  

Annual Report 2006

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Key indicators for paragon Group	2006	2005	2004	2003	2002	Change in % 2005 / 2006
Sales in millions of €	110.8	80.2	64.7	40.7	38.6	38.2
Gross profit in millions of €	56.3	41.5	29.9	19.4	16.3	35.7
EBITDA[1] in millions of €	20.2	13.9	10.3	6.2	4.8	45.3
EBIT[2] in millions of €	8.5	6.6	5.2	2.9	1.7	28.8
Net income in millions of €	2.2	2.2	2.9	1.4	1.5	0.0
Total assets in millions of €	137.8	113.0	64.5	34.4	32.2	21.9
Equity[3] in millions of €	40.8	42.6	22.8	12.1	11.2	- 4.2
Equity-to-assets ratio[3] in %	29.6	37.7	35.4	35.2	34.8	- 21.5
Liquidity in millions of €	8.8	4.8	5.4	2.5	3.8	83.3
Capital expenditure[4] in millions of €	33.2	29.6	23.1	7.0	4.8	12.2
R & D expense in millions of €	11.4	6.2	2.6	2.0	1.3	83.9
Number of employees at year-end	564	527	388	238	216	7.0
EBITDA margin[5] in %	18.3	17.3	16.0	15.2	12.3	–
EBIT margin[5] in %	7.7	8.2	8.1	7.2	5.4	–
Return on sales in %	2.0	2.8	4.4	3.4	3.8	–
Return on equity in %	12.6	12.8	14.7	11.3	13.1	–
Market capitalization at year-end in millions of €	45.2	57.2	63.6	39.6	15.8	21.0
Earnings per share in €	0.61[6]	0.55	0.71	0.34	0.37	10.9
Dividend (proposed) per share in €	0.30	0.20	0.10	—	—	50.0

[1] Earnings before interest, taxes and depreciation / amortization
[2] Earnings before interest and taxes
[3] incl. profit-sharing rights capital and dormant participation excl. minority interest
[4] incl. goodwill
[5] in proportion to sales
[6] adjusted for tax relating to previous periods

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CFO Hans-Jürgen John
CEO Klaus Dieter Frers

Sehr geehrte Aktionäre,

In 2006, the paragon Group systematically continued to grow and clearly achieved a new sales record of € 100 million. Back in 2003, our sales were still € 40 million. In fiscal year 2006, sales rose by 38.2 % to € 110.8 million. We primarily owe this positive development to our Automotive business division. This division now generates more than 80 % of our revenue and it will continue to be our growth engine in the future. EBITDA (earnings before interest, taxes depreciation and amortization) rose by 45.3 % to € 20.2 million, outpacing the growth of sales. EBIT (earnings before interest and taxes) improved even more, by 50 % to € 9.9 million. To be able to sustain such growth in the future, we took three important strategic measures last year. We have adapted our internal structures to the fast-paced development and expanded our production capacities and our complete takeover of paragon fidelity has put us in a very strong position in the Car Media growth market. We have set the stage for a successful future and it will begin to pay off already in 2007.

The year 2006 – a basis for sustained growth

The growth of recent years has transformed paragon into a group with branches in the USA, France and Japan. Italy will soon be included. Of course, this also means an increase of internal requirements. For that reason, we examined our corporate structure last year and put it in line with the new challenges by, among other things, strengthening our second layer of management and dividing our business divisions into individual profit centers.

Our completion of the second phase of construction at the Suhl factory in October 2006 was another important step in ensuring that our production capacities will provide us long-term growth. The significant expansion of our production capacity was not just in reaction to the major orders for air quality sensors received in 2006. We have also created the conditions necessary for us to be able to utilize all potentials and meet the increasing demand for our innovative products.

Our complete takeover of paragon fidelity, the former Cullmann GmbH, was specifically aimed at strengthening our position in the Car Media growth market. We are now in an excellent position to benefit from the future trend of communication in the automobile. Headunit light, iPod/MP3-connection via MDI, rSAP and eCall are only a few catchwords for the trends that will secure our sustained growth in this segment and will make the acquisition of Cullmann a value-adding investment.

The growth drivers - Car Media Systems and Climate Systems

auto.wellness.paragon® is our vision for the automotive interior. The Automotive business division is our core competence and has the greatest future potential. Car Media Systems, Climate Systems, Instrumentation and Control Systems benefit from the increased use of electronics in the automobile and represent the future for paragon. Of course, the focus of our strategy is the end customer, i.e., the driver and passengers. We want our products to make driving a car as enjoyable and safe as possible. In this context, we are far more than just a supplier. As a partner of the automobile manufacturers, we are taking over more and more areas of the value-added chain. Together with our customers, we are developing innovative solutions and are becoming the supplier of complex systems. Car Media Systems and Climate Systems will become the growth engines of paragon.

Car Media Systems is one of the most innovative divisions and is a core automotive growth area. One of the future trends is the integration of mobile communication devices. Cell phones are increasingly developing into ‘smart phones' with possibilities far exceeding conventional telephony and combining functions like navigation, audio, video and information management. The customer would also like to have these functions in the automobile and our solutions offer this possibility.

The Climate Systems division also continues to have considerable potential for growth. People should feel good in their car, not have to worry about external influences and be able to concentrate on the essential – driving. paragon is No. 1 worldwide when it comes to air quality in the vehicle interior. We have revolutionized the market in recent years with our air quality sensor AQS. In 2006, we made an important breakthrough in the high-volume compact and medium range, which will enable us to increase our sales in this area by more than 50 % over the next few years. In addition to market penetration, new products will ensure growth; the key word here is active air quality improvement. In close cooperation with the automobile manufacturers, we are developing products that not only detect the negative influences on air quality but also eliminate them. With our Air Improvement Concept, we are establishing a new trend with a clear objective: optimal air quality in the vehicle interior.

The year 2007 – the focus on results-oriented growth

We will continue to grow in 2007. Significantly higher growth in earnings will have a clear priority over sales growth. Last year, we created the ideal basis for such growth by taking the measures described above. It is now a matter of putting the existing earnings potentials into action. To that end, we will systematically apply the human and financial resources to the Automotive segment. We will review business processes and procedures, investigate and enhance synergy potentials. The cost optimization will bear fruit as early as 2007. We currently see a positive impact on earnings of at least € 2 million. In addition to the optimization of internal processes, a larger share of products from the Car Media Systems and Climate Systems divisions will also have a positive impact on earnings. It is in these areas that we generate above-average margins with our innovative solutions and systems.

Of course, the cost optimization will be accompanied by increased sales. In 2007, we made the first deliveries of our air quality sensor AQS for the compact class of a German automobile manufacturer. We anticipate that an enhanced product generation with improved function and compatibility will significantly increase demand for our hands-free speaking systems. Our product pipeline in the Car Media Systems division is well filled. Our interior mirror with an integrated navigation system is market-ready and a new multimedia interface for access to MP3 players will be delivered to Audi. Finally, we will also push ahead with our international growth. In Italy, we will establish a new sales office and we are in intensive discussions with Japanese automobile manufacturers concerning the importation of the air quality sensor AQS into Japan as well.

As the founder and majority shareholder of paragon, its lasting success is of particular importance to me. We work competently, with commitment and enthusiasm to make the most of our potentials and achieve the goals we have set for ourselves. paragon's growth story is continuing. I am therefore certain that the continued expansion will make a positive contribution to our enterprise value.

Klaus Dieter Frers
Chief Executive Officer


12:19
Option Anrufen Zurück

All of our business activities have their origin in one basic expectation: Driving an automobile should be as safe and comfortable as possible. To that end, we offer innovative and customized solutions in Car Media Systems, Climate Systems, Instrumentation and Control Systems that precisely meet these requirements.

Our expertise is in joining together electronics, sensors, software and precision engineering. We have unique experience in this market and we benefit from the long-term trend toward increased electronics in the automobile. In order to obtain the greatest possible benefit from this market environment, we systematically draw on our strengths of innovation, extremely good positioning in high-growth niche markets as well as the expertise and enthusiasm of our employees. These are the preconditions for achieving our goal of increased value for our employees and shareholders.

Profitable growth

Systematic development of strengths

To increase our enterprise value continuously and sustainably, we pursue a profit-oriented growth strategy. In order to safeguard long-term competitiveness and accordingly an increase in enterprise value, growth must go hand-in-hand with profitability. The growth we strive for will be achieved in different ways. It is based on a solid increase in sales in all divisions. In Car Media Systems and Climate Systems, we have significant market positions in the core automotive growth areas of automobile comfort and communications. However, there is also considerable potential in Instrumentation and Control Systems. To take advantage of these opportunities, we are systematically building on our strengths and are concentrating our financial and human resources on the Automotive division. In addition, we are striving to improve our margin through even higher efficiency and increasing productivity within our business processes and procedures. Based on these measures, we expect earnings growth to outpace sales in fiscal 2007.

auto. wellness. paragon®

Our entire product portfolio serves one purpose: The driver and passengers should feel good. In recent years, we have become a specialist in solutions that satisfy the basic requirements for safety and comfort. By combining individual components into complex systems, we are taking on more and more parts of the automotive value added chain and are increasing our earnings potential. As a technology leader with significant market positions in our niches, we are a direct supplier and a close partner of all large automobile manufacturers, the OEMs. We intend to make even greater use of this competitive advantage in new product launches.

€ 200 million in sales by 2010

Owing to the great potential in all four Automotive business divisions, organic growth is clearly the focus of our strategy. By doing so, we intend to achieve sales of € 200 million by 2010. We will carry out acquisitions if they provide us access to new markets or key technologies to supplement our portfolio.

Strengthening the paragon® brand

For some years we have been the world market leader in air quality sensors with a small product portfolio. From this basis, we have made the leap into the vehicle interior. Today our systems „made by paragon" deliver a directly visible and tangible value in use. Handsfree devices make safe calling possible; high-quality display instruments make it easy to read information and modern switches make it very convenient to operate a large number of devices.

To increase our public awareness, starting in January 2007 we will bundle our external presentation under the brand paragon®. This strategy applies to all marketing activities, our presence at trade fairs and our entire corporate communication. The individual divisions will continue to be managed in legally independent subsidiaries but they will recede to the background. Our automotive customers will no longer see the previous separation. In doing so, we want to document our position as an internationally active direct supplier with a broad product range and strengthen the awareness of the brand paragon®. As a global market leader in automotive air quality, we have an excellent image and very good relationships with all leading OEMs. The new brand strategy will enable us to make even better use of this competitive advantage.

In addition to the Climate Systems that have contributed to paragon's growth, Car Media Systems has developed into a broad-based core unit with great prospects for the future. We see the greatest potentials for growth for the entire Group in these two divisions.
Car Media Systems

Car Media Systems

People want to be able to benefit from modern communication and multimedia technology anywhere they are and without any impediment. This expectation makes Car Media Systems one of the most important areas of growth in the automotive environment.

Mobility is the megatrend

New technologies like UMTS and Bluetooth are an inexhaustible source of new possibilities. They make the automobile a mobile office as well as an information and entertainment center. Making calls with handsfree speaking systems and cell phones represented the start of this trend. In the meantime, mobile navigation has almost become a part of everyday life. The next trend will be sending faxes and email as well as Internet surfing in the vehicle. Cell phones are increasingly becoming 'smart phones', combining functions well beyond the bounds of telephony, such as audio, video, navigation and personal information management, in one device. In addition, audio devices such as Apple's iPod and other MP3 players are rapidly gaining in importance and the future for mobile video applications is already here. Special solutions are required to be able to make use of all these possibilities in the vehicle. All devices must be optimally integrated in the vehicle interior to ensure simple operation and simultaneously satisfy all safety standards. One thing continues to be the priority in all these technological developments: arriving safely at one's destination.

paragon offers a wide range of applications in the areas of handsfree communication, navigation, multimedia and telematics. The focus for all of these products is the optimal linking of the various communication functions with the human-machine interface. Customer satisfaction is our top priority: the highest quality in data and voice transmission, integration of varied functions in mobile communications devices and optimum orientation for drivers and passengers. We define the demands on our products not only through high-quality technological implementation. A coordinated design also ensures harmony with the vehicle interior. We thus create solutions that both function and look the best.

Fully developed hardware and software

The integration of mobile devices in the vehicle environment is the focus of our expertise. In doing so, we combine sophisticated hardware and software into a fully developed whole that is more than the sum of its parts. In this way, we create important differentiation and innovation features for our partners from the automotive industry. Fleet operators can also put considerable synergy effects and savings potentials into play using our solutions.

"Integrate – Navigate – Communicate"

Whether future trends dictate that the navigation unit will become an integral part of the vehicle or a mobile device, paragon has solutions for both possibilities. For a long time, navigation systems were only available as an installed option in luxury and full-size cars. While almost 100 % of all new cars in these classes are now equipped with devices costing several thousand euros, the penetration in the mid-size and compact class is still very low. Instead, mobile navigation devices are offered for this high-volume segment and their market is booming. The market research institution Canalys calculates that 9.5 million units will have been sold in Europe in 2006, reflecting growth of 100 %. While most of these devices are still specialized for navigation, cell phones and smart phones will take over a significant role in this market in the future.

Our individual telephone adapters, known as cradles, ensure uncomplicated use. Cradles provide the power supply and make a secure and uncomplicated fixation possible within the driver's field of view. Using our software, cell phone and smart phone functions can be transferred to the control systems and the large instrumentation systems of the vehicle, even via Bluetooth. This makes cell phone navigation function just like a preinstalled device but at significantly lower cost.

Navigation now in the interior rearview mirror

However, we also have a novel solution for users who prefer a built-in system that no longer detracts from the overall visual impression of the vehicle interior. Jointly with the global market leader for interior rearview mirrors, Magna Donnelly, we have developed the ideal combination of attractive price, perfect vehicle integration and appealing design, a navigation system in the interior rearview mirror. This unique solution integrates the entire electronic system together with the display and antenna in the housing of the rear-view mirror, making the product equally attractive for new vehicles and the aftermarket.

Whether analog or digital, voice or data, our solutions ensure that all elements are transferred from starting point A to destination B – without any loss of quality. We have developed numerous microphone versions that guarantee optimal audio quality. Our portfolio covers all function-relevant areas: handsfree microphones, invisible removable microphones and integrated steering wheel microphones.

Microphone and belt as a single unit

The belt microphone Beltmic is one of the technical highlights of our product range. As a globally unique innovation, we have been able to weave high-quality microphones into the structure of the safety belt. At the same time, we achieve hitherto unknown voice quality compared to conventional standard microphones. Of course, the function of the safety belt continues to be ensured.

The mobile office is another trend that is being closely observed. Our ingenious telematics technology brings numerous modern office applications into the automobile. Furthermore, the telematics box that we have developed is the ideal solution for individual processing of various vehicle data. Using an additional chip card reader, our modular telematics concept offers additional options of interest to fleet owners in particular for improving efficiency and optimizing processes in fleet management.

These innovative solutions for the market trends described above make the Car Media Systems division an integral and long-term growth engine in the paragon Group.

Climate Systems

Feeling good and staying healthy

Health is a primary human need and is of great importance in the automobile. Microparticles, pollen, molds, cigarette smoke and even exhaust gases are only a few examples of harmful influences on health that also distract the attention of the driver and passengers and increase the risk of accident. We want people to feel good in their vehicle, stay healthy and be able to concentrate on driving.

With more than a decade of experience, paragon is the world's leading specialist in air quality in the vehicle interior. We are completely familiar with the internal and external influences that reduce air quality and we act accordingly with our products through air flap control, filtering, germ-free evaporators, ionization and CO_2 control. In this area, we have achieved outstanding technological advances that are reflected in a continuous stream of new, compelling products.

No. 1 in air quality

Our first step was to develop products for identifying harmful substances and odors. With the air quality sensor AQS, paragon has conquered the world market within a short time. We brought this technology to market readiness more than a decade ago and pioneered in integrating it worldwide as a standard feature of automobiles. At first, only full-size cars were equipped with AQS, but now it is increasingly being used in mid-size cars, and in the meantime it has become the standard in that segment. Numerous important automobile manufacturers such as BMW, DaimlerChrysler and VW/Audi use our solutions for interior air quality. The potential for growth in this area is still far from having been exhausted. We made a breakthrough in the "Golf class" in 2006. These new orders alone will increase AQS sales by approximately 50 % over the next few years. Moreover, we expect that more manufacturers will want to offer this comfort to their customers in the compact category.

Potentials in large Asian urban areas

But not only the development of new vehicle segments offers potentials. The Asian market is still largely undeveloped. Here also, automobile manufacturers recognize that fresh air in the vehicle interior represents added value not only in large urban areas, that it is honored by customers and that they can use it to stand out against the competition. Our sales office in Amagasaki near Osaka puts us in an outstanding position to take advantage of the numerous possibilities in this region. But not only AQS will bring further growth. We have a very promising pipeline of products that have the potential to write a success story similar to that of our air quality sensors.

Active air quality improvement

With our Air Improvement Concept, we are establishing a new trend with a clear objective: optimal air quality in the vehicle interior. In recent years, AQS has propelled us into the position of technology and market leader. On this basis and in close dialogue with the automobile manufacturers, we are now developing a series of additional products that not only detect and prevent the negative influences on air quality but also actively eliminate them.

We achieved the first important milestone in this development in 2006. We obtained the first major order to supply the air quality conditioner AQC. While AQS prevents harmful gases from penetrating the interior, AQC actively provides optimal interior air. Eliminating germs and bacteria from the air conditioning system prevents the formation of unpleasant odors and prevents danger to health through the growth of molds. Starting in model year 2009, approximately 250,000 vehicle owners will benefit from this system per year.

The air improvement system AQI is the next step toward quality. Small ions are used not only to bind and neutralize odors such as cigarette smoke but they also increase the capacity of the passengers' blood to absorb oxygen. This reduces fatigue symptoms and increases concentration. In 2006, we began selling this air improvement and wellness system and it has met with great interest.

AQI is the next step

Air quality in the automobile is a market of the future and one of the growth engines in the paragon Group. The examples AQC and AQI illustrate that we are constantly developing new solutions for a diverse range of problems. Our expertise enables us to produce innovative, high-quality products that deliver genuine added value to the automobile manufacturers and their customers.

As a technology driven company, intensive research & development is the engine for paragon's sustained growth. The goal to be an innovation leader rather than an imitator within the niches we occupy makes this area an important part of our strategic direction. Many years of research have brought us extensive expertise and the highest level of competence in sensors, electronics, electromechanical devices and software. Novel solutions for all product areas arise from this pool of knowledge. To safeguard our existing potential for innovation, we continuously build up capacities in research and development. With the most advanced research and laboratory facilities in Delbrück and Cadolzburg, we create the most ideal conditions for fresh ideas and innovative products. A systematic quality management system is in place during the entire development process from the first idea, to prototype production and on to series production. In addition to technological feasibility, the focus is on competitive intelligence and efficiency. Each individual project must both meet market demands and be able to make a lasting contribution to increasing the enterprise value.

Pleasant and safe driving

In addition to the continued development of current products, we are working to expand the existing product range. The opening of new, forward looking and profitable product areas continuously expands the core competence of paragon. All of our research activities are focused on the development of new systems and products by combining maximum quality, simple functionality and creative design. All of our projects have one thing in common, namely the question, "How can we make driving a car more pleasant and safer?" In answering this question, we constantly come upon solutions that no-one has ever thought of. Examples include the AQI system for active air quality improvement or our Beltmic that significantly optimizes the voice quality in the automobile by integrating microphones in the safety belt.

Continuous expansion of competence

Partner for industry and research

The ability to make a new idea tangible and concrete in a prototype and then develop it further into a market-ready product makes paragon a competent cooperation partner. We thus have a comprehensive network of partners from industry and research for expanding our technological expertise. The constant exchange continuously gives rise to innovative

products such as the AQC system, for example. Its basic idea originated when a well-known OEM came to paragon and reported unpleasant odors in the vehicle interior. They are caused by the development of germs and bacteria in air conditioning systems that not only smell unpleasant but can even cause allergic reactions. Our research resulted in the AQC system that keeps the air conditioning system virtually germ-free and thus contributes to a sense of well-being and staying healthy.

102 employees and 255 patents

Our existing patent portfolio is one proof of how successful our research is. Overall, we currently have 255 national and international patents.

At year-end 2006, 102 persons were employed Group-wide in research & development to safeguard our Company's future technological capability. This number reflects 18.1 % of our entire workforce. In the year under review, our expenditures for research and development rose 83.9 % to € 11.4 million (2005: € 6.2 million). In proportion to Group sales, the R&D ratio was 10.3 %.

Site	Employees in R&D
Delbrück, Headquarters, R&D	39
Suhl, Sensor element factory	2
St. Georgen, Group center for instrument construction and highly specialized drive technology	2
Cadolzburg, Car Media Systems center	57
Grand Rapids, USA, paragon of NA Corp.	2
Total	**102**

Status: 12/31/2006

In line with our strategic direction, the research & development activities of paragon focused on the Automotive division.

Headunit integra

The Headunit integra is paragon's new integrated control concept. It combines the control of vehicle and infotainment components. This sophisticated integration solution makes it possible to link mobile end devices and their single functions with modern vehicle bus systems. At the same time, the Headunit integra makes it possible to control a large number of on-board systems. The headunit makes it possible to implement individual applications including regulating the air conditioning, connecting cell phones or controlling the navigation system. The driver constantly has all information in view via the central display in the headunit.

MDI

paragon has developed MDI (Media Device Interface) in cooperation with Audi. MDI is the ideal solution for connecting mobile MP3 players such as the Apple iPod to the vehicle's entertainment system. The portable player is safely stowed in the glove compartment and from there feeds the stored music directly into the vehicle audio system via USB, iPod connector or line-in. In addition, playlists of the mobile devices can be conveniently displayed in the vehicle display via MDI and controlled via a multimedia interface.

AQC

Our Air Quality Conditioner AQC solves an everyday problem in an innovative manner. Fluctuating temperatures make the evaporator of any air conditioner an ideal breeding ground for the proliferation of germs and bacteria. Metabolic processes can rapidly cause an unpleasant odor. Possible consequences of this phenomenon include allergic reactions of the occupants. AQC remedies this problem through micro-oxidants. A slight, imperceptible quantity of ozone directly eliminates the germs and bacteria on the air conditioner's evaporator. Oxidation and flushing away organic substances deprives the germs of their growth medium. In this way, AQC ensures that the evaporator is kept as germ-free as when it was new and thus produces the desired effect of well-being.

AQI

The Air Quality Improver AQI is an active air quality improvement and wellness system for the car interior. The effect is based on a physical principle in which small ions are released. This process has an astounding effect. It binds and reduces micro-particles, germs, bacteria, gases and odors. This purifying effect is clearly recognizable when cigarette smoke is used as an example; AQI virtually absorbs the smoke. In addition, it significantly increases the capacity of the passengers' blood to absorb oxygen, thus reducing fatigue.

Dual pointer instruments

paragon is putting its mark on the trend to increasing differentiation in the vehicle interior through another innovation. A newly developed dual stepper motor makes it possible to control two concentrically arranged pointers independently. This makes completely new instrumentation system designs possible. For example, this technology can be used to combine the speedometer and tachometer in one instrument with only one axis of rotation (instead of two).

3D position sensors

The 3D position sensor newly developed by paragon is a technology leap compared to conventional Hall sensors for detecting the shift lever position in shift-by-wire applications. A decisive advantage of this contactless and thus wear-free position detection is its extreme interference immunity due to the high frequency selectiveness. The innovative principle of action has enabled us to achieve a significantly higher reliability of the system, which requires no additional screening measures in the vehicle.

Sensor switch

paragon's sensor switch technology offers an alternative to mechanical switch systems. This innovative technology is the perfect solution for highly varied control functions. Since the switch panel's sensor is situated behind a closed surface, it can be readily integrated in the car's interior. In addition, this design offers effective protection against mechanical shocks, dirt and humidity. A particular advantage is that designs can be incorporated in the surfaces and they can be illuminated, thus offering the manufacturer many possibilities for individual layout.

Dear Ladies and Gentlemen,

In fiscal year 2006, paragon AG repeated the strong development of the previous years. During this time, the Supervisory Board performed its duties in compliance with legal and statutory provisions, corporate governance rules and its rules of procedure. It advised the Managing Board and continuously satisfied itself that the company is being properly managed. Using detailed reports, the Managing Board kept the Supervisory Board informed concerning the general situation, the financial situation, the strategy and key business transactions. As chairman of the Supervisory Board, I also obtained information from the Managing Board in numerous personal discussions. The cooperation was always based on trust.

Consulting focuses

The Supervisory Board met four times in the past fiscal year. On March 21, May 17, September 19 and December 7, 2006, we met jointly with the Managing Board to intensively discuss and analyze the strategy, the overall condition of the company and the significant operating events. In its supervisory responsibility, the Supervisory Board primarily relied on the written reports and its inspection of the accounting records. For the review of specific instances, qualified legal or auditing experts may be involved on a case-by-case basis. Significant consulting focuses were the complete takeover of paragon fidelity and the restructuring of the subsidiaries.

As part of its regular activity, the Supervisory Board reviewed the monthly and quarterly figures presented to it. In the last meeting of fiscal year 2006, we discussed with the Managing Board the planning and objectives for 2007 as well as the overall planning for the following years. In addition to the meetings, the Managing Board and the Supervisory Board are in regular contact for the exchange of views concerning significant business transactions and the current economic and financial situation of paragon AG. We also had detailed discussions with the Managing Board concerning significant measures requiring approval. In 2006, these included, for example, discussions concerning the capital expenditure at Suhl.

Individual and consolidated financial statements for 2006

The consolidated financial statements were prepared in accordance with the International Financial Reporting Standards (IFRS). The individual financial statements, the consolidated financial statements as well as the management report and the consolidated management report of paragon AG were audited by the auditor and were awarded an unqualified audit opinion. These financial statements, the management reports and the auditor's reports were made available to all members of the Supervisory Board and were discussed in detail in the presence of the auditor in the Supervisory Board meeting on March 28, 2007. Based on the detailed information of the auditor and the Company's own audit results, the Supervisory Board found no evidence of discrepancies and no need to undertake or initiate more extensive auditing procedures.

Corporate Governance

Please see the Corporate Governance Report on page 27 et seq. of the annual report for information regarding the independence of the Supervisory Board members, conflicts of interest and directors' dealings.

An audit certificate without reservation was awarded the report on the relationship between paragon AG and Mr. Klaus Dieter Frers and closely connected persons and companies, prepared voluntarily by paragon AG's Managing Board according to precedent contained in section 312 of the German Stock Corporation Act. According to this certificate factual information in the report is correct, remuneration by the Company was not inappropriately high nor in compensation for adverse affects with respect to the legal transactions listed in the report. None of the measures included in said report gave rise to circumstances that would result in an assessment significantly at variance with that of the Managing Board. The voluntary report submitted by the Managing Board and the auditor's report were provided to the Supervisory Board. The Supervisory Board reviewed the voluntary report prepared by the Managing Board and at the conclusion of their review agreed with the results of the auditor's examination The auditor under precedent contained in section 314 of the AktG participated in negotiations of the Supervisory Board concerning the Managing Board's report of relations with Mr. Klaus Dieter Frers and closely connected persons and companies and reported the key results of his examination.

paragon AG is growing successfully. This is possible only through the commitment and merit of all employees and the Managing Board. The Supervisory Board thanks all employees for their dedication and their enthusiasm and wishes them much success for the current fiscal year.

Delbrück, March 28, 2006

Prof. Dr.-Ing. Walter Kunerth
Chairman of the Supervisory Board

paragon AG bases its actions on the recognized principles of corporate governance. The company largely conforms to the recommendations of the German Corporate Governance Code. Existing exceptions due to individual circumstances of the company with respect to size, structure and economic situation are stated on page 30 of the annual report.

Shareholders and Annual General Meeting

www.paragon-online.de is the central information platform for our shareholders. In advance of the Annual General Meeting on May 17, 2006, it was possible, as accustomed, to inspect and download from the internet all significant documents such as the meeting agenda. If countermotions had been received prior to the Annual General Meeting, the Company would have published them on the internet site. Following the Annual General Meeting, the Chief Executive Officer's speech and presentation were made available there. More than 200 shareholders and guests attended the Annual General Meeting in 2006, the highest attendance since the IPO in 2000. The rate of attendance was 61.74 %. All agenda items to be acted on were adopted with a clear majority. For reasons of cost, we will no longer publish the Annual General Meeting in our web pages.

Cooperation between the Managing Board and Supervisory Board

The close cooperation to the benefit of the company was evident in particular in the continuous and personal exchange of information between the Managing Board and the Chairman of the Supervisory Board. The cooperation was distinguished by a relationship of trust, which made possible an open discussion between the Managing Board and Supervisory Board. All Supervisory Board meetings during the year took place with the Managing Board present. If necessary, the Supervisory Board can meet without the Managing Board. See the Report of the Supervisory Board on page 23 for further details on the number of meetings and exchange of information.

Managing Board

The Managing Board currently is made up of two members. An audit certificate without reservation was awarded the report on the relationship between paragon AG and Mr.

Klaus Dieter Frers and closely connected persons and companies, prepared voluntarily by paragon AG's Managing Board according to precedent contained in section 312 of the German Stock Corporation Act and audited (Report of the Supervisory Board, page 24).

In conformity with the recommendations of the German Corporate Governance Code, the remuneration of the Managing Board comprises fixed and variable components. The Supervisory Board regularly reviews the fixed as well as the variable component of the remuneration to determine if it is in line with market salaries and if it is fair and reasonable.

Supervisory Board

The Supervisory Board of paragon AG continues to consist of three members. To ensure that the Supervisory Board provides independent advice to and supervision of the Managing Board, its members are obligated to openly disclose possible conflicts of interest to the Supervisory Board. During the past fiscal year, there were no conflicts of interest involving members of the Supervisory Board of paragon AG. No remuneration was paid for personal services. The Supervisory Board regularly reviewed the efficiency of its activities through self-assessment.

Transparency

Open and transparent communication are fundamental values of our corporate governance. We comprehensively inform our shareholders, financial analysts, the financial press, shareholder associations as well as the general interested public concerning the most important developments in our company. In addition to the annual financial statements and quarterly reports, we use ad hoc reports and press releases as information media. Regular publication dates are summarized in the financial calendar. To provide equal access and timely information, we make all of this information available on our Internet home page for inspection and downloading.

Directors' Holdings

As of December 31, 2006, members of the Managing Board and Supervisory Board held the following shares: Managing Board: 51.44 %. Supervisory Board: 0.10%.

Accounting

paragon AG prepares its accounts according to International Financial Reporting Standards (IFRS).

If necessary, the company sends its consolidated financial statements to the German Financial Reporting Enforcement Panel and the German Supervisory Authority for Financial Services (BaFin) for auditing.

Declaration of paragon AG on the German Corporate Governance Code

In accordance with section 161 of the German Stock Corporation Act (AktG), the Managing Board and Supervisory Board of paragon AG issue the following Declaration of Compliance with the recommendations of the Government Commission of the German Corporate Governance Code:

The Managing Board and Supervisory Board of paragon AG welcome the recommendations and rules of the German Corporate Governance Code. They commit themselves to transparent, responsible corporate management and control which is oriented to creating value. paragon AG has conformed and conforms to the recommendations of the German Corporate Governance Code in the version dated June 12, 2006 with the following exceptions:

- a reasonable deductible in accordance with No. 3.8 of the Code has not been included in the Directors & Officers insurance policy that the company took out for the Managing and Supervisory Boards;

- the Supervisory Board has not set a cap for extraordinary unforeseen developments in accordance with No. 4.2.3 of the Code;

- according to the resolution of the Annual General Meeting in 2006, information on the remuneration of the members of the Managing Board is not shown individually in the notes to the consolidated financial statements in accordance with No. 4.2.4 of the Code.

- No remuneration report is prepared as a part of the Corporate Governance report as required by No. 4.2.5.

- information regarding remuneration of members of the Supervisory Board is not itemized in the financial statements as required by No. 5.4.7 of the Code.

Delbrück, December 7, 2006

paragon Aktiengesellschaft

The Managing Board The Supervisory Board

General market environment

In 2006, the performance of the national and international stock markets was pleasing, although the DAX, the German Share Index, experienced a significant correction for the first time in more than three years in May 2006. In June, the DAX dropped to its low for the year of 5,292 points primarily due to profit taking and a poor U.S. market. However, the decline of approximately 13.8 % lasted only a few weeks. After that, the German equities market performed very pleasingly. With only slight fluctuations, the DAX climbed to a five-year high of 6,629 points on December 28. Closing at 6,596.92 points, the leading German index ended the year with an approximately 22% gain.

paragon stock

The performance of the paragon stock was unsatisfactory in 2006 and does not reflect the company's development of operations. The stock opened the year at a price of € 14.10. On March 20, it reached its high for the year at € 17.80. After a period of volatility, the closing price for the year was € 10.98 and was accordingly 22.1% lower than at the start of the year. The shareholder structure did not change significantly in 2006. The Managing Board is convinced that the sustained business development and the excellent prospects will again lead to a growing stock price.

WKN:	555 869
ISIN:	DE 000 555 8696
Ticker symbol:	PGN
Trading segment:	Prime Standard
Sector:	Technology
Designated sponsors:	Close Brothers Seydler AG Wertpapierhandelsbank, Lang & Schwarz Wertpapierhandelsbank AG
Index:	GEX
Share capital:	4.113.063
Shareholder structure:	approx. 52 % Klaus Dieter Frers approx. 48 % free float
IR contact:	Haubrok Investor Relations GmbH Fabian Lorenz Phone + 49 (0) 2 11-30 12 60, e-mail: investor@paragon-online.de

Financial Markets Communication

In 2006, paragon continued to maintain close contact with the financial community. In addition to extensive information available on the company's web site, the General Annual Meeting was used for dialogue with the shareholders. In his speech, the Chief Executive Officer summarized the business development in 2005 and provided an overview of the company's future strategy. In return, the shareholders expressed satisfaction with the key indicators for 2005 and paragon's future perspectives. Consequently, the General Annual Meeting approved all points of the agenda with a large majority and in so doing affirmed the successful course of the Managing Board. Furthermore, the company regularly made roadshow presentations to numerous investors and analysts. In November, the Managing Board participated in the "German Equity Forum," the largest investors' conference in Germany.

paragon is now covered by various institutions. Based on their regular studies of the company, these analysts have issued a "buy" recommendation for the paragon stock in their most recent update. Since January 2006, Lang & Schwarz Wertpapierhandel AG has been a second designated sponsor in addition to Seydler AG and increases the liquidity of the paragon stock.

Outlook for 2007

The Managing Board will continue to seek active dialogue with the financial community in 2007. One highlight will be the International Automobile Exhibition in Frankfurt where all interested parties will have the opportunity to convince themselves of the potentials of the paragon product portfolio and accordingly of the stock.

The Managing Board has clearly stated its operating targets for 2007: Additional growth in sales with significantly higher growth in earnings. This development should again lead to a positive share price performance.

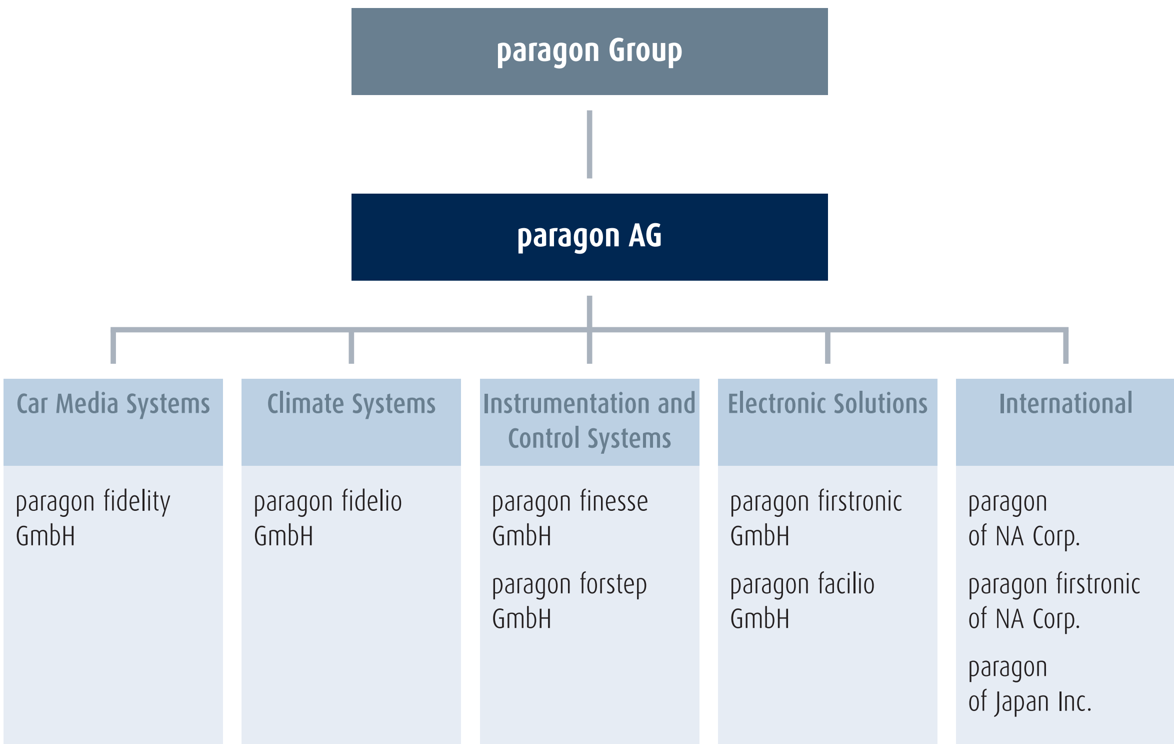
paragon stock: key financial data	2006	2005	2004	2003
Share price at start of year (in €):	14.10	15.90	10.60	3.98
Share price at year-end (in €):	10.98	14.00	15.75	9.90
52 week high (in €):	17.80	21.40	16.25	11.65
52 week low (in €):	9.65	13.50	9.99	3.40
Market capitalization on Dec. 31 (in millions of €):	45.16	57.21	63.58	39.65
Number of shares (in millions):	4.11	4.09	4.04	4.01
Earnings per share (in €):	0.61[6]	0.55	0.71	0.34

Fiscal year 2006 was the best year so far for paragon AG. The Company met or even surpassed all its stated goals over the past twelve months. The once again considerable rise in sales accompanied the complete takeover of paragon fidelity GmbH (Car Media Systems) and a significant expansion of capacity at the production site of Suhl/Thuringia. As a result, paragon has continued to make major advances in particular in the Automotive division; the ongoing focus on systems integration in the automobile has been extremely successful. All financial indicators highlight the Company's strength and the healthy asset and financial structure. The Company has continued to strengthen its market position substantially and been able to generate new impulses for growth from this position.

Group structure

paragon AG is a Group that operates internationally with the automotive field as its core business. In addition to the German sites of Delbrück, Suhl, St. Georgen, Heidenheim and Cadolzburg, the Group has production facilities in the US, as well as non-autonomous sales branches in France and a sales subsidiary in Japan.

paragon reinforces the autonomy of its individual divisions by structuring them as subsidiaries. At the same time the Group stimulates creativity with respect to expansion of available market share and the development of additional products. Last but not least, paragon can benefit from synergy: For instance simultaneous



engineering groups come together for specific projects for which they develop novel solutions and set new trends in particular for the automotive environment. As providers of ideas and as profit centers all subsidiaries also make valuable contributions to the Group's further development.

Management systems

The paragon Group is managed by means of a comprehensive planning and control system. Short and medium term plans are developed for all Group companies and checked for variances on a continuous basis by Financial Control. Primarily additional financial and profitability indicators, from accounting, financial control and investment control, are applied to the individual companies.

As a Group active in the international arena, paragon AG's business is by definition associated with risks that cannot be excluded even with the utmost degree of caution. The Managing Board is kept informed on key risks by integrated planning, control and reporting processes. The goal is to identify not only possible risks, but also potential opportunities, at an early stage, creating ample room for maneuver. The Managing and Supervisory Boards receive detailed monthly reports on business developments in paragon AG and the individual companies. Plan-to-actual comparisons are undertaken on a monthly basis and variances discussed. Top management of the paragon Group meets every month in full in order to confer on current business development, the outlook and any business events of particular note.

Economic conditions

In the past year, the German economy developed better than in years. According to calculations of the Federal Statistics Office the gross domestic product (GDP) in 2006 rose by 2.6 %. In contrast to the two immediately preceding years, growth impulses were received both on the domestic front and from exports. Private consumer spending rose slightly for the first time since 2001. Expert opinion has it that anticipation of the pending increase in value added tax also contributed to growth.

The eurozone economy also recovered substantially. Growth was 2.6 % compared to 1.4 % in the previous year. The global economy, too, expanded forcefully during 2006 with a rise of approximately 5.0 %. Key contributors in this case were rapidly growing threshold countries such as China, India, Russia and Eastern Europe, as well as the global economic upturn that has reigned for three years now. The U.S. and Japan were in a position to raise their growth rates, although the dynamism clearly faded towards the end of the year in both countries.

The upwards trend is expected to continue during the current year, although an economic slowdown is anticipated in the U.S. in particular. In Germany, too, experts believe that the value added tax increase will dampen growth rates.

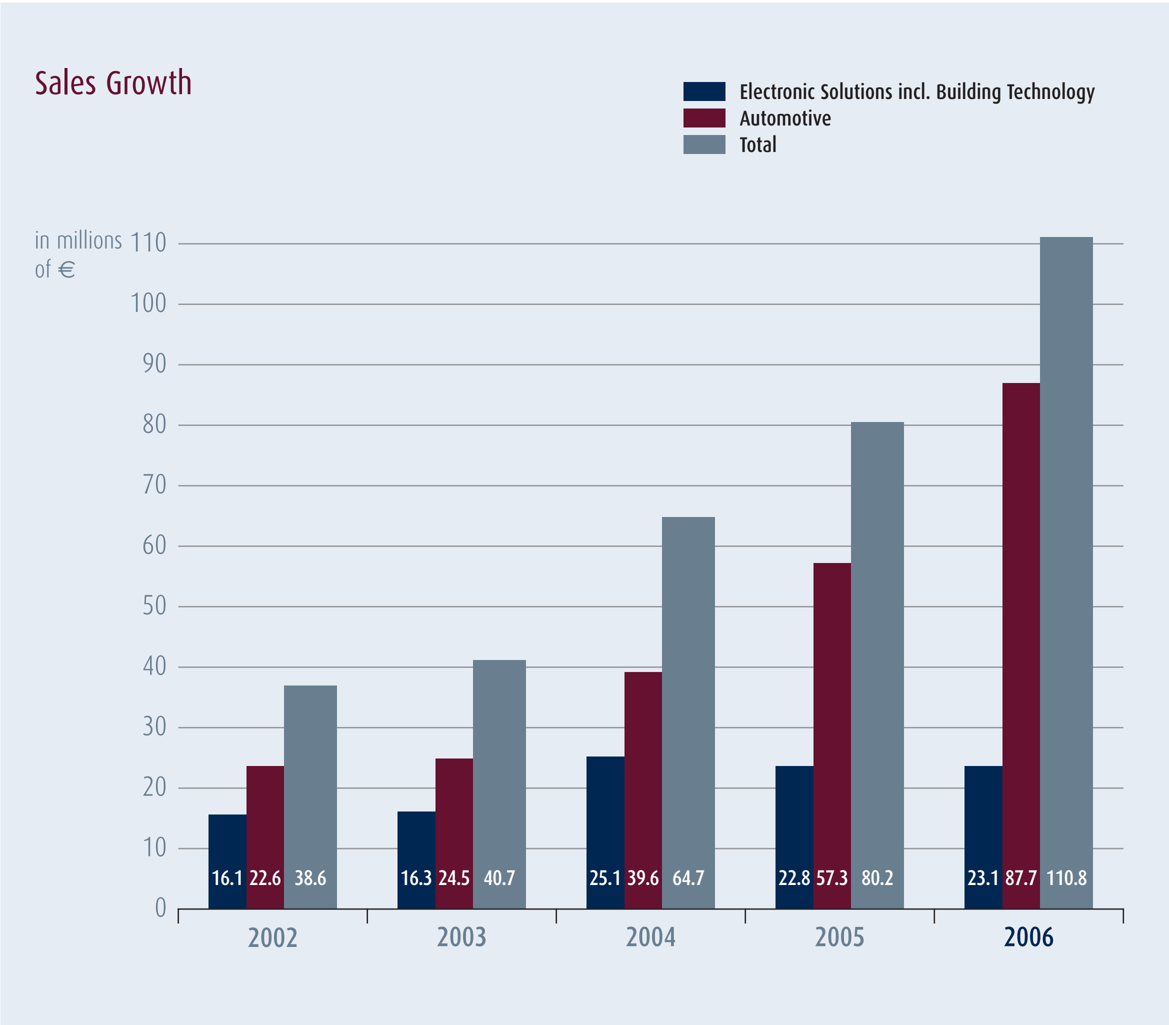
Automotive industry

The automotive industry undoubtedly has the greatest impact on paragon. It grew modestly compared to 2006. According to data from the European industry association, ACEA, approximately 14.6 million passenger cars were registered last year in Western Europe – roughly 1.0 % more than in 2005. The German market was a significant contributor to this growth. Passenger car registrations rose by 4.0 % domestically to 3.47 million units. For paragon, development with respect to German automobile manufacturers is very important; and this trend was very healthy in 2006. German manufacturer sales of passenger cars rose by 2.0 % and their market share in Western Europe rose by one percentage point to just over 47 % as a result. Global demand for automobiles remained strong. In addition to Western Europe, the U.S. and Japan also showed moderate improvement. Growth was driven by emerging countries, some of which had double-digit rates of increase.

Business development in the paragon Group

Sales

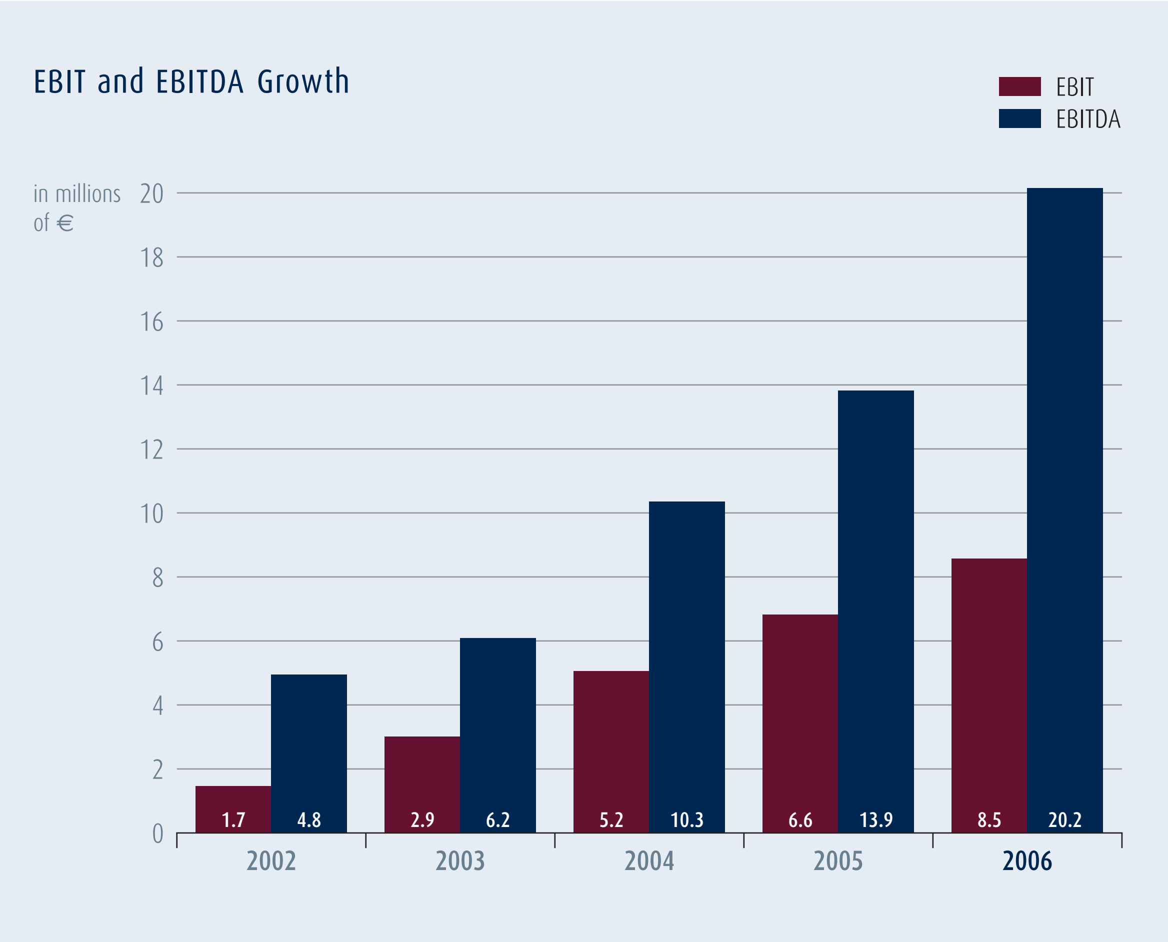
paragon can look back over another successful year. 2006 represents the year with the best results in the history of the Company, accompanied by significant leaps in all key indicators. The Company achieved sales in the triple-digit millions for the first time; the barrier of € 100 million was broken resoundingly, as predicted. In addition, investment in production capacities and the complete acquisition of paragon fidelity created the foundation for sustained growth at paragon.



Group sales rose from a total of € 80.2 million in the previous year to € 110.8 million – an increase of 38.2%. In particular the Automotive segment, but also the Electronic Solutions segment, including Building Technology, have contributed to this pleasing development. The Automotive segment has developed even more clearly into paragon's core business area with a share in sales of around 80 %. Especially the divisions of Car Media Systems and Climate Systems developed dynamically and will continue to provide key growth stimulus to the Group in future. The Instrumentation and Control Systems division also evidenced rising sales. Sales in the business area of Electronic Solutions declined slightly from an absolute perspective, but this can be traced primarily to reorganizations within the Group. Here, too, paragon anticipated growth for 2007. Sales generated in Europe in 2006 rose by 39.4 % to € 99.7 million (prior year: € 71.5 million). Revenues of € 11.1 million were achieved at the U.S. site, 27.6 % over the previous year's figure of € 8.7 million.

Income and expense

During 2006 paragon was also able to significantly raise operating earnings. The positive earnings position in the Automotive division, in particular, contribute to this growth. The Company will, therefore, focus yet more strongly on this area.



Gross income surged by 37.5 % from € 41.5 million to € 56.3 million. Key expense items rose as well, given the Company's growth strategy and the considerable rise in sales. Cost of materials is the largest single expense for a technology company such as paragon. During the period under review, cost of materials rose 50.0% from € 45.6 million to € 68.4 million. This corresponds to a cost of materials to sales ratio rise from 56.9 % (prior year) to 61.7%, due to shifts in the product range. Raw material prices on the whole declined. Personnel costs rose by 34.6 % to € 24.1 million (prior year € 17.9 million), i.e. at a lower rate than sales. The ratio of personnel expenses to sales was 21.8 % (prior year: 22.3 %).

Positive operating developments were also reflected in earnings before interest, taxes, depreciation and amortization (EBITDA), up 45.3% to € 20.2 million (prior year: € 13.9 million).

Due to higher capital expenditures in 2006 and the preceding years, depreciation and amortization rose from € 7.3 million to € 11.7 million. Other operating expenses of € 11.9 million (prior year: € 9.8 million) include primarily marketing and advertising expenses. Earnings before interest and taxes (EBIT) rose by 28.8 % to € 8.5 million. The EBIT margin was 7.7% in the year under review. Taking into account write-downs on intangible assets in connection with corporate acquisitions, the increase amounted to 50.0% to € 9.9 million (prior year: € 6.6 million); equivalent to a basic EBIT margin of 9.0 %. The medium term goal is to raise this margin to 10.0 %.

Investments were financed primarily by long-term bank loans and the issue of profit-sharing rights resulting in a net financial loss of € -4.7 million (prior year: net financial loss of € -3.1 million). Earnings before taxes amounted to € 3.8 million (prior year: € 3.5 million). The Group's net income for fiscal 2006 remained at the previous year's level at € 2.2 million (prior year: € 2.2 million). Taking into account tax expenses related to previous periods, this produces an earnings per share figure for fiscal 2006 of € 0.61 (prior year: € 0.55).

Given earnings growth, the Managing and Supervisory Boards of paragon AG intend to recommend a dividend payment of € 0.30 per share to the Annual General Meeting (prior year: € 0.20).

Automotive segment

The Automotive area is becoming ever more important for the Group. paragon products have proven themselves outstandingly in this highly technologically innovative market and gained a solid market share with considerable growth potential. The Group is pursuing a clear strategy within the automotive supply industry with its activities in three divisions that complement, and profit from, one another: Car Media Systems, Climate Systems and Instrumentation and Control Systems.

Total sales in the Automotive segment rose from € 57.3 million to € 87.7 million in fiscal 2006. All three divisions contributed to this growth. The proportion of sales to overall Group sales rose as well. It is currently 80 % and is expected to continue to rise due to dynamic growth.

The primary contributor to sales in the Car Media Systems division is handsfree equipment. The Company anticipates continued growth during 2007 due to the advent of a new product generation with improved compatibility. Moreover, a number of new products are to be launched on the market. This includes the novel headunit integra, interior mirror navigation, an innovative reversing camera system and an iPod-/MP3 connection.

Expansion of market position in 2006: New customers, orders and projects

Division	Product line	Customer / model
Climate Systems	Air quality sensors	• Audi: A4 • Porsche: Panamera • VW: Passat, Golf • Landrover: Freelander • Mini • Citroën: C5
Car Media Systems	Consoles	• Audi • Opel • Skoda
	Cell phone adapters / new universal adapters	• Audi
	rSAP-adapters	• Audi
	Microphones	• VW • Skoda • DaimlerChrysler
	Reversing cameras	• DaimlerChrysler
	Navigation mirrors	• Original Accessories • Aftermarket
Instrumentation and Control Systems	Position sensor	• Audi: A4, A5
	Signal splitters	• Hyundai / Kia
	Components for multifunction steering wheels	• Audi: Q7
	Stepper motors	• Renault / Dacia
	Car clocks	• Bugatti: 16.4 Veyron
	Single instruments	• Smart: fortwo

During 2006, models including the Mini were equipped with the AQS air quality sensor for the first time. In addition to the new major AQS order in the compact and medium-sized range, delivery of which begins in 2007, the Climate Systems division won its first order for the new product AQC. A German auto manufacturer will be using the new air treatment system in up to 250,000 of its top range of automobiles starting in 2009. This is an important milestone for paragon and shows that, with a global market share that has already reached 80 % for air quality sensors, growth will persist in the next few years. New products supporting this growth are under development.

The Instrumentation and Control Systems division also evidenced an increase in sales. Delivery of several new orders started in the last few months of the year; these will provide new impetus for 2007. For instance, paragon is supplying the position sensor for the new Audi A4 and a steering wheel module for the Audi Q7.

Electronic Solutions division

The Electronic Solutions division is primarily involved in developing and manufacturing high-end electronics for a variety of industries. Since its establishment in 1988, paragon has asserted itself in the area of commissioned production of customized solutions and is one of the leading electronic service providers in the German market. The Company covers the entire value creation chain from the initial idea to completed system.

The paragon Group boasts cutting-edge manufacturing facilities at its sites in Suhl in Germany and in Grand Rapids, Michigan, in the US; these were expanded further in 2006. Companies from industry, security technology, telecommunications, building technology, medicine and the automotive world are among the Company's customers. Due to its comparatively minor importance paragon integrated Building Technology into the Electronic Solutions division in 2006. The Building Technology domain continues to show considerable potential. In future the established production and sales structures of the Electronic Solutions division can serve to support the efficient exploitation of this potential.

paragon's Electronic Solutions division earned revenues of € 23.1 million (prior year: € 22.8 million) in the period under review. Approximately € 1.0 million (prior year: € 0.7 million) was attributable to Building Technology. Reorganizations within the Group, and the loss of a customer had a noticeably adverse impact, but this was on the whole compensated by attracting several new customers. The Electronic Solutions division contributed approximately 20 % to total Group sales.

Employees

Highly qualified and committed employees are a key factor in paragon AG's success and indispensable to planned growth. The primary goal of human resources policy, therefore, is to optimally exploit and foster the knowledge and experience of each employee.

As of December 31, 2006, a total of 564 employees were engaged throughout the Group (prior year: 527), of which 494 worked in Germany and 70 abroad. Personnel expenses have risen correspondingly, from € 17.9 million to € 24.1 million. This figure is composed of salaries and wages in the amount of € 20.1 million, social security contributions of € 3.5 million and pension expenses of € 0.5 million.

Employees by site in the paragon Group	
Delbrück	104
Suhl	256
Cadolzburg	67
St. Georgen	64
Heidenheim	5
USA	65
Paris, France	2
Osaka, Japan	1

Status: 12/31/2006

Great value is also placed on the succession planning. At the end of 2006, a total of 21 trainees were engaged in the commercial and industrial departments at the Delbrück and Suhl locations. In order to supplement its own succession program, the Company signed a cooperation agreement with the Delbrück Gymnasium (high school) under the supervision of the Chamber of Commerce and Industry of East Westphalia in October of 2006. This cooperation is intended to promote understanding of companies and Institutions of general education and stress practical orientation in instruction.

Remuneration of the Managing Board

Total compensation of the Managing Board is € 1.3 million (prior year: € 1.3 million). This includes a fixed component of € 0.6 million (prior year: € 0.6 million). The Managing Board also received a performance-related bonus. This bonus depends on the financial developments (in particular EBIT development) of the past fiscal year. The 2006 bonus was € 0.4 million (prior year: € 0.4 million).

Managing Board remuneration, moreover, includes a non-cash benefit for automobile use and stock options in the amount of € 0.2 million (prior year: € 0.3 million). Performance-related components with long-term incentive effects can be found in the Notes.

Capital Expenditure

Total capital expenditure in 2006 at € 16.0 million (prior year: € 14.2 million) was above the previous year by roughly 12.7%. € 14.8 million relates to Automotive (prior year: € 11.9 million) and € 1.2 million to Electronic Solutions (prior year: € 2.3 million).

Most of the capital expenditure involved the expansion of production capacities in the Suhl site. In 2006 alone paragon invested € 4.0 million there in new, cutting-edge manufacturing facilities and enhanced production capacity of electronic components: The Company doubled its volumes by adding two new production-lines. The Group now has a total production area of 12.300 m^2 in Suhl. paragon created 20 new jobs as part of the current expansion. In the US as well, investment continued, with double the production capacity concluded at the beginning of 2007.

Goodwill of € 9.9 million was generated in the 100 % takeover of paragon fidelity GmbH.

Trademark assets were capitalized at € 7.3 million. In August of 2005 paragon AG had taken over a majority interest in Cullmann GmbH. As a pioneer in universal handsfree automotive systems, the Company fit perfectly into the paragon Group. After all, paragon AG already supplies a wide range of products (including microphones, antenna) to the same customer group from its successful communications division. As part of the rapid integration into the Group Cullmann GmbH's name was changed to paragon fidelity GmbH effective January 1, 2006. Due to the great success of Car Media Systems it was only logical that the takeover of the whole company be completed. Synergistic effects can thus be better utilized throughout the Group and will help improve earning power in 2007.

Research & Development

Innovation and quality continue to be prime success factors for the paragon Group. Research and development expense rose to € 11.4 million in fiscal 2006. The increase of 83.9 % over last year demonstrates the Group's prioritization of this area.

Purchasing

The responsibility of purchasing in paragon AG is to select the best suppliers keeping in mind quality, innovativeness, reliability and cost. Business conditions in 2006 led once again to heightened price competition in both domestic and international markets for electronic and electromechanical components and plotters. On the whole the Group was therefore able to satisfy its materials requirements more affordably than the previous year. Due to the manufacture of products with higher material contents (in particular the manufacture of products for the Car Media Systems division) the ratio of material costs to sales rose. Material costs rose to € 68.2 million (prior year: € 45.6 million). The ratio of cost of materials to sales was 54.9% versus 52.3 % in the previous year.

International

paragon pursued a clear strategy with respect to advancing globalization. As in the past, outsourcing of production to low-wage countries will not be considered an option in future. Rather, production will only take place where sales markets exist. New markets will be penetrated by means of representative relationships. The policy of placing technical specialists in the respective branches in addition to sales staff has proven effective. The specialists can adapt paragon products quickly and easily to vehicle-specific requirements with the help of direct dialogue with the customers' technicians. Our success in fiscal year 2006 vouches for the appropriateness of this strategy.

In the US paragon has its own production capacities via the subsidiary paragon firstronic of NA Corp. In fiscal 2006 in the US paragon attained sales of € 11.2 million (prior year: € 8.7 million) with 68 employees. During 2007 sales of automotive products in particular will be intensified. It is precisely in the Car Media Systems and the Instrumentation and Control Systems divisions that paragon offers promising solutions for the American market.

The Company is also represented in Japan, by a branch, and in France, by a sales office. Developments were particularly gratifying in France in 2006. A number of major orders with well-known manufacturers were signed. The Asian market continues to offer considerable potential. The air quality sensor is currently being tested in test vehicles of different Japanese manufacturers. If these tests result in a positive decision, we will build our own on-site production together with our partner, the sensor manufacturer FIS Inc.

Net assets and financial position

Total assets at the end of the fiscal year totaled € 137.8 million, compared to € 113.0 million at the end of 2005. The share of non-current assets was 65.4 % (prior year: 63.5 %). They rose from € 71.8 million to € 90.2 million in absolute terms and primarily reflect the capital expenditures described above. Current assets rose from € 41.3 million to € 47.6 million. The most significant change in this area was the increase in inventories of about € 3.4 million, as well as higher trade receivables, now at approximately € 10.2 million. On the balance sheet date, paragon held cash and cash equivalents of € 8.8 million (prior year: € 4.8 million); this does not include an amount of € 2.6 million, which had not yet been credited to the account on December 31, 2006. In conjunction with the issue of profit-sharing rights of € 50.0 million authorized by the Annual General Meeting and unutilized account overdrafts of € 9.5 million there is sufficient liquidity available for financing further growth.

Leasing is the primary off-balance sheet financing instrument paragon has used. Lease obligations paid in 2006 totaled € 1.5 million (prior year: € 2.5 million).

Equity, including profit-sharing rights amounted to € 40.8 million as of December 31, 2006 (prior year: € 42.6 million). This includes € 23.3 million in profit-sharing rights, of which € 6.0 million were taken up in 2006. Profit-sharing rights have a term of up to seven years and fixed and variable remuneration components.

The equity and profit-sharing rights share as of December 31, 2006, was 29.6 % (prior year: 37.7 %). The decline is due largely to the much higher level of total assets.

Liabilities to banks rose to € 45.6 million. This includes a promissory note bond of € 25.0 million. The promissory note bond is directly associated with the takeover of all shares in paragon fidelity Verwaltungs GmbH. It was also used to reduce loans with higher interest rates and the silent equity holding in paragon fidelity. Long-term bank liabilities generally have an average rate of 6.5%. Short-term bank liabilities total € 13.2 million (prior year: € 13.9 million).

On the whole, the paragon Group has a sound balance sheet structure. This will continue to improve in the upcoming year by decreasing liabilities from cash flow. Cash flow from operating activities was € 4.6 million in 2006 (prior year € 7.6 million). Cash and cash equivalents of € 21.4 million (prior year: € 14.6 million) was utilized for capital expenditures. Net cash and cash equivalents of € 21.1 million (prior year: € 6.4 million) was added.

Events after the balance sheet date

We are not aware of any events of special significance subsequent to year-end 2006.

Risk report

As a Group active in the international arena, paragon AG business is by definition associated with risks that cannot be excluded even with the utmost degree of caution. As a result paragon has operated a proven risk management system for many years that identifies, assesses and controls risks.

The Managing Board is kept informed on key risks by integrated planning, control and reporting processes. The goal is to identify not only possible risks, but also potential opportunities, at an early stage, creating ample room for maneuver.

Market and industry

As an automotive supplier paragon is dependent on developments in the automobile sector. Economic development in this industry has an impact on the Group’s sales and earnings. Comprehensive, integrated sales control enables sales risks to be identified early on. Market and competitor data is analyzed and rolling plans for the short and medium term are prepared. In addition, regularly scheduled meetings help coordinate sales, production and development activities.

Internationalization minimizes dependence on individual submarkets. paragon endeavors to enlarge its customer base on an ongoing basis and is supplying a large number of leading automobile manufacturers at present. The Company views Asia as a region with special opportunities to attract new customers. There would not only be a positive effect on the risk structure, but new sales and earnings opportunities would be opened up. Loss of a customer could, nevertheless, have a major impact, although, due to lengthy contract terms associated with vehicle series, this would be known at an early stage.

sparagon counters this risk by means of in-depth development work and outstanding customer service; this results in close and stable customer ties. In particular paragon is protected by the unique characteristics of its products that it has achieved – it is not easy for manufacturers to switch suppliers. The direct dependence on the automotive economy is mitigated by the trend towards more frequent use of electronics in the automobile.

In the automotive industry, the challenges for development and the advance services required form suppliers are continually on the rise. By working closely with customers in researching and developing new products, paragon counteracts these risks. Moreover, purchasing, manufacturing and quality assurance are integrated into the development process early on to ensure optimum results throughout all phases of the process. A special development control function steers the entire process.

Purchasing and production

Master contracts and annual agreements guarantee a major portion of purchasing costs. As a result, paragon's supply situation is largely unproblematic. More than 75% of all goods purchased come from Europe; the remaining goods come from the USA and Asia. Payment terms are those common to the industry. The major purchasing currency is the euro, with a small share in US $.

Production is continually undergoing an improvement process in order to match production and logistics structures to the Group's dynamism with respect to innovation and growth.

Information technology

paragon protects its data and IT structure from unauthorized access by means of modern security solutions. Availability and reliability of the server and storage systems for crucial company applications is being continually enhanced by the Company.

Liquidity and financing

paragon minimizes the risk of insolvency through continuous liquidity control. Timely cash inflows are obtained by consistent accounts receivable management. A major share of receivables is also guaranteed by trade credit insurance. The risk of interest-rate fluctuations is insignificant, because the majority of long-term liabilities are secured by fixed-rate contracts.

Currency risks cannot be completely avoided in a Company with international operations. Risks are hedged with appropriate financing instruments if necessary, based on exchange rate expectations that are reviewed on an ongoing basis.

Overall risk

Due to the sound net assets, financial position and results of operations, as well as long-standing customer relationships, the Company's overall risk situation is not problematic. No risk can be identified at present or in the foreseeable future that might jeopardize the existence of the paragon Group. Imminent product launches on a continuous basis and a future-oriented product portfolio afford paragon a good starting point for exploiting existing opportunities to the full.

Disclosure of potential acquisition hindrances

paragon AG's equity consists of 4,113,063 shares with a nominal value of one euro. The Company's subscribed capital was also € 4,113,063 at the end of the past fiscal year. There are no restrictions against transfer or voting rights at present.

The Chairman of the Managing Board, Klaus Dieter Frers, has direct holdings in paragon AG in excess of 10 % at roughly 52 %. Special rights, such as the right to designate members of the Supervisory Board, do not exist.

There is no control of employees voting rights. The Company's Managing Board consists of at least two members, who appoint the Supervisory Board, according to the statutes. An authorization to repurchase treasury stock in amounts up to 10% of equity and to increase capital up to 50.0% of equity is in force.

In the event of a change of control as the result of a takeover bid agreements are included in the contracts of Managing Board members to award them a transitional allowance under certain conditions in the event that their contracts are not renewed. There are no other indemnification agreements in effect.

Environmental report

The paragon Group has implemented an active environmental policy, handles resources in the form of consumption of raw materials and energy with care and uses the most up-to-date manufacturing technology in this respect. Given the steep rise in raw material and energy prices this policy has contributed significantly to paragon's financial success. Each production process is reviewed and assessed on a regular basis in terms of environmental compatibility and efficient resource use.

paragon ensures that legal provisions are complied with by providing training in professional handling of relevant materials and the use of the most recent technologies.

Production subsidiaries in Germany are certified in accordance with the environmental standard DIN EN ISO 14001:2005.

Report on related parties

The report that the Managing Board of paragon AG prepared concerning the relationship of Mr. Klaus Dieter Frers, the majority shareholder, to affiliated companies in accordance with section 312 AktG contains the following concluding statement:

"We hereby declare in accordance with section 312 (3) of the AktG: In every legal transaction enumerated in the report on relationships with Mr. Klaus Dieter Frers and affiliated companies paragon AG has received appropriate consideration and was not adversely effected by actions taken or omitted. This opinion is based on the facts known to us at the time that any dealings subject to report occurred."

Outlook

Economic and industry experts expect that the robust global economic trend will continue throughout 2007, albeit with lower growth rates than in the past year. The economy is expected to slow especially in the US. In Germany, too, due to factors such as the increase in the value added tax rate, subdued economic growth is anticipated. Experts forecast growth of 2.0 % in this respect. Global growth is expected to be 4.9 % according to IMF data.

Stable growth is foreseen for the automotive industry in 2007. While a slight decline may be evidenced in the US and Western Europe, a continuing rise in demand for passenger vehicles is predicted for Asia and Eastern Europe.

Corporate development

The dynamic growth of paragon AG has already developed fairly independently from the general economy and the industry this past fiscal year. This trend is expected to continue in the next few years as a consequence of the orientation, market position and innovative power of the Company.

During fiscal 2007 paragon intends to focus on corporate growth in particular with respect to earnings. The Company anticipates internal growth of 5 % to 10 % in sales based on the favorable order situation. The emphasis, however, will be on strengthening earning power and reducing liabilities. We want operating earnings to grow at a faster rate than sales.

Capital expenditures in the past fiscal year have laid the groundwork for further growth. In 2007, capital expenditures will therefore fall short of the 2006 level. As an innovative company, we will continue our quest for new products and solutions in 2007. Research and development expenses will, therefore, remain at high levels. We perceive substantial possibilities for savings due to the optimization of cost structures and enhanced synergy potential; these will result in higher earnings at all levels. We anticipate a positive impact of at least € 2 million in consequence. The increasing share of high-margin products will also contribute substantially to improvements in earnings.

Growth will be achieved both by means of new customers and additional innovative products. We will continue to focus on products for the car interior now being supplied to almost all manufacturers in Germany and Europe. We have numerous new products in the Car Media Systems, Climate Systems and Instrumentation and Control Systems divisions which have elicited a positive response from current and potential customers upon initial presentation. In the Climate Systems division our enhancements, such as the AQC air treatment system for the car interior, have become firmly established in the market. In addition the receipt of large orders this past year from well-known manufacturers in the compact and medium-sized automobile segment will generate a significant increase in air quality sensors in 2007 and 2008. In the Car Media Systems division the new generation of hands-free equipment and the multimedia interface for MP3 player access will inter alia spur growth. We have rounded out the product portfolio in the Instrumentation and Control Systems division with modern instruments and a novel route sensor, which will contribute to ongoing growth in paragon AG.

We will also push forward with international expansion. Our excellent experience in France will be transferred to other countries and markets. We managed to attract several major orders from well-known manufacturers by combining sales and technical experts on location. This Structure will now be implemented at other sites. We also plan to open our own office in Italy in the first half of 2007.

paragon has a reputation for outstanding achievements in components and modules in the automotive industry. A project was started in 2006 that will help us to attain the higher position of systems partner we strive for. It involves development of a sports car, the interior systems of which are to be presented completely by paragon AG. Prototype development occurred in the subsidiary paragon finesse GmbH; preparation for mass production, manufacture and sales was taken over by the spin-off Artega Automobil GmbH & Co. KG at the end of 2006. This is the perfect platform for paragon to demonstrate the innovative systems that to date are not included in the product portfolio for use in series. paragon expects to be able to place systems more rapidly with OEMs as a result.

Favorable developments will, therefore, continue in the years to come. Due to the current order level we anticipate that 2008 will produce increasing growth and sales of approximately € 140 million accompanied by rising earnings. This puts us on the road to achieving our sales target of € 200 million in 2010.

Forward-looking statements contain risks

The Group's Management Report contains certain forward-looking statements. These statements are based on current estimates and are, by their very nature, subject to risks and uncertainties. Events that actually occur may differ from the statements made here.

Delbrück, March 28, 2007

Frers Member of the Managing Board	John Member of the Managing Board

Consolidated Financial Statements

Consolidated Income Statement for the year ended December 31, 2006 (paragon AG, Delbrück)

in € (000)	Notes	2006	2005
Revenue	(1)	**110,823**	**80,166**
Other operating income	(2)	5,617	4,619
Changes in inventory of finished goods and work in progress		2,622	- 655
Other own work capitalized	(3)	5,619	3,004
Total operating revenue		**124,681**	**87,134**
Cost of materials	(4)	- 68,413	- 45,611
Gross income		**56,268**	**41,523**
Personnel expense	(5)	- 24,110	- 17,863
Depreciation/amortization/impairment of property, plant and equipment and intangible assets		- 11,742	- 7,330
Other operating expenses	(6)	- 11,925	- 9,760
Earnings before interest and taxes (EBIT)		**8,491**	**6,570**
Financial income		75	114
Financing expenses		- 4,761	- 3,180
Financial result	(7)	**- 4,686**	**- 3,066**
Income before taxes		**3,805**	**3,504**
Income taxes	(8)	- 1,534	- 1,156
Other taxes		- 65	- 99
Net income		**2,206**	**2,249**
Minority interests		0	985
Net income attributable to equity holders of the parent		**2,206**	**1,264**
Earnings per share (basic)	(9)	0,54	0,55
Earnings per share (diluted)		0,54	0,55
Average number of shares outstanding (basic)		4,103,186	4,066,219
Average number of shares outstanding (diluted)		4,120,502	4,107,253

Consolidated Balance Sheet as of December 31, 2006 (paragon AG, Delbrück)

in € (000)	Notes	12/31/2006	12/31/2005
Assets			
Non-current assets			
Intangible assets	(10)	30,527	23,542
Goodwil	(11)	27,664	17,981
Property, plant and equipment	(11)	31,406	27,940
Financial assets	(12)	200	200
Deferred tax assets	(13)	392	2,111
Total non-current assets		**90,189**	**71,774**
Current assets			
Inventories	(14)	17,340	13,981
Trade receivables	(15)	19,880	9,704
Income tax claims		0	363
Other assets	(15)	1,649	12,371
Cash and cash equivalents	(16)	8,758	4,832
Total current assets		**47,627**	**41,251**
Total assets		**137,816**	**113,025**

in € (000)	Notes	12/31/2006	12/31/2005
Liabilities and equity			
Equity	(17)		
Subscribed capital		4,113	4,086
Capital reserves		7,748	7,565
Net income attributable to equity holders of the parent		2,206	1,264
Retained earnings		4,670	4,224
Reserve for currency translation differences		- 1,166	- 790
Equity before minority interests		**17,571**	**16,349**
Minority interests		**0**	**3,695**
Equity after minority interests		**17,571**	**20,044**
Non-current liabilities			
Long-term financial lease liabilities	(18)	595	1,459
Long-term loans	(18)	32,329	10,118
Profit sharing capital	(19)	23,277	17,483
Silent equity holding	(20)	0	8,754
Investment grants	(21)	10,012	10,062
Deferred tax liabilities	(16)	5,229	5,048
Provisions for pensions	(23)	1,049	853
Other non-current liabilities		3,795	0
Total non-current liabilities		**76,286**	**53,777**
Current liabilities			
Current portion of financial lease liabilities	(18)	919	1,019
Short-time loans and current portion of long-term loans	(18)	13,238	13,899
Trade liabilities	(18)	14,344	12,398
Other provisions	(22)	6,851	5,149
Income tax liabilities		3,413	1,783
Liabilities to minority shareholders		0	1,081
Other current liabilities	(18)	5,194	3,875
Total current liabilities		**43,959**	**39,204**
Total equity and liabilities		**137,816**	**113,025**

Consolidated Cash Flow Statement (paragon AG, Delbrück)

in € (000)	Notes	2006		2005	
Cash flow from operating activities					
Income before taxes and deferred taxes		**3,740**		**3,405**	
Adjustment for:					
impairment losses		11,742		7,330	
Financial result		4,686		3,066	
Gains/losses from the disposal of non-current assets		210		- 144	
Change of the other provisions and provisions for pensions		1,898		- 565	
Income from reversal of special account for grants		- 2,183		- 1,701	
Other non-cash income and expense		136		- 177	
Change in trade receivables, other receivables and other assets		- 9,278		- 1,082	
Change in inventory level		- 3,359		- 268	
Change in trade payables and other liabilities		1,935		1,751	
Interest paid		- 4,761		- 3,180	
Income taxes		- 559		- 835	
Net cash from operating activities	(24)		**4,207**		**7,600**
Cash flow from investing activities					
Payments for investment minus residual carrying amount of asset disposals		- 16,016		- 12,613	
Payments for the purchase of subsidiaries		- 7,305		- 5,214	
Additions of cash and cash equivalents from the acquisition of subsidiaries		240		1,011	
Funds from investment grants		1,958		2,094	
Interest received		75		114	
Net cash from investing activities	(25)		**- 21,048**		**- 14,609**
Cash flow from financing activities					
Dividend distribution to shareholders		- 818		- 404	
Repayment of (financial) credits		- 11,894		- 11,887	
Proceeds from (financial) credits taken		32,909		8,818	
Proceeds from equity additions		111		211	
Net cash outflow from redemption of silent equity holding		- 4,925		0	
Net cash inflow from the issuance of profit-sharing capital		5,760		9,665	
Net cash from financing activities	(26)		**21,143**		**6,403**
Exchange rate changes			- 376		5
Change in cash and cash equivalents			**3,926**		**- 600**
Cash and cash equivalents at the beginning of the period			**4,832**		**5,432**
Cash and cash equivalents at the end of the period	(27)		**8,758**		**4,832**

Segment Report (paragon AG, Delbrück)

According to business segments

in € (000)	Automotive 2006	Automotive 2005	Electronic Solutions 2006	Electronic Solutions 2005	Building Technology 2006	Building Technology 2005	**Total 2006**	Total 2005
Revenues from third parties	87,719	57,325	22,128	22,113	976	728	110,823	80,166
Earnings before interest and taxes (EBIT)	**7,933**	**5,822**	**463**	**706**	**95**	**42**	**8,491**	**6,570**
Segment assets	113,722	82,376	12,202	10,927	1,093	45	127,017	93,348
Segment liabilities	11,182	11,080	3,045	1,313	117	5	14,344	12,398
Capital expenditure	32,047	11,954	1,197	2,282	16	0	33,260	14,236
Depreciation, amortization and impairment losses	10,677	6,418	1,027	912	38	0	11,742	7,330

According to geographical segments

in € (000)	Europe 2006	Europe 2005	USA 2006	USA 2005	Japan 2006	Japan 2005	**Total 2006**	Total 2005
Revenues from third parties	99,660	71,477	11,163	8,689	0	0	110,823	80,166
Earnings before interest and taxes (EBIT)	**10,262**	**6,968**	**- 1,690**	**- 398**	**- 81**	**0**	**8,491**	**6,570**
Segment assets	123,235	87,881	3,854	5,467	- 72	0	127,017	93,348
Segment liabilities	12,231	10,296	2,108	2,102	5	0	14,344	12,398
Capital expenditure	32,039	13,738	1,221	498	0	0	33,260	14,236
Depreciation, amortization and impairment losses	11,463	7,138	278	192	1	0	11,742	7,330

Consolidated Statement of Changes in Equity (paragon AG, Delbrück)

in € (000)	Subscribed capital	Exchange rate difference	Capital reserves	Profit / loss carried forward	Net income	Minority interests	Total
Balance Jan. 01, 2005	**4,037**	**- 987**	**7,318**	**1,765**	**2,863**	**0**	**14,996**
Net income					1,264	985	2,249
Profits/loss carried forward				2,863	- 2,863		0
Dividend distribution				- 404			- 404
Capital increase (exercise of stock options)	49		162				211
Addition due to stock option valuation			85				85
Minority interests						2,710	2,710
Currency translation changes		197					197
Balance Dec. 31, 2005	**4,086**	**- 790**	**7,565**	**4,224**	**1,264**	**3,695**	**20,044**
Balance Jan. 01, 2006	**4,086**	**- 790**	**7,565**	**4,224**	**1,264**	**3,695**	**20,044**
Net income					2,206		2,206
Profits/loss carried forward				1,264	- 1,264		0
Dividend distribution				- 818			- 818
Capital increase (exercise of stock options)	27		84				111
Addition due to stock option valuation			99				99
Minority interests						- 3,695	- 3,695
Currency translation changes		- 376					- 376
Balance Dec. 31, 2006	**4,113**	**- 1,166**	**7,748**	**4,670**	**2,206**	**0**	**17,571**

Notes to the Consolidated Financial Statements

Basis of presentation (IFRS)

paragon Aktiengesellschaft's consolidated financial statements as of December 31, 2006, were prepared using the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB), London, Great Britain, applicable on the balance sheet date. All mandatory International Financial Reporting Standards (IFRS) and interpretations of the International Financial Reporting Interpretations Committee/Standing Interpretations Committee (IFRIC/SIC) applicable in the European Union for fiscal 2006 were adopted. Additional explanations as required by section 315a of the HGB (German Commercial Code) were added to the consolidated financial statements. The previous year's figures were determined following the same principles.

The income statement was prepared using the nature of expense method. paragon AG's shares are traded on the Frankfurt Stock Exchange in the Prime Standard segment of the regulated market.

The consolidated financial statements present a true and fair view of the paragon Group's net assets, financial position and results of operations. The requirements pursuant to Section 315a of the German Commercial Code (HGB) for the preparation of consolidated financial statements in accordance with IFRS, as applicable in the EU, have been met.

During 2006 the following revised and new standards and interpretations of the IASB/IFRIC became binding; they had no significant impact on paragon's consolidated financial statements:

- IAS 19 – Changes to IAS 19, Employee Benefits
- IAS 39 – Financial Instruments: Recognition and Measurement
- IAS 39 – Financial Instruments: Recognition and Measurement (including provisions on the use of the Fair Value Option)
- IFRS 6 – Exploration for and Evaluation of Mineral Resources
- IFRIC 4 – Determining Whether an Arrangement contains a Lease
- IFRIC 5 – Rights to Interests arising from Decomissioning, Restoration and Environmental Rehabilitation Funds

The IASB has issued the following standards, interpretations and changes to existing standards, which paragon must use due to its business operations. Their application, however, is not yet mandatory and paragon has not applied them prematurely.

The IASB published IFRS 7 in August 2005. This standard combines the information relating to financial instruments, which previously had been covered in IAS 30 "Disclosures in the Financial Statements of Banks and Similar Financial Institutions" and IAS 32 "Financial Instruments: Disclosure and Presentation." Individual disclosure obligations were changed or supplemented in IFRS 7, which is mandatory for fiscal years starting on or after January 1, 2007. Earlier application is encouraged. The standard, which is mandatory for all companies, will require paragon to provide expanded disclosures on financial instruments when applied for the first time.

In August 2005, the IASB announced an amendment of IAS 1 in connection with the publication of IFRS 7 "Financial Instruments: Disclosures." Accordingly, information must be published in the financial statements enabling the reader to evaluate the goals, methods and processes of the management of capital. The amendment of IAS 1 must be applied for fiscal years starting on or after January 1, 2007. Earlier application is encouraged. The first-time application of this amendment of IAS 1 by paragon will lead to expanded disclosures in the notes.

Application of IFRS 8 will convert segment reporting from the so-called 'risk and reward approach' under IAS 14 to the 'management approach' with respect to segment identification. The information regularly provided to the so-called 'chief operating decision maker' for decision-making are of key significance in this approach. At the same time measurement of segments will change from the 'financial accounting approach' under IAS 14 to the 'management approach'. The use of IFRS 8 is mandatory for fiscal years starting on or after January 1, 2009. Earlier application is permitted. IFRS 8 will not result in a change in disclosures in segment reporting in its first-time application by paragon AG for fiscal 2009.

IFRIC 11 on IFRS 2 – Group and Treasury Share Transactions relates to the issue of how Group-wide share-based payment is to be accounted for, what effect employee changes have within a Group and how share-based payment is to be treated in cases in which an enterprise issues its own shares or must acquire shares from a third party. The use of IFRS 11 is mandatory for fiscal years starting on or after March 1, 2007. Earlier application is encouraged. IFRIC 11 is not expected to have a significant impact on paragon AG's future consolidated financial statements.

The Managing Board of paragon AG forwarded the consolidated financial statements to the Supervisory Board on March 23, 2007. It is the responsibility of the Supervisory Board to review the consolidated financial statements and to decide if it will approve them.

Scope of consolidation

In addition to the parent company paragon AG, Delbrück, Germany, ten companies are fully consolidated. The balance sheet date for all companies is December 31. The scope of consolidation and the shareholdings can be seen in the following table:

(The remaining 49 % of shares in paragon fidelity Verwaltungs-GmbH with registered offices in Suhl, Thüringen, were taken over by IKB Private Equity GmbH, Düsseldorf, under the terms of a purchase agreement dated August 24, 2006. paragon fidelity Verwaltungs-GmbH, Suhl, in turn held 100 % of shares in paragon fidelity GmbH (formerly Cullmann GmbH), Cadolzburg. It functioned purely as a holding company, while paragon fidelity GmbH, Cadolzburg, conducted operations in the Communications division.

Minority interests were acquired for € 18,169 thousand. Minority interests of € 3,695 thousand already existed, so a netting difference of € 14,474 thousand resulted.

Of this difference, € 7,309 thousand relates to the assets identified with the brand name 'Cullmann' minus € 2,770 thousand in deferred tax liabilities. The capitalized value corresponds to a share of the acquisition ratio of 49 %. Additional separate assets and liabilities have not been identified, so that the remaining amount of € 9.935 thousand has been recognized as goodwill.

paragon fidelity Verwaltungs GmbH, Suhl, under the merger agreement dated August 28, 2006, was merged with paragon

Scope of consolidation of paragon AG

	Shareholding	Consolidation	Sales in local currency (pre-consolidation)
Germany			
paragon AG, Delbrück	**parent company**		**€ 63,285,056**
paragon fidelio GmbH, Suhl	100 %	full	€ 958,030
paragon firstronic GmbH, Suhl	100 %	full	€ 14,783,395
paragon facilio GmbH, Delbrück	100 %	full	€ 732,341
paragon forstep GmbH, St. Georgen	100 %	full	€ 10,645,319
paragon finesse GmbH, Delbrück	100 %	full	€ 2,000,000
paragon fidelity GmbH, Cadolzburg	100 %	full	€ 31,865,322
USA			
paragon of NA Corp., Grand Rapids / Michigan	100 %	full	USD 4,666,184
paragon firstronic of NA Corp., Grand Rapids / Michigan (previously Miquest Corp.)	100 % (via paragon of NA Corp.)	full	USD 13,293,792
Chipco Inc., Elkhart / Indiana	100 % (via paragon of NA Corp.)	full	USD 1,292,781
Japan			
paragon of Japan K.K., Tokio	100 %	full	JPY 46,100

fidelity GmbH, Cadolzburg, effective January 1, 2006. A merger loss with no tax impact merger arose in the amount of € 30 thousand; this was, however, eliminated in the consolidated financial statements. As a result this merger has no effect on the consolidated financial statements.

Principles of consolidation

The consolidated financial statements are based on the separate financial statements of the subsidiaries included in the consolidated Group which are prepared according to uniform policies under IFRS as of December 31, 2006, and audited and certified by independent auditors.

When preparing the consolidated accounts, capital is accounted for according to the purchase method as provided in IAS 27.22 in conjunction with IFRS 3. Recognizing shares in the subsidiaries at their carrying amount in the parent company is replaced by recognizing the assets and the liability items of the consolidated companies at fair value. The equity of the subsidiaries is compared with the carrying amount of the shares in the parent company. A difference on the assets side is reported as goodwill under non-current assets and is tested annually for impairment in accordance with IFRS 3 and IAS 36.

Intercompany sales, expenses and revenues as well as all receivables and payables between consolidated companies are eliminated. Results arising from intercompany deliveries are eliminated from the asset categories of non-current assets and inventory.

Currency translation

The reporting currency is generally the euro, the currency in which the financial statements are prepared. Since the functional currencies of foreign companies in the Group (US dollar, Japanese yen) differ from the functional currency of the reporting entity paragon AG (euro), the financial statements of the foreign companies are translated from the relevant functional currency (US dollar, Japanese yen) into the reporting currency (euro). Assets and liabilities are translated at the exchange rate applicable on the balance sheet date and income and expenses at the average exchange rate for the period. Translation differences are reported separately under equity. Goodwill arising from the acquisition of an economically autonomous partial entity is also translated at the closing rate in accordance with IAS 21.47. The resulting difference is recognized directly in equity with no impact on income.

Foreign currency transactions when first recorded are translated into local currency at the exchange rate applicable on the transaction date.

Monetary accounts (cash and cash equivalents, payables and receivables) in foreign currency, which appear in the individual local currency financial statements of the consolidated companies, are valued at the rate applicable on the balance sheet date according to IAS 21. Non-monetary accounts in foreign currency are carried at historical rates. Exchange differences due to the conversion of monetary positions are taken to income.

Exchange rate losses from operations in the amount of € 40 thousand (prior year: € 14 thousand) and exchange rate gains in the amount of €78 thousand (prior year: € 48 thousand) are contained in the income statement. These exchange rate differences are stated in other operating expenses or other operating income.

As of the balance sheet date, the balance of the currency translation differences, which was recognized as a separate item in equity, is € 1,166 thousand (prior year: € 790 thousand). The changes in exchange rate differences during the fiscal year in equity in the amount of € -376 thousand (prior year: € 197 thousand) relate to the differences from the currency translation of the financial statements of the American subsidiaries, which were prepared in US dollars.

Notes on the income statement

The consolidated income statement is prepared in accordance with the cost of production method.

Sales revenues are reported as soon as the delivery has been made or the service rendered. For delivery/supply transactions, this is basically the time of transfer of risk after physical delivery. Furthermore, economic benefit must be sufficiently probable and the incurred costs reliably determinable. Operating expenses are recognized at the time the service is used or at the time of economic causation.

(1) Revenue

Revenue includes sales of products and services from which sales reductions have been deducted. Of the sales revenues for the fiscal year of € 110,823 thousand (prior year: € 80,166 thousand), domestic sales accounted for € 90,409 thousand (prior year: € 66,438 thousand) and foreign sales € 20,414 thousand (prior year: € 13,728 thousand).

Sales revenues are broken down according to strategic divisions as well as regions in the appended segment report.

(2) Other operating income

Other operating income includes income from the reversal of the special account for subsidies of € 2,183 thousand (prior year: € 1,701 thousand) and income from the liquidation of other provisions of € 708 thousand (prior year: € 1,818 thousand). This item also contains other income from grants from the employment office, exchange rate differences, automobile transfer to employees and the disposal of assets. Income from currency translation amounts to € 78 thousand (prior year: € 48 thousand).

(3) Other own work capitalized

Own work performed includes project-related development expenses of € 5,619 thousand (prior year: € 3,004 thousand), which fulfill the criteria under IAS 38.45. The capitalized amounts are recognized under intangible assets.

(4) Cost of materials

in € (000)	2006	2005
Raw materials and supplies	61,840	42,222
Purchased services	6,573	3,389
Total	**68,413**	**45,611**

(5) Personnel expense

Expenses related to salaries and wages amounted to € 20,067 thousand over the past fiscal year (prior year: € 14,574 thousand). The sum of €4 ,043 thousand (prior year: € 3,289 thousand) was expended on social security contributions and pensions. This amount included expenses for pensions of € 492 thousand (prior year: €221 thousand).

(6) Other operating expenses

Other operating expenses are comprised primarily of legal and consultancy fees, investor relations expenses, advertising and marketing, vehicle costs, costs related to EDP fees and EDP training, costs related to building rentals and energy, as well as leasing and corporate insurance expenses. Expenses from currency translation amount to € 40 thousand (prior year: € 14 thousand).

Other operating expenses in the reporting year amounted to € 11,925 thousand (prior year: € 9,760 thousand).

(7) Financial result

The financial result arises from the netting of interest and similar income amounting to € 75 thousand (prior year: € 114 thousand) and interest expense of € 4,761 thousand (prior year: € 3,180 thousand).

(8) Income Taxes

Income tax includes the taxes to be paid under the tax pooling arrangement for which paragon AG is the entity liable for taxes, the income taxes of paragon fidelity GmbH and the US subsidiaries, as well as deferred taxes. € 2,405 thousand (prior year: € 2,405 thousand) relates to income taxes and € 871 thousand (prior year: € 1,249 thousand) to deferred taxes.

Deferred taxes are the result of timing differences in reporting between the Company's statements for tax purposes and the consolidated financial statements using the liability method, as well as loss carryforwards from the US and Japanese subsidiaries.

Deferred tax assets and liabilities are formed in connection with the following accounts and situations:

in € (000)	12/31/2006		12/31/2005	
	Deferred tax assets	Deferred tax liabilities	Deferred tax assets	Deferred tax liabilities
Intangible assets	2,385	7,498	1,886	4,362
Property, plant and equipment	96	311	19	333
Receivables and other assets	252	58	35	15
Provisions for pensions	178	0	171	0
Other provisions	99	0	0	93
Liabilities	0	167	0	35
Profit sharing rights	0	197	0	210
Tax loss carryforwards	384	0	0	0
	3,394	**8,231**	**2,111**	**5,048**
Net balance	- 3,002	- 3,002		
	392	**5,229**		

The increase in deferred tax assets is essentially the result of an intragroup transfer of a customer portfolio, as well as a reversal of loss carryforwards from the previous year. The increase of deferred tax liabilities on intangible assets relates primarily to the capitalization of development expenses as well as additional intangible assets acquired in connection with the acquisition of the remaining 49% of shares in paragon fidelity GmbH.

Domestic deferred taxes were computed as of December 31, 2006, as in the previous year, based on a corporate tax rate of 25 %, a solidarity surcharge of 5.5 % and an effective trade tax rate of 15.2%. This reflects a combined tax rate of 37.6 %.

A combined income tax rate of 34 % was used in calculating deferred taxes in the US.

Deferred tax liabilities amounting to € 3,394 thousand (prior year: € 2,111 thousand) involve € 3,010 thousand (prior year: € 2,058 thousand) related to domestic taxes and € 384 thousand (prior year: € 53 thousand) related to foreign taxes. Deferred tax liabilities amounting to € 8,231 thousand (prior year: € 5,048 thousand) relate only to domestic taxes.

Domestic deferred tax assets of € 3,010 thousand (prior year: € 2,058 thousand) relate to deferred tax claims arising from timing differences in valuation.

There are no domestic corporate or trade tax loss carryforwards at present. Loss carryforwards in Germany may be used at any time provided the minimum taxation is considered, whereas in the US their use is limited to 20 years.

Foreign deferred tax claims of € 384 thousand relate to the subsidiaries in the US and Japan as of December 31, 2006. Tax loss carryforwards in the amount of USD 1,358 thousand exist for the subgroup paragon of North America Corp. as of the balance sheet date. This is composed of a tax loss carryforward as of December 31, 2005, in the amount of USD 1,131 thousand, as well as the tax loss from the current fiscal year, 2006, in the amount of USD 227 thousand. No deferred tax assets have yet been applied to the loss carryforwards of the subgroup paragon of North America Corp. as of December 31, 2005. Deferred tax claims relating to the loss carryforwards of Japan K.K. amount to € 34 thousand and constitute the current loss from fiscal 2006, translated at € 82 thousand. Based on current positive earnings forecasts, in particular with regard to the manufacture of new products in the telecommunications division in the US, the Managing Board assumes that the tax losses available as of December 31, 2006, can be utilized in the medium term.

Deferred tax liabilities in the amount of € 8,231 thousand involve temporary differences in valuation and chiefly apply to intangible assets capitalized under IFRS, but which may not be capitalized under German tax law. € 2,770 thousand in deferred tax liabilities were recorded without impact on income as a consequence of the acquisition of 49% of the shares in paragon fidelity Verwaltungsgesellschaft mbH and the related purchase price allocation.

Dividends to be paid by paragon AG in the future have no impact on the Group's tax burden.

Pursuant to IAS 12.81 the actual tax expense is to be compared with the tax expense that would theoretically result from using the applicable the tax rates on reported pre-tax earnings.

Of the income taxes for fiscal year 2006 in the amount of € 1,156 thousand (prior year: € 1,156 thousand), domestic taxes accounted for € 1,918 thousand (prior year: € 1,207 thousand) and foreign taxes for € -384 thousand (prior year: € -49 thousand). Income taxes are composed of current income taxes of € 2,405 thousand (prior year: € 2,405 thousand), fully attributable to domestic taxes, as well as deferred income taxes of € -871 thousand (prior year: € -1,248 thousand), of which € -487 thousand (prior year: € -1,992 thousand) relate to domestic taxes and € -384 thousand (prior year: € -56 thousand) to foreign taxes.

The following statement reconciles the theoretical tax expense to the actual tax expense.

(9) Earnings per share

Basic earnings per share are calculated by dividing Group net income by the weighted average number of shares issued. The weighted average number of shares issued was 4,103,186 in the year under review (prior year: 4,066,219).

With Group net income of € 2,249 thousand (prior year: € 2,206 thousand), the basic earnings per share is € 0.54 (prior year: € 0.55). Earnings per share in the year under review was € 0.61 excluding the impact of taxes from other periods.

To calculate diluted earnings per share, the number of all potentially diluting shares is added to the weighted average number of shares issued.

paragon AG's stock option plans create the basis for a potential dilution of earnings per share. Under these plans, management receives option rights for the purchase of paragon AG shares. Exercising these subscription rights depends on the price movement of the paragon share. During 2006, based on an average share price of € 13.93 (prior year: € 16.38) and a strike price of € 7.98 (first tranche), € 3.78 (second tranche), € 3.88 (third tranche) and € 15.09 (fourth tranche), dilution by 17,317 shares occurred (prior year: 41,034 shares).

in € (000)	2006	2005
Group net income before tax	**3,805**	**3,405**
Theoretical tax expense at a tax rate of 37.6 %	1,431	1,280
Tax effects of subsidiary with negative contributions to consolidated income	- 140	132
Differences arising from disparity in tax rates	14	-21
Tax effects from non-deductible expenses and tax-exempt income	86	- 480
Differences resulting from consolidation measures	- 138	0
Tax expense from previous years	369	203
Miscellaneous	- 88	0
Actual income tax expense	**1,534**	**1,156**

The calculation of diluting shares was undertaken according to the following formula:

Potentially diluting common shares [each] =

$$\text{subscription rights issued [each]} \times \left(1 - \frac{\text{strike price}}{\text{Ø share price}}\right)$$

1st tranche

$$1{,}485 = 3{,}477 \times \left(1 - \frac{€\ 7.98}{€\ 13.93}\right)$$

2nd tranche

$$3{,}546 = 4{,}867 \times \left(1 - \frac{€\ 3.78}{€\ 13.93}\right)$$

3rd tranche

$$12{,}285 = 17{,}028 \times \left(1 - \frac{€\ 3.88}{€\ 13.93}\right)$$

4th tranche

$$0 = 30{,}000 \times \left(1 - \frac{€\ 15.09}{€\ 13.93}\right)$$

The number of shares to be used in calculating the diluted earnings thus rose to 4,120,502 (prior year: 4,107,253). The diluted earnings per share figure is rounded to € 0.54 (prior year: € 0.55). The diluted earnings per share figure was calculated according to IAS 33.24 et seqq.

Further explanation concerning the stock option program can be found in Item (31).

Notes to the consolidated balance sheet

Recognition and measurement

The consolidated financial statements were prepared based on the historical cost concept except for assets and liabilities that must be recognized at fair value. In the paragon Group, this relates to specific financial instruments and provisions.

We refer in this regard to the notes accompanying the numbered items.

Estimates and assumptions must be made in preparing the consolidated financial statements. These influence the amounts indicated for assets, liabilities and contingent liabilities as of the balance sheet date, as well as the reporting of income and expense in the period under review. The actual amounts may deviate from these estimates.

Assets

Changes in non-current assets are presented in a separate consolidated statement of changes in non-current assets which is appended to the notes.

(10) Goodwill and other intangible assets

Acquired intangible assets are reported at cost. They are amortized over their useful life according to the straight-line depreciation method. In the case of licenses, patents and software, the useful life is taken to be between three and ten years. To the extent necessary, impairment losses are recorded, which can be reversed at a later date, if reasons for the original write-down are permanently eliminated. Due to the voluntary earlier application of IFRS 3 (2004), goodwill has not been amortized since January 1, 2004. An impairment test as defined in IAS 36 (2004) must be performed at least annually. A review showed that there were no events and circumstances in fiscal 2006 that led to an impairment or the reversal of an impairment. Goodwill from the companies included in the US subgroup amounts to € 2,249 thousand (USD 2,971 thousand) as of December 31, 2006.

Goodwill of € 9.9 million has arisen as a result of the acquisition of the remaining 49 % shares in paragon fidelity Verwaltungs-GmbH, Suhl, during 2006. Together with the goodwill from the 51 % shareholding acquired in the previous year, goodwill attributable to the cash-generating unit paragon fidelity GmbH, Cadolzburg, now amounts to € 23.8 million.

Pursuant to IAS 36, goodwill must be annually tested for impairment. In doing this, the carrying amount of a cash-generating unit is compared with the recoverable amount. Each individual legal entity is regarded as a cash-generating unit. The recoverable amount corresponds to the value in use determined according to the discounted cash flow method. The basis for determining future cash flows is the data from the detailed corporate planning for the fiscal years until 2010 with a subsequent transition to perpetual annuity. The free cash flows are discounted at an appropriate interest rate to determine the present value of the cash flows. If the recoverable amount of a business division is less than its carrying amount, an impairment loss in the amount of the difference is initially applied to goodwill.

An intangible asset produced in the development or during the development phase of an internal project is to be capitalized at cost, providing criteria (a) to (f) f IAS 38.45 are met, and amortized over the anticipated useful life of from three to six years. Total development costs for the period amounted to € 11,350 thousand (prior year: € 6,194 thousand). Of that amount, € 5,619 thousand (prior year: €3,004 thousand) in internal development costs were capitalized as intangible assets; amortization during the fiscal year amounted to € 2,571 thousand (prior year: €1,007 thousand). This includes an impairment loss of € 528 thousand (prior year: €9 8 thousand) in accordance with IAS 38.97 in conjunction with IAS 36. As of the balance sheet date total internal development costs have been capitalized as intangible assets with a residual carrying amount of € 6,940 thousand (prior year: € 3,913 thousand). Development has been focused on the communications division with Car Media Systems, air quality sensors and air quality treatment for automobiles, as well as in the area of instrumentation and control.

(11) Property, plant and equipment

Plant, property and equipment is measured at cost and depreciated according to the straight-line method over the expected useful life of the asset. Subsequent purchase costs are capitalized. Where acquisitions are made in a foreign currency, subsequent changes in exchange rates have no effect on the reporting of original cost.

In the case of buildings, useful life is considered to be 20 to 25 years, for technical plant five to ten years, and for other plant and office furniture and equipment three to ten years. To the extent necessary, impairment losses are recognized pursuant to IAS 36, which can be reversed at a later date if reasons for the original impairment are permanently eliminated. The terms used for depreciation and useful life are reviewed on a yearly basis.

Where items are rented or leased and beneficial ownership lies with the Group company concerned (finance lease), they are capitalized at the lower of the net present value of lease installments or their fair value in accordance with IAS 17 and depreciated over their useful life. Portions of movable fixed assets are financed under lease contracts that normally run for four years. Payments corresponding to future lease installments are recorded as liabilities. The net carrying amount of capitalized lease objects as of December 31, 2006 amounts to € 2,680 thousand (prior year: € 3,750 thousand). Corresponding payment obligations from future lease installments amount to € 1,515 thousand (prior year: € 2,478 thousand) and are recorded as liabilities. Capitalized lease objects are without exception technical plant and machinery.

(12) Financial assets

Shares in the amount of € 200 thousand recognized in financial assets relate to the unconsolidated investment in Paderborner Stadiongesellschaft mbH, Paderborn, Germany. The shares are recognized at cost (€ 200 thousand), since no different present value is available.

(13) Deferred taxes

All income tax amounts to be paid in future arising from timing differences that are subject to taxes are accounted for as deferred tax liabilities; all future refundable amounts resulting from deductible timing differences, unutilized tax loss carryforwards and tax credits are reported as deferred tax assets. Deferred taxes are provided for in accordance with IAS 12. Tax rates applicable at the balance sheet date or future tax rates already resolved and known are recorded according to the 'liability method'. Additional explanation on deferred tax assets and liabilities is included under Item (8).

Fixed asset schedule 2005

in € (000)	Cost as of 01/01/2005	Exchange rate changes	Additions (third party)	Addition "Cullmann and ChipCo acquisition" 10/01/2005	Re-classifications	Disposals (third party)	Cost as of 12/31/2005	Accumulated depreciation/ amortization as of 12/31/2005	Accumulated depreciation/ amortization as of 12/31/2004	Carrying amount as of 12/31/2005	Carrying amount as of 12/31/2004	Depreciation/ amortization 2005
Intangible assets												
Licenses, patents, software	17,301	25	435	7,577	0	77	25,261	5,632	3,176	19,629	14,125	2,281
Capitalized development costs	3,162	-20	3,004	0	0	489	5,657	1,744	1,267	3,913	1,895	1,007
- thereof impairment pursuant to IAS 36								98				98
Goodwill	2,775	156	0	15,365	0	2	18,294	313	299	17,981	2,476	0
Total	**23,238**	**161**	**3,439**	**22,942**	**0**	**568**	**49,212**	**7,689**	**4,742**	**41,523**	**18,496**	**3,288**
Property, plant and equipment												
Land and buildings	12,253	112	3,907	103	1,330	600	15,774	1,934	1,144	15,189	11,109	786
Technical plant and machinery	12,320	52	4,475	921	380	727	17,041	9,061	6,748	8,363	5,572	2,265
Office furniture and equipment	3,675	29	2,001	3,132	165	753	8,085	4,081	1,540	4,167	2,135	991
Prepayments and equipment under construction	1,731	0	214	180	-1,875	9	2,116	0	0	241	1,731	0
Total	**29,979**	**193**	**10,597**	**4,336**	**0**	**2,089**	**43,016**	**15,076**	**9,432**	**27,940**	**20,547**	**4,042**
Financial assets												
Investments	0	0	200	0	0	0	200	0	0	200	0	0
Total	**0**	**0**	**200**	**0**	**0**	**0**	**200**	**0**	**0**	**200**	**0**	**0**
Total	**53,217**	**354**	**14,236**	**27,278**	**0**	**2,657**	**92,428**	**22,765**	**14,174**	**69,663**	**39,043**	**7,330**

Fixed asset schedule 2006

in € (000)	Cost as of 01/01/2006	Exchange rate changes	Additions (third party)	Addition acquisition 49 % paragon fidelity GmbH	Re classifications	Disposals (third party)	Cost as of 12/31/2005	Accumulated depreciation/ amortization as of 12/31/2006	Accumulated depreciation/ amortization as of 12/31/2005	Carrying amount as of 12/31/2006	Carrying amount as of 12/31/2005	Depreciation/ amortization 2006
Intangible assets												
Licenses, patents, software	25,261	- 9	515	7,309	- 7	3	33,066	9,479	5,632	23,587	19,629	3,847
Capitalized development costs	5,657	- 21	5,619	0	0	0	11,255	4,315	1,744	6,940	3,913	2,571
- thereof impairment pursuant to IAS 36								528	98			528
Goodwill	18,294	- 252	0	9,935	0	0	27,977	313	313	27,664	17,981	0
Total	**49,212**	**- 282**	**6,134**	**17,244**	**- 7**	**3**	**72,298**	**14,107**	**7,689**	**58,191**	**41,523**	**6,418**
Property, plant and equipment												
Land and buildings	17,105	- 93	1,542	0	- 196	0	18,358	2,832	1,934	15,526	15,171	898
Technical plant and machinery	17,421	- 68	3,576	0	233	35	21,127	11,766	9,061	9,361	8,360	2,705
Office furniture and equipment	8,249	- 19	1,695	0	65	831	9,159	5,802	4,081	3,357	4,168	1,721
Prepayments and equipment under construction	241	- 53	3,069	0	- 95	0	3,162	0	0	3,162	241	0
Total	**43,016**	**- 233**	**9,882**	**0**	**7**	**866**	**51,806**	**20,400**	**15,076**	**31,406**	**27,940**	**5,324**
Financial assets												
Investments	200	0	0	0	0	0	200	0	0	200	200	0
Total	**200**	**0**	**0**	**0**	**0**	**0**	**200**	**0**	**0**	**200**	**200**	**0**
Total	**92,428**	**- 515**	**16,016**	**17,244**	**0**	**869**	**124,304**	**34,507**	**22,765**	**89,797**	**69,663**	**11,742**

(14) Inventories

Inventories consist of the following:

in € (000)	12/31/2006	12/31/2005
Raw materials and supplies	8,056	7,708
Work in progress and finished goods	8,901	6,259
Advance payments on inventory	383	14
Total	**17,340**	**13,981**

Inventories are valued at cost. In accordance with IAS 2, costs include, in addition to direct costs, overhead costs that can be attributed to the production process including appropriate depreciation on production equipment (costs of conversion). Pursuant to IAS 23.7, financing costs are directly recognized as an expense. If lower, the net realizable value is recorded. Write-downs of inventory to the lower net realizable value as of the balance sheet date amount to € 877 thousand (prior year: € 399 thousand). As in the prior year, there were no grounds for reversals of impairment losses. As of the balance sheet date, inventory was no longer utilized as collateral for liabilities (prior year: € 9,662 thousand). Orders that would need to be reported under IAS 11 (long-term construction contracts) did not exist on the balance sheet date.

(15) Trade receivables and other assets

in € (000)	12/31/2006	12/31/2005
Trade receivables	19,880	9,704
Other assets	1,649	12,371
Total	**21,529**	**22,075**

Trade receivables and other assets are recognized at amortized cost. Other assets include grant claims for subsidies in connection with investments in property, plant and equipment at the Suhl site in the amount of € 183 thousand. Default and transfer risks are covered by appropriate allowances in the amount of € 407 thousand (prior year: € 534 thousand) to the extent not covered by insurance. Receivables in foreign currency are translated at the exchange rate applicable at the time of the transaction. As of the balance sheet date, receivables in foreign currency are converted at the closing rate.

(16) Cash and cash equivalents

Changes in cash and cash equivalents that constitute financing funds according to IAS 7 are shown in the appended cash flow statement. Cash on hand and bank deposits are shown at nominal value. Cash and cash equivalents include € 7 thousand (prior year: € 7 thousand) in cash on hand and € 8,751 thousand (prior year: € 5,825 thousand) in bank deposits.

Liabilities and equity

(17) Equity

Changes in equity are shown in the statement of changes in equity. Financial instruments are allocated to equity according to their economic nature under IAS 32.18.

paragon AG's share capital as of December 31, 2006, amounts to € 4,113,063.00 (prior year € 4,086,106,00) and is divided into 4,113,063 bearer shares with a notional share in capital of € 1.00 each. The capital increase is the result of the exercise of 26,957 options under paragon AG's stock option plan no. 1.

The capital reserve includes additional cash payments for the issue of shares. It rose during fiscal 2006 due to the exercise of option rights – by € 84 thousand (prior year: € 162 thousand) – and the granting of share-based payments in accordance with IFRS 2 – by € 99 thousand (prior year: € 85 thousand). The capital reserve thus increased during the fiscal year from € 7,565 thousand to € 7,748 thousand.

Exchange rate differences arising from the translation of financial statements prepared in foreign currencies or during consolidation are recognized directly in equity without impact on profit or loss in accordance with IAS 21.

Further explanation concerning the stock option plan can be found in Item (31).

Authorized capital

In accordance with the resolution of the Annual General Meeting dated May 24, 2005, on the suspension of authorized capital and the creation of new authorized capital, as well as on the corresponding modification of the statutes, the Managing Board was authorized in pursuant to Section 5 (6) of the statutes, with the consent of the Supervisory Board, to raise the Company's capital in the period to April 30, 2010, by the issue of new bearer shares against cash or non-cash contributions on one or more occasions, however, not exceeding € 2,000,000.00 in total. Shareholders are to be granted subscription rights.

The Managing Board, however, is authorized, with the consent of the Supervisory Board, to:

- exclude the subscription rights of shareholders up to an amount of 10% of the share capital, in order to issue new shares against cash contributions at an issue price not significantly lower than the stock exchange price and
- exclude shareholders from subscription rights in order to issue new shares against non-cash contributions for the acquisition of companies or interests in companies.
- exclude fractional amounts from subscription rights of shareholders.

The Managing Board is entitled to establish conditions of the share issue with the consent of the Supervisory Board. The Supervisory Board is authorized to modify the version of the statutes with respect to the scope of capital increases from authorized capital.

Moreover, in accordance with the resolution of the Annual General Meeting on May 17, 2006, the Managing Board is authorized to acquire shares of the Company as intended under section 71 (1) no. 8 of the AktG (German Stock Corporation Act). The authorization for the purchase of treasury shares resolved at the Annual General Meeting of May 24, 2005, was rescinded from the moment at which the new authorization became effective.

The new authorization is restricted to the acquisition of shares not exceeding 10 % of existing capital in order to

- offer such shares to third parties in the event of mergers or the acquisition of companies or interests in companies,
- sell them at a price not significantly lower that the Company's share price as quoted on the stock exchange at the time of the sale, or
- to withdraw them.

The new authorization is in effect until November 16, 2007. It may not be exercised in order to trade in treasury shares.

As of the balance sheet date, no shares have yet been issued under authorized capital.

Conditional capital

A conditional capital increase of up to € 284,874.00 by issue of 284,874 common shares was resolved (Stock option plan no. 1) by resolution of the Annual General Meeting of October 17, 2000, modified by the Annual General Meeting resolution of May 15, 2002, and supplemented by the resolution of the Annual General Meeting of May 12, 2004). The conditional capital increase is to be used only for granting option rights to the Managing Board and employees of paragon AG and to directors and employees of its subsidiaries. As of the balance sheet date, conditional capital I relating to the exercise of options amounted to € 176,737.00.

The resolution for additional issues of option rights to members of the Managing Board and senior managers of the Company (Stock option plan no. 2) was passed at the time of the Annual General Meeting of May 12, 2004. Additional conditional capital II, entailing a conditional capital increase of up to € 115,000.00 by the issue of 115,000 common shares, was created to secure these option rights. As of the balance sheet date, no option rights had yet been issued from this conditional capital.

Each option right carries an entitlement to acquire one paragon AG bearer share with a notional share capital value of € 1.00 in accordance with option conditions to be established.

Dividend distribution

For fiscal year 2006, a proposal will be made to the Annual General Meeting to distribute a dividend of € 0.30 (prior year: € 0.20) per share. For 4,113,063 shares (prior year: 4,086,106 shares), this implies a total dividend payment of € 1,233,918.90 (prior year: € 817,221.20).

(18) Liabilities

in € (000)	12/31/2006	12/31/2005
Current liabilities		
Current portion of financial lease liabilities	919	1,019
Short-time loans and current portion of long-term loans	13,238	13,899
Trade liabilities	14,344	12,398
Other current liabilities	5,194	4,956
Non-current liabilities		
Long-term financial lease liabilities	595	1,459
Long-term loans	32,329	10,118
– including those with a remaining term of one to five years –	23,090	7,404
– including those with a remaining term in excess of five years –	9,239	2,714
Other non current liabilitities	3,795	0

Loan liabilities and trade payables are recorded at amortized cost. Amortized cost of a financial debt is the amount

- at which the financial debt was initially measured
- minus any repayments and
- minus or plus the accumulated distribution of any differences between the original amount and the repayable amount at maturity (premium, discount or transaction costs), which are apportioned over the term of the financial debt using the effective interest method.

Interest expense from amortization of discounts during fiscal 2006 amounted to € 83 thousand (prior year: € 59 thousand).

Liabilities in foreign currency are translated at the exchange rate applicable at the time of the transaction. At the balance sheet date, liabilities in foreign currency are translated at the closing rate.

Liabilities under finance leases (in particular lease agreements) normally have a term of four years. Repayments for the following years amount to € 1,515 thousand (prior year: € 2,478 thousand), of which € 919 thousand will come due during the 2007 calendar year. Future interest payments related to lease agreements amount to a total of € 86 thousand of which € 65 thousand will come due during 2007. Liabilities under finance leases are recorded at their present value or amortized cost in accordance with IAS 17.

Current and non-current liabilities to banks total € 45,567 thousand (prior year: € 24,017 thousand); collateral for liabilities to banks exists in the amount of € 11,389 thousand.

Liabilities to banks are secured by property charges for loan liabilities in the amount of € 11,149 thousand (prior year: € 5,620 thousand), collateral assignment of property, plant and equipment of € 240 thousand (prior year: € 27,940 thousand) and by the cession of rights and claims under a subsidy notice of the Thüringer Aufbaubank concerning € 5,027 thousand dated June 21, 2005.

In addition to the property charges, additional securities exist for some of the liabilities mentioned above in the form of collateral assignments of property, plant and equipment or the cession of rights and claims under subsidy notices. Additional security is provided by a directly enforceable fixed guarantee on the part of Mr. Klaus Dieter Frers in the amount of € 153 thousand.

The term of non-current financial liabilities is up to 15 years. The interest rates for liabilities to banks are between 4.50 % and 8.75 % and are fixed for the contract term for the major portion of the loans and thereby not exposed to any significant risk of change. Individual risks relating to variable-interest loans are hedged by derivative financial instruments in the form of interest rate swaps.

Other current liabilities chiefly refer to payment for profit-sharing rights recorded in the amount of € 1,679 thousand (prior year: € 1,334 thousand), as well as the remaining liability of € 3,795 thousand relating to IKB Private Equity GmbH, Düsseldorf, in connection with the silent equity holding reported in the previous year. Other liabilities include liabilities from transport taxes or other indirect taxes in the amount of € 2,050 thousand (prior year: € 680 thousand), social security liabilities of € 1 thousand (prior year: € 483 thousand) and salary and wage liabilities of € 892 thousand (prior year: € 263 thousand).

Categorization of financial assets and debt

Financial assets and liabilities in the paragon Group refer almost without exception to financial assets and liabilities in the 'loans and receivables' category. They are measured at amortized cost.

The only financial asset held for trading involves the shareholding in Paderborner Stadiongesellschaft mbH, Paderborn. This is measured at cost, since market value figures are not available. Please refer to Item (12).

Derivative financial instruments are categorized as 'Financial assets and liabilities' according to IAS 39.9 (a) (iii). They are recognized at fair value in profit or loss.

As of the date of the balance sheet, financial derivatives existed in the form of interest-rate swaps and hedging contracts. The paragon Group is exposed to a number of financial risks due to its international activities. These include in particular the impacts of changes in interest rates and exchange rates.

paragon uses non-exchange-traded interest rate swaps to hedge interest rates. The transactions are only entered into with banks of impeccable financial standing. If the trade date and settlement date do not coincide, then the settlement date is used for the initial recording. All derivatives are recognized in the balance sheet at their fair value. The fair value of financial instruments is determined on the basis of published market prices on the balance sheet date.

paragon uses currency forwards in the form of forward plus contracts to hedge currency risks. They are recognized at fair value as of December 31, 2006. Fair value is determined using the Black Scholes model.

Fair values are reported in other current liabilities and in other assets.

The fair values of the interest rate swaps reported are calculated according to the Black Scholes model, as well as the discounted cash flow model. A bandwidth swap is measured as the total of three digital options (caps and floors) using the reference interest rate. Each digital option is measured according to market convention using a spread of two leveraged vanilla options in order to take into account the effect of the volatility smile.

Interest rate derivatives

Counterparty	Product	Contract date	Start date	End date	Reference amount	Fair value
Commerzbank AG, Bielefeld	Swap	04/30/2004	05/15/2004	03/15/2007	208,333.00 €	- 4,332.00 €
IKB Financial Products S.A., Luxembourg	Bandwidth swap	08/05/2004	08/16/2004	03/30/2007	208,333.00 €	- 379.79 €
Commerzbank AG, Bielefeld	Swap	04/14/2005	04/30/2005	03/30/2015	825,000.00 €	9,961.00 €
IKB Financial Products S.A., Luxembourg	Payer Swap	07/10/2006	07/14/2006	12/30/2013	12,500,000.00 €	- 127,232.72 €
Commerzbank AG, Bielefeld	Swap	07/10/2006	07/14/2006	12/30/2013	12,500,000.00 €	- 128,352.00 €
Postbank S.A. Luxemburg	Swap	12/07/2006	12/07/2006	09/30/2010	2,025,000.00 €	- 686.81 €
HypoVereinsbank AG, München	Swap	12/07/2006	12/07/2006	09/30/2011	2,000,000.00 €	- 2,698.83 €

IThe vanilla options in turn are measured using the Black-76 model. This is an adaptation of the Black Scholes model for options on forward rates (e.g. caps and floors). The implicit volatilities needed for measurement are derived from the current market cap/floor interface.

Currency derivates

Bank	Product	Contract	Maturity	Due	Reference amount	Hedging rate	Trigger rate
Commerzbank AG, Bielefeld	Fordward Plus Contract	11/22/2006	03/14/2007	03/16/2007	$ 250,000.00	1.2800 €	1.3280 €
Commerzbank AG, Bielefeld	Fordward Plus Contract	11/22/2006	05/14/2007	05/16/2007	$ 250,000.00	1.2825 €	1.3380 €

paragon AG is entitled and obligated to repay the profit-sharing rights to the acquiring parties in the form of two partial amounts of € 3.0 million each before the end of the term of the profit-sharing rights. This early repayment need only be made on July 1, 2009, or July 1, 2010, if the profit-sharing capital has not been reduced by losses.

Currency derivatives are reported according to the 'European' trigger style, i.e. the settlement rate is established only at the maturity date. The rate may therefore fall below the hedging rate or exceed the trigger rate up to the maturity date, without thereby establishing the settlement rate. Fair values of both currency derivates are € -4,505 and € -4,529, respectively.

Gains or losses from changes in the fair value of derivative financial instruments of € -254 thousand are included in net income. The derivatives have default risks in the amount of their positive fair value. These risks are minimized by the high demands placed on the contracting parties' credit standing.

Derivative financial instruments of the previous year include interest rate swaps with positive fair values of € 6 thousand and negative fair values of € 27 thousand. The fair value of the forward exchange deal of the previous year was € 27 thousand.

(19) Profit-sharing rights

By resolution of the Annual General Meeting of May 12, 2004, paragon AG was authorized, with the consent of the Supervisory Board, to issue profit-sharing rights in the period up to December 31, 2008, on one or more occasions, excluding shareholders' subscription rights. paragon AG granted profit-sharing rights at a par value of one euro each as part of a private placement against payment of a total of € 8.0 million as provided for in the profit-sharing rights agreement dated June 3, 2004. Of that amount, € 5.0 million profit-sharing rights at a par value of one euro each were issued to IKB Private Equity GmbH, Düsseldorf, and € 3.0 million profit-sharing rights at a par value of one euro each were issued to DKB Deutsche Kreditbank AG, Suhl. The term of all acquired profit-sharing rights will end no later than Dec. 31, 2010.

In a profit-sharing rights agreement dated October 27, 2005, paragon AG issued additional profit-sharing rights totaling € 6.0 million at a par value of one euro each to Force 2005-1 Ltd. Partnership, St. Helier, Jersey, Channel Islands as part of the private placement. This company is a member of a consortium in which, among others, IKB Deutsche Industriebank AG, Düsseldorf and Deutsche Bank AG, London, act as administrators or lead managers. The term of these acquired profit-sharing rights will end no later than January 15, 2013.

Due to the contractual form, this profit-sharing capital must be recognized as a financial liability according to the provisions of IAS 32. The directly attributable transaction costs amounting to € 210 thousand have reduced the value of the addition of the profit-sharing capital as defined by IAS 39.43 and will be recorded as expenses over the term of the profit-sharing capital.

Holders of profit-sharing rights receive compensation consisting of a fixed amount independent of profit and a component that varies with profit for the profit-sharing rights they have been granted. Compensation totals € 1,726 thousand (prior year: € 1,201 thousand) for fiscal year 2006 with respect to the profit-sharing rights of € 14.0 million (institutional tranche) reported at the balance sheet date.

By resolution of the Annual General Meeting held on May 12, 2004, the Managing Board was further authorized to offer profit sharing rights in the aggregate par value of up to a maximum of €15 million on one or several occasions until December 31, 2008 to the shareholders for subscription. Based on this resolution paragon AG's Managing Board decided to issue profit-sharing rights with a total par value of € 14,511,016.80 to paragon AG shareholders, divided into 12,092,514 equivalent profit-sharing rights with a par value of € 1.20 each. The shareholders of paragon AG were given preference in acquiring profit-sharing rights through exercise of the subscription right in the period from November 4, 2004, to December 03, 2004. The subscription right ratio was 1:3; one paragon share entitled the shareholder to purchase three profit-sharing rights. The profit-sharing rights are traded neither on the floor of the stock exchange nor over the counter; they can only be transferred by assignment with the consent of the Company. For the minimum term until December 31, 2010, annual fixed compensation of six percent plus a profit-dependent compensation of up to three percent, depending on the EBITDA margin, will be paid. Shareholders and interested investors were able to subscribe to additional profit-sharing rights by way of oversubscription until December 31, 2005.

As of the balance sheet date, a total of 3,363,584 profit sharing rights at a par value of € 1.20 per profit-share were subscribed. The profit-sharing rights therefore amount to € 4,036,300.80. Profit-sharing rights carry an entitlement to compensation from the date on which they are granted. For fiscal 2006, compensation amounts to € 322,904.06.

Due to the contractual form, these profit-sharing rights must be recognized as a financial liability according to the provisions of IAS 32. Directly attributable transaction costs amounting to € 248 thousand have reduced the value of the addition of the profit-sharing rights as defined by IAS 39.43 and will be recorded as expenses over the term of the profit-sharing rights.

By resolution of the Annual General Meeting of May 17, 2006, paragon AG was authorized, with the consent of the Supervisory Board, to issue profit-sharing rights in the period up to April 30, 2011, on one or more occasions, of up to € 50.0 million, excluding shareholders' subscription rights, according to the following conditions:

- profit-sharing rights issued under this authorization confer no entitlements to memberships nor conversion or option rights relating to the Company's shares
- profit-sharing rights issued under this authorization confer no share in the Company's liquidation proceeds.

The Managing Board is entitled to exclude shareholders' subscription rights with the consent of the Supervisory Board.

As a result of this resolution, the authorizations to issue profit-sharing rights of May 12, 2004 lose their validity to the extent not already utilized.

paragon AG granted new profit-sharing rights in the amount of € 6.0 million at a par value of one euro each to StaGe Mezzanine Capital S.A., Luxembourg, as part of a private placement as provided for in the profit-sharing rights agreement dated December 14, 2006. The term of these acquired profit-sharing rights will end no later than December 20, 2013. No ordinary termination of these profit-sharing rights is anticipated. The Managing Board made use of its authorization to exclude shareholders' subscription rights in relation to these profit-sharing rights.

Holders of profit-sharing rights receive compensation consisting of a fixed amount independent of profit, and a component that varies with profit for the profit-sharing rights they have been granted. Compensation totals € 13,061.66 in fiscal 2006 for new profit-sharing rights of € 6.0 million issued in 2006.

Due to the contractual form, these profit-sharing rights must be recognized as a financial liability according to the provisions of IAS 32. Directly attributable transaction costs amounting to € 317 thousand have reduced the value of the addition of the profit-sharing rights as defined by IAS 39.43 and will be recorded as expenses over the term of the profit-sharing rights.

(20) Silent equity holding

In the course of the acquisition of shares of paragon fidelity Verwaltungsgesellschaft mbH, paragon also acquired a silent equity holding and a partnership loan of IKB Private Equity GmbH, Düsseldorf, to Cullmann GmbH, Cadolzburg (presently paragon fidelity GmbH) in the amount of € 8,720 thousand. The silent equity holding and the partnership loan were canceled in December of 2006 and the contribution and loan, respectively, fully repaid. In connection with the acquisition of the silent equity holding in paragon fidelity GmbH, Cadolzburg, € 4,925 thousand was paid to IKB Private Equity GmbH, Düsseldorf, in fiscal 2006. Repayment of the remaining obligation to IKB Private Equity GmbH, Düsseldorf, in the amount of € 3,795 thousand will occur in two installments on June 30, 2008, and June 30, 2009.

(21) Investment subsidies

This represents government investment allowances and investment grants. Accounting for government subsidies is undertaken in accordance with IAS 20, that is, only if there is reasonable assurance that the conditions attaching to them will be complied with and the grants will be received. Government grants and subsidies are accounted for as deferred liabilities and liquidated over the average useful life of the asset subsidized. The liquidation amounts are recognized in other operating income with impact on the income statement.

Government assistance during the year under review amounted to € 2,141 thousand (prior year: € 2,591 thousand), of which € 2,133 thousand consists of asset-related subsidies.

Provisions

Provisions developed as follows during the year under review:

in € (000)	01/01/2006	Amount utilized	Reversal	Increase	12/31/2006
Other provisions	5,149	3,608	708	6,018	6,851
Provisions for pensions and similar obligations	853	0	31	227	1,049
Total:	**6,002**	**3,608**	**739**	**6,245**	**7,900**

(22) Other provisions

Legal or constructive obligations give rise to provisions in the balance sheet pursuant to IAS 37, in the event that a funds outflow to settle the obligation is deemed likely and the amount can be reliably estimated. The amount reported as the provision is the best estimate of the payment that will be required to fulfill the current obligation as of the balance sheet date.

Other provisions are created with respect to risks arising from retroactive vacation entitlements, director's fees, bonuses, warranties as well as legal and consulting fees and other obligations from ongoing business operations. Other provisions include tax provisions of € 207 thousand for risks arising from claims pending for withholding tax under liability principal status pursuant to Section 50a Income Tax Act (EStG). The remaining terms of all other provisions amounting to a total of € 6,644 thousand (prior year: € 5,149 thousand) are less than one year.

(23) Provisions for pensions

Pension provisions are created for obligations for projected benefits and for current benefits to eligible active and former employees of companies of the paragon Group, as well as their surviving dependents.

Pensions are in principle classified as defined contribution or defined benefit plans.

In defined benefit plans the Company's obligation is to fulfill benefit commitments made to active and former employees, with a distinction being drawn between pension systems financed by provisions and those financed by funds.

The paragon Group finances pension commitments by endowing provisions.

A provision for a defined benefit pension plan was created in accordance with IAS 19. This relates to a commitment of a fixed amount at age 65 based on an individual contract. In addition to this existing pension agreement, a new commitment was made in fiscal year 2005. This concerns a commitment at age 65 established under an individual contract, which is based on length of employment and salary level. The provision was valued based on actuarial expert opinion using the projected unit credit method' pursuant to IAS 19. The calculation is based on assumptions of an interest rate of 4.50 % (prior year: 4.25 %), annual benefits indexing of 0% (prior year: 0.0 %) for the previous commitment and of 10 % for the new commitment (for service years up to 2009, afterwards 0%) and annual pension indexing of 1.5 % (prior year: 0.0 %). The retirement age is assumed to be 65 years for purposes of calculation. Mortality and morbidity statistics are based on Prof. Dr. Klaus Heubeck's tables RT 2005 G . The anticipated return on plan assets is 4.00 % p.a.

The increase in the pension provision totals € 462 thousand (prior year: € 291 thousand) not taking into account any changes in plan assets. This includes, recorded as personnel expenses, service costs of € 255 thousand (prior year: € 51 thousand), interest of € 48 thousand (prior year: € 44 thousand and an actuarial loss of € 159 thousand (prior year: € 196 thousand). The corridor provision was not applied. The option to offset actuarial gains and losses in full against retained earnings as provided for in IAS 19.93A was not elected. The option to offset actuarial gains and losses in full against retained earnings as provided for in IAS 19.93A was not elected.

and an actuarial gain of € 30 thousand (prior year: loss of € 20 thousand). The corridor provision was not applied.

The fair value of plan assets is derived as follows:

in € (000)		12/31/2006	12/31/2005
	Fair value of plain assets at the beginning of the year	592	357
+	Anticipated return on plain assets	24	14
+/-	Actuarial gains and losses	- 94	- 87
+	Employer contributions	308	308
=	**Fair value of plan assets on balance sheet date**	**830**	**592**

The carrying amount of the reinsurance claim deducted as plan assets from the obligation amounts to € 830 thousand (prior year: € 592 thousand). The present value of the pension liability as of the balance sheet date is € 1,592 thousand (prior year: € 1,130 thousand). After deducting reinsurance claims a reportable obligation of € 762 thousand (prior year: € 539 thousand) remains.

Another portion of the pension provision relates to obligations of paragon forstep GmbH for benefits under the group relief fund of Andreas Haller Fabrik für Feinmechanik GmbH & Co. KG and was valued based an actuarial expert opinion using the projected unit credit method pursuant to IAS 19. The calculations are based on the benefit plan of the group relief fund. An interest rate of 4.50 % (prior year: 4.25 %) and pension indexing of 1.5 % (prior year: 1.5 %) were used in the calculation. 32 projected benefits with a present value of earned pension claims of active and inactive employees in the amount of € 138 thousand (prior year: € 162 thousand), as well as 29 (prior year 28) current benefits with a present value of € 149 thousand (prior year: € 152 thousand) were calculated and are reflected in the provision.

The addition to the pension provision totals € 3 thousand (prior year: € 38 thousand). This reflects service costs recognized as personnel expenses amounting to € 3 thousand (prior year: € 3 thousand), interest of € 13 thousand (prior year: € 15 thousand

Notes on the cash flow statement

The cash flow statement was prepared according to the indirect method as defined in IAS 7.18b.

(24) Net cash used for operating activities
This item includes interest paid in the amount of € 4,761 thousand (prior year: € 3,180 thousand). The higher interest payments reflect the issue of a promissory note to finance planned acquisitions and from interest expense related to the issue of profitsharing rights, on which interest in the previous year was paid only pro rata temporis.

(25) Net cash used for investing activities
paragon AG acquired minority interests in paragon fidelity Verwaltungs-GmbH, Suhl, from IKB Private Equity GmbH, Düsseldorf, under a purchase agreement dated August 24, 2006. A total purchase price of € 18.2 million was agreed. The purchase price was offset against an existing receivable from restitution claims in accordance with sections 30 and 31 of the limited liabilities company law in the amount of € 10.9 million and did not involve a cash transaction for this portion. The remaining purchase price of € 7.3 million was paid in fiscal 2006.

Additional cash outflows in the year include the sixth construction installment at the Suhl site of € 1.0 million and the purchase of an additional assembly line for € 1.9 million to expand capacity in electronic circuit board assembly.

(26) Net cash from financing activities

A promissory note in the amount of € 25.0 million with a term of 7 years was signed in order to provide financing for acquisitions and the expansion of the product business. Additional cash inflows are due to the issue of profit-sharing rights at a par value of € 6.0 million, which generated net cash flows of € 5.8 million in the fiscal year.

Cash outflows during the year chiefly relate to the silent equity holding paragon fidelity GmbH, Cadolzburg, reported in the previous year in the amount of € 4.9 million. Please refer to Item (20) in this regard.

(27) Cash and cash equivalents at the end of the period

Cash and cash equivalents include € 7 thousand in cash on hand and € 8,751 thousand in bank deposits.

Notes on the segment report

Segment reporting reflects paragon's internal reporting system, which in turn corresponds to the risk and reward approach under IAS 14. The breakdown of asset and income figures as well as additional indicators according to business area and region are presented in the segment report as stipulated in IAS 14. Business segments are individually detailed in the management report.

Income, expense, asset and liability accounts that cannot be directly attributed to a business segment are allocated using a suitable allocation key, provided that such income, expense and asset and liability accounts do not relate to overall corporate aspects. Segment assets include intangible assets, plant, property and equipment; inventories and trade receivables. Segment liabilities include trade payables that do not form part of finance lease agreements according to IAS 17.

Write-downs include an impairment loss as defined by IAS 38.97, in conjunction with IAS 36, amounting to € 528 thousand (prior year: € 98 thousand), which is attributable to the Automotive business segment. Non-cash expenses and income are not shown explicitly in segment reporting, as it is not possible to allocate them specifically to the segments generating them.

Sales between the segments were transacted at arm's length. Only an insignificant number of intersegment sales were transacted in fiscal 2006.

Please see attachment 4 for segment reporting.

Segment assets are reflected as follows in the segment report:

in € (000)	12/31/2006	12/31/2005
Total assets	137,816	113,026
less monetary assets	- 8,758	- 4,832
less deferred taxes	- 392	- 2,111
less other non-segment-specific assets	- 1,649	- 12,735
Segment assets	**127,017**	**93,348**

Segment liabilities are reflected as follows in the segment report:

in € (000)	12/31/2006	12/31/2005
Total liabilities	137,816	113,026
less equity	- 17,571	- 20,043
less special item	- 10,012	- 10,063
less loans and other liabilities	- 95,889	- 70,522
Segment liabilities	**14,344**	**12,398**

Other notes

(28) Contingent liabilities

No contingent liabilities existed for the Group as of the reporting date.

(29) Other financial liabilities

Other financial liabilities amount to € 6,161 (prior year € 5,522 thousand), of which € 1,939 thousand (prior year: € 2,444 thousand) can be attributed to the calendar year 2007. Other financial liabilities include € 3,390 thousand (prior year: € 1,967 thousand) for the next 1 to 5 years and € 832 thousand (prior year: € 1,111 thousand) for terms exceeding 5 years.

Other financial liabilities include open purchase orders for property, plant and equipment amounting to € 1,000 thousand (prior year: € 246 thousand), as well as an open purchase order for electronic components that are already stored in the consignment warehouse in the Suhl plant amounting to € 593 thousand (prior year: € 1,067 thousand). In addition, other financial liabilities exist from rental and lease agreements. The liabilities under operating leases for the next five years total € 1,555 thousand (prior year: € 1,249 thousand), of which € 663 thousand (prior year: € 639 thousand) are due in 2007. Lease objects in the main consist of vehicles that are returned to the lessor after the uncancellable basic lease period has expired. Expenses from leases amount to € 814 thousand (prior year: € 653 thousand) in fiscal 2006.

The building at Schwalbenweg 29, 33129 Delbrück is leased by paragon AG. Mr. Klaus Dieter Frers is the building's landlord. The expense for the calendar year came to € 150 thousand (prior year: € 150 thousand).

The building at Bösendamm 11 – 13, 33129 Delbrück is also rented by paragon AG. The building's landlord is Frers Grundstücksverwaltungs GmbH & Co. KG, Delbrück. Related expense during the year under review amounted to € 127 thousand (prior year: € 98 thousand for approximately 9 months).

Expenses from rental agreements amount to € 683 thousand (prior year: € 491 thousand) in fiscal 2007. Liabilities include € 1,499 thousand (prior year: € 1,360 thousand) for the next 1 to 5 years and € 832 thousand (prior year: € 1,109 thousand) for terms exceeding 5 years. As in the previous year, no contingent assets or liabilities of note exist as at the balance sheet date.

Please refer also to the notes under Item (30).

(30) Related parties

Related parties include members of the Managing Board and the Supervisory Board and their immediate families.

Total compensation of the Managing Board is € 1,771 thousand (prior year: € 1,545 thousand). This includes a fixed component of € 622 thousand (prior year: € 573 thousand). The amount of € 500 thousand (prior year: € 420 thousand) was booked as expense for performance-related components. Short-term performance-related components are linked to Group EBIT.

In addition, total compensation also includes a € 462 thousand (prior year: € 291 thousand) pension provision allocation increment, a non-cash benefit for vehicle use, and a share purchase of € 187 thousand (prior year: € 260 thousand). Please refer to details in the Section "Share-based payment' under Item (31) for information on the performance-related components providing long-term incentives. More detailed explanations of the pension provision can be found in Item (23).

Disclosure of itemized remuneration for members of the Managing Board was waived in accordance with the Annual General Meeting resolution of May 17, 2006, concerning omission of the disclosures under section 285 (1), no. 9a, (5 – 9) and sections 315a, 314 (1), no. 6a (5 – 9) of the German Commercial Code.

In the past calendar year, the members of the Supervisory Board received fixed compensation as well as variable compensation through stock appreciation rights. Please refer to Item (31) in this regard. Total compensation of the Supervisory Board in the year under review was € 45 thousand (prior year: € 56 thousand). Of that amount, € 41 thousand (prior year: € 41 thousand) was fixed compensation; the variable compensation component totaled € 4 thousand (prior year: € 15 thousand).

As of the balance sheet date, the Managing Board held 2,115,730 shares out of a total of 4,113,063, of which 2,111,730 are in the hands of Mr. Klaus Dieter Frers. The Supervisory Board holds 4,000 shares.

In 2006, rental payments totaling € 281 thousand were paid to the Frers family based on existing agreements; € 277 thousand related to the two company buildings in Delbrück.

As of the balance sheet date, a directly enforceable fixed guarantee without consideration on the part of Mr. Klaus Dieter Frers existed for paragon AG's obligations to banks in the amount of € 153 thousand (prior year: € 1,153 thousand).

Moreover, on the balance sheet date, an agreement was in existence between the State of Thuringia (represented by the Thüringer Aufbaubank, Erfurt) and Mr. Klaus Dieter Frers concerning a co-debtor obligation under public law, according to which Mr. Frers, in addition to paragon AG, assumes the liability for reimbursement as recipient of grants. This liability would arise if the State of Thuringia requested the Company to reimburse an investment subsidy in the amount of € 4,898 thousand (prior year: € 3,850 thousand), of which € 4,898 thousand (prior year: € 3,850 thousand) have been paid out.

Please refer to the details under Item (29).

(31) Share-based payments

paragon AG has been applying IFRS 2 "Sharebased payment" since fiscal 2004. Accordingly, the rules of IFRS 2 with respect to share-based payment must already have been applied to relevant transactions after November 7, 2002, provided the options had not yet been exercised on January 1, 2005.

Stock option plan 1

paragon AG grants its employees and its Managing Board members stock options that entitle the holder to purchase one share for each option after the expiration of the blocking period at a previously fixed subscription price (plain vanilla options). According to IFRS 2, the value of employee options that are paid in shares (equity settled payments) is determined at the time of the grant based on a recognized option pricing model. The total expense that results is spread out uniformly over the blocking period of the option and is recognized as equity in the capital reserve. Changes of the option value due to changed parameters (e.g., later price changes) have no impact on the expense to be recognized. The same applies to options that lapse after the end of the blocking period. Stock options were valued using a binomial model. The value of the options was determined using appropriate probabilities based on price scenarios at fixed time intervals.

Assumption of an early exercise before the expiration of the total term of the option reduces the amount recognized.

Based on the resolution of the Annual General Meeting of October 17, 2000, modified by the resolutions of the Annual General Meetings of May 15, 2002, and May 12, 2004, stock options in four tranches have so far been granted annually to some employees and the Managing Board of paragon AG in connection with Stock Option Plan 1. The first tranche was offered to employees and Managing Board members on January 10, 2001; the second tranche was offered on April 10, 2002, the third tranche on April 7, 2003, and the fourth tranche on November 6, 2004.

If the options could not be exercised by January 1, 2005, the rules of IFRS 2 must be applied to those issued under the third and fourth tranche, which were granted after November 7, 2002.

The following parameters were assumed for the third tranche for calculating the option value in the binomial model:

Date granted	April 7, 2003
Total term of the option plan	6 years
Blocking period	2 or 3 years
Share price when options were issued	€ 3.73
Strike price of the option	€ 3.88
Anticipated dividend yield	1.60 %
Risk-free rate	3.40 %
Volatility of the share	26.0 %
The valuation of the option is based on the historical average of the share volatility.	
Option value as of April 7, 2003	€ 0.94

As a modification of the existing authorization, the Managing Board, with the consent of the Supervisory Board, or the Supervisory Board alone, were authorized by resolution of the Annual General Meeting of May 12, 2004, to, on one or more occasions, grant option rights to a total of 123,976 bearer shares of the Company with a term up to six years to members of the Company's Managing Board or senior executives of the Company or executives acting as 'division managers' in accordance with their employment contract in the period until the end of 2005. In its meeting on September 28, 2004, the Supervisory Board decided to offer for purchase a total of 30,000 option rights in the fourth tranche to members of the Managing Board within two weeks of the announcement of the quarterly results for the third quarter of 2004.

The following parameters were assumed for the fourth tranche for calculating the option value in the binomial model:

Date granted	November 3, 2004
Total term of the option plan	6 years
Blocking period	2 or 3 years
Share price when options were issued	€ 15.75
Exercise price of option	€ 15.09
Anticipated dividend yield	1.60 %
Risk-free rate	3.30 %
Volatility of the share	35.0 %
The valuation of the option is based on the historical average of the share volatility	
Value of option on November 6, 2004	€ 5.52

In fiscal 2006, personnel expense totaling € 98,806 (prior year: € 84,625) was allocated to capital reserve for the granting of stock options of the third and fourth tranche of stock option program 1.

Stock option plan 2

The resolution on additional issues of option rights to Managing Board members and senior executives of the Company was passed at the time of the Annual General Meeting of May 12, 2004. Additional conditional capital II, entailing a conditional capital increase of up to € 115,000.00 by the issue of 115,000 common shares, was created to secure these option rights.

Each option right confers an entitlement to acquire one paragon AG share in accordance with option conditions to be established.

As in the previous year no option rights under this program were issued in the year under review.

Stock Appreciation Rights Program (STAR Program)

paragon AG grants members of the Supervisory Board stock appreciation rights for which a cash payment in the amount of the difference between the share price and the previously fixed strike price is distributed if the option is exercised after the expiration of the blocking period. According to IFRS 2, the reporting value of cash settled share-based payment transactions is determined based on a recognized option pricing model on the relevant reporting date. The resulting total expense must be spread out uniformly over the blocking period of the rights granted and recognized as a liability. Changes to option rights due to changed parameters or price changes during the year until the time actually exercised must be recognized as an expense in the provision in the relevant fiscal year. This results in total personnel expenses at the level of the payment actually made.

The stock appreciation rights program No. 1 (2003 conditions for the granting of stock appreciation rights to paragon AG's Supervisory Board members) was adopted in a resolution of the Annual General Meeting of May 14, 2003. The STAR program includes a total of 20,000 stock appreciation rights, which the Managing Board is required to offer to paragon AG's Supervisory Board members in five tranches. In mid-November 2003, a total of 4,000 stock appreciation rights were offered and granted to the Supervisory Board in a first tranche at a price of € 8.24. Of that amount, a total of 3,000 rights were exercised in November 2004, entailing cash payments amounting to € 21 thousand. The remaining 1,000 stock appreciation rights of the first tranche were still outstanding on the balance sheet date. As a second tranche, an additional 4,000 stock appreciation rights were offered and granted to the Supervisory Board in November 2004 at a price of € 15.09. These 4,000 stock appreciation rights of the second tranche were still outstanding on the balance sheet date. In November of 2005 the Supervisory Board was offered and granted an additional 4,000 stock appreciation rights for € 16.43; these rights, too, are still outstanding at the balance sheet date.

For the stock appreciation rights granted in November 2003 and November 2004, the following parameters were used in the binomial model to calculate the option value:

Total term of the option plan	4 years
Blocking period	1 year
Anticipated term to end of blocking period	1.5 years
Share price on December 30, 2006	€ 10.98
Strike price of the option	
2005 tranche	€ 16.43
2004 tranche	€ 15.09
2003 tranche	€ 8.24
Anticipated dividend yield	1.60 %
Risk-free rate 2003	4.07 %
Risk-free rate 2004	3.86 %
Risk-free rate 2005	4.12 %
Volatility of the share	39.10 %
Option value as of December 31, 2005	
2005 tranche	€ 0.65
2004 tranche	€ 0.10
2003 tranche	€ 3.14

A provision in the amount of € 4,146 was established for the 9,000 stock appreciation rights of the Supervisory Board outstanding as of December 31, 2006.

By resolution of the Managing Board of April 2, 2004, the stock appreciation rights program No. 2 of paragon AG was adopted for the granting of stock appreciation rights to employees of paragon AG, as well as to employees and members of management of affiliated companies. STAR Program No. 2 includes a total of 100,000 stock appreciation rights for the period up to December 31, 2005, and a total of 250,000 stock appreciation rights in the period from January 1, 2006, to December 31, 2008, which the Managing Board can offer to the eligible individuals.

Each appreciation right confers to the participant the right to receive, on the day the stock appreciation right is exercised, a cash payment in the amount of the difference between the basis price and the share price on the day the stock appreciation right is exercised. By the balance sheet date, no stock appreciation rights had been offered from the STAR Program No. 2.

The following table shows the stock options and stock appreciation rights that have been granted and exercised:

Stock options and stock appreciation rights

	Stock option plan 1				STAR plan1		
	1st tranche	2nd tranche	3rd tranche	4th tranche	1st tranche	2nd tranche	3rd tranche
Issue date	Jan. 2001	Apr. 2002	Apr. 2003	Nov. 2004	Nov. 2003	Nov. 2004	Nov. 2005
Stock options granted	46,365	47,990	71,469	30,000			
Stock granted Appreciation Rights (SAR)					4,000	4,000	4,000
Strike price in €	7.98	3.78	3.88	15.09	8.24	15.09	16.43
Expiration of waiting time	Jan. 2003	Apr. 2004	Apr. 2005	Nov. 2006	Nov. 2004	Nov. 2005	Nov. 2006
in units							
Options outstanding at start of year	5,195	6,258	40,876	30,000			
SARs outstanding at start of year					1,000	4,000	4,000
Options granted	0	0	0	0			
SARs granted					0	0	0
Options exercised	1,718	1,391	23,848	0			
SARs exercised					0	0	0
Expired options	0	0	0	0			
Expired SARs					0	0	0
Options outstanding at year-end	3,477	4,867	17,028	30,000			
SARs outstanding at year-end					1,000	4,000	4,000
Options exercisable at year-end	3,477	4,867	17,028	30,000			
SARs exercisable at year-end					1,000	4,000	4,000
in €							
Valuation per option			0.94	5.52			
Valuation per SAR as of Dec. 31, 2006					3.14	0.10	0.65
Previous year					2.24	1.99	5.88

(32) Events after the Balance Sheet Date

We are not aware of any events of special significance subsequent to year-end 2006.

(33) Risk management

Please refer to the Management Report for information on the Group's risk management system.

(34) Employee Benefits

Since January 1, 2002, paragon AG has offered employees a pension option by joining a group relief fund with compensation payments to the reinsurance-funded plan. A reinsurance policy has been taken out with Delta Lloyd Deutschland AG, part of AVIVA, plc., London, in order to fulfill associated claims.

During the reporting year, paragon AG paid an amount of € 77 thousand (prior year: € 60 thousand) into the reinsured relief fund.

(35) Board members

During the period under review paragon AG's Managing Board consisted of the Chairman of the Board, Mr. Klaus D. Frers, graduate engineer, responsible for the Technology, Corporate Development and Sales & Marketing departments, as well as the Chief Financial Officer, Mr. Hans-Jürgen John, business economist, responsible for both the Finance and Investor Relations departments.

Members of paragon AG's Supervisory Board

		Memberships in Supervisory Boards and other monitoring bodies
Prof. Dr.-Ing. Walter Kunerth Chairman	Management Consultant, Zeitlarn	Götz Management Holding AG, Regensburg (Chairman) Gildemeister Aktiengesellschaft, Bielefeld Autoliv, Stockholm (Member of the Board of Directors)
Dr. Klaus G. Weyer	Managing Board of ELMOS Semiconductor AG, Dortmund	–
Dr. Peter Penczynski	Graduate physicist, Langquaid	–

(36) Employees

The average number of employees engaged in the companies included in the consolidation during 2006 was 556 (prior year: 450), of which 204 were industrial workers (prior year: 205).

(37) Declaration of Compliance with the German Corporate Governance Code

The statement stipulated in Section 161 of the AktG was submitted; shareholders have permanent access to this statement at the Company's website (www.paragon-online.de).

(38) Fees

Total fees paid to the independent auditor during the fiscal year were € 157 thousand (prior year: € 338 thousand). The amount includes costs of the audit of € 132 thousand (prior year: € 160 thousand) and costs for other assurances and valuation services of € 25 thousand (prior year: € 117 thousand). Tax advice costs (prior year € 13 thousand) and other payments (prior year: € 48 thousand) were not incurred this year. Costs in the amount of € 56 thousand relating to the prior year audit were paid to the external auditor of the previous year, KPMG Deutsche Treuhand-Gesellschaft AG, Wirtschaftsprüfungsgesellschaft, Berlin and Frankfurt am Main.

Delbrück, March 28, 2007

Frers	John
Member of the Managing Board	Member of the Managing Board

We have audited the consolidated financial statements of paragon AG, Delbrück, consisting of the balance sheet, the income statement, the statement of changes in shareholders' equity, the cash flow statement and the notes – as well as the group management report – for the fiscal year January 1 through December 31, 2006. Preparation of the consolidated financial statements and the group management report in accordance with the IFRS, as adopted by the EU, and the requirements of German commercial law pursuant to Section 315a (1) HGB is the responsibility of the Company's legal representatives. It is our responsibility to submit an assessment of the consolidated accounts based on our audit examination.

We conducted our audit of the consolidated financial statements in accordance with section 317 of the German Commercial Code, taking into consideration generally accepted German standards for the audit of financial statements as promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the audit such that misstatements and violations materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements, in accordance with the applicable financial reporting framework, and in the Group management report are detected with reasonable assurance. Knowledge of the Company's business activities and economic and legal environment and evaluation of possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the Group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the separate financial statements of the companies included in the consolidation, determination of the companies to be included in the consolidation, accounting and consolidation principles used and key estimates made by the companies' legal representatives, as well as evaluating the overall presentation of the consolidated financial statements and Group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion based on the findings of our audit, the consolidated annual financial statements comply with the IFRSs, as adopted by the EU, the additional requirements of German commercial law pursuant to Section 315a (1) HGB and provide a true and fair view of the net assets, financial position and results of operations of the group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the group's position and suitably presents the opportunities and risks of future development.

Nuremberg, March 28, 2007

Rödl & Partner GmbH
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Dr. Rödl	Dr. Keller
Accountant	Accountant

3D position sensor
Sensor to determine clearly the 3-dimensional position of the transmission selector lever within a transmission system at any time.

AQC
Acronym for "Air Quality Conditioner"

AQI
Acronym for "Air Quality Improver"

AQS
Acronym for "Air Quality Sensor"

Bluetooth
Industry standard for wirelessly networking devices over short distances. Bluetooth offers a wireless interface with which both small mobile devices such as cell phones and PDA's, as well as computers and peripherals, can communicate with each other.

Cradle
Telephone adapter into which the cell phone is placed and connected with the equipment, for instance in a car.

DIN EN 50194
German and European standard for electrical devices for the detection of combustible gases in dwellings.

Reverberation sensor
Sensors that can identify the position of a magnet.

Interface
A connection between tow parts of a system (usu. computing).

ISO TS 16949
Highest internationally recognized quality management standard for companies in the automotive industry, developed jointly by the International Automotive Task Force (IATF) and the Japanese Association of Automotive Manufacturers (JAMA).

ISO TS 14001
Internationally recognized standard that establishes the requirements for special environmental management systems.

ISO 15504
See SPICE.

Picking
Collecting certain part quantities (items) from a total quantity (assortment) based on an order.

Position sensor
The position sensor records distances and set poits at predefined intervals.

MDI
Acronym for "Media Device Interface".

Multimedia
The definition of multimedia applies to contents and works consisting of the following digital media: text, photography, graphics, animation, audio, video, interaction, games.

OEM
Original Equipment Manufacturer, international description for the manufacturer responsible for the original end product.

rSAP
Acronym for "remote SIM Access Profile"

Step motor
A special type of electric motor, the mechanism of which triggers locomotion in target-oriented steps.

Shift-by-wire
Electronic transmission of switching operation in a vehicle without traction rope.

Slider
Regulator which functions by sliding a finger over it.

Smartphone
A smartphone combines the performance of a cell phone with that of a PDA. In a smartphone the PDA operating system is supplemented by typical phone functions. This would include Personal Information Manager (PIM) with calendar, address book, task list, notebook, phone applications including short lists and phone register; on-line applications such as web browsers or e-mail programs.

SPICE
Acronym for Software Process Improvement and Capability Determination. SPICE is a model for analyzing the effectiveness of corporate processes and was adapted as 'Technical Report' in 1998 under the standard ISO 15504.

Telematics
Technology that combines the technological fields of telecommunications and informatics.

Cash flow
Flow of cash and cash equivalents generated from current business activities in a period of time, adjusted for significant non-cash expenses and income.

Cash flow statement
View of the liquidity development and the payment flows with consideration of the effects of inflows and outflows of funds within the fiscal year.

DAX
Deutscher Aktienindex: measures the performance of the 30 largest German Prime Standard companies with respect to order book turnover and market capitalization.

Debt capital
Comprehensive designation for the provisions, liabilities and deferred income to be reported on the liabilities side of the balance sheet.

Deferred taxes
Asset and/or liability accounts in the balance sheet for balancing the difference between the tax liability actually assessed and the tax burden based on accounting under commercial law.

Designated Sponsor
Banks or financial service companies that provide price limits for the purchase and sale of stocks (quotes) in Xetra electronic trading and accordingly bridge over temporary imbalances between supply and demand.

EBITDA
Earnings before interest, taxes, depreciation and amortization.

EBIT
Earnings before interest and taxes.

EBT
Earnings before taxes.

Equity
Resources made available to the company through payments and/or deposits from owners or from retained profits.

Free float
Number or proportion of shares not possessed by strategic investors and thus available for stock exchange trading.

Goodwill
Portion of the purchase price that exceeds the net value of the assets ascertained according to going-concern value.

GEX
German Entrepreneurial Index. The new Deutsche Börse index of medium-sized companies. It was introduced on January 3, 2005 and includes all "owner-dominated" companies that are listed on the Frankfurt Stock Exchange FWB® and whose IPO was not longer than ten years ago. More than 120 companies of extremely diverse sizes currently satisfy these criteria.

IFRS
International Financial Reporting Standards, the obligatory accounting standard for all companies listed on European stock exchanges starting in 2005.

Market capitalization
The value of a company resulting from multiplying the shares issued by the share price.

Prime Standard
Listing segment of Deutsche Börse for companies that satisfy particularly high international standards for transparency. The following transparency requirements must be satisfied for admission to listing on the Prime Standard: quarterly reports, international accounting standards according to IFRS or US-GAAP, presentation of a corporate calendar, at least one analysts' conference per year, ad hoc notifications also in English. Companies wanting to be listed in this segment must request admission. A listing in the Prime Standard is a prerequisite for inclusion in one of the indices of Deutsche Börse.

Prepaid expenses and deferred income
Receipts and payments within the reporting period, whose consequences on the company's performance affect a period after the balance sheet date.

Roadshow
Presentation in which an issuing company or a lead manager promotes the value of the company or the purchase of shares or bonds of the company in various financial centers.

ROI (Return on Investment)
Period-specific return on the invested capital. It gives a comparative assessment of investment projects of different types and scales in terms of the yield on the capital tied up in them.

TecDAX
Special index of Deutsche Börse that shows the development of the 30 largest technology companies of the Prime Standard that follow the companies contained in the DAX stock index with respect to order book turnover and market capitalization.

2006	Complete take-over of the paragon fidelity GmbH (Car Media Systems) Further major orders for automotive products Production capacity in Suhl/Thuringia doubled
2005	Acquisition of Cullmann GmbH and entering into the business with Car Media Systems Opening of new production facility for Electronic Solutions in Suhl
2004	Acquisition of the Andreas Haller Fabrik für Feinmechanik GmbH & Co. KG Formation of the sensor element plant paragon fidelio GmbH
2003	Take-over of the air quality sensor sector of Robert Bosch GmbH
2002	Company-wide introduction of the quality standard ISO / TS 16949 Introduction of the business segment of Building Technology
2001	Acquisition of the Miquest Corp. (Grand Rapids, MI, USA) Doubling and modernization of the production area in the USA
2000	World market leader in air quality sensors for automobiles Formation of the paragon of North America Corp. paragon AG goes public at German Stock Exchange (Börse)
1999	First patents in communication electronics (acoustic sensors) Company-wide introduction of the quality standards QS 9000, VDA 6.1 and ISO 9001
1998	Start of the production of components of operating elements in the automobile
1997	Concentration of production in Suhl Large series application of paragon air quality sensors in automobiles
1995	First air quality sensors introduced into automobiles by paragon
1994	Start of the development of air quality sensors
1993	Company-wide introduction of the quality standard ISO 9002 Start of development and production of sensors
1991	Plant for Electronic Services in Zella-Mehlis (formerly robotron)
1988	Formation as electronic manufacturer in Delbrück by Klaus Dieter Frers

paragon AG
Headquarters
Schwalbenweg 29
33129 Delbrück
Phone: +49 (0) 5250 9762-0
Fax: +49 (0) 5250 9762-60
E-Mail: info@paragon-online.de
Internet: www.paragon-online.de

Communication / Investor Relations:
Phone: +49 (0) 5250 9762-160 / -140
Fax: +49 (0) 5250 9762-61
E-Mail: investor@paragon-online.de

paragon finesse GmbH
Bösendamm 13
33129 Delbrück
Phone: +49 (0) 5250 9762-900
Fax: +49 (0) 5250 9762-901
E-Mail: info@paragon-finesse.de

paragon AG
Suhl
Sommerbergstraße 4
98527 Suhl
Phone: +49 (0) 3681 8929-0
Fax: +49 (0) 3681 8929-560
E-Mail: info@paragon-online.de
Internet: www.paragon-online.de

paragon firstronic GmbH
Headquarters
Sommerbergstraße 18
98527 Suhl
Phone: +49 (0) 3681 8929-500
Fax: +49 (0) 3681 8929-560
E-Mail: info@paragon-firstronic.de
Internet: www.paragon-firstronic.de

paragon fidelio GmbH
Sommerbergstraße 2
98527 Suhl
Phone: +49 (0) 3681 8929-900
Fax: +49 (0) 3681 8929-903
E-Mail: info@paragon-fidelio.de
Internet: www.paragon-fidelio.de

paragon fidelity GmbH
Schwadermühlstraße 4a
90556 Cadolzburg
Phone: +49 (0) 9103 50 00-0
Fax: +49 (0) 9103 50 00-365
E-Mail: info@paragon-fidelity.de
Internet: www.paragon-fidelity.de

paragon finesse GmbH
Bühlstraße 13
78112 St. Georgen
Phone: +49 (0) 7724 88090
Fax: +49 (0) 7724 880945
E-Mail: info@paragon-finesse.de
Internet: www.paragon-finesse.de

paragon firstronic GmbH
European Sales Office
Hauptstraße 53
89522 Heidenheim
Phone: +49 (0) 7321 278218
Fax: +49 (0) 7321 278220
E-Mail: vertrieb@paragon-firstronic.de
Internet: www.paragon-firstronic.de

paragon of North America Corp.
paragon firstronic of NA Corp.
1655 Michigan Street NE
Grand Rapids, MI 49503, USA
Phone: +1 616 456 9220
Fax: +1 616 456 9230
E-Mail: info@paragon-online.de
Internet: www.paragon-online.de
E-Mail: info@paragon-firstronic.com
Internet: www.paragon-firstronic.com

paragon AG
Sales Office France
177 av Georges Clemenceau
92000 Nanterre, Frankreich
Phone: +33 141968666
Fax: +33 141968667
E-Mail: info@paragon-online.de
Internet: www.paragon-online.de

paragon of Japan Inc.
Sales Office Japan
Meishin-Cho 2-2-23 (1F)
Amagasaki-City, Hyogo-Ken
661-0021, Japan
Phone: +81 6-6429-1690
Fax: +81 6-6429-1690
E-Mail: info@paragon-online.de
Internet: www.paragon-online.de

Dates 2007

March 22, 2007	Financial Statement Press Conference (Delbrück, GER)
March 29, 2007	DVFA Analysts' Conference (Frankfurt a. M., GER)
May 9, 2007	Publication of First Quarter Statements
May 22, 2007	Annual Meeting (Delbrück)
August 9, 2007	Publication of Second Quarter Statements
November 8, 2007	Publication of Third Quarter Statements

paragon AG
Schwalbenweg 29
33129 Delbrück · Germany
Phone: + 49 (0) 52 50 - 97 62 - 0
Fax: + 49 (0) 52 50 - 97 62 - 60
E-Mail: investor@paragon-online.de
Internet: www.paragon-online.de