate loss is accrued. As of June 30, 2008, there are no contracts that are anticipated to result in a loss.

The Company believes that it has the ability to reasonably estimate the total costs and applicable gross profit margins at the inception of the contract for all of its systems contracts. However, where cost estimates change, there could be a significant impact on the amount of revenue recognized. The Company's failure to estimate accurately can result in cost overruns which will result in the loss of profits if the Company determines that it has significantly underestimated the costs involved in completing contracts. The Company had cost overruns which resulted in a reduction in profits on one contract during the six months ended June 30, 2008.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

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 two percent of the cost of the system being sold. A detailed review of products still in the warranty period. Historically, the level of warranty reserve has been appropriate based on management's assessment of estimated future warranty claims. However, if unanticipated warranty issues arise in the future, there could be a significant impact on the recorded warranty reserve. The warranty reserve as of June 30, 2008 and December 31, 2007 was \$431,000 and \$234,000, respectively.

Inventories

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

(a) Results of Operations – Six Months Ended June 30, 2008 Compared to the Six Months Ended June 30, 2007

Earnings Summary

The Company had a net loss of \$3,000 (or \$0.00 basic loss per share) for the six months ended June 30, 2008, compared to a net loss of \$257,000 (or \$0.09 basic loss per share) for the six months ended June 30, 2007. The decrease in the net loss was primarily due to:

- an increase during the first half of 2008 in gross profit of \$86,000, as described below; and
- a decrease in selling, general and administrative expenses of \$311,000 as described below.

Partially offsetting the above decrease in the net loss was:

- an increase in product development costs of \$38,000 as described below;
- a decrease of \$15,000 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;
- a decrease of \$18,000 in other income, net attributable to a decrease in royalty income from a license agreement related to material handling equipment sales; and
- a decrease in the income tax benefit of \$72,000 as described below.

Net Sales and Gross Profit on Sales

	<u>2008</u>	<u>2007</u>
Net sales	\$ 9,168,000	9,626,000
Cost of sales	<u>6,677,000</u>	<u>7,221,000</u>
Gross profit on sales	<u>\$ 2,491,000</u>	<u>2,405,000</u>
Gross profit as a percentage of sales	<u>27.2%</u>	<u>25.0%</u>

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

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

The decrease in sales was associated with a smaller amount of orders received during 2008 when compared to the amount of orders received during 2007.

Gross profit, as a percentage of sales, for the six months ended June 30, 2008, when compared to the six months ended June 30, 2007, was favorably impacted by 5.6% due to product mix, and unfavorably impacted by 3.4% due to the reduced absorption of overhead costs.

Selling, General and Administrative Expenses

Selling, general and administrative expenses of \$2,629,000 were lower by \$311,000 for the six months ended June 30, 2008 than for the six months ended June 30, 2007. The favorable variance in selling, general and administrative expenses was primarily attributable to a decrease of \$279,000 of expenditures relating to sales efforts in response to quoting and sales activities, and a decrease of \$101,000 in professional fees and consulting expenses. Partially offsetting the aforementioned favorable variance was an increase of \$73,000 in marketing expenses primarily associated with product promotion.

Product Development Costs

Product development costs, including patent expense, of \$106,000 were higher by \$38,000 for the six months ended June 30, 2008 than for the six months ended June 30, 2007. Development programs in the six months ended June 30, 2008 and 2007 were primarily aimed at improvements to the Company's Order Fulfillment systems technologies. Order Fulfillment development efforts during the six months ended June 30, 2008 and 2007 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 \$214,000 was lower by \$15,000 for the six months ended June 30, 2008 than for the six months ended June 30, 2007. 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.

Other Income, Net

The unfavorable variance of \$18,000 in other income, net for the six months ended June 30, 2008 as compared to the six months ended June 30, 2007 was primarily attributable to a decrease in royalty income from a license agreement related to material handling equipment sales. Effective February 1, 2007, the license agreement became royalty-free. Therefore, the Company no longer receives royalty income from the license agreement.

Income Tax Expense (Benefit)

The Company recognized an income tax benefit of \$26,000 during the six months ended June 30, 2008 compared to an income tax benefit of \$98,000 during the six months ended June 30, 2007. The income tax benefit for the six months ended June 30, 2008 was higher than statutory federal and state tax rates primarily due to a change in unrecognized tax benefits and an adjustment in the effective income tax rate expected to apply based on the projected profitability of the Company for 2008. The income tax benefit for the six months ended June 30, 2007 was lower than statutory federal and state tax rates primarily due to the effect of tax-exempt interest on certain investments on the annualized effective rate.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

(b) Results of Operations – Three Months Ended June 30, 2008 Compared to the Three Months Ended June 30, 2007

Earnings Summary

The Company had a net loss of \$109,000 (or \$0.04 basic loss per share) for the three months ended June 30, 2008, compared to net income of \$11,000 (or \$0.00 basic earnings per share) for the three months ended June 30, 2007. The decrease in net income was primarily due to:

- a decrease during the second quarter of 2008 in sales and gross profit of \$1,896,000, and \$510,000, respectively, as described below; and
- a decrease of \$24,000 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 decrease in net income was:

- a decrease in selling, general and administrative expenses of \$276,000 as described below; and
- an increase in the income tax benefit of \$133,000 as described below.

Net Sales and Gross Profit on Sales

	<u>2008</u>	<u>2007</u>
Net sales	\$ 4,123,000	6,019,000
Cost of sales	<u>3,158,000</u>	<u>4,544,000</u>
Gross profit on sales	<u>\$ 965,000</u>	<u>1,475,000</u>
Gross profit as a percentage of sales	<u>23.4%</u>	<u>24.5%</u>

The decrease in sales was associated with a smaller amount of orders received during 2008 when compared to the amount of orders received during 2007.

Gross profit, as a percentage of sales, for the three months ended June 30, 2008, when compared to the three months ended June 30, 2007, was favorably impacted by 6.2% due to product mix, and unfavorably impacted by 7.3% due to the reduced absorption of overhead costs.

Selling, General and Administrative Expenses

Selling, general and administrative expenses of \$1,260,000 were lower by \$276,000 for the three months ended June 30, 2008 than for the three months ended June 30, 2007. The favorable variance in selling, general and administrative expenses was primarily attributable to a decrease of \$170,000 of expenditures relating to sales efforts in response to quoting and sales activities, and a decrease of \$144,000 in professional fees and consulting expenses. Partially offsetting the aforementioned favorable variance was an increase of \$47,000 in marketing expenses primarily associated with product promotion.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

(b) Results of Operations – Three Months Ended June 30, 2008 Compared to the Three Months Ended June 30, 2007 *(Continued)*

Product Development Costs

Product development costs, including patent expense, of \$11,000 were lower by \$7,000 for the three months ended June 30, 2008 than for the three months ended June 30, 2007. Development programs in the three months ended June 30, 2008 and 2007 were primarily aimed at improvements to the Company's Order Fulfillment systems technologies. Order Fulfillment development efforts during the three months ended June 30, 2008 and 2007 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 \$93,000 was lower by \$24,000 for the three months ended June 30, 2008 than for the three months ended June 30, 2007. 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 \$103,000 during the three months ended June 30, 2008 compared to income tax expense of \$30,000 during the three months ended June 30, 2007. The income tax benefit for the three months ended June 30, 2008 was higher than statutory federal and state tax rates primarily due to an adjustment in the effective income tax rate expected to apply based on the projected profitability of the Company for 2008 and a change in unrecognized tax benefits. Income tax expense for the three months ended June 30, 2007 was higher than statutory federal and state tax rates primarily due to tax-exempt interest, a change in unrecognized tax benefits, and an adjustment in the effective income tax rate expected to apply based on the projected profitability of the Company for 2007.

Liquidity and Capital Resources

The Company's cash and cash equivalents and short-term investments at June 30, 2008 were \$11,070,000, representing 72.3% 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 \$541,000, purchases of capital equipment totaling \$100,000, and cash used by operating activities totaling \$593,000.

Cash used by operating activities totaling \$593,000 during the six months ended June 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 \$2,272,000 in accordance with contractual requirements; and
- an increase in prepaid expenses and other current assets in the amount of \$193,000 primarily associated with payment of insurance premiums for the current year.

Item 2. 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 decrease in receivables in the amount of \$1,067,000 in accordance with contractual requirements; and
- a decrease in costs and estimated earnings in excess of billings in the amount of \$828,000 in accordance with contractual requirements.

The Company's cash and cash equivalents and short-term investments at June 30, 2007 were \$11,551,000, representing 62.4% of total assets, compared to \$12,072,000, or 72.1% of total assets, at December 31, 2006. The decrease was primarily due to the repurchase and retirement of common stock totaling \$567,000, and purchases of capital equipment totaling \$43,000, partially offset by cash provided by operating activities totaling \$89,000.

Cash provided by operating activities totaling \$89,000 during the six months ended June 30, 2007 was primarily due to:

- an increase in accounts payable in the amount of \$1,840,000 associated with the purchases of goods and services rendered in accordance with job completion requirements; and
- an increase in customers' deposits and billing in excess of costs and estimated earnings in the amount of \$892,000 in accordance with contractual requirements.

Partially offset by the following factors:

- an increase in costs and estimated earnings in excess of billings in the amount of \$1,843,000 in accordance with contractual requirements;
- a net loss in the amount of \$257,000 for the first half of 2007;
- an increase in prepaid expenses and other current assets in the amount of \$192,000 primarily associated with payment of insurance premiums for the current year; and
- an increase in inventories in the amount of \$327,000 relating to the purchase of safety stock and long-lead time items.

The Company repurchased \$541,000 of its common stock during the six months ended June 30, 2008 compared with \$567,000 of stock repurchases during the six months ended June 30, 2007. The Company's Board of Directors amended its existing stock repurchase program by increasing the amount it has authorized management to repurchase from up to \$15,000,000 of the Company's common stock to up to \$17,000,000. As of June 30, 2008, the Company has \$2,343,070 authorized by the Board of Directors to use for future stock repurchases.

The Company has a line of credit facility which may not exceed \$5,000,000 and is to be used primarily for working capital purposes. Interest on the line of credit facility is at the LIBOR Market Index Rate plus 1.4%. As of June 30, 2008, 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, 2008, 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 June 30, 2008. The line of credit facility expires effective September 30, 2008. The Company expects to renew the line of credit facility under similar terms and conditions during 2008.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Liquidity and Capital Resources (Continued)

The Company anticipates that its financial resources, consisting of cash and cash equivalents and short-term investments, and its line of credit, will be adequate to satisfy its future cash requirements through the next year. Sales volume, as well as cash liquidity, may experience fluctuations due to the unpredictability of future contract sales and the dependence upon a limited number of large contracts with a limited number of customers.

The Company continues to review opportunities with the goal of maximizing resources, increasing stockholder value, and considering strategies and transactions intended to improve liquidity. At this time, the Company believes that an increase in stockholder value will be best obtained through increases in the Company's internal technology base, strengthening the Company's sales and marketing capabilities, growth of the Company's continuing operations and other higher growth markets, by the enhancement of the Company's products with advanced proprietary software capabilities through research and development efforts and/or possible acquisitions, mergers, and joint ventures. Although the Company enters into preliminary discussions and non-disclosure agreements from time to time, the Company does not have any material definitive agreements in place. There is no assurance that the Company will be able to consummate any of these strategic options.

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.

Future contractual obligations and commercial commitments at June 30, 2008 as noted above are as follows:

	Total	Payments Due by Period					
		2008	2009	2010	2011	2012	After 2012
Contractual obligations:							
Operating leases....	\$ 1,008,000	108,000	216,000	216,000	216,000	216,000	36,000
	Total Amounts Committed	Amount of Commitment Expiration Per Period					
		2008	2009	2010	2011	2012	After 2012
Other commercial commitments:							
Letters of credit	\$ 200,000	-	200,000	-	-	-	-

As of June 30, 2008, the Company has unrecognized tax benefits of \$244,000. 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, 2007.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

Off-Balance Sheet Arrangements

As of June 30, 2008, the Company had no off-balance sheet arrangements in the nature of guarantee contracts, retained or contingent interests in assets transferred to unconsolidated entities (or similar arrangements serving as credit, liquidity, or market risk support to unconsolidated entities for any such assets), obligations (including contingent obligations) under a contract that would be accounted for as a derivative instrument, or obligations (including contingent obligations) arising out of variable interests in unconsolidated entities providing financing, liquidity, market risk, or credit risk support to the Company, or that engage in leasing, hedging, or research and development services with the Company.

Related Party Transactions

From time to time, the Company enters into transactions with related parties. For further information, please refer to the Company's disclosure regarding "Commitments and Related Party Transactions" in Note 9 of the Notes to Consolidated Financial Statements of the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

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 on January 1, 2008. 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. The adoption of SFAS No. 159 did not have a material impact on the Company's financial statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

Recently Issued Accounting Pronouncements *(Continued)*

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 is currently evaluating the impact, if any, the adoption of SFAS No. 141R will have on the Company's financial statements.

In December 2007, the Financial Accounting Standards Board issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51 ("SFAS No. 160"). SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, with earlier adoption prohibited. SFAS No. 160 requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net earnings attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. SFAS No. 160 also amends certain of ARB No. 51's consolidation procedures for consistency with the requirements of SFAS No. 141R. SFAS No. 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. The Company is currently evaluating the impact, if any, the adoption of SFAS No. 160 will have on the Company's financial statements.

In May 2008, the Financial Accounting Standards Board issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles ("SFAS No. 162"). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. This Statement will become effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board (PCAOB) amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The Company does not anticipate a material impact on its financial statements from the adoption of SFAS No. 162.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

Cautionary Statement

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company does not believe that its exposures to interest rate risk or foreign currency exchange risk, risks from commodity prices, equity prices and other market changes that affect market risk sensitive instruments are material to its results of operations.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

An evaluation was performed under the supervision and with the participation of the Company's management, including its Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, of the effectiveness of the Company's disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of June 30, 2008. Based on that evaluation, the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act, is accumulated and communicated to the Company's management, including the Company's CEO and CFO, to allow timely decisions regarding required disclosure, and is recorded, processed, summarized and reported as specified in Securities and Exchange Commission rules and forms.

(b) Change in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting identified in connection with the evaluation of such controls that occurred during the Company's fiscal quarter ended June 30, 2008 that has materially affected, or that is reasonably likely to materially affect the Company's internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. 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.

Item 1A. Risk Factors

Item 1A, "Risk Factors," of our 2007 Form 10-K includes a detailed discussion of our risk factors. There have been no material changes in our Risk Factors from those disclosed in our annual report on Form 10-K for the year ended December 31, 2007.

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

The following table represents the periodic repurchases of equity securities made by the Company during the three months ended June 30, 2008:

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
4/01/08 – 4/30/08	49,019	\$ 5.31	49,019	\$ 260,133	\$ 2,376,700
5/01/08 – 5/31/08	6,329	\$ 5.31	6,329	\$ 33,630	\$ 2,343,070
6/01/08 – 6/30/08	-	\$ -	-	\$ -	\$ 2,343,070
	55,348	\$ 5.31	55,348	\$ 293,763	

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, and 2007 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 \$15,000,000.

On January 9, 2008, the Company's Board of Directors amended its existing stock repurchase program by increasing the amount it has authorized management to repurchase from up to \$15,000,000 of the Company's common stock to up to \$17,000,000.

During the three months ended June 30, 2008, the Company repurchased 55,348 shares of common stock at a weighted average cost, including brokerage commissions, of \$5.31 per share. During the six months ended June 30, 2008, the Company repurchased 98,948 shares of common stock at a weighted average cost, including brokerage commissions, of \$5.47 per share. Cash expenditures for the stock repurchases during the three and six months ended June 30, 2008 were \$293,763 and \$540,787, respectively. From the inception of the Company's stock repurchase program on August 12, 2004 through June 30, 2008, the Company repurchased 1,736,666 shares of common stock at a weighted average cost, including brokerage commissions, of \$8.44 per share. Cash expenditures for the stock repurchases since the inception of the program were \$14,656,930. As of June 30, 2008, \$2,343,070 remained available for repurchases under the stock repurchase program.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds *(Continued)*

Based on market conditions and other factors, additional repurchases may be made from time to time, in compliance with SEC regulations, in the open market or through privately negotiated transactions at the discretion of the Company. There is no expiration date with regards to the stock repurchase program. The purchase price for the shares of the Company's common stock repurchased was reflected as a reduction to stockholders' equity. The Company allocates the purchase price of the repurchased shares as a reduction to common stock for the par value of the shares repurchased, with the excess of the purchase price over par value being allocated between additional paid-in capital and retained earnings. All shares of common stock that were repurchased by the Company since the inception of the program were subsequently retired.

Item 3. Defaults Upon Senior Securities

Not applicable.

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

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

<u>Exhibit No.</u>	<u>Description</u>
31.1	Certification by Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed by Leonard S. Yurkovic, Acting CEO (filed herewith).
31.2	Certification by Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed by Ronald J. Semanick, Chief Financial Officer and Vice President - Finance and Treasurer (filed herewith).
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by Leonard S. Yurkovic, Acting CEO (filed herewith).
32.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by Ronald J. Semanick, Chief Financial Officer and Vice President - Finance and Treasurer (filed herewith).

SIGNATURES

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

PARAGON TECHNOLOGIES, INC.

/s/ Leonard S. Yurkovic

Leonard S. Yurkovic
Acting CEO

/s/ Ronald J. Semanick

Ronald J. Semanick
Chief Financial Officer

Dated: /s/ August 13, 2008

EXHIBIT INDEX

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SECTION 302 CERTIFICATION

I, Leonard S. Yurkovic, certify that:

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

Date: /s/ August 13, 2008

/s/ Leonard S. Yurkovic
Leonard S. Yurkovic
Acting CEO

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

In connection with the Paragon Technologies, Inc. (the "Company") Quarterly Report on Form 10-Q for the period ended June 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Leonard S. Yurkovic, Acting CEO of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

/s/ Leonard S. Yurkovic
Leonard S. Yurkovic
Acting Chief Executive Officer
August 13, 2008

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

In connection with the Paragon Technologies, Inc. (the "Company") Quarterly Report on Form 10-Q for the period ended June 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Ronald J. Semanick, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

/s/ Ronald J. Semanick

Ronald J. Semanick

Chief Financial Officer and Vice President - Finance
and Treasurer

August 13, 2008