



# Report

on the First Half of 2006

# Report

This quarterly report has been prepared in accordance with the same accounting principles of the International Financial Reporting Standards (IFRS), which were applied to the 2005 annual report. The standards of the International Accounting Standards Board (IASB) and interpretations of the International Financial Reporting Interpretations Committee (IFRIC) valid on the balance sheet date have been applied. In form and content, this interim report complies with the reporting obligations of the German Stock Exchange. The quarterly report represents an update of the annual report. Its focus is on the current reporting period and should be read in connection with the annual report and the additional information on the Company contained therein.

### The first six month at a glance

| in € (000)              | 2006<br>through 6/30 | 2005<br>through 6/30 | Change<br>in % |
|-------------------------|----------------------|----------------------|----------------|
| Sales                   | 50,641               | 35,934               | 40.9 %         |
| EBITDA                  | 8,873                | 6,188                | 43.4 %         |
| EBIT                    | 3,606                | 2,905                | 24.1 %         |
| Net earnings for period | 796                  | 850                  | - 6.4 %        |
| Liquidity               | 2,414                | 4,511                | - 46.5 %       |
| Equity ratio*           | 36.0 %               | 35.1 %**             | -              |
| Employees               | 553                  | 428                  | 29.2 %         |

\* compared to balance sheet date as of December 31, 2005

\*\* shareholders' equity including profit-sharing rights, silent equity holding and excluding minority interests

|                                |                |
|--------------------------------|----------------|
| Securities Identification No.: | 555 869        |
| ISIN:                          | DE0005558696   |
| Ticker symbol:                 | PGN            |
| Trading segment:               | Prime Standard |
| Sector:                        | Technology     |

#### Highlights of the 1st half of 2006 (compared with 1st half of 2005)

- Sales: up 40.9% to € 50.6 million
- EBITDA: 43.4% growth to € 8.9 million
- Authorization to issue new profit-sharing rights

## Sales

The paragon Group achieved considerable sales growth in the first half of 2006. Sales totaled € 50.6 million, compared with € 35.9 million in the same period in the previous year. This is equivalent to growth of 40.9%.

The core Automotive division reported particularly positive developments, with sales growth of 62.1% to € 40.9 million (previous year: € 25.2 million). paragon thus generated 80.8% of total sales in this division (previous year: 70.2%). The share of sales generated by the US location amounted to € 2.4 million (previous year: € 2.4 million).

One major success factor driving this strong growth is the ongoing transformation of a product-based company into system provider. This involves the development of individual products into complex systems, thus broadening the product range. Part of the strategy also includes deepening the value-added chain by increasing the share of components manufactured in-house. This will continue to impact positively on the sales and earnings performance of paragon in future.

The Electronic Solutions division generated sales of € 9.1 million (previous year: € 10.4 million). In absolute terms, sales in this division were therefore 12.3% lower than in the previous year. However, this development is chiefly due to a reallocation of sales within the Group at the beginning of the 2006 financial year. If this is accounted for in the previous year's figures, then sales at this high-quality industrial electronics division showed further growth. The US location contributed sales of € 3.0 million (previous year: € 1.1 million) to overall sales in this division.

Sales in the Building Technology division rose to € 597 thousand (previous year: € 293 thousand).

## Earnings

During the period under report, paragon improved its earnings before interest, taxes, depreciation and amortization (EBITDA) by 43.4% to € 8.9 million (previous year: € 6.2 million). Adjusted EBIT rose to € 4.3 million in the first six months, an increase of 48.3% on the equivalent period in the previous year (€ 2.9 million). Taking account of the amortization of intangible assets, this growth amounted to 24.1% or € 3.6 million. The net income for the period amounted to € 796 thousand (previous year: € 850 thousand). This is equivalent to diluted and undiluted earnings of € 0.19 per share (previous year: € 0.21). This development is due to the expansion of produc-

tion capacities and the taking on of highly-qualified employees. These factors will have a positive impact on the company's sales and especially on its earnings performance in future.

## Financial Position

The cash and cash equivalents of the Group amounted to € 2.4 million as of June 30, 2006 (previous year: € 4.5 million). The equity totaled € 20.0 million at the end of the first half of 2006 (12.31.2005: € 20.0 million). In the first half of the financial year, paragon invested around € 4.4 million in property, plant and equipment and intangible assets. These investments focused on the expansion of production facilities at the location in Suhl. The equity ratio, including profit-sharing rights and silent equity holdings and excluding minority interests, amounted to 36.0% as of June 30, 2006.

## Research und Development

The research and development division is of great strategic significance. This division is responsible for the innovations for which paragon is well-known and which generate a considerable competitive advantage. paragon has proven that it is also possible with the assistance of intense research to achieve sustainable and profitable growth in a market characterized by tough competition and pressure on markets, such as the automotive sector.

R&D activities in the Automotive division focused during the first half of the financial year on the enhancement of existing air quality sensors. Moreover, individual prototypes of the AQC air quality conditioning system were developed for several customers. R&D activities in the field of operating and indicator systems focused on the development of an initial clutch release indicator.

In the field of Car Media, the range of hands-free speaking systems models (cradles) has been revised and adapted to numerous new types of cellular phones. Moreover, a new ACMI (Advanced Car Media Interface) has been developed which facilitates the integration of mobile appliances into the vehicle environment.

Research in the Building Technology division focused on the further development of electronic ballasts.

## Stock Performance

The share showed a highly positive performance at the beginning of the 2006 financial year, rising by more than 20%. In the 2nd quarter, the share did not escape the general negative trend on the

capital markets and fell to almost € 12. The share nevertheless recovered rapidly from this low, closing at € 13.40 on June 30, 2006 (XETRA). This is equivalent to a performance of -5% during the period under report.

The 6th Annual General Meeting of paragon AG was held in Delbrück on May 17, 2006. All items on the agenda were approved with large majorities. One decision of importance to the future strategy of the company was the authorization of the Board of Directors to issue new profit-sharing rights of up to € 50 million. This has therefore created financial scope for the continuation of paragon's successful growth.

Talks concerning the coverage of the company by analysts were held with Merck Finck & Co. in the 2nd quarter of 2006. The first study appeared on July 7 and included a buy recommendation. The study is available in the Investor Relations section of the company's homepage at [www.paragon-online.de](http://www.paragon-online.de).

Further Investors Relations measures are planned for the second half of the year. These include the presentation of the company and its future potential by the Board of Directors to institutional investors at road shows.

## Outlook

The Board of Directors expects the positive performance of the company to be maintained in all divisions in the remainder of the financial year.

The Automotive division will continue to gain in significance and show considerable growth. The trend towards integrating electronic components into automobiles is continuing apace and this is precisely the area in which paragon specializes. The market potential of existing products is far from having been exhausted. Air quality sensors in particular still harbor considerable opportunities, both from being introduced into lower vehicle classes and from the acquisition of new customers. An extended production site for hands-free speaking systems will be completed in the Car Media division in the 2nd half of the financial year and will already generate new sales before the end of the financial year. Furthermore, paragon's sustainable growth will also be driven by new innovative products.

The Electronic Solutions and Building Technology divisions will also contribute to the positive performance of the company.

The successful performance of the company should provide the share price with upward momentum once again and lead to positive performance in the 2nd half of the financial year.

## Consolidated Income Statement

for the period from January 1 to June 30, 2006

| in € (000)  | Q-2 2006<br>04/01/06 –<br>06/30/06 | Q-2 2005<br>04/01/05 –<br>06/30/05 | First Half of 2006<br>01/01/06 –<br>06/30/06 | First Half of 2005<br>01/01/05 –<br>06/30/05 |
|---|------------------------------------|------------------------------------|--|--|
| <b>Revenue</b>  | <b>26,481</b>                      | <b>19,384</b>                      | <b>50,641</b>                                | <b>35,934</b>                                |
| Other operating income  | 676                                | 779                                | 1,403  | 1,275  |
| Changes in inventory of finished goods and work in progress                                 | 2,124                              | - 418                              | 3,461  | 380  |
| Other own work capitalized  | 1,057                              | 501                                | 1,857  | 701  |
| <b>Total operating revenue</b>  | <b>30,338</b>                      | <b>20,246</b>                      | <b>57,362</b>                                | <b>38,290</b>                                |
| Cost of materials   | - 16,491                           | - 10,474                           | - 30,831                                     | - 19,506                                     |
| <b>Gross income</b>   | <b>13,847</b>                      | <b>9,772</b>                       | <b>26,531</b>                                | <b>18,784</b>                                |
| Personnel expense   | - 6,269                            | - 4,492                            | - 11,961                                     | - 8,420                                      |
| Depreciation/amortization/impairment of property, plant and equipment and intangible assets | - 2,672                            | - 1,729                            | - 5,267                                      | - 3,283                                      |
| Other operating expenses  | - 3,092                            | - 2,059                            | - 5,697                                      | - 4,176                                      |
| <b>Earnings before interest and taxes (EBIT)</b>  | <b>1,814</b>                       | <b>1,492</b>                       | <b>3,606</b>                                 | <b>2,905</b>                                 |
| Financial income  | 9                                  | 14                                 | 14   | 54   |
| Financing expenses  | - 1,025                            | - 643                              | - 2,090                                      | - 1,283                                      |
| <b>Financial result</b>   | <b>- 1,016</b>                     | <b>- 629</b>                       | <b>- 2,076</b>                               | <b>- 1,229</b>                               |
| <b>Income before taxes</b>  | <b>798</b>                         | <b>863</b>                         | <b>1,530</b>                                 | <b>1,676</b>                                 |
| Income taxes  | - 413                              | - 445                              | - 690  | - 791  |
| Other taxes   | - 36                               | - 27                               | - 44   | - 35   |
| <b>Net income</b>   | <b>349</b>                         | <b>391</b>                         | <b>796</b>                                   | <b>850</b>                                   |
| Minority interests  | 0                                  | 0                                  | 0  | 0  |
| <b>Net income attributable to equity holders of the parent</b>                              | <b>349</b>                         | <b>391</b>                         | <b>796</b>                                   | <b>850</b>                                   |
| Earnings per share (basic)  | 0.08                               | 0.10                               | 0.19   | 0.21   |
| Earnings per share (diluted)  | 0.08                               | 0.10                               | 0.19   | 0.21   |
| Average number of shares outstanding (basic)  | 4,109,375                          | 4,049,731                          | 4,109,375                                    | 4,049,731                                    |
| Average number of shares outstanding (diluted)  | 4,130,041                          | 4,100,609                          | 4,130,041                                    | 4,100,609                                    |

## Segment Report

| in € (000)           | Exterior sales                     |                                    | Earnings before interest and taxes (EBIT) |                                    |
|----------------------|------------------------------------|------------------------------------|---|------------------------------------|
|                      | Q-1 2006<br>01/01/06 –<br>06/30/06 | Q-1 2005<br>01/01/05 –<br>06/30/05 | Q-1 2006<br>01/01/06 –<br>06/30/06        | Q-1 2005<br>01/01/05 –<br>06/30/05 |
| Automotive           | 40,927                             | 25,242                             | 3,287                                     | 2,514                              |
| Electronic Solutions | 9,117                              | 10,399                             | 347                                       | 378                                |
| Building Technology  | 597                                | 293                                | - 28                                      | 13                                 |
| <b>Total</b>         | <b>50,641</b>                      | <b>35,934</b>                      | <b>3,606</b>                              | <b>2,905</b>                       |

## Consolidated Balance Sheet

as at June 30, 2006

| in € (000)  | 06/30/2006     | 12/31/2005     |
|---|----------------|----------------|
| <b>Assets</b>   |                |                |
| <b>Non-current assets</b>                               |                |                |
| Intangible assets                                       | 22,869         | 23,542         |
| Goodwill  | 17,811         | 17,981         |
| Property, plant and equipment                           | 28,979         | 27,940         |
| Financial assets  | 200            | 200            |
| Deferred tax assets                                     | 1,988          | 2,111          |
| <b>Total non-current assets</b>                         | <b>71,847</b>  | <b>71,774</b>  |
| <b>Current assets</b>                                   |                |                |
| Inventories   | 19,553         | 13,981         |
| Trade receivables                                       | 12,227         | 9,704          |
| Income tax claims                                       | 0              | 363            |
| Other assets  | 12,715         | 12,371         |
| Cash and cash equivalents                               | 2,414          | 4,832          |
| <b>Total current assets</b>                             | <b>46,909</b>  | <b>41,251</b>  |
| <b>Total assets</b>                                     | <b>118,756</b> | <b>113,025</b> |
| <b>Liabilities and equity</b>                           |                |                |
| <b>Equity</b>   |                |                |
| Subscribed capital                                      | 4,109          | 4,086          |
| Capital reserves  | 7,667          | 7,565          |
| Net income attributable to equity holders of the parent | 796            | 1,264          |
| Retained earnings                                       | 4,670          | 4,224          |
| Reserve for currency translation differences            | - 976          | - 790          |
| <b>Equity before minority interests</b>                 | <b>16,266</b>  | <b>16,349</b>  |
| Minority interests                                      | 3,695          | 3,695          |
| <b>Equity after minority interests</b>                  | <b>19,961</b>  | <b>20,044</b>  |
| <b>Non-current liabilities</b>                          |                |                |
| Long-term financial lease liabilities                   | 983            | 1,459          |
| Long-term loans   | 10,022         | 10,118         |
| Profit sharing capital                                  | 17,538         | 17,483         |
| Silent equity holding                                   | 8,958          | 8,754          |
| Investment grants                                       | 9,915          | 10,062         |
| Deferred tax liabilities                                | 4,958          | 5,048          |
| Provisions for pensions                                 | 900            | 853            |
| <b>Total non-current liabilities</b>                    | <b>53,274</b>  | <b>53,777</b>  |
| <b>Current liabilities</b>                              |                |                |
| Current portion of financial lease liabilities          | 990            | 1,019          |
| Short-time loans and current portion of long-term loans | 20,215         | 13,899         |
| Trade liabilities                                       | 14,727         | 12,398         |
| Other provisions  | 4,047          | 5,149          |
| Income tax liabilities                                  | 1,838          | 1,783          |
| Liabilities to minority shareholders                    | 1,119          | 1,081          |
| Other current liabilities                               | 2,585          | 3,875          |
| <b>Total current liabilities</b>                        | <b>45,521</b>  | <b>39,204</b>  |
| <b>Total equity and liabilities</b>                     | <b>118,756</b> | <b>113,025</b> |

## Shares held by members of the Executive and Supervisory Board as at June 30, 2006

| Share capital: 4,109,375        | Shares           | Options       |
|---------------------------------|------------------|---------------|
| <b>Executive Board, total</b>   | <b>2,115,730</b> | <b>30,000</b> |
| <b>Supervisory Board, total</b> | <b>6,000</b>     | <b>0</b>      |
| <b>Boards, total</b>            | <b>2,121,730</b> | <b>30,000</b> |
| <b>as % of share capital</b>    | <b>51.63 %</b>   |               |

## Consolidated Statement of Changes in Equity

| in € (000)                                   | Subscribed Capital | Exchange rate differences | Capital reserves | Profit/loss carried forward | Net income   | Minority interests | Total         |
|--|--------------------|---------------------------|------------------|-----------------------------|--------------|--------------------|---------------|
| <b>January 1, 2005</b>                       | <b>4,037</b>       | <b>- 987</b>              | <b>7,318</b>     | <b>1,765</b>                | <b>2,863</b> | <b>0</b>           | <b>14,996</b> |
| Income after taxes                           |                    |                           |                  |                             | 850          | 0                  | 850           |
| Accumulated profits/losses                   |                    |                           |                  | 2,863                       | - 2,863      | 0                  | 0             |
| Dividend distribution                        |                    |                           |                  | - 404                       |              | 0                  | - 404         |
| Capital increase (exercise of stock options) | 37                 |                           | 111              |                             |              | 0                  | 148           |
| Addition due to stock option valuation       |                    |                           | 42               |                             |              | 0                  | 42            |
| Minority interests                           |                    |                           |                  |                             |              |                    | 0             |
| Currency translation changes                 |                    | 208                       |                  |                             |              | 0                  | 208           |
| <b>June 30, 2005</b>                         | <b>4,074</b>       | <b>- 779</b>              | <b>7,471</b>     | <b>4,224</b>                | <b>850</b>   | <b>0</b>           | <b>15,840</b> |
| <b>January 1, 2006</b>                       | <b>4,086</b>       | <b>- 790</b>              | <b>7,565</b>     | <b>4,224</b>                | <b>1,264</b> | <b>3,695</b>       | <b>20,044</b> |
| Income after taxes                           | 0                  | 0                         | 0                | 0                           | 796          | 0                  | 796           |
| Accumulated profits/losses                   | 0                  | 0                         | 0                | 1,263                       | - 1,264      | 0                  | - 1           |
| Dividend distribution                        | 0                  | 0                         | 0                | - 817                       | 0            | 0                  | - 817         |
| Capital increase (exercise of stock options) | 23                 | 0                         | 69               | 0                           | 0            | 0                  | 92            |
| Addition due to stock option valuation       | 0                  | 0                         | 33               | 0                           | 0            | 0                  | 33            |
| Minority interests                           | 0                  | 0                         | 0                | 0                           | 0            | 0                  | 0             |
| Currency translation changes                 | 0                  | - 186                     | 0                | 0                           | 0            | 0                  | - 186         |
| <b>June 30, 2006</b>                         | <b>4,109</b>       | <b>- 976</b>              | <b>7,667</b>     | <b>4,670</b>                | <b>796</b>   | <b>3,695</b>       | <b>19,961</b> |

## Consolidated Cash Flow Statement (IFRS)

| in € (000)  | 01/01 - 06/30/2006 |                | 01/01 - 06/30/2005 |                |
|---|--------------------|----------------|--------------------|----------------|
| <b>Cash flow from operating activities</b>                                  |                    |                |                    |                |
| <b>Income before taxes and deferred taxes</b>                               | <b>1,530</b>       |                | <b>1,641</b>       |                |
| Adjustment for:   |                    |                |                    |                |
| impairment losses   | 5,267              |                | 3,283              |                |
| Financial result  | 2,076              |                | 1,229              |                |
| Gains/losses from the disposal of non-current assets                        | - 3                |                | 0                  |                |
| Change of the other provisions and provisions for pensions                  | - 1,001            |                | 768                |                |
| Income from reversal of special account for grants                          | - 981              |                | - 768              |                |
| Other non-cash income and expense   | - 41               |                | 0                  |                |
| Change in trade receivables,<br>other receivables and other asset           | - 3,503            |                | - 3,547            |                |
| Change in inventory level   | - 6,653            |                | - 1,641            |                |
| Change in trade payables<br>and other liabilities                           | 1,337              |                | 1,692              |                |
| Interest paid   | - 2,090            |                | - 1,283            |                |
| Income taxes  | - 293              |                | - 703              |                |
| <b>Net cash from operating activities</b>                                   |                    | <b>- 4,355</b> |                    | <b>671</b>     |
| <b>Cash flow from investing activities</b>                                  |                    |                |                    |                |
| Payments for investment minus residual carrying amount of asset disposals   | - 4,393            |                | - 5,993            |                |
| Payments for the purchase of subsidiaries                                   | 0                  |                | - 100              |                |
| Additions of cash and cash equivalents from the acquisition of subsidiaries | 41                 |                | 0                  |                |
| Funds from investment grants  | 1,642              |                | 3,928              |                |
| Interest received   | 14                 |                | 54                 |                |
| <b>Net cash from investing activities</b>                                   |                    | <b>- 2,696</b> |                    | <b>- 2,111</b> |
| <b>Cash flow from financing activities</b>                                  |                    |                |                    |                |
| Dividend distribution to shareholders                                       | - 817              |                | - 404              |                |
| Repayment of (financial) credits  | - 2,131            |                | - 3,098            |                |
| Proceeds from (financial) credits taken                                     | 7,491              |                | 3,008              |                |
| Proceeds from equity additions  | 92                 |                | 148                |                |
| Net cash from the issuance of profit-sharing capital                        | 0                  |                | 860                |                |
| <b>Net cash from financing activities</b>                                   |                    | <b>4,635</b>   |                    | <b>514</b>     |
| Exchange rate changes   |                    | - 2            |                    | 5              |
| <b>Change in cash and cash equivalents</b>                                  |                    | <b>- 2,418</b> |                    | <b>- 921</b>   |
| <b>Cash and cash equivalents at the beginning of the period</b>             |                    | <b>4,832</b>   |                    | <b>5,432</b>   |
| <b>Cash and cash equivalents at the end of the period</b>                   |                    | <b>2,414</b>   |                    | <b>4,511</b>   |



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