



Report on the Short Fiscal Year  
June 1 to December 31, 2010

### Key indicators for paragon AG

in EUR thousands	01.06.2010 – 31.12.2010	01.06.2009 – 31.12.2009	Change in %
Sales	35,250	30,249	16.5 %
EBITDA	7,506	- 11,246	> 100 %
Adjusted EBITDA*	6,178	3,961	56.0 %
EBIT	4,567	- 14,143	> 100 %
Adjusted EBIT*	3,239	1,064	> 100 %
Net income for period	3,169	- 17,814	> 100 %
Earnings per share in EUR	0.77	- 4.33	> 100 %
Liquidity	13,790	8,268	66.8 %
Employees**	304	258	17.8 %

\* EBITDA/EBIT adjusted for additional restructuring and insolvency costs.

\*\* Information relates to paragon AG excluding contract workers.

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*Dear Shareholders,*

paragon is taking off! We have utilized the effects of the global financial crisis, which resulted in a sales crisis among automotive manufacturers and as a consequence also to problems at paragon, to set ourselves up anew. Our Company today is in top-notch condition in terms of both performance and finance after a period of steadfast restructuring. The partial fiscal year from June 1 to December 31, 2010, has once again shown positive signs of continued growth. The development of the share price in the period under review underlines this trend; the capital markets have become increasingly interested in paragon precisely because of the results of the preceding months. 2010 will, therefore, enter the Company's history books as a special year.

In the short fiscal year of January 1 to May 31, 2010, we were able to report double-digit sales growth compared to the same period of the previous year. This significant growth continued in the next six-month period from June 1 to November 30, 2010. The month of December 2010 developed as expected in terms of sales.

The second partial fiscal year from June 1 to December 31, 2010, affirmed our strong constitution. According to the resolution of the Annual General Meeting of September 30, 2010, we shall return to the calendar year as fiscal year starting in 2011.

In order to obtain a better overview of the Company's development, I shall comment on the entire fiscal year 2010 in relation to paragon AG's comparable business in fiscal 2009. It is noteworthy that we were able to drive up sales from EUR 52.6 million to EUR 60.4 million – by 14.7% – while personnel expenses remained almost constant at EUR 12.5 million. EBITDA adjusted for restructuring effects rose by 41.0% (2009: EUR 7.2 million; 2010: EUR 10.2 million); our most recent forecast, already increased, from December 2010 (EUR 9.0 million) was, therefore, once again substantially exceeded. Adjusted EBIT rose even more steeply (2009: EUR 1.9 million; 2010: EUR 5.2 million). It is also gratifying that our equity once again attained the value of EUR 4.5 million as at December 31, 2010.

### Good reasons for continued growth

But why will paragon's recovery continue? There are several good reasons. The recovery of the world economy, which Germany is benefiting from significantly, and the return to normal of the economic level in the automotive industry will certainly contribute to this development. A number of manufacturers have even recently curtailed or cancelled plant holidays and instituted additional shifts. The automotive industry is booming, not least because German cars are in great demand abroad. Strong stimuli are anticipated from the Chinese market alone in the near future; growth rates of 15% in 2011 will no longer be a rarity.

The recovery in the automotive industry is accompanied by a special upswing in the premium segment, one in which German manufacturers dominate the world market by a significant stretch. This segment, which was unable to benefit from the expired government buyer incentive programs, and which has always been of great importance to paragon, achieved high growth rates. According to a study of the IKB Deutsche Industriebank dated November 2010, over 60% of vehicles manufactured in Germany are included in the premium segment.

Complete concentration on automotive electronics and a focus on the needs of passengers have proven to be the correct approach in this market scenario. But even the ups and downs of registration figures are not necessarily a solid indicator of our Company's starting point. We cannot, after all, influence the number of vehicles being built. But we can ensure that more and more paragon is used in the car, thus expanding our market.

## Product innovations with a great deal of potential

Numerous communications in the recent past show that paragon has the right stuff. I would like to point out two products at this point which may well develop into additional mega-sellers in our portfolio. Our belt microphone, which received the “Plastics Oscar (SPE Automotive Division Award of the Society of Plastics Engineers, Inc. Europe) in the fall of 2010, for instance, has enormous potential. This product, which achieves unimaginable voice quality when talking on the phone in the car, is already being installed in the sports car series, Audi R8 Coupé and Spyder. Our novel start-stop sensor, which allows the gear position to be identified precisely, has had a huge response. This solution is also outstandingly suited for use in hybrid vehicles, so that we are taking our first successful steps in the field of New Drives.

While we are on the topic of New Drives and the electrification of cars: Electronics is the top-ranked innovation driver in the industry; pretty much all automotive novelties are based on electronics. Instead of steel and aluminum, there is an increasing trend for bits and bytes to be the determining factors in the automotive industry. Not only valuable innovation potential, but also appealing savings potential, exists in electronics. Intelligent technology enables both enhanced comfort for passengers and economic advantages for the manufacturer. Niche suppliers, such as paragon, who can demonstrate well-developed electronics and software competence, are thus part of the future.

Cars with combustion engines will continue to hold the lion’s share of the market over the next few years. But New Drives will enrich certain markets. The focus is clearly on the US in the case of hybrid vehicles, while electric cars will sell faster in all areas of higher population density, as delivery vehicles or taxis. But all classes of vehicles have one thing in common: The electronics share will continue to increase and usher in a number of improvements in driving.

## Advantages of a family company

Market developments are not the sole factors which are favorable for paragon. Another core advantage, which is mentioned again and again in discussions with potential investors, is its role as a family-managed company. Such companies constitute a guarantee for customers, suppliers and employees, since they behave differently and above all with a view to the long term. paragon’s vision is of sustained growth and it strives for ever more independence from banks. Last but not least, we have clearly shown in the past fifteen months: Family-led companies overcome crises by tough acts of will.

Perhaps the most important aspect of a promising future lies in the order level. And it is precisely in this area that paragon's position is stronger than at any time in our 20-year history. Our order books are full and we are delighted to have an order backlog more than double the size even of the period before the crisis. 97% of the sales aspired to in 2011 are already covered by orders; this percentage for the next two years is already at 85%. Especially worthy of mention is the solid and stable nature of these figures due to the excellent prospects of our core customers: Audi, VW, BMW and Daimler. We believe we are very well-positioned in view of the sales plans of our major buyers.

And of course we have also learned something from the crisis in automotive sales. Even if the cause of the crisis was hardly due to paragon, we should point out that it revealed deficiencies in the Company's financing structure. Too many financiers, unachievable key financial indicators (financial covenants) as a prerequisite for maintaining loans and the absence of financial reserves caused paragon to end up fully dependent in terms of financial restructuring, despite its rapid recovery in performance.

### Valuable lessons from the crisis in sales

The lessons from the crisis are: Reduce fixed costs considerably in order to decrease the profit threshold, reduce the circle of financiers, conclude long-term loan agreements without covenants, create reserves and, in particular, avoid dependence on the financing parties. From now on I, as Chairman of the Board and majority shareholder, shall take direct responsibility for the financial area, so as to consolidate company and shareholder interests. In the past we achieved strong EBIT and EBITDA figures, but profits were literally devoured by high interest payments. We have clearly reversed our course in this respect. Profitability and growth must be in harmony; the creation of adequate financial buffers cannot be neglected.

paragon today is a restructured automotive supplier without inherited liabilities. We will rely in future on strong diversification and continue to nurture a constant inflow into our product pipeline. Our healthy financial structure, moreover, ensures that our Company's earnings also truly benefit the Company. This point of departure should have a positive effect on our business figures in 2011 and the value of the paragon share as well.



Klaus Dieter Frers

paragon's recipe for success, which the Company has followed since the time of its foundation in 1988, is embodied in its name. The word paragon means 'a model of excellence' or 'a peerless example'. The core principle for the Company's activities is based on this concept. paragon is distinguished by its pro-active product development, consistently strives for improvement and works on electronic solutions for car interiors with great passion. We are ahead of the game, we are not imitators – we are, in fact, original.

While suppliers customarily approach the car primarily from the perspective of the manufacturer as customer (business to business), paragon places its focus on the passengers and buyers of the vehicle (business to customer). The Company combines this broader perspective with the virtues of creativity, surprise and courage. This results in solutions for problems that no-one else has yet perceived and products that no-one else has yet thought about. This pioneering function has led to paragon being listed as a direct supplier to automotive manufacturers, thus affording direct access to the customers' development departments.

Concentration on products beyond the mainstream is a core element of paragon's strategy. This implies products that the large suppliers are not focusing on. paragon solutions can be viewed as niche products, with unique characteristics that have been developed in crystal-clear fashion, but which nevertheless exhibit high mass production potential. The engineers at paragon have developed a holistic understanding of systems, which forms the basis for tailor-made customer solutions. Perfect systems integration and optimum adaptation of the car interior play a large part, as does the right technology.

paragon demonstrates the highest technical competence under the slogan 'Ideas in Motion'. As a full-service provider, paragon's spectrum ranges from the initial idea through development and production to after-sales service. paragon develops new solutions with enormous enthusiasm, opening up additional markets without any direct competition. To put it more simply: paragon creates its markets!

# Moving Ideas





### General stock market environment

The positive developments in the German economy in the period from June 1 to December 31, 2010, were reflected on the stock exchange floor. At the start of the period under review the Deutsche Aktien Index (DAX) stood at 5,981 points. It broke through the 6,000 threshold relatively quickly and rose in the months to follow. Until December a recovery prevailed with small setbacks; the pinnacle was reached at the end of the year. On December 7, 2010, the DAX briefly exceeded the 7,000 mark. On December 30, 2010, the leading German index was at 6,914, signifying an increase of over 15% in the past seven months. The TecDAX of German technological securities was also close to its highest level during the period under review at the end of the year at 851 points. The European benchmark index EURO STOXX 50 rose less sharply than the German indices, from 2,607 on June 1, 2010, to 2,793 on December 31, 2010.

### Performance of the paragon share

Between June 1, 2010, and December 31, 2010, movements in the paragon share were characterized by a highly dynamic price rally, especially in the last few weeks of the year. In the first quarter of the partial fiscal year the security roughly maintained its level (June 1, 2010: EUR 4.30; August 31, 2010: EUR 4.23), but rose steeply in the second quarter to EUR 5.15 (November 1, 2010). The paragon share really picked up speed in December of 2010. Above all, the Managing Board's announcement on December 1, 2010, that the Company was expecting considerably higher profits than originally forecast, was responsible for this surge. This information, together with numerous discussions with investors, ensured that the paragon share rose to the year's high at EUR 11.15 as at December 31, 2010.

The paragon share attracted increasing attention from the financial press against the backdrop of this

exceptionally positive development. "Der Aktionär" (The Shareholder) used a double-page spread to analyze the 'comeback of the year' in its 52/2010 edition, while "Börse Online" (Stock Exchange Online) wrote a two-page article entitled 'Successful New Start' in its double edition 52/2010 and 01/2011. The paragon share was by far the share with the highest price increase in Germany in 2010.

There were no significant changes from the previous year in the shareholder structure. Free float as defined by the Deutsche Börse AG stayed at a comparatively high level at 48.65%.

### Financial market communications

paragon AG values and nurtures continuous information exchange with investors, analysts, journalist and the interested public. After its successful restructuring, the Company communicated its ongoing business development in the form of press releases, personal discussions, interviews and articles on the Company's website from June 1, 2010.

The highlights in terms of financial market communication included the presentation of the annual financial statements for fiscal 2008, 2009 and the partial fiscal year from January 1 to May 31, 2010, at a press conference on August 12, 2010, the Annual General Meeting on September 30, 2010, at which paragon announced the quarterly figures as at August 31, 2010, and the increase in earnings forecast announced on December 1, 2010.

Parallel to intensifying work with the public, paragon also increased its dialogue with partners in the financial markets. In addition to numerous discussions with shareholders, this included the first so-called 'fire-side chat' with interested investors on December 13, 2010, in Frankfurt, as well as a series of interviews with financial journalists. Wide-ranging articles on paragon AG in many technical journals were the result.

The Managing Board and Supervisory Board of paragon AG welcome the suggestions and recommendations of the German Corporate Governance Code. The Code promotes transparency and thereby strengthens the trust of international and domestic investors, customers and employees, as well as the financial community as a whole.

During the period between June 1 and December 31, 2010, paragon was once again able to comply with the principles of the German Corporate Governance Code to the greatest extent possible.

### Shareholders and Annual General Meeting

The period under review, June 1 to December 31, 2010, was characterized by intensive dialogue with existing and new shareholders. The paragon share engendered great interest among private and institutional investors after the Company's successful turnaround after the crisis in the automotive industry. The Managing Board conducted a wide range of talks with a variety of shareholders, both at the Company's headquarters in Delbrück and in the central financial location of Frankfurt.

The Annual General Meeting on September 30, 2010, was akin to a premiere. The Managing Board reported on three fiscal years (2008, 2009 and the partial fiscal year from January 1, to May 31, 2010) in an extensive presentation. Shareholders expressed their pleasure at the success of the restructuring and discharged the Chairman of the Board with a large majority of between 94 and 98 percent.

### Cooperation between the Managing Board and Supervisory Board

The Managing Board worked together closely and in a trusting atmosphere with the previous Supervisory Board, which has monitored paragon AG in part since the IPO in November of 2000, as well as with the new

Supervisory Board, appointed by the Annual General Meeting on September 30, 2010. The Managing Board reported to the Supervisory Board on all subjects related to business development, planning, the risk situation and compliance. All Supervisory Board meetings took place with the attendance of the Managing Board.

### Managing Board

The Managing Board of paragon AG consisted of one member as at December 31, 2010. During the period from June 1 to December 31, 2010, the Managing Board's rules of procedure remained unchanged. Compensation received by the Managing Board includes, in accordance with the provisions of the German Corporate Governance Code, components that are based on performance and components that are independent of performance. Both fixed and variable components of remuneration reflected market conditions and were reviewed by the Supervisory Board for their appropriateness and subsequently established.

### Supervisory Board

The Supervisory Board of paragon AG had three members, as in the previous year. During the Annual General Meeting of September 30, 2010, the shareholders elected a completely new Supervisory Board; Hans-J. Zimmermann assumed the chairmanship of this Board. The Supervisory Board monitored the work of the Managing Board on a regular basis and assisted the latter in a consulting capacity. No conflicts of interest arose among the members during the past fiscal year which would require disclosure to the Supervisory Board. The Supervisory Board conducted a self-assessment to review its efficiency. The Supervisory Board member, Hermann Börnemeier, who provides paragon AG with tax advice, rendered personal services during the period under review. The Supervisory Board approved this activity in its constituent session on September 30, 2010.

## Transparency

paragon AG informed all capital market participants on the Group's financial situation on a regular and timely basis during the period under review. Shortly after the positive vote on the insolvency plan submitted at the creditor meeting on April 16, 2010, the Managing Board published a forecast for sales and earnings for all of 2010 as early as May 3, 2010. paragon AG submitted financial reports on a quarterly basis in the time frames stipulated. On December 1, 2010, moreover, the Managing Board announced that earnings figures for all of 2010 were anticipated to be 20% higher than originally anticipated. The relevant notifications took place as required in the form of ad hoc announcements and press releases with supplementary information provided by the Managing Board.

## Directors' Holdings

Members of the Managing Board held 51.32% of paragon AG shares as at the balance sheet date. No members of the Supervisory Board held paragon shares as at December 31, 2010.

## Accounting

The financial statements as at December 31, 2010, have been prepared according to the International Financial Reporting Standards (IFRS) or the International Accounting Standards (IAS) as they are to be applied in the EU. There were two partial fiscal years in the calendar year 2010 due to the successful insolvency process. The first partial fiscal year from January 1, 2010, to May 31, 2010, encompassed the period during which the insolvency was initiated. The second partial fiscal year from June 1, 2010, to December 31, 2010, related to the resolution of the Annual General Meeting on September 30, 2010, according to which paragon AG is to return to the calendar year as fiscal year on January 1, 2011. At this Annual General

Meeting Rödl & Partner GmbH was chosen as external auditor for the financial statements from the partial fiscal year from June 1 to December 31, 2010, and subsequently commissioned by the Supervisory Board.

## Declaration of paragon AG on the German Corporate Governance Code

In accordance with Section 161 of the German Stock Corporation Act (AktG), paragon AG submits the following declaration of compliance with the recommendations of the Government Commission on the German Corporate Governance Code: The Managing Board and Supervisory Board of paragon AG welcome the suggestions and recommendations of the German Corporate Governance Code. They commit themselves to transparent, responsible corporate management and control that is oriented to creating value. paragon AG has conformed and conforms to the recommendations of the German Corporate Governance Code in the version dated July 2, 2010, with the following exceptions:

- The Managing Board is not comprised of several individuals (item 4.2.1).
- The Supervisory Board has not agreed a cap for extraordinary unforeseen developments, since the current Managing Board agreement was entered into prior to the relevant adoption of the code on June 18, 2009 (item 4.2.3).
- No agreement on a limitation of severance pay (severance cap) has been entered into with the Managing Board (item 4.2.3).
- 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 (item 4.2.4).
- No remuneration report is prepared as a part of the

Corporate Governance report (item 4.2.5 and 7.1.3).

- The Supervisory Board did not form any committees (items 5.3.1 to 5.3.3).
- No age limit has been set for Supervisory Board and Managing Board members (items 5.1.2 and 5.4.1).
- Disclosures on the remuneration of the members of the Managing Board are not itemized. In the invitation to the Annual General Meeting on September 30, 2010, however, remuneration was listed on an itemized basis, so this item is indirectly being complied with (item 5.4.6).

- The Company fulfils its obligation to publish the purchase and sale of Company shares and options by members of the Managing and Supervisory Boards. However, separate disclosures on such directors' dealings are not made in the Corporate Governance report in the financial statements of the partial fiscal year as recommended under item 6.6.

Delbrück, March 10, 2011

**paragon AG**

The Managing Board  
The Supervisory Board

The Supervisory Board of paragon AG performed the duties incumbent on it according to legal and statutory provisions during the partial fiscal year from June 1 to December 31, 2010. It monitored and reviewed the activities and work of the Managing Board on a regular basis with due diligence. Furthermore, It provided assistance in a consulting capacity to paragon AG on all issues. The Supervisory Board was furnished with both written and oral reports on ongoing developments in the sales and earnings situation, on adherence to corporate planning and on developments in the financial situation. Moreover, the Managing Board informed the Supervisory Board in advance regarding important decisions and involved it in the decision-making process.

During the partial fiscal year June 1 to December 31, 2010, the Supervisory Board consulted with the Managing Board on developments in paragon AG in several conference calls and two Supervisory Board sessions. The Chairman and Deputy Chairman of the new Supervisory Board were appointed in the constituent Supervisory Board session on September 30, 2010. In the ordinary session on November 29, 2010, developments in the current fiscal year and planning submitted for fiscal 2011 were explained by the Managing Board and discussed in detail and adopted by the Supervisory Board. The documentation prepared and the reports of the Managing Board were reviewed extensively and discussed. The Company's risks and opportunities above all were debated and deliberated. No transactions requiring Supervisory Board consent have been submitted for resolution.

The Chairman of the Managing Board remained in contact with the Chairman of the Supervisory Board outside the framework of the meetings and joint consultations. The Supervisory Board was fully informed concerning extraordinary events which might impact the assessment of the year's results.

The audit firm, Rödl & Partner, Nuremberg, was appointed as external auditor of the partial fiscal year June 1

to December 31, 2010, by resolution of the Annual General Meeting dated September 30, 2010, and commissioned by the Chairman of the Supervisory Board accordingly. The annual financial statements as at December 31, 2010, as well as paragon AG's management report for fiscal the partial fiscal year June 1 to December 31, 2010, constituted the subject of the audit. The audit firm made available to each member of the Supervisory Board the documentation to be audited regarding the annual financial statements, the management report and the proposal for the appropriation of net profits for the year, as well as the audit report. The Supervisory Board discussed the annual financial statements and the management report and the recommendation for appropriation of profits with the Managing Board in the presence of the external auditors in the session of March 10, 2011.

The external auditor was able to answer all questions on the significant findings of the audit to the Board's complete satisfaction. The Supervisory Board approved the external auditors' report. The findings of the report reflect those of the Supervisory Board. The latter, therefore, endorsed the annual financial statements drawn up by the Managing Board in the Supervisory Board session of March 10, 2011, and joined in the recommendation on the appropriation of profits.

The auditor has audited the annual financial statements and management report prepared by the Managing Board for the partial fiscal year from June 1 to December 31 of 2010 and issued an unqualified audit opinion. Accordingly, the annual financial statements of paragon AG as at December 31, 2010, are confirmed.

The Supervisory Board of paragon AG wishes to thank all employees, as well as the Managing Board, for their personal commitment.

Delbrück, March 10, 2011

Chairman of the Supervisory Board

### A. Business and Framework Conditions

paragon Aktiengesellschaft (paragon AG or paragon), headquartered in Delbrück, Schwalbenweg 29, Germany, is a joint stock company set up under German law. paragon AG shares have been traded on the Frankfurt stock exchange in the Prime Standard segment since 2000. paragon develops, manufactures and markets electronic components and sensors for the automotive industry.

The Annual General Meeting on September 30, 2010, resolved to restore paragon's fiscal year as the calendar year starting on January 1, 2011. Due to the prior partial fiscal year from January 1 to May 31, 2010, a second partial fiscal year covering June 1, 2010, to December 31, 2010, ensued.

After the successful restructuring that the Company undertook in connection with the crisis in the automotive industry, which has since been surmounted, paragon is in a gratifying upwards trend. In May of 2010 the Managing Board issued a forecast for calendar year 2010 (sales of EUR 58 million, adjusted EBITDA of EUR 7.5 million), which was raised on December 1, 2010 (adjusted EBITDA of at least EUR 9.0 million). Even this higher figure was exceeded as at December 31, 2010. These business results, in conjunction with significantly lower debt and strong demand on the part of car manufacturers, create anticipation of additional growth in the core earnings indicators in future.

#### Management Systems

paragon attributes great value to a comprehensive planning and control system. In addition to continuous updates of weekly, monthly and annual plans the traditional financial and profitability indicators, such as cash flow, expense ratios, EBIT and/or EBITDA, EBIT margin and contribution margin, are key management figures.

The Managing Board and the Supervisory Board of

paragon AG receive regular reports on the segments based on the monthly, and therefore up-to-date, reports on business developments. They show monthly variances from planned figures in an actual to target comparison and are used as a basis to arrive at solutions in Managing and Supervisory Board meetings. In addition, paragon's extended top management meets on a regular basis to discuss the course of business, the outlook and other business events of particular note.

#### Economic Situation

During the course of 2010 the German economy emerged from the deepest recession in post-war history. The Institut für Weltwirtschaft (ifw – Kiel Institute for the World Economy), headquartered in Kiel, described Germany's economic development as 'still very dynamic', even at the end of the period under review.

Real gross domestic product increased significantly once again in the third quarter of 2010; the annualized rate was 2.8% compared to the previous quarter. Both export, customarily strong, and rising domestic demand were factors driving this expansion. In the fourth quarter, too, private consumption continued to take root; expenditures from private households rose palpably compared to both past years and previous quarters. Favored by healthy profit prospects, companies expanded their investment in equipment, without, however, reaching the levels of 2008, i.e. prior to the economic downturn. In the final quarter of 2010 the positive trend was confirmed, although the increase in order receipts in the industry slowed somewhat.

The Federal Statistics Office (Destatis) commented on the development of the German gross domestic product (GDP) in a press release dated January 12, 2011. According to the press release the German economy grew more strongly during 2010 at 3.6% than at any time since reunification. It was particularly noteworthy that the stimuli for growth were coming not

just from export trade, but from the domestic market as well. Significantly more investment was being undertaken in equipment (+9.4%) than in the previous year, but construction investment (+2.8%) and price-adjusted consumer expenditures (private +0.5%, public +2.2%) also rose.

Germany's consumer price index increased by 1.1% vis-à-vis the previous year according to Destatis. The annual inflation rate was considerably higher than the previous year (2009: +0.4% increase from 2008) but in a longer-term comparison still well under annual inflation rates for most years. The 2% threshold of importance in monetary policy was not reached either on average for the year or in any single month in 2010.

#### **Economic Performance in the Eurozone**

During the period under review the industry evidenced considerable growth in the Eurozone as compared to the previous year, both in terms of order receipts and production. According to information of the statistical bureau of the European Union, Eurostat, order receipts rose 19.9% and production by 7.4% over the previous year's figures in November of 2010. Order receipts in order-based processing sectors increased in all member states of the EU in November compared to 2009 ranging from 1.0% (Denmark) to 59.2% (Estonia). Industrial production rose by up to 35.0% (Estonia); declines were experienced in Greece (-8.0%) and Malta (-2.7%), however. Industry in the Eurozone picked up pace at the end of the year: Increases of 2.1% in order receipts and 1.2% in production were noted from October 2010 to November 2010.

Eurostat announced an annual inflation rate in the Eurozone of 2.2% for in a press release dated January 14, 2011, after 1.9% in November of 2010. The inflation rate was 0.9% in the previous year. In December 2010 the monthly inflation rate was 0.6%.

#### **Developments in the Automotive Industry**

The international automotive trade recovered far more

rapidly than anticipated in 2010 and picked up speed especially at the end of the year. According to information provided by the Verband der Automobilindustrie (VDA – German Automotive Industry Association) the global automobile market was up 12% in 2010 to 61.7 million passenger vehicles, already exceeding pre-crisis levels. The growth drivers in international trade were above all the four BRIC countries (Brazil, Russia, India and China), as well as the US market. The export strength of German auto makers allowed them to benefit especially from the recovery with their efficient and attractive models.

The automotive trade developed very strongly in Brazil in 2010. Demand for light vehicles (passenger cars and light trucks) rose 11% to 3.3 million units, for the first time surpassing the volume of new registrations in the German market. Russia, successfully ensuring a rise in demand by means of a scrapping bonus program since March of 2010, evidenced an even larger leap of 30% to 1.9 million new vehicles,

In India, too, the passenger vehicle business grew steeply, as anticipated, over the past twelve months. This growth market increased its sales of new cars by 31% to 2.4 million units. The largest increase in the world, however, took place in the Chinese passenger car trade, which rose by 34% to 11.3 million vehicles in the past year. German manufacturers are especially strong here; almost every fifth new car in China is a German brand.

Despite a rather weak overall economy, sales of light vehicles rose by 11% in the previous year, about 11.6 million units. In this case, too, German manufacturers proved strong, achieving much higher growth than average at 15%. They reached record levels with a 12% share in the passenger vehicle market.

In Western Europe new registrations at almost 13 million units were, as expected, lower than the high results of the previous year. The expiration of national economic stimulus programs was key in this drop in demand, at

5% significantly lower than forecast at the beginning of the year. The passenger vehicle business developed hesitantly in the large Western European markets. The previous year's figures were slightly exceeded in Spain (+3%) and Great Britain (+2%); decreases were recorded in France (-2%) and Italy (-9%).

The German manufacturers were delighted by significant domestic demand especially at the end of the year, along with the hike in exports (+25% to 4.2 million passenger vehicles). In December of 2010 more new cars were registered than in the same month of the previous year for the first time in a year in Germany, at 230,400 passenger cars (+7%). Since September of 2010, domestic order receipts, too, were higher; in December alone they were up a good 19%. 2.92 million new passenger vehicles were registered in Germany throughout 2010; the market share of German brands rose to approximately 70% (2009: 66%).

### B. Course of Business and the Situation of paragon AG

Thanks to high demand levels from the automotive industry, in 2010 paragon AG exceeded its sales and earnings forecasts that the Managing Board had announced in May of 2010 and raised in December of 2010, in some areas quite significantly. Business developments in the partial fiscal year from June 1 to December 31, 2010, contributed greatly to this result. paragon achieved sales of EUR 35.2 million during this time period.

Due to a broadly diversified customer base, close connection with core customers, as well as pro-active product development geared strategically to mega-trends in the industry (comfort, safety and health) paragon was able to secure and expand its competitive position for the long term in the last few months. As a Tier 1 supplier (i.e. a direct supplier) paragon benefited directly from the upwards trend in the automotive industry.

The new, trim structure with the company headquarters at Delbrück and branches in Nuremberg, Suhl and St. Georgen proved to be a winning solution in response to the break-neck recovery in the automotive industry. Quick decisions and efficient organization of work flows were a great advantage against the backdrop of customer release orders at short notice. The division into the product groups Air Quality, Power Train, Acoustics, Stepper Motors, Media Interfaces and Cockpit undertaken as part of the restructuring was revealed as future-oriented.

It was also seen to be positive that responsibilities are clearly distributed among locations:

#### Delbrück headquarters

Sales, Purchasing, Finance  
Development of Air Quality, Power Train, Acoustics, Stepper Motors

#### Nuremberg branch

Development of Media Interfaces, Cockpit

#### Suhl branch

Production

#### St. Georgen branch

Production

paragon was able to continue to define its profile as pioneer and innovation leader in accordance with the strategy under the slogan "Ideas in Motion". The Company was able to add new products to the established portfolio during the period under review (e.g. new sensors for power trains) that have already evoked considerable interest among manufacturers. This has allowed paragon to lay the foundation for playing a part in the growth story of the automotive industry in the well-respected field of New Drives.



### C. Net Assets, Financial Position and Results of Operations

Figures of the partial fiscal year from June 1 to December 31, 2010, are compared below with figures from the preceding partial fiscal year from January 1 to May 31, 2010. For purposes of simplicity the term 'prior year' is used for the preceding partial fiscal year.

#### Net Assets and Financial Position

Total assets rose by EUR 4.5 million to EUR 43.5 million as at December 31, 2010 (prior year: EUR 39.0 million). This increase is due in particular to the rise in cash and cash equivalents.

Non-current assets were down to EUR 18.2 million from EUR 18.8 million. This change is due primarily to scheduled depreciation during the period under review. Current assets rose by EUR 5.0 million to EUR 25.3 million (prior year: EUR 20.3 million), a result mainly of the increase in cash and cash equivalents (EUR 5.1 million). Cash and cash equivalents of EUR 13.8 million include the insolvency escrow account in the amount of EUR 3.8 million and the escrow account for the "insolvency dividend payout" in the amount of EUR 4.0 million. Both accounts are under the sole authority of the former insolvency administrator.

Non-current provisions and liabilities rose by EUR 6.7 million in the period under review. This rise is due in great part to the insolvency mass share loan taken out (EUR 12.7 million), valued at EUR 11.3 million as at December 31, 2010 and the collateral redemption loan (EUR 1.4 million).

Payment to the insolvency creditors is financed by means of the insolvency mass share loan. EUR 8.7 million had been paid out as at December 31, 2010. The collateral redemption loan is used especially to redeem physical collateral. As at December 31, 2010, an amount of EUR 1.4 million has been utilized to redeem such collateral.

Current provisions and liabilities were down by EUR 5.4 million to EUR 18.5 million as at May 31, 2010. The reason for this is the payout of the insolvency dividend resulting from the implementation of the insolvency plan. Financing this payment on the other hand led to a rise in both current and non-current loan liabilities.

Equity increased by net income for the year in the amount of EUR 3.2 million and equaled EUR 4.5 million at the balance sheet date.

Cash flow from operating activities as at December 31, 2010, amounted to EUR 5.0 million and improved over the previous year by EUR 2.8 million. Cash flow from investment activities has declined due above all to the purchase of assets from the former subsidiary paragon finesse GmbH by EUR 1.9 million to EUR 2.3 million. Higher cash flow from financing activity stems from taking out the insolvency share loan in the amount of EUR 12.7 million and the collateral redemption loan of EUR 2.0 million, as well as the payout of the insolvency share specified in the insolvency plan of EUR 8.7 million. By December 31, 2010, EUR 1.4 million had been drawn down from the collateral redemption loan. Financing resources include only cash and cash equivalents.

#### Results of Operations

paragon achieved earnings of EUR 35.2 million (prior year: EUR 25.1 million) from June 1 to December 31, 2010. Cost of materials rose by EUR 4.9 million to EUR 18.7 million, although the comparison period (partial fiscal year from January 1 to May 31, 2010) covered two months less; once the different time frames are factored in, cost of materials dropped by EUR 0.6 million. Personnel expenses increased by EUR 3.3 million (taking into account the different time frames, this figure would be EUR 1.5 million); the increase was due to necessary new hires and expenses associated with outsourcing pension obligations.

Operating results in the period under review are influenced by both income and expenses in connection with the implementation of the insolvency plan.

Financing expenses were up to EUR 0.8 million (prior year: EUR 0.1 million) due to the insolvency share loan of EUR 12.7 million and the collateral redemption loan in the amount of EUR 1.4 million taken out during the period, as well as the refinancing of the existing loans with Deutsche Kreditbank (DKB).

Income taxes rose during the partial fiscal year from June 1 to December 31, 2010, to EUR 0.7 million due to positive operating results (not including restructuring effects).

All in all period income as at December 31, 2010, amounted to EUR 3.2 million (prior year: EUR 100.3 million). Consequently earnings per share amounted to EUR 0.77 with 4,115 million shares outstanding (prior year: EUR 24.36).

### Overall assessment of paragon AG's situation

The Managing Board is satisfied with the development of paragon AG in 2010 due to the increase in sales revenues.

## D. Employees

As at December 31, 2010, paragon engaged 304 employees and 39 contract workers at its four locations. Employee numbers have gone up vis-à-vis the last partial fiscal year as at May 31, 2010 (247 employees and 19 contract workers) due to the takeover of the staff of the former subsidiary paragon finesse GmbH and due to new hires as a consequence of excellent order levels. The numbers of employees are distributed over the individual locations as at December 31, 2010 as follows (employees/contract workers): Delbrück (55/0), Suhl (189/25), Nuremberg (19/1) and St. Georgen (41/13).

In the period under review personnel expense amounted to EUR 7.9 million. EUR 5.7 million of this was due to salaries and wages (prior year: EUR 3.8 million), EUR 0.9 million (prior year: EUR 0.5 million) spent on social security contributions and EUR 0.6 million (prior year: EUR 0.1 million) on retirement expenses. Expenses for contract workers amounted to EUR 0.7 million in the period under review (prior year: EUR 0.2 million).

## E. Remuneration of the Managing Board

paragon AG's Managing Board during the period under review consisted only of Mr. Klaus Dieter Frers. The Managing Board's remuneration was established by the Supervisory Board and was subject to continuous review. Remuneration is composed of components that are based on performance and components that are independent of performance. No benefits were realized related to stock options. The performance-dependent bonus was geared to the Company's financial development in the period under review just elapsed, in particular EBITDA. Please refer to the information in the notes to the consolidated financial statements for the amount and breakdown of the Managing Board's remuneration.

## F. Investments

During the period under review paragon AG undertook investments in the amount of EUR 2.5 million (prior year: EUR 0.5 million). Higher investment expenditures were due above all to the takeover of the assets of the former subsidiary, paragon finesse GmbH as at September 1, 2010.

The 2011 fiscal year investment plan for paragon AG includes EUR 3.5 million for both replacement investment and new facilities.

## G. Principles of Financial Management

The primary goal of financial management is a good equity-to-assets ratio. The capital structure is managed and adapted to changing economic conditions. During all of 2010, including the period under review up until December 31, 2010, no fundamental changes in objectives, methods and processes in capital management took place.

Capital management refers only to the recorded equity of paragon AG. Reference is made to the statement of changes in equity regarding any movements in this respect.

paragon was required to adhere to financial indicators during fiscal 2008 in association with financing by lending banks. During the course of the implementation of the insolvency plan debt financing was thoroughly reorganized in the period under review; the major financing banks now no longer require adherence to such financial indicators.

## H. Research and Development

During the period from June 1 to December 31, 2010, paragon has been working at full throttle on new products in order to benefit in future from the substantial rise in demand on the part of manufacturers for new solutions in the area of comfort, safety and health. The division into two development locations with clear responsibilities for individual product groups has had a noticeably positive impact on these activities. In Delbrück the focus is on Air Quality, Power Train, Acoustics and Stepper Motors, while in Nuremberg it is all about Media Interfaces and Cockpit.

Key development projects in Delbrück included the customer-specific layout of the air quality system AQI, the start-stop sensor, a new microphone with cardioid characteristics, as well as a novel all-gear sensor, for which a patent has already been filed. At the Nurem-

berg site research and development focuses on signal processing and the vehicle-specific integration of the belt microphone belt-mic, the Bluetooth profile for the most up-to-date cell phone models at media extender, an optimized manufacturing concept for the instrument dials of on-board clocks and the innovative attachment of a smartphone holder in the car interior.

Expenses for contract workers amounted to EUR 2.5 million in the period under review (prior year: EUR 1.3 million).

## I. Procurement

Quality, high-performance suppliers and innovative materials procurement remain as cornerstones of paragon's purchasing philosophy after the successful restructuring. In order to guarantee achievement of production targets, the Group relied on close cooperation with strong partners as part of the procurement process. This approach proved to be particularly advantageous especially during the insolvency period.

Material usage amounted to approximately EUR 17.6 million in the partial fiscal year from June 1 to December 31, 2010 (prior year: EUR 13.2 million). This means that the cost of materials ratio has been reduced to 49.9%; it was still 52.4% in the comparable period.

## J. Report on Risks and Opportunities

paragon has established a comprehensive risk management system in order to determine the risks and opportunities in the Company's development. Management is informed on the probability of occurrence and potential extent of damage by means of risk reports prepared on a regular basis by all business segments. Furthermore, the reports contain an estimate of risks and recommendations for countermeasures, in addition

to opportunities in the market and in the Company's development. Please refer to the notes for risk management goals and methods as they relate to the use of financial derivatives.

#### **Accounting-based internal control system**

Since the internal control and risk management system is not defined by law, we rely on the definition of the Institut der Wirtschaftsprüfer in Deutschland e.V., Düsseldorf, (German Institute of External Auditors) regarding accounting-based internal control systems (IDW PS 261). The internal control system can be interpreted as the principles, processes and measures that management has introduced into the Company that are aimed at the implementation of management's decisions in the organization and have the following objectives:

- a) assure the effectiveness and efficiency of business activities (including protection of assets, covering also the prevention and detection of damage to assets),
- b) appropriateness and reliability of internal and external accounting and
- c) adherence to the key legal and statutory regulations that apply to the Company.

The risk management system encompasses the totality of all organizational rules and measures for risk identification and for dealing with the risks of entrepreneurial activity.

paragon AG's Managing Board bears the overall responsibility for the internal control and risk management system with respect to the accounting process. The principles, process instructions, operational and organizational structure, as well as the processes included in the accounting-based internal control and risk management system, are documented in an accounting guideline and additional organizational instructions, which are adapted to external and internal developments on a regular basis.

Given the size and limited complexity of the accounting process, we specified the scope and design of these control activities and implemented the process.

Furthermore, we set up controls that are independent of processes. Control activities address such control risks as could significantly impact accounting and the overall statement regarding the financial statements and the management report in terms of their likelihood of occurrence and their effects. Important principles, processes, measures and control activities include:

- Identification of the key control risks of relevance to the accounting process
- Process-independent controls to monitor the accounting process and its results at the level of paragon AG's Managing Board
- Control activities in paragon AG's accounting and financial control areas that provide important information for the preparation of the financial statements and management report, including the requisite segregation of duties and integrated approval processes,
- Measures that assure the proper EDP processing of accounting-based information.

#### **Market and Industry**

paragon was able to quickly establish its market position as a renowned and innovative automotive supplier after the most difficult industry crisis. The most recent successes are based on the fact that a fully restructured company is encountering brightening prospects in the economy of the industry. In future, too, economic developments in the automotive industry will have considerable influence on the sales and earnings situation of the Company, which has concentrated fully on automotive electronics since 2010. Due to this concentration on its core competences the opportunity arises for the Company to develop new sales potential as a result of its close bonds with key customers.

In general paragon identifies sales opportunities and risks through its comprehensive sales control system. Market and competitor data is analyzed, rolling plans for the short and medium term are prepared and regularly scheduled meetings help coordinate sales, production and development activities. paragon continuously increases its independence from individual sub-markets and customers through the expansion of the product range and the customer base. The loss of a major customer might, nonetheless, have an enormous impact. Due to long contract terms in the case of vehicle series, however, this would be known early on. paragon counters this risk by dint of development work, innovation and outstanding customer service.

Pro-active product development, taking into account the interests and wishes of the end customers (the car's passengers), distinguishes paragon from the majority of automotive suppliers. The electronics manufacturer has a significant opportunity here, since a large part of key innovations in the car will in future be in the electrical/electronics area. Furthermore, paragon has the automotive industry's mega-trends in its sights, given its focus on the aspects of comfort, safety and health. It cannot be ruled out, however, that a developed product does not reach production of the expected number of units. paragon counters this risk by means of intensive dialogue with the development departments of automotive manufacturers, as well as its long-term experience in the market.

### **Research and Development**

As an innovative direct supplier to the automotive industry, paragon is involved in numerous development projects with customers. Major deviations from project goals in terms of timing or money could entail cost and legal risks (contractual penalties). paragon counters these risks by means of ongoing development and project control that include placing time and expense targets. The field of research and development taps into additional potential for paragon in the case of existing, as well as new, customers. By exploiting existing sales channels additional business can be generated with new products that complement the previous portfolio.

As a result of investment levels of almost EUR 30 million in the past five years, the average age of the Company's equipment is less than three years. All investment necessary for operations was undertaken in the past few years.

### **Procurement and Production**

Many commodities have become more expensive in the period under review. Global competition in the segments of relevance to paragon, as well as master contracts, annual agreements and long-term supplier relations, enable paragon to assure guaranteed prices for a major portion of procurement. The Company continues to procure over 80% of purchasing value from Europe, while the remaining purchasing expenditure goes to the US and Asia. Payment terms are those common to the industry. The major purchasing currency is the euro, with a small share also in US dollars. paragon, moreover, uses continuous improvements to optimize the production and logistics structures, thereby improving the efficiency of the production process.

### **Information Technology**

The ever increasing use of computers and the Internet in all areas of the Company has correspondingly increased information technology risks, such as that of computer failure or unauthorized access to hardware and software. To prevent possible risks, paragon has collaborated with professional service providers to develop modern security solutions ranging from prevention to intervention in order to protect data and IT infrastructure. paragon also invests in modern information technology on an ongoing basis, so that processes in the Company become yet more stable.

### **Liquidity and Financing**

Initially paragon has in fact reduced its international activities within the context of its restructuring. Nevertheless, exchange rate risks arising from procurement and sales cannot in principle be ruled out. Risks are hedged with appropriate financing instruments as required, based on exchange rate expectations that are reviewed on an ongoing basis.

paragon safeguards its solvency through comprehensive liquidity planning and control. Plans are prepared on a long, medium and short term basis. In addition the Company conducts consistent accounts receivable management in order to ensure timely cash inflows. A major share of receivables is also guaranteed by trade credit insurance. The risk of interest-rate fluctuations is insignificant for paragon, because the majority of non-current liabilities are covered by agreed fixed interest rates. Moreover, no agreements to comply with financial indicators (financial covenants) are in place for the central financing via the Deutsche Kreditbank (DKB).

### Overall Risk

paragon AG's Managing Board always assesses risks in close coordination with the Supervisory Board. The successful restructuring, associated with a considerable reduction in liabilities, and the powerful recovery in the automotive industry have served to lessen paragon AG's overall risk for the long term. Further development of the Company is, of course, closely linked to economic developments in the automotive industry.

The Company will be exposed to general market risks in the future as well. Due to full concentration on its core business in the automotive field, paragon AG is limiting potential risks that could have arisen from an expansion of activities to complementary areas in the past. Products that have long been established with customers, furthermore, have the potential for expansion and further development. According to the Managing Board's opinion paragon AG is likely to be able to cope with future market fluctuations better as a result of its reorganized financing.

As at the balance sheet date no provisions for income taxes were recorded regarding recapitalization gains. This decision is based on the premise that income taxes on the recapitalization gains in the period under review, as well as the recapitalization gain of the previous year, will be exempted after deduction of the income tax loss carryforwards pursuant to the decree of the Ministry of Finance of March 27, 2003 (BStBl

2003 I S. 240 et seq.) for reasons of equity. In the event that the exemption from income tax on the previous year's recapitalization gain fails to materialize, the income taxes that would become due would jeopardize the Company's continued existence. Measurement of income tax provisions is also based on key assumptions regarding the distinction between income and expense related to the insolvency (recapitalization gains) and operating results. It is possible that legal interpretations in this respect will differ between the tax authorities and paragon, which might lead to higher or lower taxes for the fiscal year.

At the time of publication of this report, no additional risks have been identified that might jeopardize the Company's continued existence. This includes possible risks, such as risks of an incorrect product mix or the threat of credit withdrawal. Rather, the opportunity exists for paragon to exploit the recovery of the automotive industry in order to expand the customer relationships that have existed for so many years.

## K. Capital Structure, Managing Board and Change of Control

Pursuant to the provisions of section 289, paragraph 4, of the German Civil Code, paragon AG provides the following comments:

### Capital

paragon AG's capital stock as at December 31, 2010, consisted of 4,114,788 shares with a par value of EUR 1.00. Subscribed capital amounted to EUR 4,114,788. Capital has been increased conditionally by up to 1,750,000 shares (conditional capital III).

The conditional capital III serves to grant shares to the holders or creditors of conversion rights and/or options from bonds which were issued pursuant to the authorization of the Annual General Meeting of May 22, 2007, for cash in accordance with the terms of the bond. This authorization is in effect until April 30, 2012.

All shares carry an entitlement to dividend payments. As far as the Managing Board is aware no restrictions on transfer and voting rights existed over the past fiscal year. There are no shares with special rights that grant control authorities. Klaus Dieter Frers, Chairman of the Board, has direct holdings in paragon AG in excess of 10% (51.32%). Employees of paragon AG do not participate in such a way in the Company's capital that they are in a position to exercise control rights directly.

### Managing Board

paragon AG's Managing Board consisted of one member appointed by the Supervisory Board as at December 31, 2010: Mr. Klaus Dieter Frers, at the same time Chairman of the Board. In other respects, the provisions of sections 84 and 85 of the German Stock Corporation Act apply.

paragon AG's Managing Board is constantly committed to the Company's interests and to maintaining and enhancing shareholder value. Furthermore, the sole member of the Managing Board did not exercise any Supervisory Board functions. Subject to the condition of a change of control resulting from a takeover bid, no agreement existed within the Company's Managing Board contracts that the Managing Board should be indemnified under certain conditions.

### L. Declaration on Corporate Governance

The declaration on corporate governance in accordance with section 289a of the German Civil Code and the declaration in accordance with section 161 of the German Stock Corporation Act can be viewed at any time on the paragon website at [www.paragon-online.de/Investor-Relations/Corporate-Governance](http://www.paragon-online.de/Investor-Relations/Corporate-Governance) and is printed in the annual report in the section on Corporate Governance.

### M. Environmental Protection and Occupational Safety

paragon AG is committed to in-depth environmental protection and occupational safety. With a view to financial success under the best possible conditions paragon implemented comprehensive measures and training sessions in the area of occupational safety in work processes as early as several years ago. These measures result in improved employee working conditions, less work-force stress and thus reduced absenteeism due to illness and lower risk of accidents.

Furthermore, paragon is actively involved in the area of environmental protection due to its regular reviews of manufacturing processes and guarantees compliance with legal provisions by means of stringent controls. Production branches in Germany are certified in accordance with the environmental standard DIN EN ISO 14001:2005. At the same time paragon assures that raw materials and energy resources are carefully handled by using the most up-to-date manufacturing techniques. Environmental management is solidly integrated into the work processes and contributes significantly to the Group's financial success based on well-grounded quality management.

### N. Events after the balance sheet date

No reportable events of special significance have occurred since the end of the fiscal year.

### O. Report on Anticipated Developments

paragon AG's corporate planning is based on a Top Line, which is broken down per customer at the sub-level. Key cost components are planned over a time period of several years using individual planning models and then extrapolated in proportion to sales developments. Significant parameters, such as price changes in purchasing or sales and possible cost increases in the

personnel area or tax changes, are incorporated in planning. The risk management system, updated on a continuous basis, permits the Company to identify risks early on and counteract them appropriately.

### **Development of the General Economy and Industries**

After the major recession in the global economy a phase of moderate expansion has been ushered in, according to the Institut für Weltwirtschaft (ifw). The upwards trend is expected to continue until well into 2011, even if more and more decelerating factors are becoming noticeable. In addition to financial policy that is becoming considerably more stringent in an increasing number of countries, the ifw is anticipating consolidation processes in the private sector. The rise in global production is expected to slow to 3.6% in 2011 (prior year: 4.8%).

In Germany, too, in the institute's opinion, growth in economic performance is losing its momentum. The cloud over the export economy is likely to cast a shadow over the prospects of a production increase domestically. On the other hand, the ifw is assuming that domestic demand will continue to be robust. The institute mentions an expansion of the debt crisis in several European countries as a risk factor in future development. A rise in gross domestic product of 2.3% (prior year: 3.7%) is anticipated for 2011. The institute expects inflation to go up by 1.6% (prior year: 1.1%).

The German automotive industry is assuming new records in passenger car exports and domestic production for 2011. The VDA (German Automotive Industry Association) expects a rise to 3.1 million units against the backdrop of a domestic market returning to normal, so that the pre-crisis level of 2008 is likely to be exceeded. The Association is counting on 4.4 million units for exports, which would mean a new record high. Domestic passenger car production should also grow by 5%, increasing to 5.8 million vehicles – yet another record. The VDA points out that percentage shares in the global automotive market can change quickly. China's

share is expected to climb to 19% in 2011; in 2008 it was still at 10%. The German manufacturers are well-positioned in this arena; almost one in five new cars in China is a German model.

### **Corporate Development**

The successful restructuring undertaken by the Managing Board up until spring of 2010 has endowed paragon AG with new energy for further development. The Company is well-positioned in terms of its product portfolio, customer structure, choice of suppliers and financing arrangements to be able to satisfy the demand of the automotive manufacturers. The main reasons for paragon's current success lie in the Company's long-term restructuring and the upswing in the industry. The Company can, in particular, benefit from the economic recovery, because its products are at the cutting edge of technology.

Business figures as at December 31, 2010, have considerably surpassed the Managing Board's forecast, especially in terms of earnings. It is anticipated that paragon will be able to maintain this high level in 2011, too. Sales plans are based on over 60 million; moderate growth should be possible in the upcoming twelve months. Double-digit increases over 2010 will not be possible, if only for the fact that the Company has failed to regain several new orders from 2009, since the relevant manufacturers have submitted them to other suppliers for reasons of caution due to the uncertain situation in connection with the restructuring. This effect will scarcely be noticeable in 2012, since the issue of new orders has not been restricted for some time now.

Since the Company has once again stabilized financially a clear trend reversal is noticeable; its positive effect on the balance sheet, however, will only become apparent after 2011. Despite the need for new hires, paragon will certainly surpass operating earnings for 2010; this is evidence of the Company's sustainable profitability.



While a flattening in the upwards trend is likely in the upcoming year, the Managing Board expects a significant hike in sales for 2012 and 2013. This forecast is supported by appropriate order levels. Double-digit growth in sales is probable for these years especially due to the fact that 85% of the requisite orders have already been received for these two years.

paragon anticipates additional potential for the near future from the further development of existing and well-established solutions in the product fields of Air Quality and Media Interfaces. In the Acoustics segment additional usage options exist above all with the belt microphone, belt-mic, and the novel integra-mic plus microphone in cylinder shape and with cardioid features. Furthermore, the Company is filling the pipeline in the field of sensors for power trains with additional products; in addition to the stop-start sensor, the new all-gear sensor is particularly worthy of note. Further innovative sensors for power train are currently under development. Automotive manufacturers demonstrated great interest in these novelties, which would complement our business well, in discussions and presentations. There are also interesting opportunities for paragon in the field of New Drives, which will be developed successively. After all, paragon products are especially desirable, because they are energy efficient or contribute to energy efficiency.

A practiced team, which has grown closer during the restructuring, is one of the Company's core success factors. Our employees' high level of identification with paragon, in connection with available know-how, is a superb foundation for adding further chapters to the Company's success story. The sustained reinforcement of the second leadership level, which took place during 2010, will constitute a valuable contribution in this domain.

### Disclaimer

The 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 10, 2011



Klaus Dieter Frers  
Chairman of the Managing Board



“When paragon AG made it through bankruptcy, it was the first time a public company in Germany managed to do so. And we emerged completely intact.”



## What moved us in 2010.



“In addition to the good operational business, we are pleased to report that profits are rising. As a consequence, we have been able to significantly surpass the prior-year levels.”



1 At the Annual General Meeting on September 30, CEO Klaus Dieter Frers received between 94% and 98% approval.

2 paragon is making new onboard clocks featuring outstanding design and function for its largest single customer, Audi.

3 Highly automated processes define the production facility in Suhl, Thuringia.

4 Hans J. Zimmermann, Hermann Börnemeier, and Walter Schäfers (from left to right) bring a lot of competence to paragon's new Supervisory Board.

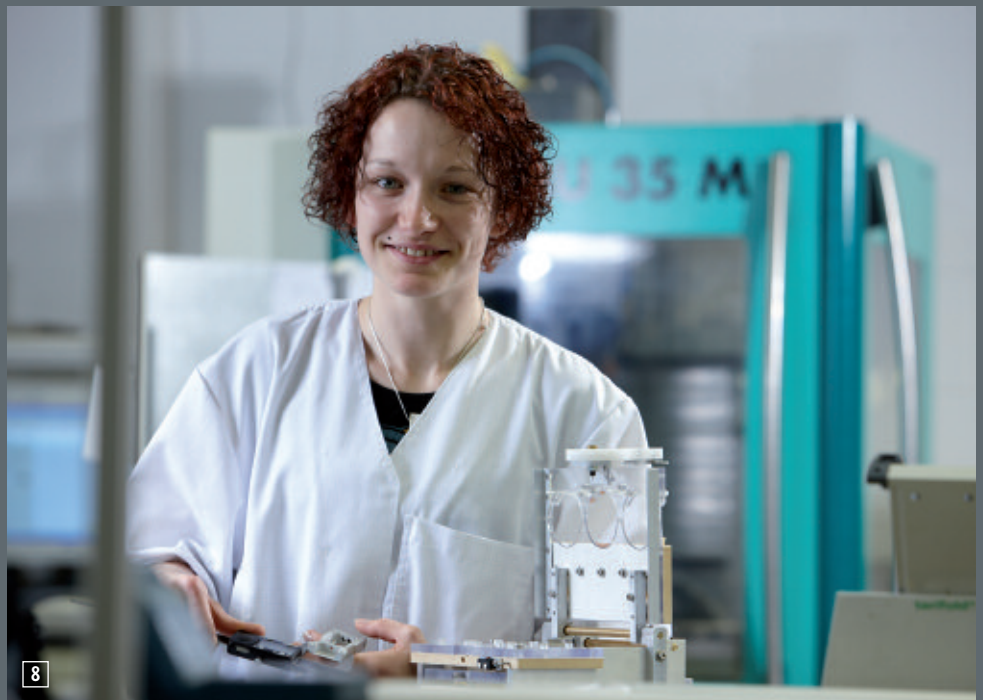
5 We entered the New Drives segment with the start-stop sensor, offering technology that is optimally suited for both conventional and hybrid vehicles.

6 We are fortunate that Burkhard Krüger, a well-established industry expert, has taken on responsibility for Sales & Marketing.

7 State-of-the-art equipment and machinery provide highest quality, especially for high volume production.

8 paragon achieved another success in training when Nancy Lorenz was nominated as "Best in the Profession."

9 In the Cockpits product group, we expanded our product range with a climate control unit for a new VW model.





# What moved us in 2010.



“Under the motto ‘New power, moving ideas’ we developed additional market opportunities. Now we want to focus on further improving the positioning of our portfolio among manufacturers.”

“The new division into six product groups has reduced complexity and created clarity. We are already seeing favorable results from the new alignment, including on the cost side.”

10 The new integra-mic plus with a cylindrical shape and cardioid characteristics has expanded paragon's microphone range.



11 Ralf Mönkemöller, Director Development in Delbrück, celebrated his twentieth anniversary with the Company.



12 The innovative belt-mic belt microphone is revolutionizing voice quality in cars and is already being used in mass-produced vehicles.



13 We sponsored the paragon night bicycle race in the inner city of Delbrück for the sixth time.

14 New displays featuring high quality design present our many products at tradeshows and expos.

15 Dr. Gerhard Wessels took on responsibility for Development at the Nuremburg facility.

16 Dr. Norbert Kalliwoda, an industry expert with TV experience, is working with paragon in the area of investor relations.

17 Remote control for a relaxation seat is one of the latest products from paragon's idea factory.

18 The Plastics Oscar, the highest award for modern plastics technology in cars, went to paragon for its belt-mic.



19 The Company got qualified reinforcement when Markus Reisinger joined us as Director of Controlling.



20 State-of-the-art and gorgeous onboard clocks like this one for a Bentley are one of paragon's specialties.







## Consolidated Balance Sheet of paragon AG, Delbrück, as of December 31, 2010

in EUR thousands	Notes	31.12.2010	31.05.2010
<b>Assets</b>			
<b>Non-current assets</b>			
Intangible assets	D(1)	3,080	3,976
Property, plant and equipment	D(2)	14,250	13,992
Financial assets	D(3)	0	180
Other assets		151	0
Deferred taxes	C(9)	718	617
<b>Total non-current assets</b>		<b>18,199</b>	<b>18,765</b>
<b>Current assets</b>			
Inventories	D(4)	6,472	5,407
Trade receivables	D(5)	3,910	5,546
Income tax assets		195	0
Other assets	D(6)	904	672
Cash and cash equivalents	D(7)	13,790	8,658
<b>Total current assets</b>		<b>25,271</b>	<b>20,283</b>
<b>Total assets</b>		<b>43,470</b>	<b>39,048</b>

in EUR thousands	Notes	31.12.2010	31.05.2010
<b>Liabilities</b>			
<b>Equity</b>			
Subscribed capital	D(8)	4,115	4,115
Capital reserves	D(8)	7,753	7,753
Profit carried forward		- 10,574	- 110,828
Consolidated net income/comprehensive income		3,169	100,254
<b>Total equity</b>		<b>4,463</b>	<b>1,294</b>
<b>Non-current provisions and liabilities</b>			
Non-current finance lease obligations	D(9)	444	555
Non-current borrowings	D(10)	14,727	7,869
Investment grants	D(14)	3,467	4,204
Deferred taxes	C(9)	0	75
Pension provisions	D(11)	1,914	1,150
<b>Total non-current provisions and liabilities</b>		<b>20,552</b>	<b>13,853</b>
<b>Current provisions and liabilities</b>			
Current portion of finance lease obligations	D(9)	441	277
Current borrowings and current portion of non-current borrowings	D(10)	5,890	177
Trade payables		4,909	5,434
Other provisions	D(15)	2,736	1,935
Income tax liabilities	D(16)	408	0
Other current liabilities	D(13)	4,071	16,078
<b>Total current provisions and liabilities</b>		<b>18,455</b>	<b>23,901</b>
<b>Total equity and liabilities</b>		<b>43,470</b>	<b>39,048</b>



## Consolidated Income Statement of paragon AG, Delbrück, for the period from June 1 to December 31, 2010

in EUR thousands	Notes	31.12.2010	31.05.2010
<b>Sales revenue</b>	C(1)	35,250	25,113
Other operating income	C(2)	4,255	101,923
Increase or decrease in finished goods and work in progress		322	253
Other own work capitalized	C(3)	113	111
<b>Total operating performance</b>		<b>39,940</b>	<b>127,400</b>
Cost of materials	C(4)	- 18,651	- 13,764
<b>Gross profit</b>		<b>21,289</b>	<b>113,636</b>
Personnel expense	C(5)	- 7,911	- 4,590
Depreciation and amortization of property, plant and equipment	C(7)	- 2,939	- 2,030
Impairment of property, plant and equipment and intangible assets	D(1)	- 114	0
Other operating expenses	C(6)	- 5,758	- 6,732
<b>Earnings before interest and taxes (EBIT)</b>		<b>4,567</b>	<b>100,284</b>
Financial income	C(8)	130	85
Finance costs	C(8)	- 847	- 145
<b>Net financing costs</b>		<b>- 717</b>	<b>- 60</b>
<b>Earnings before taxes</b>		<b>3,850</b>	<b>100,224</b>
Income taxes	C(9)	- 681	30
<b>Consolidated net income</b>		<b>3,169</b>	<b>100,254</b>
Earnings per share (basic)	C(10)	0,77	24,36
Earnings per share (diluted)	C(10)	0,77	24,36
Average number of shares outstanding (basic)	C(10)	4,114,788	4,114,788
Average number of shares outstanding (diluted)	C(10)	4,114,788	4,114,788
<b>Comprehensive income</b>		<b>3,169</b>	<b>100,254</b>

**Consolidated Cash Flow Statement of paragon AG, Delbrück,  
in accordance with IFRS**

in EUR thousands	Notes	01.06. – 31.12.2010		01.01. – 31.05.2010	
Earnings before taxes		3,850		100,225	
Depreciation/amortization of non-current assets		2,939		2,030	
Net financing costs		717		61	
Gains (-), losses (+) from the disposal of property, plant and equipment and financial assets		53		0	
Increase (+), decrease (-) in other provisions and pension provisions		1,565		- 2,366	
Income from the reversal of the special item for investment grants		- 737		- 527	
Increase (-), decrease (+) in trade receivables, other receivables and other assets		2,303		- 1,454	
Impairment of intangible assets and property, plant and equipment		114		0	
Increase (-), decrease (+) in inventories		- 1,066		- 980	
Increase (+), decrease (-) in trade payables and other liabilities		- 3,406		- 92,381	
Interest paid		- 847		- 146	
Income taxes paid		- 449		- 2,193	
<b>Cash flow from operating activities</b>	D (22)		<b>5,036</b>		<b>2,269</b>
Cash receipts from disposals of property, plant and equipment		59		0	
Cash payments to acquire property, plant and equipment		- 2,515		- 498	
Cash payments to acquire intangible assets		- 12		- 18	
Interest received		130		85	
<b>Cash flow from investing activities</b>	D (22)		<b>- 2,338</b>		<b>- 431</b>
Cash repayments of borrowings		- 1,490		- 2,540	
Cash proceeds from issuing borrowings		14,061		0	
Amounts paid on insolvency ratio		- 8,739		0	
Cash repayments for liabilities from finance lease		- 306		0	
<b>Cash flow from financing activities</b>	D (22)		<b>3,526</b>		<b>- 2,540</b>
Cash-effective change in liquidity			6,224		- 702
Cash and cash equivalents at beginning of period			7,566		8,268
Cash and cash equivalents at end of period	D (7; 22)		13,790		7,566

## Statement of Changes in Equity of paragon AG, Delbrück

in EUR thousands	Subscribed capital	Capital reserve	Accumulated other comprehensive income	Profit/loss brought forward	Total
Balance as of Jan, 1, 2010	4,115	7,753	0	- 110,828	- 98,960
Consolidated net income	0	0	100,254	0	100,254
Other comprehensive income	0	0	0	0	0
Comprehensive income	0	0	100,254	0	100,254
Balance as of May 31, 2010	4,115	7,753	100,254	- 110,828	1,294

in EUR thousands	Subscribed capital	Capital reserve	Accumulated other comprehensive income	Profit/loss brought forward	Total
Balance as of June 1, 2010	4,115	7,753	0	- 10,574	1,294
Consolidated net income	0	0	3,169	0	3,169
Other comprehensive income	0	0	0	0	0
Comprehensive income	0	0	3.169	0	3.169
Balance as of December 31, 2010	4,115	7,753	3,169	- 10,574	4,463

## Shareholdings of the members of the Managing Board and Supervisory Board as of December 31, 2010

Stock capital: 4,114,788 shares

Managing Board, total  
 Supervisory Board, total  
 Boards, total  
 in % of stock capital

Shares as of December 31, 2010

2,111,730  
 0  
 2,111,730  
 51.32





## A. Information on paragon AG

### (1) General information

paragon Aktiengesellschaft (paragon AG or paragon), with its registered office in Delbrück, Schwalbenweg 29, Germany, is a stock corporation under German law. Since 2000, paragon AG's shares have been traded on the Frankfurt Stock Exchange in the Prime Standard segment of the regulated market. paragon AG is registered in the Commercial Register of the Local Court of Paderborn (HRB 6726). paragon develops and produces electronic components and sensors for the automotive industry.

The Managing Board of paragon AG released the financial statements as of December 31, 2010 and the management report for the period June 1 to December 31, 2010 to the Supervisory Board on March 14, 2011.

The financial statements prepared for the period June 1 to December 31, 2010, and the management report of paragon AG are submitted to the electronic Federal Gazette (elektronischer Bundesanzeiger) and are available on the Company's website ([www.paragon-online.de](http://www.paragon-online.de)).

### (2) Insolvency proceedings

The effects of the global financial crisis led paragon AG to file for insolvency protection on October 5, 2009 at the Local Court of Paderborn with the aim to conduct an insolvency planning procedure subject to self-administration (Insolvenzplanverfahren in Eigenverwaltung). On October 5, 2009, the Local Court of Paderborn appointed Dr. Frank Kebekus, Kebekus & Zimmermann law firm, Carl-Theodor-Strasse 1, 40213 Düsseldorf, Germany as preliminary insolvency administrator. On December 16, 2009, the Managing Board of paragon AG withdrew its motion of October 5, 2009 to conduct insolvency proceedings in self-administration. The Local Court of Paderborn then instituted insolvency proceedings over the assets of paragon AG on January 1, 2010 and appointed Dr. Frank Kebekus as ultimate insolvency administrator.

On April 16, 2010, the insolvency plan of paragon AG was presented to, and accepted by, the creditors' meeting. As a result, the insolvency proceedings related to paragon AG were repealed effective June 1, 2010 by a ruling of the Local Court of Paderborn dated May 28, 2010. The Annual General Meeting of September 30, 2010 resolved that paragon should return to the calendar year as its fiscal year as of January 1, 2011. As a result, the preceding short fiscal year from January 1, 2010 to May 31, 2010 is followed by another short fiscal year covering the period from June 1, 2010 to December 31, 2010.

## B. Basis of accounting and accounting policies

### (1) Application of the International Financial Reporting Standards (IFRSs)

These financial statements of paragon AG as of December 31, 2010 have been prepared in accordance with the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB), London, as adopted by the European Union (EU) and applicable on the balance sheet date, and in accordance with the interpretations of the International Financial Reporting Interpretations Committee (IFRIC).

### (2) Going concern

The financial statements for the reporting period from June 1 to December 31, 2010 were prepared under the going concern assumption. The carrying amounts of assets and liabilities were therefore determined on the basis of going concern values.

### (3) Events after the balance sheet date

The financial statements have to be prepared on the basis of the circumstances existing as of the balance sheet date. In accordance with IAS 10.7, events after the reporting period include all events up to the date when the financial statements are authorized for issue. The financial statements as of December 31, 2010 will be authorized for issue by the Managing Board and submitted to the Supervisory Board for signing on March 14, 2011. Until that date, all information available with regard to the circumstances on the balance sheet date have to be taken into account.

No significant events occurred after the close of the reporting period as of December 31, 2010.

### (4) New accounting principles due to new standards

The following revised and new standards promulgated by the IASB as well as interpretations of the IFRIC were endorsed by the EU and were required to be applied for the first time as of December 31, 2010:

- In October 2009, the IASB published amendments to IAS 32. This amendment clarifies how certain rights issues should be recognized if the issued instruments are not denominated in the functional currency of the issuer. The changes are required to be applied for fiscal years beginning after January 31, 2010. EU endorsement was given on December 23, 2009. The amendments had no effect on the financial statements.

As of the date the financial statements for the reporting period from June 1 to December 31, 2010 were prepared, the following IASB standards and IFRIC interpretations had already been issued, but were not required to be applied and/or had not been endorsed by the EU at that date:

- In January 2010, the IASB published amendments to IFRS 1. The amendments concern the exemption for first-time adopters in relation to IFRS 7 for information concerning fair value and liquidity risk. The changes are required to be applied for fiscal years beginning after June 30, 2010. EU endorsement was given on June 30, 2010. The amendment will have no effect on the financial statements.
- In November 2009, the IASB published IFRS 9 Financial Instruments. Together with two further addenda, the standard will replace IAS 39 with regard to the classification and measurement of financial assets. The changes are required to be applied for fiscal years beginning after January 1, 2013. EU endorsement has not yet been given. The Company will evaluate the expected effects and determine a date for initial application.
- In November 2009, the IASB published amendments to IAS 24. The amendments clarify the definition of a related party and simplify the disclosure requirements for government-related entities. The changes are required to be applied for fiscal years beginning after January 1, 2011. EU endorsement was given on July 19, 2010. The amendment will have no effect on the financial statements.
- In November 2009, the IASB published IFRIC 19. IFRIC 19 explains the IFRS requirements in the event that an entity partially or entirely settles a financial obligation by issuing shares or other equity instruments. The changes are required to be applied for fiscal years beginning after July 1, 2010. EU endorsement was given on July 23, 2010. The amendment will have no effect on the financial statements.
- In November 2009, the IASB published amendments to IFRIC 14. The explanation provides an interpretation of IAS 19 and deals with questions concerning the inclusion of a defined benefit asset. The amendments deal with the special case in which entities make an early payment of contributions in order to satisfy their minimum funding requirements. The changes are required to be applied for fiscal years beginning after January 1, 2011. EU endorsement was given on July 19, 2010. The amendment will have no effect on the financial statements.
- In May 2010, the IASB published the exposure draft "Fair Value Option for Financial Liabilities." This draft follows the portion that was already completed on the classification and measurement of financial assets and is part of the project concerning a follow-up standard to IAS 39. It is currently planned that the new regulations will take compulsory effect as of January 1, 2013. EU endorsement has not yet been given. The amendment will have no effect on the financial statements.
- In May 2010, the IASB published improvements to IFRSs as part of its annual improvements project. Most of the amendments involve clarifications or corrections to existing IFRSs or amendments that have arisen from modifications made to the IFRSs previously. In addition, amendments were made to a total of seven standards. The changes are required to be applied for fiscal years beginning after January 1, 2011. EU endorsement was given on February 19, 2011. The Company will evaluate the expected effects and determine a date for initial application.
- In October 2010, the IASB published requirements for the recognition of financial liabilities which supplement the already existing requirements for the classification and measurement of financial assets that were already published in November 2009 in IFRS 9 Financial Instruments. The changes are required to be applied for fiscal years beginning after January 1, 2013. EU endorsement has not yet been given. The Company will evaluate the expected effects and determine a date for initial application.
- In October 2010, the IASB published amendments to IFRS 7 Financial Instruments: Disclosures. These amendments relate to the transfer of financial assets. The expanded disclosure requirements should enable the reader of the financial statements to understand the relationship between the transferred financial assets and the associated financial liabilities. The amendments require additional disclosures if a disproportionately large number of transfers occurs near the end of a reporting period. The changes are required to be applied for fiscal years beginning after July 1, 2011. EU endorsement has not yet been given. The Company will evaluate the expected effects and determine a date for initial application.

- In December 2010, the IASB published two small amendments to IFRS 1 First-time Adoption of the International Financial Reporting Standards (IFRSs). The first amendment replaces references to a fixed transition date of ‘January 1, 2004’ with ‘the date of transition to IFRSs’, thus eliminating the need for companies adopting IFRSs for the first time to restate derecognition transactions that occurred before the date of transition to IFRSs. The second amendment provides guidance on how an entity should resume presenting financial statements in accordance with IFRSs after a period when the entity was unable to comply with IFRSs because its functional currency was subject to severe hyperinflation. The amendments to IFRS 1 are set out in Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters and are effective from July 1, 2011. Early adoption is permitted. EU endorsement has not yet been given. The amendment will have no effect on the financial statements.
- In December 2010, the IASB published amendments to IAS 12 Income Taxes. The amendments set out in Deferred Tax: Recovery of Underlying Assets, result from proposals published for public comment in an exposure draft in September. The remaining guidance was incorporated into IAS 12 and SIC 21 was withdrawn. EU endorsement has not yet been given. The amendment will have no effect on the financial statements.

**(5) Currency translation**

In the financial statements of paragon AG, receivables and liabilities denominated in foreign currencies are measured at the transaction rate in effect at the time they are added and adjusted to the exchange rate in effect as of the balance sheet date. Exchange rate gains and losses are recognized in income under other operating income or other operating expenses.

Exchange rate losses from operations in the amount of EUR 30,000 (prior year: EUR 34,000) and exchange rate gains in the amount of EUR 27,000 (prior year: EUR 12,000) are recognized in the income statement. These exchange rate differences are contained in the other operating expenses or other operating income.

**(6) Significant accounting and valuation principles**

The accounting and valuation principles used in the previous year have been reapplied unaltered.

The financial statements were prepared in euros (EUR). The reporting currency is the euro in accordance with IAS 21. All amounts – unless stated otherwise – are disclosed in thousands of euros (EUR ‘000). The reporting period of paragon AG comprises the period from June 1 to December 31, 2010 in the present financial statements, as, on the one hand, a new accounting period was started beginning with the insolvency proceedings on January 1, 2010, and the accounting period relating to the insolvency ended with the ruling given by the local court of Paderborn effective June 1, 2010 to annul the insolvency proceedings as of May 31, 2010. On the other hand, the Annual General Meeting of September 30, 2010 resolved that paragon should return to the calendar year as its fiscal year as of January 1, 2011. This resulted in an additional short fiscal year including the period from June 1, 2010 to December 31, 2010. As a result of this, the reference amounts of the prior year are not entirely comparable. For improved clarity, the term “prior year” is used for the preceding short fiscal year in these Notes.

Individual items in the balance sheet and income statement have been combined in order to provide better clarity and lucidity. Where this has occurred, the items are explained individually in the notes to the financial statements. The income statement continues to be structured according to the cost of production method. Non-current and current assets and liabilities are shown separately in the balance sheet; partial details on their maturities can be found in the Notes. Assets and liabilities are recognized as current if they mature within one year.

The financial statements comprise the balance sheet, income statement, notes to the financial statements, cash flow statement, and the statement of changes in shareholders’ equity. As in previous years, a management report has been prepared as a supplement to the above statements.

Foreign currency for 1 EUR	Balance sheet - middle rate as of December 31.	Income statement - average rate	Balance sheet - middle rate as of May 31	Income statement average rate
	<b>06.12.2010</b>		01.05.2010	
U.S. dollar (USD)	1.3253	1.3108	1.2276	1.35216



### Intangible assets

Intangible assets acquired for a consideration are entered in the balance sheet at cost, taking into account ancillary acquisition costs and cost reductions.

Research costs are recognized as expenses in the period in which they are incurred. Development costs arising from projects focused on developing patents and client-specific solutions are recognized as intangible assets at cost, provided the unambiguous attribution of expenses required by IAS 38 is possible, technical feasibility and commercialization are assured, and the anticipated realization of future economic benefit has been demonstrated. Costs comprise all costs directly and indirectly attributable to the development process, as well as necessary portions of project-related overhead costs. If the asset recognition requirements have not been fulfilled, the development costs are recognized immediately in income within other operating expenses in the year in which they were incurred. After their initial recognition, development costs are entered in the balance sheet at cost less cumulative amortization and cumulative impairment losses.

If intangible assets have limited useful lives, they are written down on a straight-line basis in accordance with their economic useful lives. Amortization begins upon completion of the development phase and from the point at which the asset can be used. Intangible assets with indefinite useful lives are subject to annual impairment tests. At each reporting date, the carrying amounts of such intangible assets are used as a basis for determining whether there are reasons to believe an impairment exists. If such reasons are found, an impairment test is performed in accordance with IAS 36. The residual values, useful lives and amortization methods are reviewed at the end of each fiscal year and adapted as necessary.

The useful lives for internal development costs correspond to the anticipated product life cycles and amount to between three to four years. The useful lives for licenses, patents and software range from three to ten years.

### Property, plant and equipment

Additions to property, plant and equipment are measured at cost plus ancillary acquisition costs and less all reductions to acquisition costs. If the cost of certain components of an item of property, plant and equipment is significant when measured against the item's to-

tal cost then such components are entered and depreciated in the balance sheet individually. Depreciation takes place on a straight-line basis. In the case of buildings, the useful life is considered to be 20 to 33 years, for technical plant five to ten years, and for other plant and office furniture and equipment three to ten years.

Fully depreciated items of property, plant and equipment are shown under costs and cumulative depreciation until the assets become in-operative. Amortized costs and cumulative depreciation are deducted from the revenue derived from retired assets. Results derived from retired assets (proceeds from asset retirement less residual carrying amounts) are shown in the income statement under other operating income or other operating expenses. All residual values, useful lives and depreciation methods are reviewed annually and adapted as necessary.

As of every balance sheet date, the carrying amounts of property, plant and equipment (which are depreciated in accordance with their useful lives) are tested to see if there is reason to believe an impairment exists. If such evidence exists, an impairment test is performed.

### Lease agreements

Lease agreements are regarded as finance leases if all risks and opportunities connected with the beneficial ownership of an asset are essentially transferred to paragon. Property, plant and equipment leases that fulfill the criteria of a finance lease in accordance with IAS 17 are capitalized at the lower of their fair value and the present value of the minimum leasing payments. A liability is then entered in the balance sheet for the same amount. Subsequent valuations take place using the effective interest method with amortized costs. The amortization methods and useful lives correspond to those of assets acquired in a similar manner.

If beneficial ownership in a lease agreement falls to the lessor (operating leases), the object(s) of the lease are entered in the balance sheet of the lessor. Expenses arising from such lease agreements are shown within other operating expenses.

Determining whether an agreement constitutes a lease agreement is done on the basis of the economic nature of the agreement at the time it is concluded. Therefore, an estimate is made regarding every lease agreement as to whether fulfilling the agreement is dependent on using a specific asset or specific assets and whether the agreement grants a right to use the asset.

A sale-and-lease-back transaction involves the sale of an asset, which is already in the possession of the future lessee, to the lessor, and the subsequent continued use of the asset by the lessee by means of a lease agreement. In this respect, two economically interdependent agreements are involved (purchase agreement and lease agreement). However, the transaction is entered in the balance sheet of the lessee as one item. Depending on how the lease-back agreement is organized, it is either entered in the balance sheet as an operating lease or a finance lease.

### Impairment of non-financial assets

At each balance sheet date, it is assessed whether any indication exists that non-financial assets (in particular intangible assets having a definite useful life) have become impaired. If evidence of an impairment exists, the recoverable amount of the relevant asset is estimated. Pursuant to IAS 36.6 'Impairment of Assets,' the recoverable amount reflects the higher of fair value less cost to sell and value in use of the asset or an identifiable group of assets which is a cash generating unit (CGU). If the carrying amount of an asset or a CGU exceeds the recoverable amount, the asset is impaired and written down to its recoverable amount.

For property, plant and equipment and intangible assets except goodwill, it is assessed at each balance sheet date whether any indication exists that a previously recognized impairment loss no longer exists or has decreased. If such an indication exists, the recoverable amount of the asset or the CGU is estimated. A previously recognized impairment loss is reversed only if the assumptions used for determining the recoverable amount have changed since the last impairment loss was recognized. The reversal of the impairment loss is limited to the extent that the carrying amount of an asset may neither exceed its recoverable amount nor the carrying amount which would have resulted after taking scheduled depreciation/amortization into account if no impairment loss was recorded for the asset in earlier years.

### Financial instruments

A financial instrument is an agreement that simultaneously leads to the formation of a financial asset at one entity and to a financial liability or equity instrument at another entity. A necessary require-

ment is that the rights or obligations based on commercial law in the form of agreements or contracts contain financial data.

Financial assets particularly comprise cash and cash equivalents, trade receivables, loan agreements, other receivables and primary and derivative financial assets held for trading purposes. Financial assets are measured at their fair values or carrying amounts in accordance with their classification. The fair values recorded in the balance sheet as a general rule correspond to the market prices of the financial assets. If no market prices are available, they are calculated using recognized valuation models and by referring to current market parameters.

Financial assets, finance lease liabilities and derivative financial instruments held for trading purposes are measured at fair value. Financial instruments belonging to the category 'loans and receivables' are entered in the balance sheet at their carrying amounts. Scheduled amortization costs take into account amortization payments and the amortization of any possible difference between costs and the anticipated payment inflows at maturity, using the effective interest rate method and less any possible decreases stemming from write-downs due to potentially non-collectable accounts.

Financial liabilities generally substantiate claims for repayment in cash or another financial asset. In accordance with IAS 39, at paragon this particularly includes trade liabilities and other current liabilities and obligations to banks. paragon classifies its financial liabilities in the measurement category 'loans and receivables' and measures them at their amortized costs, taking into account amortization payments and the amortization of any possible difference between costs and the payment obligation to be fulfilled upon maturity using the effective interest method.

Financial assets are deleted from the accounts if the contractual rights in relation to cash flows from such financial assets have expired, or if paragon has transferred its contractual rights in relation to cash flows from the financial asset to a third party, or has assumed a contractual obligation to immediately pay the cash flow to a third party as part of an agreement that fulfills the requirements of IAS 39.19 (pass-through arrangement) and thereby (1) either transferred all significant opportunities and risks connected with the financial asset, or (2) in fact neither transferred nor retained all significant opportunities and risks connected with the financial asset, but transferred the power of disposition over the asset.

paragon records a new asset if (1) all contractual rights to cash flows from an asset have been transferred, or (2) all significant opportunities and risks connected with the asset have neither been transferred nor retained but paragon retains the power of disposition over the transferred asset. Financial liabilities are deleted from the accounts if the underlying obligation has been fulfilled, abolished or has expired. If an existing financial liability to the same creditor is replaced with significantly new contract terms or if the terms of an existing liability are fundamentally changed, such a replacement or change is treated as a write-off of the original liability and the recognition of a new one. The difference between the respective carrying amounts is recognized in income.

Financial assets and liabilities that are not denominated in euros are initially recognized using the middle rate as of the transaction date and subsequently translated as of each reporting date. Any translation differences that arise are recognized in income.

Financial assets and liabilities are shown as being current if they are either classified as being for trading purposes or if they are expected to be liquidated within one year from the balance sheet date.

#### Income taxes

Income taxes contain both income taxes to be paid immediately and deferred taxes.

Income taxes to be paid immediately for the current and earlier periods are measured at the amount at which a refund from or payment to fiscal authorities is anticipated. The calculation of that amount is based on the fiscal law situation and therefore on the tax rates that are in effect or that have been advised as of the balance sheet date.

Deferred taxes are recognized using the balance sheet liability method in accordance with IAS 12 ('Income Taxes'). Deferred tax assets and liabilities are recognized for differences arising from the different treatment of specific balance sheet items in the IFRS financial statements and the tax accounts ('temporary concept'). In addition, deferred taxes are recognized for future tax reduction claims.

Deferred taxes on loss carryforwards are carried as assets if it can be assumed that they can be expected to be used in future periods due to the availability of adequate taxable income.

The calculation of actual and deferred taxes is based on judgments and estimates made by paragon. If actual events deviate from these estimates, this could have positive and negative impacts on the net assets, financial position and results of operations. A deciding factor for the impairment of deferred tax assets is the estimate of the likelihood of valuation differences being reversed and the usability of tax loss carryforwards and tax benefits that led to the recognition of the deferred tax assets. This is in turn dependent on the accrual of future taxable profits during the period in which tax loss carryforwards can be claimed. Deferred taxes are measured using the tax rates applicable at the time of realization based on the current legal situation as of the balance sheet date.

A net balance of deferred tax assets and liabilities is only obtained if the tax debtees are identical and if offsetting is legally possible. Deferred taxes are shown as being non-current in accordance with IAS 1.70.

#### Inventories

Inventories are measured at the lower of cost or net realizable value. In accordance with IAS 2 'Inventories', inventories include all expenses that are directly attributable to finished goods and work in progress, as well as systemically attributable fixed and variable production overhead costs. In addition to production material and direct labor, they therefore also contain proportional production material and overhead costs. Management and social security expenses are taken into account provided they can be attributed to production. Financing costs are not recognized as part of production costs. Inventory risks resulting from the storage period and reduced usability are taken into account during the calculation of the net realizable value using value discounts. Lower values at year-end stemming from reduced market prices are also taken into account. Raw materials and trading goods are primarily measured using the moving average method.

### Trade receivables and other current assets

Trade receivables are allocated as financial assets to 'loans and receivables' and carried at amortized cost less necessary allowances. Allowances in the form of specific allowances sufficiently take into account the expected default risks. Actual defaults lead to derecognition of the receivables concerned. The calculation of allowances for doubtful accounts is primarily based on estimates and evaluations of the creditworthiness and solvency of the client.

Other current assets are measured at amortized cost, taking into account necessary allowances adequate to the expected default risks. If recourse to the courts is taken for the collection of claims carried as other current assets, the Company firmly expects that its recognized claims will be fully enforceable. If other current assets are financial assets (financial instruments), they are allocated to the 'loans and receivables' category.

### Cash and cash equivalents

Cash and cash equivalents include cash and bank balances with primary remaining terms of up to three months. Measurement is at nominal value; foreign currency positions are measured at fair value. Total cash and cash equivalents corresponds to cash and cash equivalents (cash and bank balances).

### Provisions for pensions

Provisions for pensions are calculated using the projected unit credit method in accordance with IAS 19 'Employee Benefits'. This method not only takes into account the pension benefits and benefit entitlements known as of the balance sheet date, but also the increases in salaries and pension benefits to be expected in the future by estimating the relevant impacting factors. The calculation is based on actuarial opinions, taking into account biometric principles. Amounts not yet recorded in the balance sheet (through actuarial gains and losses) result from changes in inventory and differences between the assumptions made and actual developments. Actuarial gains and losses that arise during the period under review are immediately recognized in income in accordance with IAS 19.95. The possibility of only recognizing actuarial gains and losses in income if they fall outside a fluctuation margin of 10% of total obligations

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 either. The service cost is shown under personnel expenses, and the interest accretion to provisions is allocated to the financial result.

### Other provisions

In accordance with IAS 37 ('Provisions, Contingent Liabilities and Contingent Assets'), other provisions are recognized if legal or factual liabilities to third parties exist which are based on past transactions or events and will likely lead to outflows of resources. The amount of the provisions is determined based on the best possible estimation of the expenditures needed to discharge the liability, in accordance with IAS 37, without offsetting them against recourse claims. The evaluation of the probability that pending proceedings will be successful and the qualification of the possible amount of the payment obligations are based on an estimate of the situation in question. In each case, the most probable settlement amount has been taken into account. Long-term provisions have been measured at their discounted settlement amount as of the balance sheet date.

Due to the uncertainty associated with this evaluation, the actual losses may deviate from the original estimates and accordingly from the amounts of the provisions. In addition, estimates may change based on new information and may have a substantial impact on the future earnings position.

### Government subsidies

Government grants and subsidies are recognized in accordance with IAS 20 'Accounting for government grants and disclosure of government assistance', and shown in the balance sheet under non-current liabilities. 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 being subsidized. Liquidation occurs in accordance with the assumed useful life of the asset concerned in favor of other operating income.

#### Financial liabilities and equity instruments

Financial liabilities and equity instruments are classified according to the economic substance of the underlying agreements. Equity instruments are recognized at the value of the funds or other assets received less directly attributable external transaction costs.

#### Trade liabilities and other current liabilities

Trade liabilities and other current liabilities do not bear interest and are recognized at their nominal value.

#### Recognition of income and expenses

Income is recognized when it is probable that there will be economic benefit for paragon and the amount of the income can be reliably determined. Income is measured at the fair value of the consideration received. Discounts, rebates and value added tax or other duties are not taken into consideration. If transactions provide for a declaration of acceptance on the part of the purchaser, the value added tax concerned is only taken into account if such a declaration takes place. If the sale of products and services involves several delivery and service components, such as varying compensation agreements like prepayments, milestone payments and similar payments, it is examined whether several separate realization times for partial sales should be taken into account. Contractually agreed prepayments and other one-off payments are differentiated and released to income over the period that the contractually agreed consideration is performed.

Income from the sale of products is recognized if the relevant opportunities and risks connected with the ownership of the products being sold is transferred to the purchaser. This normally occurs upon shipment of the products, as value creation is considered to have ceased at that point. Sales are shown after deduction of discounts, rebates and returns.

Interest income and expenses are recognized using the effective interest method. Operating expenses are charged to income on the date of performance or expensed as incurred.

#### Borrowing costs

Borrowing costs are recognized as an expense in the period in which they are incurred. They are capitalized if the prerequisites of a qualifying asset in accordance with IAS 23 have been fulfilled.

#### (7) Use of estimates and assumptions

Preparing the financial statements in accordance with IFRS requires assumptions and estimates to be made that influence the assets and liabilities entered in the balance sheet, the declaration of contingent liabilities as of the balance sheet date, and statements concerning expenses and income during the period under review. If actual events deviate from these estimates, this could have positive and negative impacts on the net assets, financial position and results of operations.

When applying the relevant accounting and valuation principles, the following estimates and assumptions were made that significantly influence the amounts contained in the financial statements:

#### Capitalized development costs

In order to measure capitalized development costs, assumptions were made concerning the amount of anticipated future cash flows from assets using applicable discount rates and over the period of anticipated future cash flows that these assets generate. Assumptions concerning the period and amount of future cash flows are based on expectations surrounding the future development of orders on hand from those clients with whom development projects are being conducted.

#### Inventories

Inventories are measured in terms of their scope or in terms of the expected sales less estimated costs through to completion and the estimated necessary operating costs. Actual sales and the associated costs may deviate from the anticipated amounts.

#### Other assets and liabilities

Assumptions and estimates are generally also necessary when making allowances for doubtful accounts, as well as for contingent liabilities and other provisions, and when determining the fair value of long-life property, plant and equipment and intangible assets.

## Consolidated statement of changes in non-current assets, January 1 to May 31, 2010

in EUR thousands	ACQUISITION			DEPRECIATION/AMORTIZATION				CARRYING AMOUNT				
	01.01.2010	Addition	Disposal	Reclas- sification	31.05.2010	01.01.2010	Current depreciation and amortization	Impairments in accordance with IAS 36/38	Disposal	31.05.2010	31.12.2009	31.05.2010
<b>Intangible assets</b>												
Licenses, patents, software	17,947	18	0	0	17,965	13,685	526	0	0	14,211	4,262	3,754
Capitalized development costs	359	0	0	0	359	82	55	0	0	137	277	222
<b>Total intangible assets</b>	<b>18,306</b>	<b>18</b>	<b>0</b>	<b>0</b>	<b>18,324</b>	<b>13,767</b>	<b>581</b>	<b>0</b>	<b>0</b>	<b>14,348</b>	<b>4,539</b>	<b>3,976</b>
<b>Property, plant and equipment</b>												
Land and buildings	12,685	0	0	0	12,685	3,821	277	0	0	4,098	8,864	8,587
Technical equipment and machinery	15,648	29	0	0	15,677	11,042	960	0	0	12,003	4,606	3,674
Other equipment, furniture and office equipment	6,736	68	0	72	6,876	5,450	212	0	0	5,662	1,286	1,214
Payments on account	188	402	0	- 72	518	1	0	0	0	1	187	517
<b>Total property, plant and equipment</b>	<b>35,257</b>	<b>499</b>	<b>0</b>	<b>0</b>	<b>35,756</b>	<b>20,314</b>	<b>1,449</b>	<b>0</b>	<b>0</b>	<b>21,764</b>	<b>14,943</b>	<b>13,992</b>
<b>Financial assets</b>												
Equity investments	266	0	0	0	266	86	0	0	0	86	180	180
<b>Total financial assets</b>	<b>266</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>266</b>	<b>86</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>86</b>	<b>180</b>	<b>180</b>
<b>Total</b>	<b>53,829</b>	<b>517</b>	<b>0</b>	<b>0</b>	<b>54,346</b>	<b>34,167</b>	<b>2,030</b>	<b>0</b>	<b>0</b>	<b>36,198</b>	<b>19,662</b>	<b>18,148</b>

## Consolidated statement of changes in non-current assets, June 1 to December 31, 2010

in EUR thousands	ACQUISITION			DEPRECIATION/AMORTIZATION				CARRYING AMOUNT				
	01.06.2010	Addition	Disposal	Reclas- sification	31.12.2010	01.06.2010	Current depreciation and amortization	Impairments in accordance with IAS 36/38	Disposal	31.12.2010	31.05.2010	31.12.2010
<b>Intangible assets</b>												
Licenses, patents, software	17,965	12	0	0	17,977	14,211	722	0	0	14,933	3,754	3,044
Capitalized development costs	359	0	0	0	359	137	72	114	0	323	222	36
<b>Total intangible assets</b>	<b>18,324</b>	<b>12</b>	<b>0</b>	<b>0</b>	<b>18,336</b>	<b>14,348</b>	<b>794</b>	<b>114</b>	<b>0</b>	<b>15,256</b>	<b>3,976</b>	<b>3,080</b>
<b>Property, plant and equipment</b>												
Land and buildings	12,685	1,056	0	0	13,741	4,098	406	0	0	4,504	8,587	9,237
Technical equipment and machinery	15,677	671	0	210	16,558	12,003	1,359	0	0	13,362	3,674	3,196
Other equipment, furniture and office equipment	6,876	525	- 65	156	7,492	5,662	380	0	- 12	6,030	1,214	1,462
Payments on account	518	263	- 60	- 366	355	1	0	0	- 1	0	517	355
<b>Total property, plant and equipment</b>	<b>35,756</b>	<b>2,515</b>	<b>- 125</b>	<b>0</b>	<b>38,146</b>	<b>21,764</b>	<b>2,145</b>	<b>0</b>	<b>- 13</b>	<b>23,896</b>	<b>13,992</b>	<b>14,250</b>
<b>Financial assets</b>												
Equity investments	266	0	- 266	0	0	86	0	0	- 86	0	180	0
<b>Total financial assets</b>	<b>266</b>	<b>0</b>	<b>- 266</b>	<b>0</b>	<b>0</b>	<b>86</b>	<b>0</b>	<b>0</b>	<b>- 86</b>	<b>0</b>	<b>180</b>	<b>0</b>
<b>Total</b>	<b>54,346</b>	<b>2,527</b>	<b>- 391</b>	<b>0</b>	<b>56,482</b>	<b>36,198</b>	<b>2,939</b>	<b>114</b>	<b>- 99</b>	<b>39,152</b>	<b>18,148</b>	<b>17,330</b>

The actual values may deviate from the assumptions and estimates made, requiring a significant adjustment of the carrying amounts of the assets or liabilities concerned.

#### Deferred tax assets

Deferred tax assets are only recorded if a positive tax result is expected in future periods and their realization therefore appears sufficiently assured. The actual tax result situation in future periods may deviate from the estimate made at the time the deferred tax assets were capitalized.

Domestic deferred taxes were computed as of December 31, 2010, at a combined income tax rate of 29.2% (prior year: 28.4%). This includes a corporate tax rate of 15% and a solidarity surcharge of 5.5%. The change in the combined income tax rate is based on changed assumptions related to the breakdown of the trade tax assessment rate to the Company's production sites and related to the trade tax rates valid at these locations.

#### Provisions for pensions

Expenses arising from defined benefit plans are arrived at using actuarial calculations. The actuarial measurement takes place based on assumptions related to discount rates, expected revenue from plan assets, future wage and salary increases, mortality rates and future pension increases. These estimates are subject to significant uncertainty due to the long-term nature of such plans.

As part of the measurement as of December 31, 2010, the discount rate increased from 4.5% to 5.37% in comparison with May 31, 2010, to reflect the anticipated long-range change in the market interest rate.

## C. Notes on individual items of the statement of comprehensive income

### (1) Sales revenue

Sales revenues include sales of products and services less any sales reductions. Of the sales revenues for the fiscal year of EUR 35,250 thousand (prior year: EUR 25,113 thousand), domestic sales accounted for EUR 26,185 thousand (prior year: EUR 19,979 thousand) and foreign sales for EUR 9,065 thousand (prior year: EUR 5,134 thousand).

The breakdown and classification of sales revenues according to strategic business fields and regions are shown in the "Segment Report" chapter of the management report.

### (2) Other operating income

Other operating income primarily contains income from the derecognition of financial liabilities in connection with the implementation of the insolvency plan in the amount of EUR 2,531 thousand (prior year: EUR 100,930 thousand). This book gain is broken down by creditor group as follows:

in EUR thousands	01.06. – 31.12.2010	01.01. – 31.05.2010
Banks	2,409	40,946
Holders of profit participation rights	0	23,418
Subsidiaries	0	19,320
ABS financing	0	5,377
Suppliers	122	4,407
Public institutions	0	2,951
Employees	0	2,082
Other	0	2,429
<b>Restructuring profit</b>	<b>2,531</b>	<b>100,930</b>

Other operating income includes income from the reversal of the special account for subsidies of EUR 737 thousand (prior year: EUR 527 thousand) and income from the release of other provisions of EUR 212 thousand (prior year: EUR 0 thousand). This item also contains other income from grants from the federal employment office, exchange rate differences, use of company cars by employees and rentals.

### (3) Other own work capitalized

Insofar as development projects satisfied the requirements of IAS 38.45 in the period under review and were capitalized, project-related development costs were reported in other own work



capitalized. The capitalized amounts are recognized under intangible assets. Production costs for test equipment for automotive products were also reported in other own work capitalized.

in EUR thousands	01.06. – 31.12.2010	01.01. – 31.05.2010
Project-related development costs	0	0
Production costs of test rigs	113	111
Other own work capitalized	113	111

#### (4) Cost of materials

in EUR thousands	01.06. – 31.12.2010	01.01. – 31.05.2010
Raw materials and supplies	17,601	13,166
Cost of purchased services	1,050	598
Cost of materials	18,651	13,764

#### (5) Personnel expense

Personnel expense amounted to EUR 7,911 thousand in the period under review (prior year: EUR 4,590 thousand) and can be broken down as follows:

in EUR thousands	01.06. – 31.12.2010	01.01. – 31.05.2010
Wages and salaries	5,642	3,758
Social security contributions	918	495
Pension expenses	646	114
Expenses for temporary staff	705	223
Staff costs	7,911	4,590

Personnel levels developed as follows compared to the previous year:

	01.06. – 31.12.2010	01.01. – 31.05.2010
Salaried employees	148	135
Wage-earning employees	139	112
Average number of employees	287	247

#### (6) Other operating expenses

Other operating expenses primarily comprise expenses arising from cost allocations concerning former affiliated companies (EUR 610 thousand; prior year: EUR 1,221 thousand), compensation for the redemption of assets assigned as securities (EUR 656 thousand; prior year: EUR 845 thousand) as well as expenses from litigation risks (EUR 500 thousand, prior year: EUR 0 thousand). Furthermore, this

item also shows expenses from value readjustments in respect of loans and advances, legal and consultancy fees, vehicle costs, I.T. and telephone costs, costs related to building rentals and energy, as well as leasing and corporate insurance expenses. The expenses contained under other operating expenses during the period under review comprised other taxes of EUR 12 thousand (prior year: EUR 10 thousand).

#### (7) Depreciation, amortization and impairment losses

Depreciation, amortization and impairment losses on intangible assets, property, plant and equipment and financial assets can be found in the statement on fixed assets.

#### (8) Financial result

in EUR thousands	01.06. – 31.12.2010	01.01. – 31.05.2010
Financial income	130	85
Interest income	130	85
Finance costs	- 847	- 145
Other financial and interest expenses	- 847	- 145
Net finance costs	- 717	- 60

Interest expenses owed to banks of EUR 723 thousand are reported in other financing and interest expenses.

#### (9) Income taxes

in EUR thousands	01.06. – 31.12.2010	01.01. – 31.05.2010
Current taxes	573	0
Current domestic taxes	573	0
Deferred taxes	108	30
Deferred domestic taxes	108	30
Income taxes	681	30

Current taxes reflect corporate and trade tax. Foreign taxes were not levied during the period under review.

Domestic deferred taxes were computed as of December 31, 2010, at a combined income tax rate of 29.2% (prior year: 28.4%). This includes a corporate tax rate of 15% and a solidarity surcharge of 5.5%. The change in the combined income tax rate is based on changed assumptions related to the breakdown of the trade tax assessment rate to the Company's production sites and related to the trade tax rates valid at these locations.

Current taxes in the amount of EUR 573 thousand result from the taxable net earnings generated within the short fiscal year from

June 1, 2010 to December 31, 2010. In determining the current taxes, it was taken into account that the income taxes on restructuring profits of EUR 2,531 thousand (prior year: EUR 100,930 thousand) – after deduction of the existing loss carryforwards – will be waived on grounds of equity in accordance with the decree issued by the German Minister for Finance on March 27, 2003 (Federal Tax Gazette 2003 I pages 240 et seq.).

Deferred tax assets as of the end of the period under review refer exclusively to domestic taxes and are the result of timing differences in valuation. Deferred tax assets and liabilities were created in connection with the following accounts and situations:

in EUR thousands	31.12.2010		31.05.2010	
	De-ferred tax assets	De-ferred tax liabilities	De-ferred tax assets	De-ferred tax liabilities
Intangible assets	0	11	0	63
Property, plant and equipment	277	0	257	0
Receivables and other assets	0	9	0	12
Provisions for pensions	461	0	360	0
Deferred tax assets and liabilities prior to offsetting	738	20	617	75
Offset	- 20	- 20	0	0
Deferred tax assets and liabilities, net	718	0	617	75

The increase in deferred tax assets in the amount of EUR 121 thousand primarily results from the first-time carrying amount differences between the IFRS method and the tax base in connection with the outsourcing of the plan assets for pension provisions. In contrast, the timing differences in valuation for pension provisions compared to the prior year were reduced due to the continued development of the tax base. The reduction in deferred tax liabilities primarily concerns the reduction in carrying amount differences in intangible assets in connection with the capitalized development costs.

No domestic corporate and trade tax loss carryforwards arise from net earnings for previous years.

Deferred tax liabilities in the amount of EUR 20 thousand (prior year: EUR 75 thousand) as of the end of the period refer exclusively to domestic taxes, reflect timing differences and chiefly apply to intangible assets capitalized under IFRS but which may not be capitalized under German tax law, as well as to trade receivables.

Dividends to be paid by paragon AG in the future have no impact on paragon AG'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 tax rates on reported pre-tax earnings.

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

in EUR thousands	01.06. – 31.12.2010	01.01. – 31.05.2010
Net income for the period before income taxes	3,850	100,224
Calculatory tax expense at a tax rate of 29.2% (prior year: 28.4%)	1,124	28,464
Non-taxable restructuring profit	- 472	- 29,033
Non-deductible expenses and tax-free income	- 26	- 2
Other non-taxable net income for the reporting period	55	541
Actual tax expense	681	- 30

**(10) Earnings per share**

Basic earnings per share are calculated by dividing net income by the weighted average number of shares issued. The weighted average number of shares issued was 4,114,788 in the period under review (prior year: 4,114,788).

With net income of EUR 3,169 thousand (prior year: EUR 100,254 thousand), the basic earnings per share amount to EUR 0.77 (prior year: EUR 24.36).

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

Stock option plans create the basis for a potential dilution of earnings per share. Under stock option plans, management receives option rights to purchase paragon AG shares. Exercising these subscription rights depends on the price movement of the paragon share. Up to December 31, 2010, based on an average share price of EUR 4.99 (prior year: EUR 2.88) and a strike price of EUR 15.09 (fourth tranche), no dilution occurred (prior year: 0 shares). All options still exercisable within the fiscal year from June 1, 2010 to December 31, 2010 lapsed on November 6, 2010.

The diluting shares are calculated according to the following formula:

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**Potentially diluting common shares [each] =  
subscription rights issued and exercisable [each] x  
(1 - strike price / share price)**

Fourth tranche:  $0 = 30,000 \times (1 - 15.09 \text{ EUR} / 4.99 \text{ EUR})$

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The number of shares to be used in calculating the diluted earnings thus did not rise in the reporting period up to December 31, 2010. The diluted earnings per share figure is rounded to EUR 0.77 (prior year: EUR 24.36). The diluted earnings per share figure was calculated according to IAS 33.24 et seq.

Additional information on the stock option plans can be found in the section on "Share-based payments".

## D. Notes on individual items of the balance sheet

The development and breakdown of intangible assets, goodwill, property, plant and equipment and financial assets are reflected in the statement of fixed assets. Comments on capital expenditure can be found in the management report.

### (1) Intangible assets

#### Capitalized development costs

Development costs of EUR 36 thousand (prior year: EUR 222 thousand) have been capitalized under intangible assets. Total development costs for the period amounted to EUR 2,548 thousand (prior year: EUR 1,312 thousand). As in the prior year, no internal development costs included in that amount were capitalized as intangible assets in the period under review.

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.

Depreciation, amortization and impairment losses during the period under review amount to EUR 72 thousand (prior year: EUR 55 thousand).

Pursuant to IAS 36, an impairment test was performed on the capitalized development costs. The impairment test showed that the maximum recoverable amount for individual development projects was EUR 0 thousand. The recoverable amount in each case reflects the fair value of the development projects determined based on new information concerning the salability of the development projects. The impairment loss pursuant to IAS 36 came to EUR 114 thousand (prior year: EUR 0 thousand) in the year under review.

### (2) Property, plant and equipment

Depreciation, amortization and impairment losses during the period under review amount to EUR 2,145 thousand (prior year: EUR 1,449 thousand). Land and buildings are encumbered with property charges as collateral for long-term bank loans.

Portions of movable fixed assets are financed under lease contracts with terms from four to five years as a rule. Payments reflecting future lease installments are recorded as liabilities. The net carrying amount of capitalized assets under financial leases as of December 31, 2010, amounts to EUR 1,043 thousand (prior year: EUR 1,181 thousand). Corresponding payment obligations from future lease

installments come to EUR 885 thousand (prior year: EUR 832 thousand) and are recorded as liabilities at present value. Capitalized lease objects are without exception technical plant and machinery. The greatest share of the leases includes arrangements for the transfer of ownership without additional payments after complete performance of all obligations during the basic lease period (full amortization). Otherwise, no firm agreements were made concerning the further use of the lease objects after expiration of the basic lease period. paragon AG assumes, however, that the lease objects can be acquired at a favorable price after the basic lease period has expired or may continue to be used at a favorable rent.

In the period under review, the expense from the disposal of property, plant and equipment came to EUR 53 thousand (prior year: EUR 0 thousand).

### (3) Financial assets

Shares of Paderborner Stadiongesellschaft mbH, Paderborn, which were recognized in financial assets at EUR 180 thousand in the prior year, were sold on June 23, 2010. The purchase price claim still outstanding as of the end of the period under review on December 31, 2010 is reported in other assets.

Furthermore, shares in affiliated companies (paragon finesse GmbH, paragon fidelio GmbH, paragon firstronic GmbH and paragon facilio GmbH) are capitalized unaltered at EUR 0 thousand (prior year: EUR 0 thousand). The shares were already written down in full at their fair value in fiscal 2008. The insolvency proceedings of the affiliated companies were not completed by the date of preparation. Consequently, there were no reversals of impairment losses in the period under review.

### (4) Inventories

Inventories consist of the following:

in EUR thousands	31.12.2010	31.05.2010
Raw materials and supplies	3,463	2,942
Changes in work in progress and finished goods	2,907	2,012
Advance payments on inventories	102	453
<b>Inventories</b>	<b>6,472</b>	<b>5,407</b>

During the period under review, write-downs of inventories were recorded in the amount of EUR 309 thousand (prior year: EUR 0 thousand). No reversals of impairment losses were undertaken in the period under review (prior year: EUR 1,224 thousand). The carrying amount of the inventories recognized at net realizable value (fair value minus disposal costs) came to EUR 213 thousand as of December 31, 2010. As of the balance sheet date, inventories in the amount of EUR 5,018 thousand (prior year: EUR 0 thousand) were used to secure liabilities.

Orders that would need to be reported under IAS 11 ("Construction Contracts") did not exist on the balance sheet date.

### (5) Trade receivables

The carrying amount of trade receivables is arrived at as follows:

in EUR thousands	31.12.2010	31.05.2010
Receivables, gross	4,176	6,023
less impairments	- 266	- 477
<b>Receivables, net</b>	<b>3,910</b>	<b>5,546</b>

The aging structure of non-impaired trade receivables as of the balance sheet date is shown below:

in EUR thousands	Carrying amount	of which neither impaired nor past due	of which past due but not impaired, as follows			
			0 – 30 days	30 – 60 days	60 – 90 days	> 90 days
<b>31.12.2010</b>						
Trade receivables	3,801	2,610	785	81	105	220
<b>31.05.2010</b>						
Trade receivables	5,217	3,275	1,072	210	414	246

With regard to receivables that have neither been written down nor are overdue there were no indications as of the balance sheet date that the respective debtors would fail to meet their payment obligations.

The impaired receivables developed as follows based on these findings:

in EUR thousands	31.12.2010	31.05.2010
Impaired receivables before allowances	375	806
Allowance for credit losses	- 266	- 477
<b>Impaired receivables after allowances</b>	<b>109</b>	<b>329</b>

Impairment losses and derecognition of trade receivables are reported under other operating expense. Income from receipts associated with derecognized receivables are reported under other operating income. No write-downs or derecognition of other financial assets occurred either during the period under review or the previous year.

#### (6) Other current assets

Other current assets include:

in EUR thousands	31.12.2010	31.05.2010
Other current assets		
Creditors with debit balances	432	584
Prepaid expenses	247	58
Miscellaneous other assets	225	30
<b>Other current assets</b>	<b>904</b>	<b>672</b>

Overdue other current assets as of the balance sheet date are reflected below:

in EUR thousands	Carrying amount	of which neither impaired nor past due	of which past due but not impaired, as follows			
			0 – 30 days	30 – 60 days	60 – 90 days	> 90 days
<b>31.12.2010</b>						
Other current assets		904	904	0	0	0
<b>31.05.2010</b>						
Other current assets		672	672	0	0	0

There were no indications that notable payment defaults were likely to arise in the case of other current assets as of December 31, 2010.

#### (7) Cash and cash equivalents

Cash on hand and bank deposits are shown at nominal value. Cash and cash equivalents include EUR 12 thousand (prior year: EUR 8 thousand) in cash on hand and EUR 13,778 thousand (prior year: EUR 8,650 thousand) in bank deposits. Among other things, cash and cash equivalents include the escrow account in the amount of EUR 3,845 thousand (prior year: EUR 7,540 thousand) and the escrow account "quota distribution" in the amount of EUR 3,961 thousand (prior year: EUR 0 thousand). Both accounts are under the sole power of disposal of the former insolvency administrator. As of December 31, 2010, bank deposits included no time deposits pledged as collateral (prior year: EUR 1,092 thousand). Pursuant to IAS 7, financing funds for the previous short fiscal year included the cash and cash equivalents minus these bank deposits, which cannot be converted to cash at any moment. Changes in financing funds are shown in the cash flow statement.

#### (8) Equity

The development of the individual components of equity for the fiscal year from January 1 to May 31, 2010, and for the reporting period from June 1 to December 31, 2010, is presented in the statement of changes in equity.

#### Share capital

paragon AG's share capital as of December 31, 2010 amounts to EUR 4,115 thousand (prior year: EUR 4,115 thousand) and is divided into 4,114,788 bearer shares with a notional share in capital of EUR 1.00 each. No increase in share capital due to the exercise of options under the stock option plan took place during the period under review.

Conditional capital

A conditional capital increase of EUR 1,750 thousand by issue of 1,750,000 no par-value shares was adopted (conditional capital III) by resolution of the Annual General Meeting of May 22, 2007.

The conditional capital increase exclusively serves the purpose of granting shares to the holders or creditors of conversion rights and/or options from bonds which were issued pursuant to the authorization of the Annual General Meeting of May 22, 2007 to issue convertible bonds and/or bonds with warrants against cash according to the terms of the bond. This authorization is in effect until April 30, 2012. As of the balance sheet date, no option rights had yet been issued from this conditional capital.

The Managing Board may, with the consent of the Supervisory Board, also issue convertible bonds for which the holders of convertible bonds may be required, under the terms of the bond or by the Managing Board with the consent of the Supervisory board, to exchange the bonds for shares of paragon AG during the conversion period or at its end.

The bond terms of bonds granting or specifying a conversion right, a conversion obligation and/or an option, may also determine that in the event of conversion or exercise of an option, own shares of the Company may be granted.

The shareholders of paragon AG are entitled to subscribe to the bonds. The bonds may also be offered to the shareholders of paragon AG by way of an indirect subscription right.

The Managing Board is also authorized, with the consent of the Supervisory Board, to exclude shareholders from subscription rights if the issue price of the bonds is not significantly lower than the fair

value of the convertible bonds or bonds with warrants. This authorization applies, however, only if shares issued or to be issued to service the conversion rights or options or in the event of mandatory conversion do not exceed 10% of the share capital. Shares issued from authorized capital with exclusion of subscription rights under section 203 (1) and (2) in conjunction with section 186 (3) sentence 4 German Stock Corporation Act (AktG) and treasury shares sold based on an authorization pursuant to section 71 (1) (8) sentence 5 in conjunction with section 186 (3) sentence 4 AktG, with exclusion of subscription rights are counted towards this limitation of 10% of the share capital.

Each option right carries an entitlement to acquire one paragon AG bearer share with a notional share capital value of EUR 1.00.

Capital reserves

Capital reserves at EUR 7,753 thousand as of December 31, 2010, are unchanged from the previous year.

Dividends

As in the short fiscal year until May 31, 2010, the Annual General Meeting does not intend to propose a dividend per share for the period ending December 31, 2010.

(9) Finance lease obligations

Liabilities under finance leases are recorded at their present value or amortized cost in accordance with IAS 17. The redemption component can be derived as follows:

in EUR thousands	Remaining term to maturity < 1 year	Remaining term to maturity between 1 and 5 years	Remaining term to maturity more than 5 years	31.12.2010	31.05.2010
Minimum lease payments	486	477	0	963	940
Future interest payments	- 45	- 33	0	- 78	- 108
<b>Finance lease obligations (reduction of outstanding liability)</b>	<b>441</b>	<b>444</b>	<b>0</b>	<b>885</b>	<b>832</b>
of which reported under non-current liabilities				441	555
of which reported under current liabilities				444	277

in EUR thousands	Remaining term to maturity < 1 year	Remaining term to maturity between 1 and 5 years	Remaining term to maturity more than 5 years	31.12.2010	31.05.2010
Liabilities to banks	5,890	6,464	8,263	20,617	8,046
of which reported under non-current liabilities				14,727	177
of which reported under current liabilities				5,890	7,869

**(10) Liabilities to banks**

Current and non-current liabilities to banks total EUR 20,617 thousand (prior year: EUR 8,046 thousand); collateral for liabilities to banks exists in the amount of EUR 20,617 thousand (prior year: EUR 6,750 thousand).

Liabilities to banks are secured by property charges for loan liabilities in the amount of EUR 7,207 thousand (prior year: EUR 4,174 thousand), by collateral assignment of property, plant and equipment of EUR 467 thousand (prior year: EUR 2,576 thousand), by collateral assignment of merchandise of EUR 5,018 thousand (prior year: EUR 0 thousand) and the assignment of trade receivables of EUR 3,910 thousand (prior year: EUR 0 thousand).

Liabilities to banks have terms of (see table above).

The interest rate for liabilities to banks is 6% and is fixed for all loans with the result that there is no risk of interest rate changes.

**(11) Pension provisions**

A provision for a defined benefit pension plan was created in accordance with IAS 19. This relates in part 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. Pension provisions exist for pension commitments to members of the Managing Board. Based on a decision by the Supervisory Board of August 31, 2009, pension obligations and corresponding plan assets of paragon AG were partially outsourced to HDI Gerling Pensionsfonds. In the period under review until December 31, 2010, the pension obligation of EUR 794 thousand and the corresponding plan assets of EUR 1,425 thousand were partially outsourced.

The following assumptions underpin the actuarial computations:

in %	31.12.2010	31.05.2010
Discount rate	5.37	4.50
Expected return on plan assets	0.00	4.50
Wage increase (recommitment based on an individual contract until year of service 2009, 0% thereafter)	10.00	10.00
Pension increase	2.00	2.00
Fluctuation	0.00	0.00

Actuarial gains and losses may arise from increases or decreases in the net present value of the defined benefit obligations, which may in turn be brought about by changes in calculation parameters and estimates regarding the risks related to the pension obligations. The net value of pension provisions can be derived as follows:

Net present value of defined benefit obligation:

in EUR thousands	31.12.2010	31.05.2010
Present value of defined benefit obligation at beginning of year	2,838	2,809
Service cost	190	136
Interest cost	74	53
Pension payments	0	0
Settlements	- 794	0
Actuarial gains (-), losses (+)	- 394	- 160
<b>Present value of defined benefit obligation at the balance sheet date</b>	<b>1,914</b>	<b>2,838</b>

Fair value of plan assets:

in EUR thousands	31.12.2010	31.05.2010
Fair value of plan assets at beginning of year	1,688	1,550
Expected return on plan assets	48	32
Loss on plan assets	- 311	- 22
Settlements	- 1,425	0
Employer contributions	0	128
<b>Fair value of plan assets as of the balance sheet date</b>	<b>0</b>	<b>1,688</b>

Net value of reported defined benefit obligation:

in EUR thousands	31.12.2010	31.05.2010
Present value of defined benefit obligation	1,914	2,838
less fair value of plan assets	0	1,688
<b>Unfunded defined benefit obligation</b>	<b>1,914</b>	<b>1,150</b>

The net value has developed as follows:

in EUR thousands	31.12.2010	31.05.2010
Unfunded defined benefit obligation at beginning of year	1,150	1,259
Settlements	631	0
Pension expenses	133	19
Contributions paid	0	- 128
<b>Unfunded defined benefit obligation as of the balance sheet date</b>	<b>1,914</b>	<b>1,150</b>

The following amounts were taken into account in the comprehensive statement of income:

in EUR thousands	01.06. - 31.12.2010	01.01. - 31.05.2010
Service cost	190	136
Interest cost	74	53
Expected return (-) on plan assets	- 48	- 32
Actuarial gains (-)	- 83	- 138
<b>Pension expenses</b>	<b>133</b>	<b>19</b>

In past years the financing status, consisting of the net present value of all pension commitments and the fair value of plan assets, has changed as follows:

in EUR thousands	31.12.2010	31.05.2010	31.12.2009	2008	2007
Present value of defined benefit obligation	1,914	2,838	2,809	1,931	2,031
less fair value of plan assets	0	- 1,688	- 1,550	- 1,308	- 1,072
<b>Unfunded defined benefit obligation</b>	<b>1,914</b>	<b>1,150</b>	<b>1,259</b>	<b>622</b>	<b>959</b>

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.

### (12) 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 the insurance company Delta Lloyd Deutschland AG, a unit of the insurer AVIVA plc., London, to ensure that claims can be met.

paragon AG contributed EUR 27 thousand (prior year: EUR 16 thousand) in the year under review.

### (13) Other liabilities

Other current liabilities primarily include accruals. The previous short fiscal year primarily includes remaining old debts arising from the implementation of the insolvency plan, which were incurred up to December 31, 2009 and were measured as insolvency dividends.

Other current liabilities comprise the following items:

in EUR thousands	31.12.2010	31.05.2010
<b>Other current liabilities</b>		
Accruals	2,883	4,685
Old debts measured at insolvency ratio	886	10,928
Liabilities from other taxes	294	422
Other current liabilities	8	43
<b>Other current liabilities</b>	<b>4,071</b>	<b>16,078</b>

Other non-current liabilities are not included as of the reporting period ending December 31, 2010 and in the previous year.



Other liabilities have a term of:

in EUR thousands	Remaining term to maturity < 1 year	Remaining term to maturity between 1 and 5 years	Remaining term to maturity more than 5 years	31.12.2010	31.05.2010
Other liabilities	4,071	0	0	4,071	16,078
of which reported under non-current liabilities				0	0
of which reported under current liabilities				4,071	16,078

#### (14) Investment grants

These are government investment allowances, reported as liabilities in accordance with IAS 20. During the year under review, the paragon Group received no government aid (prior year: EUR 0 thousand).

#### (15) Other provisions

Changes in other provisions are shown below:

in EUR thousands	01.06.2010	Utilization	Reversal	Additions	31.12.2010
Credits	1,140	0	0	559	1,699
Guarantees and ex gratia payments	460	150	0	0	310
Miscellaneous provisions	335	83	158	633	727
Other provisions	1,935	233	158	1,192	2,736

#### (16) Income tax liabilities

This relates to EUR 408 thousand (prior year: EUR 0 thousand) in unpaid trade tax for the current reporting period.

**(17) Additional information on financial instruments**

This section provides a summary of financial instruments employed by paragon AG. The table below shows the carrying amounts (BW) and fair values (FV) of financial assets and financial liabilities as of December 31, 2010 and May 31, 2010:

		<b>December 31, 2010</b>							
		Nominal amount		Amortized cost		Fair value			
		Cash reserve		Loans and receivables		Held for trading		Available for sale	
in EUR thousands		Carrying amount	Fair Value	Carrying amount	Fair Value	Carrying amount	Fair Value	Carrying amount	Fair Value
<b>ASSETS</b>									
	Cash and cash equivalents	13,790	13,790						
	Trade receivables			3,910	3,910				
	Other assets			1,055	1,055				
	Financial assets							0	0
	<b>Total assets</b>	<b>13,790</b>	<b>13,790</b>	<b>4,965</b>	<b>4,965</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>EQUITY AND LIABILITIES</b>									
	Liabilities to banks			20,617	20,350				
	Finance leasing			885	918				
	Trade payables			4,909	4,909				
	Other liabilities			4,071	4,071				
	<b>Total equity and liabilities</b>	<b>0</b>	<b>0</b>	<b>30,482</b>	<b>30,248</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

		<b>May 31, 2010</b>							
		Nominal amount		Amortized cost		Fair value			
		Cash reserve		Loans and receivables		Held for trading		Available for sale	
in EUR thousands		Carrying amount	Fair Value	Carrying amount	Fair Value	Carrying amount	Fair Value	Carrying amount	Fair Value
<b>ASSETS</b>									
	Cash and cash equivalents	8,658	8,658						
	Trade receivables			5,546	5,546				
	Other assets			672	672				
	Financial assets							180	180
	<b>Total assets</b>	<b>8,658</b>	<b>8,658</b>	<b>6,218</b>	<b>6,218</b>	<b>0</b>	<b>0</b>	<b>180</b>	<b>180</b>
<b>EQUITY AND LIABILITIES</b>									
	Liabilities to banks			8,046	8,046				
	Finance leasing			832	845				
	Trade payables			5,434	5,434				
	Other liabilities			16,078	16,078				
	<b>Total equity and liabilities</b>	<b>0</b>	<b>0</b>	<b>30,390</b>	<b>30,403</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

#### Determination of fair value

The fair value of cash and cash equivalents, current receivables and other assets, trade payables and other liabilities roughly reflects the carrying amount due to the short term to maturity.

paragon measures non-current receivables and other assets based on specific parameters such as interest rates and the customer's credit standing and risk structure. Accordingly, paragon sets up allowances for anticipated defaults on receivables.

paragon determines the fair value of liabilities under finance leases by discounting the anticipated cash flows using the interest rates applicable for similar financial liabilities with a comparable remaining term.

paragon determines the fair value of liabilities to banks by discounting the anticipated cash flows using the interest rates applicable for similar financial liabilities with a comparable remaining term.

Financial assets available for sale (from the prior year) represent for paragon a residual measure of the financial assets that cannot be recognized in any of the other possible measurement categories. The price in an active market is recognized as the fair value, if such a price is available. Financial assets available for sale from the prior year concern the shares in Paderborner Stadiongesellschaft mbH, Paderborn. A different fair value of EUR 180 thousand was calculated as part of a purchase offer. Accordingly, the shareholdings were written down to the different fair value in fiscal year 2009.

The Company generally engages in the use of derivative financial instruments with financial institutions of high credit standing as contracting partners. The determination of their fair value depends on the type of the financial instrument.

For the measure of fair value, a corresponding hierarchical classification has taken place, which makes allowance for the materiality of the factors influencing the valuation (Level 1 – Level 3). These comprise the prices listed on the markets for identical assets or liabilities (Level 1) or, if Level 1 prices are not available, input factors that can be observed for the asset or liability either directly (e.g. as a price) or indirectly (e.g. through price derivation) (Level 2). If no factors are found for the measurement of the asset or liability, which are based on observable market data, they are calculated separately (Level 3).

As of the balance sheet date and as in the previous year, only Level 2 financial instruments measured at fair value have been recognized (EUR 0 thousand).

The fair value of interest rate derivatives (interest rate swaps) is determined by discounting anticipated future cash flows over the remaining term of the contract based on current market interest rates and the interest rate structure curve. The fair value of forward exchange contracts is determined as a function of the forward exchange rates. paragon recognizes currency derivatives based on an estimated value calculated using an option pricing model.

#### Net gains

Net gains from financial instruments have been realized as shown below:

in EUR thousands	01.06. – 31.12.2010	01.01. – 31.05.2010
Receivables	168	- 500
Financial liabilities at amortized cost	2,531	100,930
Financial assets and financial liabilities held for trading	0	520
<b>Net gains</b>	<b>2,699</b>	<b>100,950</b>

The net gain (prior year: net loss) from receivables includes changes in bad debt allowances, gains and losses from derecognition, as well as payment inflows and reversals of impairment losses on receivables originally written down, which were recorded against income in the consolidated financial statements. The net gain from financial liabilities at amortized cost contains the book gain arising from the derecognition of financial liabilities as part of the implementation of the insolvency plan.

Net gains and losses from financial assets and financial liabilities of the prior year held for trading include all fair value changes of the derivative financial instruments (interest rate swaps).

#### (18) Derivative financial instruments

In addition to the primary financial instruments, paragon employs various derivative financial instruments as needed. As part of risk management, the Company has primarily limited the risk from interest rate and exchange rate fluctuations by employing derivative financial instruments. Further information on risk management strategies can be found in the section entitled 'Management of risks arising from financial instruments'. The Company engages in the use of derivative financial instruments only with financial institutions of the very highest credit standing.

### Derivative financial instruments for currency hedging

paragon is exposed to a number of financial risks due to its international activities. This includes, in particular, the effects of changes in exchange rates. paragon takes an integrated approach in hedging the risks inherent to fluctuating exchange rates. Company-wide risks are centralized and hedged using derivative financial instruments. If necessary, paragon AG enters into forward exchange contracts as part of the hedging process. There were no forward exchange contracts recorded as of December 31, 2010.

### Derivative financial instruments for interest rate hedging

Interest rate risk results from the sensitivity of financial liabilities to changes in the market interest rate. paragon hedges these risks by employing interest rate derivatives. The Company uses non-exchange-traded interest rate swaps to hedge interest rates. The transactions are primarily 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 recognition.

To hedge a possible interest rate risk, the company follows an approach geared to the variable interest rate of individual financial liabilities. Swap contracts are therefore tailored to the hedged variable-rate borrowings in terms of both amount and maturity. The Company does not use hedge accounting as defined in IAS 39.85. No financial liabilities at variable interest or derivative financial instruments for an interest rate hedge were present as of December 31, 2010 or in the prior year.

### **(19) Management of risks from financial instruments**

Market price fluctuations can lead to considerable cash flow and profit risks for paragon. Changes in exchange rates and interest rates influence operations, as well as investing and financing activities. To optimize financial resources within the Company, the risks from changes in interest rates and exchange rates are continuously analyzed and ongoing business and financial market activities are thus controlled and monitored. The use of derivative financial instruments contributes significantly to this control.

Price fluctuations in currencies and interest rates can entail significant profit and cash flow risks. Consequently paragon centralizes these risks to the greatest extent possible and manages them with foresight by using derivative financial instruments. As a part of the overall risk management system, the management of this risk is a central responsibility of the Managing Board of paragon AG. Part of the financial market risks fall under the area of responsibility of the

Managing Board. The Managing Board bears total responsibility for the overall risk management process at the highest level.

paragon has implemented an internal sensitivity analysis system based on a variety of methods of risk analysis and risk management. Sensitivity analysis enables the Company to identify risk positions in the business units. Sensitivity analyses quantify the risks that can arise within given assumptions when certain parameters are changed in a defined range. The following assumptions are made:

- appreciation of the euro against all foreign currencies by 10 percentage points
- a parallel shift of interest rate curves by 100 basis points (one percentage point)

The potential effects of the sensitivity analysis are estimates and are based on the assumption that the supposed negative market changes will occur. The actual effects may deviate significantly if market developments are different than assumed.

### Foreign currency risks

Because of its international orientation, paragon is exposed to foreign currency risks in connection with its ongoing business activities. The Company employs derivative financial instruments to limit these risks. Exchange rate fluctuations can lead to undesirable earnings and liquidity fluctuations. paragon is exposed to exchange rate risks when transacting business with foreign contracting parties resulting in future cash flows that are not in the local currency (transaction risk). The Company limits the risk primarily by settling purchases and sales of merchandise and services in the particular local currency.

paragon determines the sensitivity of foreign currency fluctuations by aggregating the net currency position of the operating business not reflected in the Company's functional currency. Sensitivity is calculated by simulating a 10 percent depreciation of the euro in relation to all foreign currencies. The simulated appreciation of the euro would have resulted in a reduction of future payment inflows in the amount of EUR 10 thousand as of December 31, 2010 (prior year: EUR 220 thousand). To the extent future purchases are not hedged against currency risks, a depreciation of the euro against other currencies would have adverse impacts on the financial position and results of operations because of foreign currency outflows that exceed foreign currency inflows to the Company.

The following table shows the net foreign currency risk of the individual primary currencies as of December 31, 2010:

in EUR thousands	31.12.2010		31.05.2010	
	USD	Other	USD	Other
<b>Transaction-related currency risk</b>				
Currency risk from balance sheet items	100	0	2,204	0
Currency risk from pending transactions	0	0	0	0
	<b>100</b>	<b>0</b>	<b>2,204</b>	<b>0</b>
Items economically hedged through derivatives	0	0	0	0
<b>Net exposure to currency risk</b>	<b>100</b>	<b>0</b>	<b>2,204</b>	<b>0</b>
Change of currency exposure resulting from a 10% appreciation of the euro	10	0	220	0

#### Interest rate risks

Interest rate risk applies to any change in interest rates as they affect the earnings, equity or cash flow of current or future periods. Generally an interest rate risk exists in connection with financial liabilities.

Most of the interest-bearing financial liabilities have a fixed interest rate. Changes in the interest rate would have an effect in this case only if these financial instruments were recorded at fair value. Since this is not the case, the financial instruments with a fixed interest rate are not subject to the risk of interest rate changes as spelled out in IFRS 7.

In the case of financial liabilities with variable interest rates the interest rate risk is essentially measured by cash-flow sensitivity. As no financial liabilities at variable interest were present as of the end of the reporting period on December 31, 2010, a change of the interest rate level in following fiscal years will not result in a cash flow risk.

#### Liquidity risks

Liquidity risk, i.e. the risk that paragon might not be able to meet its financial obligations, is limited by means of flexible cash management. As of December 31, 2010, cash and cash equivalents in the amount of EUR 13,790 thousand (prior year: EUR 8,658 thousand) were available to paragon. Free credit lines were not available as of December 31, 2010. In addition to the aforementioned instruments to assure liquidity, paragon continuously follows the developments in the financial markets in order to be able to take advantage of emerging financing options that might prove beneficial.

The following table shows the payments made for principal payments, repayments and interest from capitalized financial liabilities as of December 31, 2010:

in EUR thousands	2011	2012 - 2015	2016 and thereafter
<b>Non-derivative financial liabilities</b>			
Liabilities to banks	6,933	9,413	12,908
Liabilities from finance leases	486	477	0
Trade payables	4,909	0	0
Other financial liabilities	4,071	0	0
<b>Total non-derivative financial liabilities</b>	<b>16,399</b>	<b>9,890</b>	<b>12,908</b>
<b>Derivative financial liabilities</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total</b>	<b>16,399</b>	<b>9,890</b>	<b>12,908</b>

Net liquidity and net borrowing is derived from the sum of cash and cash equivalents less liabilities to banks and liabilities under finance leases, as shown in the balance sheet:

in EUR thousands	31.12.2010	31.05.2010
Cash and cash equivalents	13,790	8,658
<b>Total liquidity</b>	<b>13,790</b>	<b>8,658</b>
Current financial liabilities and current portion of non-current financial liabilities	6,331	454
Non-current financial liabilities	15,171	8,424
<b>Total financial liabilities</b>	<b>21,502</b>	<b>8,878</b>
<b>Net debt</b>	<b>7,712</b>	<b>220</b>

Credit risk

A credit risk is defined as a financial loss that arises when a contracting partner fails to meet its payment obligations. The maximum risk of default is therefore equal to the positive fair value of the interest rate instruments in question. Effective monitoring and control of credit risk is a core task of the risk management system. paragon reviews the creditworthiness of all customers with borrowing requirements that exceed specifically defined limits. The Company continuously monitors credit risk.

**(20) Capital management**

The paramount goal of capital management is to maintain a reasonable equity-to-assets ratio. The capital structure is managed and adapted to suit changing economic conditions. In the fiscal year up to December 31, 2010, no fundamental changes in capital management goals, methods or processes were introduced.

Capital management relates only to paragon AG's reported equity. For movements in equity, please refer to the statement of changes in shareholders' equity.

paragon was not required to adhere to financial indicators during the reporting period up to December 31, 2010, primarily in association with financing provided by lending banks.

**(21) Contingent liabilities and other financial liabilities**

As of December 31, 2010, no guarantees or other commitments or off-balance sheet contingent assets or liabilities exist for the Company. Other financial liabilities are reflected below:

in EUR thousands	Remaining term to maturity < 1 year	Remaining term to maturity between 1 and 5 years	Remaining term to maturity more than 5 years	31.12.2010	31.05.2010
Capital commitments	13,759	6	0	13,765	12,483
Lease obligations	444	1,610	1,671	3,725	321
Other liabilities	355	543	0	898	964
<b>Other financial liabilities</b>	<b>14,558</b>	<b>2,159</b>	<b>1,671</b>	<b>18,388</b>	<b>13,768</b>

**(22) Notes on the cash flow statement**

In accordance with IAS 7 ('Cash Flow Statements') the cash flows occurring during a fiscal year are recorded in the cash flow statement, in order to present information concerning movements in the Company's cash and cash equivalents. The cash flow statement was prepared according to the indirect method as defined in IAS 7.18b. Cash flows are differentiated according to cash flows from operating activities and from investment and financing activities.

The cash and cash equivalents shown in the cash flow statement comprise all cash and cash equivalents that are available at short notice.

in EUR thousands	31.12.2010	31.05.2010
Bank deposits	13,778	8,650
Cash on hand	12	8
Cash and cash equivalents	13,790	8,658
Time deposits pledged as collateral	0	- 1,092
Financing funds (cash)	13,790	7,566

Among other things, cash and cash equivalents include the escrow account in the amount of EUR 3,845 thousand (prior year: EUR 7,540 thousand) and the escrow account "quota distribution" in the amount of EUR 3,961 thousand (EUR 0 thousand). Both accounts are under the sole power of disposal of the former insolvency administrator.

**(23) Segment reporting**

Due to a change in reporting with effect from January 1, 2010, segment reporting was converted to adhere to location- and product-specific segmentation. For performance measurement and management purposes and in accordance with IFRS 8 'Operating Segments', paragon AG's business activities are now divided according to products and services into the five operational segments Air Quality, Power Train, Acoustics, Media Interfaces and Cockpit. The three former segments are assigned to the Delbrück site, and the two latter segments to the site in Nuremberg. Both short-term reporting and resource deployment management take place for these segments, as well as planning and budgeting. The members of paragon AG's Managing Board are the leading decision-takers and monitor

the activities of the operational segments based on key figures that are based on the same data used to prepare the IFRS financial statements.

The sales revenues of the business segments are monitored separately by the Managing Board in order to take decisions concerning the distribution of resources and to calculate the profitability of the subdivisions. The economic development of the segments is therefore measured based on sales revenues and in accordance with sales revenues on the level of paragon AG. All expenses, the financing of the paragon AG, and the profit tax burden are centrally managed for the entire company and not shown in the individual segments. The Delbrück site functions as the central part of the business and assumes the company-wide duties of Finance, Controlling, Purchasing, Corporate Communication and Personnel Management. No charges took place between the segments during the period under review. A product-specific regrouping of the gearboxes and transmissions division from Delbrück to Nuremberg was made in the current fiscal year. For that reason, the figures in the segment report of the prior year were changed.

Sales revenue in EUR thousands	01.06. - 31.12.2010	01.01. - 31.05.2010
<b>Delbrück</b>		
Air Quality, Power Train, Acoustics	15,789	12,201
<b>Nuremberg</b>		
Media Interfaces, Cockpit	16,997	12,912
<b>St. Georgen</b>	2,464	0
<b>Total</b>	<b>35,250</b>	<b>25,113</b>
<b>Reconciliation to comprehensive income</b>		
Income	4,691	102,287
Expense	- 35,374	- 27,116
Financial result	- 717	- 60
Income tax	- 681	30
<b>Net profit/loss for the year</b>	<b>3,169</b>	<b>100,254</b>

**Information about geographical regions**

The following table contains information concerning sales revenues with external clients and the non-current assets of the geographical regions of the Company. The assignment of revenues from external clients to the individual geographical regions is based on the location of the registered head office of the respective external client.

in EUR thousands	Germany 01.06. - 31.12.2010	Germany 01.01. - 31.05.2010	EU 01.06. - 31.12.2010	EU 01.01. - 31.05.2010	Other countries 01.01. - 31.12.2010	Other countries 01.01. - 31.05.2010	Total 01.01. - 31.12.2010	Total 01.01. - 31.05.2010
Sales revenue	26,185	19,979	1,385	4,544	7,680	590	35,250	25,113
Non-current assets (Property, plant and equipment and intangible assets)	17,330	17,968	0	0	0	0	17,330	17,968

At EUR 8,372 thousand (prior year: EUR 6,640 thousand), 23.8% (prior year: 26%) of sales revenues relate to one client; an additional 20.8% (prior year: 21%) of sales revenues relate to a second client at EUR 7,348 thousand (prior year: EUR 5,312 thousand); and a further 11.3% (prior year: 12%) of sales revenues relate to a third client at EUR 3,985 thousand (prior year: EUR 2,944 thousand).

The product portfolio results from the operational segments. The products mentioned differ in terms of their value creation component and with regard to their field of application.

**(24) Related party disclosures**

Related parties include members of the Managing Board and the Supervisory Board and their immediate families as stipulated in IAS 24 ("Related Parties").

Total remuneration of the Managing Board includes salaries and one-off payments in the amount of EUR 488 thousand (prior year: EUR 103 thousand). Expenses in connection with share-based payments were not incurred during the period under review (prior year: EUR 0 thousand). With regard to expenses for payments occurring after the termination of employment relationships, we refer to the information in the section 'Provisions for pensions.'

Disclosure of itemized remuneration for members of the Managing Board and principles of the remuneration system was waived in accordance with the Annual General Meeting resolution of May 17, 2006, concerning omission of the disclosures under section 285 (1) (9a) (5-9) and sections 315a, 314 (1) (6a) (5-9) of the German Commercial Code.

Members of the Supervisory Board received fixed remuneration in the calendar year just ended. Total remuneration of the Supervisory Board in the period under review amounted to EUR 29 thousand (prior year: EUR 17 thousand), all of which falls under fixed remuneration.

Expenses in connection with share-based payments were not incurred during the period under review (prior year: EUR 0 thousand).

As of the balance sheet date, the Managing Board held 2,111,730 shares out of a total of 4,114,788, of which 2,111,730 are allotted to Mr. Klaus Dieter Frers. The Supervisory Board holds no shares.

Rental payments for buildings and for other plant and office furniture and equipment of EUR 80 thousand (prior year: EUR 26 thousand) were paid to Frers Grundstückverwaltungs GmbH & Co. KG, Delbrück, of which EUR 36 thousand (prior year: EUR 26 thousand) relates to a company building 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 EUR 153 thousand (prior year: EUR 497 thousand). The Company has redeemed one directly enforceable fixed guarantee without consideration.

Moreover, on the balance sheet date, an agreement existed 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 the recipient of grants. This liability would arise if the State of Thuringia requested the Company to reimburse an investment subsidy in the amount of EUR 1,048 thousand (prior year: EUR 4,898 thousand), of which EUR 1,048 thousand (prior year: EUR 4,898 thousand) had been paid out as of the balance sheet date.

**(25) Statutory Boards of the Company**

During the period from June 1 to December 31, 2010, the Managing Board of paragon AG comprised the Chairman of the Managing Board, Mr. Klaus D. Frers.

The Company's Supervisory Board consists of the following individuals:

Name	Profession	Memberships in Supervisory Boards and other committees
<b>Prof. Dr.-Ing. Walter Kunerth</b> Chairman (until September 30, 2010)	Management consultant, Zeitlarn	Supervisory Board Memberships: <ul style="list-style-type: none"> <li>• Götz Management Holding AG, Regensburg (Chairman)</li> <li>• GILDEMEISTER AG, Bielefeld</li> <li>• Autoliv Inc., Stockholm (member of the Board of Directors)</li> </ul>
<b>Dr. Klaus G. Weyer</b> (until September 30, 2010)	Physicist, Dortmund	Supervisory Board membership: <ul style="list-style-type: none"> <li>• ELMOS Semiconductor AG, Dortmund</li> </ul>
<b>Dr. Peter Penczynski</b> (until September 30, 2010)	Physicist, Langquaid	



Name	Profession	Memberships in Supervisory Boards and other committees
<b>Hans, J. Zimmermann</b> Chairman (from September 30, 2010)	Managing Director of HSBC Trinkaus Private Wealth GmbH and HSBC Trinkaus Consult GmbH	Supervisory Board Memberships: <ul style="list-style-type: none"> <li>• Schaltbau AG, Munich (Chairman)</li> <li>• SIAG Schaaf Industrie AG, Dernbach (Deputy Chairman)</li> <li>• Merkur Bank KGaA, Munich (Deputy Chairman)</li> <li>• GARANT Schuh + Mode AG, Düsseldorf (Chairman)</li> </ul> Other board memberships <ul style="list-style-type: none"> <li>• ante-holz GmbH, Bromskirchen-Somplar (Chairman of the Advisory Board)</li> <li>• Rheinzink GmbH &amp; Co. KG, Datteln (Member of the Board of Directors)</li> <li>• Commerzbank AG, Frankfurt (Member of the Advisory Board, until year-end 2010)</li> </ul>
<b>Hermann Börnemeier</b> (from September 30, 2010)	Specialist in Tax Law and Tax Adviser, Managing Director of Treu-Union Treuhandgesellschaft mbH	
<b>Walter Schäfers</b> (from September 30, 2010)	Attorney, Partner in Societät Schäfers Rechtsanwälte und Notare	

## (26) Share-based payments

paragon AG grants the members of its Managing Board stock options (acquired based on a contingent capital increase), which 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)

### • Stock option plan 1

paragon AG granted some of its employees and the members of its Managing Board stock options that entitle the holders 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. Additional conditional capital II, entailing a conditional capital increase of up to EUR 290 thousand by the issue of 289,900 common shares, was created to secure these option rights. 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, IFRS 2 regulations are to be applied to those issued under the fourth tranche, which were granted after November 7, 2002.

As a modification of the existing authorization, the Managing Board, with the consent of the Supervisory Board, or the Supervisory Board alone, was 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 6, 2004
Total term of the option plan	6 years
Blocking period	2 or 3 year
Share price when options were issued	EUR 15.75
Strike price of the option	EUR 15.09
Anticipated dividend yield	1.60 %
Risk-free rate	3.30 %
Historic average share volatility	35.0 %
Option value as of November 6, 2004	EUR 5.52

During the period up to December 31, 2010, no personnel expense was allocated to the capital reserve for the granting of stock options of the fourth tranche of stock option plan 1 (prior year: EUR 0 thousand).

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

Information	Stock option plan 1			
	1st tranche Jan. 2001	2nd tranche April 2002	3rd tranche April 2003	4th tranche Nov. 2004
Date of issue	Jan. 2001	April 2002	April 2003	Nov. 2004
Options granted	46,365	47,990	71,469	30,000
Exercise price in EUR	7.98	3.78	3.88	15.09
Waiting period lapses	Jan. 2003	Apr. 2004	Apr. 2005	Nov. 2006

**Total number**

Options outstanding as of the beginning of the year	0	0	0	30,000
Options granted	-	-	-	-
Options exercised	-	-	-	-
Options lapsed	-	-	-	30,000
Options outstanding	-	-	-	0
Exercisable options	-	-	-	0

**in Euro**

Price per option at December 31, 2010				lapsed
Price per option at Monday, May 31, 2010				0.0124

**(27) External audit fee**

The expense recorded during the period under review from June 1 to December 31, 2010 as fees for the external audit of paragon AG's single-entity financial statements prepared in accordance with the German Commercial Code and for the external audit of paragon AG's single-entity financial statements prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU, conducted by Rddl & Partner GmbH, Wirtschaftsprüfungsgesellschaft, Steuerberatungsgesellschaft amounts to EUR 95 thousand, EUR 25 thousand of which is for the financial statements as of May 31, 2010 (prior year: EUR 40 thousand).

**(28) Risk management**

The Company's risk management strategy is explained in the management report.

**(29) Declaration on the German Corporate Governance Code**

The statement of compliance with the German Corporate Governance Code stipulated in Section 161 of the AktG was last submitted on May 26, 2010; shareholders have permanent access to this statement on the Company's website ([www.paragon-online.de](http://www.paragon-online.de)).

**(30) Responsibility Statement**

To the best of our knowledge, and in accordance with the applicable reporting principles for interim financial reporting, the single-entity financial statements pursuant to Section 325 (2a) of the German Commercial Code for the short fiscal year from June 1 to December 31, 2010 give a true and fair view of the assets, liabilities, financial position and profit or loss of the group, and the interim management report of the group includes a fair review of the development and performance of the business and the position of the group, together with a description of the principal opportunities and risks associated with the expected development of the group for the remaining months of the financial year.

Delbrück, March 10, 2011

paragon AG  
The Managing Board

Klaus Dieter Frers  
paragon AG

We have audited the single-entity financial statements pursuant to section 325 (2a) of the German Commercial Code (HGB) as of December 31, 2010 – comprising the balance sheet, statement of comprehensive income, statement of changes in equity, cash flow statement and the notes – including the bookkeeping system and the management report prepared by paragon AG, Delbrück, for the short fiscal year from June 1 to December 31, 2010. The maintenance of the books and records and the preparation of the single-entity financial statements as of December 31, 2010 and the management report for the period from June 1 to December 31, 2010 in accordance with International Financial Reporting Standards (IFRS), as adopted by the EU, and the additional provisions under German commercial law pursuant to section 325 (2a) HGB are the responsibility of the company's management. Our responsibility is to express an opinion on the single-entity financial statements as of December 31, 2010, including the bookkeeping system, and the management report based on our audit.

We conducted our audit of the single-entity financial statements in accordance with section 317 HGB and the German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW – Institute of Public Auditors in Germany). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the financial position and financial performance in the single-entity financial statements as of December 31, 2010 in accordance with the applicable accounting principles and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the company and evaluations 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 books and records, the single-entity financial statements as of December 31, 2010 and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the single-entity financial statements as of December 31, 2010 and the 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 single-entity financial statements as of December 31, 2010 comply with the IFRSs, as adopted by the EU, and the additional provisions under German commercial law pursuant to section 325 (2a) HGB and provide a fair presentation of the financial position and financial performance of the Company in accordance with these requirements. The management report is consistent with the single-entity financial statements as of December 31, 2010 and as a whole provides a suitable view of the company's position and suitably presents the opportunities and risks of future development.

Nuremberg, March 14, 2011

Rödl & Partner GmbH  
Wirtschaftsprüfungsgesellschaft  
Steuerberatungsgesellschaft

Dr. Keller	Freytag
German public accountant	German public accountant



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