

# PARAGON TECHNOLOGIES, INC.

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To The Shareholders of Paragon Technologies (“Paragon”):

Paragon’s per share book value increased by 26.0% in 2015, to \$2.13 per share, compared with \$1.69 per share in 2014. Shareholder’s equity equated to \$3.6 million at year end 2015 compared with \$2.85 million at the end of 2014. Shares outstanding remained unchanged year over year.

Paragon’s strong performance was a direct result of a great year at our material handling business, SI Systems, which generated an operating profit of \$1 million compared with an operating loss of approximately \$500,000 in 2014. Shareholders should direct their thanks to SI Systems CEO John Molloy and his team at SI Systems.

In last year’s letter, I noted that 2014 was a transition year for the company. Paragon experienced numerous changes including the appointment of a new CEO and CFO for SI Systems 2014, a change that could cause significant disruption for the biggest of organizations. Both John and our CFO Deb Mertz, who were complete strangers to one another, came and moved SI Systems forward. The result of their work speaks for itself in 2015.

Long-term shareholders, - I being one of them – clearly understand that Paragon’s operating performance has been a rollercoaster ride over the past several years. During the six year period between 2010 and 2015, Paragon did not have two consistent years of operating profit but rather alternated between operating profit and operating loss. This one-step forward, one-step backward performance is something I am acutely aware of and am dissatisfied with. Fortunately, SI Systems’ brand and reputation as a material handling solutions provider remains as strong as ever and we are firmly committed to delivering more consistent long-term operating results. We would stress that we don’t view consistency as a straight upward sloping line; however, over time, consistency does require that we increase per share book value with some regularity. Maximizing shareholder value is a phrase easily tossed around these days. At Paragon, when we talk about a commitment to shareholder value, you can bank on it: nearly one of every three shares is owned by your Chairman and CEO – 99% acquired through open market purchases.

## **2015 Year in Review**

Paragon reported a net profit of \$800,000 in 2015 compared with a net loss of \$(431,000) in 2014. The result of this operating improvement was a strong rebound our material handling business which generated revenues of \$11.6 million in 2015, a year over year increase of over 73 percent.

Paragon Technologies is a holding company that today consists of three primary components: wholly owned subsidiaries, businesses in which we have a significant investment, and minority owned investments.

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## SI Systems

Our material handling business experienced a solid year in 2015. The two “parts” of our material handling operations consists of a Production and Assembly division (PAS), representing the foundation of our material handling roots and our Order Fulfillment Systems (OFS) division, which provides order fulfillment systems and solutions to customers via our suite of branded and patented products.

Last year, we noted that SI’s installed base of over 200 customers was an undervalued and underutilized asset. The value of that installed base bore fruit in 2015 as SI was able to capture some significant projects, including a seven figure project from one of the country’s most iconic retailers, Macy’s. More noteworthy, however, was the explosive growth in SI’s pipeline of potential projects which continued to growth throughout the year. Heading into 2016, our pipeline of opportunities remains robust.

For our shareholders who may get lost with the terminology of material handling, perhaps an easier way to describe SI’s business is as a company that supplies the supply chain. The supply chain is the DNA of an economy’s production system. Whether a book, engine, toothpaste, or computer, all products require the supply chain to facilitate the movement of goods during the stages of production, warehousing and ultimately delivery to the end user. As the United States became a manufacturing powerhouse in the twentieth century, the demand and requirements for innovative and efficient supply chain solutions grew enormously. The supply chain was no longer a cost of doing business but a way to enhance and grow a business. Supply chain automation offered competitive advantages to manufacturers.

The explosive growth in e-commerce over the past decade has placed a new emphasis on the supply chain, likely in ways we cannot yet grasp. Five years ago, who thought it possible that a ready to cook gourmet dinner could be ordered in California on Sunday and delivered to your door step in Georgia on Tuesday - for less than what it would cost you to replicate at your neighborhood grocery store? Twenty-two years ago, a 400 square foot online bookstore opened up in a garage in Bellevue, Washington. Today, Amazon has over 25 million square feet of office space spread out over 100 locations, many of which are able to deliver a product that is ordered in the morning to its destination by day’s end. As this demand for immediate order fulfillment and delivery grows, the demand for material handling and order fulfillment solutions should remain healthy. Additionally, the continued migration of manufacturing onshore to the U.S. creates further demand for our material handling solutions as more and more businesses turn to automation eliminate headcount.

Our PAS business focuses on providing automated material handling systems to manufacturer assembly lines and distribution center operations via our branded towline conveyance and transportation technologies. These systems are sold primarily to end users, who then typically rely on SI for future enhancements, additions, or repairs to the system. As such, customer relationships tend to be very cooperative and long-lasting. One of SI’s key advantages is an existing installed base of high quality customers who are likely to come to us for replacement and enhancement projects for years after system installation.

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In our Order Fulfillment Systems (OFS) business, we continue to see significant demand opportunity in order fulfillment as a result of the continued growth in e-commerce as well as specific areas such as prescription fulfillment and health & beauty. The uncompromising need for timely and precise product fulfillment appears to be a long-lasting tailwind favoring fulfillment solutions providers.

Looking ahead in 2016, we continue to remain optimistic about our material handling business. Our focus and objectives remain unchanged from last year: We will continue to exploit the abundance of opportunities that SI's existing customer base can provide our core material handling operation, continue to invest opportunistically in our sales and marketing efforts, and invest in our material handling products and solutions in order to enhance our capabilities in becoming a highly versatile partner to our customers.

SI Systems has a nearly 60 year history of providing high quality material handling and supply chain solutions to our customers. Over the past six decades, we have been privileged to serve some of the most respected businesses and institutions including the United States Postal Service, Caterpillar, Harley Davidson, and Johnson & Johnson.

Our pipeline continues to remain very robust. We ended 2015 with approximately \$2.1 million worth of backlog along with over \$30 million in potential projects. During the first quarter of 2016, SI was awarded two contracts that each represented approximately \$1 million and a \$2.4M contract from the United States Postal Service.

Maintaining impeccable financial quality and strength is religion at Paragon. Our culture is to always operate with a sound balance sheet. We want our customers to know that doing business with Paragon and SI will never encounter any issues due to a lack of resources. More so, our financial position enables us to take on any major new projects without our customers ever having to be concerned about our ability to deliver a timely solution that meets or exceeds their needs. Our customers come to SI with projects that are crucial to their businesses and we are keenly aware of our responsibility to provide our services and solutions without compromise or delay.

In SI's 50 year plus history, our customers and partners have never had to harbor any concern about our creditworthiness nor our ability to complete our projects in a timely and efficient manner. Going forward, that stability should never change as SI benefits from the double advantage of having its own financial strength as well the support of Paragon.

## **Investment Activities**

Paragon intends to discuss its direct investments in SED International and Rubicon Technology in subsequent disclosures to shareholders when significant developments occur.

## Marketable Securities

The following chart lists Paragon's minority investments, with an aggregate market value of \$100,000 or more, as of April 30, 2016:

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Security	Cost Basis	Market Value
<b>Common Stock</b>		
10,000 sh National Security Group	\$95,636	\$158,200
5,000 sh TowneBank	\$91,184	\$105,000
<b>Preferred Stock</b>		
14,000 sh Meritage Hospitality 8% Series B	\$128,037	\$261,800
<b>Fixed Income</b>		
Sanchez Energy, June 2021, 7.75%	\$77,827	\$123,375

The face value of the Sanchez bonds is \$150,000

For the 2015 year, the investment portfolio recorded a net realized gain of approximately \$17,300 plus dividend income of approximately \$16,400 for a total gain of \$33,700, or approximately 3.5% based on average capital employed of roughly \$1 million during 2015. This return compares with an S&P 500 return of 1.4%, which includes the reinvestment of dividends. We remain optimistic about the long-term performance of our securities portfolio. (Please note: this reference to a realized gain does not incorporate any unrealized gains or losses in our portfolio. Please refer to Paragon's annual report for a breakdown of current unrealized gains and losses).

Shareholders should note that Paragon's investment policy is strictly utilized to provide an intelligent capital allocation structure for the Company's excess cash. Our approach to investment selection is businesslike – we buy securities; we invest in companies. If we are unable to buy entire businesses or sensibly reinvest in our existing ones, we take advantage of opportunities to invest partially in other business through the stock market. Concurrent with our investment philosophy is a philosophical view that Paragon will always maintain a healthy, unencumbered cash balance that will always be available to support our businesses at a moment's notice.

As the Chairman, CEO, and chief capital allocator at Paragon, shareholders are, to a great extent, relying on my ability to effectuate value creating decisions that ultimately leads to in an increase in Paragon's per share intrinsic value. I am the company's largest shareholder. My financial net worth and that of the Gad family is fully hitched to the Paragon wagon. I will win alongside Paragon shareholders, not at their expense. More importantly, I will experience the greatest financial pain as a result of any deterioration in Paragon's value.

## The Annual Meeting

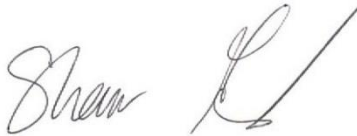
The Annual Meeting/Shareholder Presentation will be held on Tuesday, June 21, 2016 from 10:00 a.m. to 12:00 p.m. EST at the company's offices located at **101 Larry Holmes Drive, Suite 500, Easton, PA 18042.**

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We will start the meeting promptly at 10:00 a.m., and we will devote the bulk of the meeting to shareholder Q&A. We encourage all shareholders to attend as this will provide the best forum to communicate with management.

Sincerely,

A handwritten signature in cursive script, appearing to read "Hesham Gad". The signature is written in black ink on a white background.

Hesham Gad,  
Chairman and Chief Executive Officer  
May 13, 2016