paragon®

Annual Report

2007

Key indicators for paragon Group	2007	2006	2005	2004	2003	2002	Change in % 2006 / 2007
Sales in millions of €	108.9	110.8	80.2	64.7	40.7	38.6	- 1.8
Gross profit in millions of €	59.8	58.7[8]	41.5	29.9	19.4	16.3	1.9
EBITDA[1] in millions of €	18.7	20.2	13.9	10.3	6.2	4.8	- 7.1
EBIT[2] in millions of €	6.8	8.4[6]	6.6	5.2	2.9	1.7	- 19.3
Net income in millions of €	2.5	2.2	2.2	2.9	1.4	1.5	11.7
Total assets in millions of €	136.1	137.8	113.0	64.5	34.4	32.2	- 1.2
Equity[3] in millions of €	43.6	40.8	42.6	22.8	12.1	11.2	6.8
Equity-to-assets ratio[3] in %	32.1	29.6	37.7	35.4	35.2	34.8	8.5
Liquidity in millions of €	6.4	8.8	4.8	5.4	2.5	3.8	- 26.4
Capital expenditure[4] in millions of €	14.4	33.2	29.6	23.1	7.0	4.8	- 56.8
R&D expense in millions of €	10.7	11.4	6.2	2.6	2.0	1.3	- 6.1
Number of employees at year-end[9]	594	564	527	388	238	216	5.3
EBITDA margin[5] in %	17.2	18.2[6]	17.3	16.0	15.2	12.3	—
EBIT margin[5] in %	6.2	7.6[6]	8.2	8.1	7.2	5.4	—
Return on sales in %	2.3	2.0	2.8	4.4	3.4	3.8	—
Return on equity in %	13.6	12.6	12.8	14.7	11.3	13.1	—
Market capitalization at year-end in millions of €	38.6	45.2	57.2	63.6	39.6	15.8	- 14.6
Earnings per share in €	0.60	0.54	0.31	0.71	0.34	0.37	11.1
Dividend (proposed) per share in €	0.10[7]	0.30	0.20	0.10	—	—	- 66.7

1 Earnings before interest, taxes and depreciation / amortization
2 Earnings before interest and taxes
3 incl. profit-sharing rights capital and dormant participation excl. minority interest
4 incl. goodwill
5 in proportion to sales
6 due to reclassification of other tax expense
7 Proposal to the Annual General Meeting
8 adjusted for temporary workers
9 excluding temporary workers

Contents

Sehr geehrte Aktionäre,

In fiscal 2007 we managed to successfully assert our position in a market environment that had grown increasingly challenging. In addition to the fact that our operational performance was once again favorable, we laid the foundation for further growth. We also made significant steps toward our strategic objective, and this is something I consider especially important. Among other things, we reinforced our management structure and positioned ourselves higher in the supply chain hierarchy with the Artega project.

Own products generate higher revenues

Thanks to our innovative developments, revenues from our own products increased by 2.6 % in fiscal 2007. Even though in contrast to 2006 we refrained almost entirely from selling goods for resale, total sales remained close to the prior-year level at € 108.9 million. As in previous years, the primary contributor to sales in 2007 was our Automotive division. We generate approximately 80 % of our revenues in this division, and it will continue to be our core business in the future.

The Managing Board of paragon AG (left to right): Volker Brinkmann, Klaus Dieter Frers (chairman) and Golo Alexander Wahl.

Our gross profit increased slightly from the prior year to € 59.8 million while our gross profit margin rose by as much as 2.0 percentage points to 55.0 %. Other operating expenses were above all affected by high expenditures for the biannual IAA, one of the most important presentation opportunities for paragon. Together with the slightly higher than average personnel expenses, these expenditures, which should be considered an investment, led to a reduction of earnings before interest and taxes (EBIT) to € 6.8 million.

Strategic focus on the automotive industry

The Automotive division already emerged as paragon’s most important and highest margin business division in years past. Our products have stood the test of time in this extremely innovative technology market and have allowed us to carve out a solid market share with considerable growth potential. What is important at this juncture is to take full advantage of the excellent opportunities this market has to offer and continuously expand our automotive activities as our core competence.

We have already successfully established ourselves as a manufacturer of components and modules for the automotive industry. Our current objective is to position paragon more solidly as a system supplier. According to recent studies, suppliers will be generating 75 % of the added value of a vehicle within two to three years. Qualified development and systems partners will play an especially prominent role in this rising trend toward outsourcing

Artega® GT raises our position as a supplier

The road from being a component manufacturer to a system supplier is typically very long. To speed up the process, we initiated the Artega® GT reference project, making paragon an exclusive supplier of interior systems. For the first time, all of the interior systems for a mass-produced vehicle will come from paragon as a single source.

Artega Automobil GmbH & Co. KG plans to roll out its new German sports car in mid-2008. Our highly advanced prototype has already generated an overwhelming response after being presented at the 2007 International Motor Show (IAA) and at a number of automotive manufacturers. Successor projects based on the Artega initiative are already in the works. Our customers know that what we have developed for small-scale manufacturers is the perfect preparation for large-scale production.

The Artega® GT and the high level of attention it is receiving prove that we are a capable systems manufacturer as we can now demonstrate the full extent of our ingenuity and capabilities on the basis of a reference project.

Enhancing our Managing Board

In anticipation of our future responsibilities and continued growth, we reinforced the management structure in 2007 by expanding the Managing Board. I am pleased to report that we were able to attract two industry experts to paragon as part of this process. Golo Alexander Wahl assumed the newly created position of Director of Marketing and Sales on October 1, 2007, and Volker Brinkmann took over as Chief Financial Officer in November. Volker Brinkmann has many years of experience in the fields of corporate finance and investor relations from his previous role on the Managing Board of Balda AG, another company that is listed on the stock exchange. Golo Alexander Wahl is a real sales pro and has worked in the automotive industry for nearly a decade. I am convinced that the new board members will help accelerate growth even further.

Emerging as a systems supplier

In 2008, we will continue to systematically advance our efforts to become a systems supplier. We will focus even more attention on consolidating our Automotive segments Climate Systems, Car Media Systems and Instrumentation and Control Systems to form a single unit. A year ago, we already demonstrated our production efficiency in this area with the advanced headunit integra. This system incorporates components from all three Automotive segments. This results in new and better products for the human-machine interface in automobiles. Our integrated solutions for cockpit systems offer vehicle passengers a level of operating comfort that they can experience directly and see with their own eyes.

During the current year we will also align our strategic decisions and actions to achieve an attractive return. This all depends on the expertise and commitment of our employees. They have played a major role in the favorable development of our Company over the years and we are greatly indebted to them.

Please continue to put your trust in us as we work together for a successful future.

Sincerely,

Twenty years ago, CEO Klaus Dieter Frers founded paragon as an electronics contract manufacturer. Management recognized the growth and margin potential in the automotive industry early on and increasingly oriented the Company in that direction. The automotive business has become the leading division in the Company, with sales totaling € 88.5 million and approximately an 80 % share in sales.

Today, paragon is an international direct supplier to the automotive industry with subsidiaries in Europe, USA and Asia. Our product innovations and forward-looking systems solutions are in demand around the world. We are recognized as a tier-one company, and we have been able to establish a presence in the automotive market. This has allowed us to clearly strengthen awareness of the paragon brand.

During the period under review, we took various actions to reinforce our strategic alignment. This will gradually position paragon as a system supplier in order to better profit from the increasing trend toward outsourcing. We are taking two steps to this end: first of all, we initiated the Artega® GT reference project. Secondly, we will increasingly market our three Automotive segments – Climate Systems, Car Media Systems and Instrumentation and Control Systems – as a single consolidated unit.

Climate Systems

paragon entered the automotive market in the mid-1990s with sensors that detect harmful substances. Today, paragon is the world's leading specialist in interior automotive air quality and is able to draw on a

strong technological competitive edge. We are always developing new solutions in close cooperation with automotive manufacturers to monitor and actively improve air quality in vehicles.

Our AQS® air quality sensor detects harmful gases such as diesel and gasoline exhaust and prevents harmful substances from penetrating the interior by actively controlling the ventilation system. As a result of continuous innovation, the AQS® can now detect manure and skunk odors using an optional odor sensor and automatically close the air vents. Since 2007, we now have our own, mass-produced sensor elements for the first time. This represents another leap forward in quality and independence.

At first, only full-sized luxury vehicles were equipped with the AQS®. It has now become a standard feature in many mid-size vehicles, a trend that will continue into the compact class. This will result in new revenue opportunities from the sale of paragon products in new vehicle segments as well as from penetrating new regional markets.

The AQS® is not our only growth engine in the Climate Systems segment. The AQC® air quality conditioner and the AQI® air quality improver represent products in our portfolio that could achieve similar success to the AQS®. Alongside the brisk sales we have already achieved in Europe, we have now sparked interest in these products in the USA and Asia as well, and this should soon lead to new orders.

Our AQC® air quality conditioner eliminates germs, bacteria and mold spores in air conditioning systems, especially on the evaporator. This prevents unpleasant odors and contributes to the well-being and health of a vehicle's passengers. The system will be used on a mass-production scale for the first time in 2008.

The next step for improving air quality in vehicles is our AQI® air quality improver. The AQI® uses small ions to bind micro-particles, gases and odors, thereby further reducing the level of germs inside a vehicle and purifying the air. As an added benefit, the negatively charged small ions boost vitality and increase the safety of the passengers.

Through many years of experience and continuous innovation, we now have an extensive portfolio of intelligent components, modules and systems for vehicle climate systems that enhance the health and safety of passengers.

Car Media Systems

In the Car Media Systems segment, paragon offers a wide range of solutions in the areas of hands-free communication, navigation, multimedia and telematics. When designing our products, we focus on the highest data and voice transmission quality, safe operation and the optimal integration of the widest variety of functions in mobile communications devices. Our portfolio is rounded off by our efforts to seamlessly integrate vehicle interior concepts with mobile devices such as phones and the Apple iPod®.

Communication in vehicles is becoming increasingly important. Mobile phones are evolving into "smart phones" – tiny all-in-one devices that users can now even use for GPS navigation. Our individual telephone adapters, or cradles, enable uncomplicated use. Cradles provide the power supply, transmit radiation out of the interior via the antenna coupling and make it possible to easily secure the phone within the driver's field of view or in the center console. Moreover, mobile phone functions can be transmitted via Bluetooth to the vehicle's larger instrumentation and control systems to make it even easier and safer to use. We are always developing new cradles as we focus on adapting to new mobile phone and vehicle models and strive for new innovations.

Together with the global market leader in vehicle mirrors, Magna Donnelly, we developed the MirrorPilot® Navigator, the world's first rearview mirror navigation system. Equipped with a speaker, this navigation mirror replaces the existing rearview mirror without further impairing the driver's field of view. A navigation system that can be integrated into the vehicle after it has left the factory is an innovative and safe solution as conventional retrofitted navigation systems with commercial suction cup mounts are highly prone to theft and not accident proof. This fact has already prompted discussions to prohibit this dangerous mounting method. We have taken safety another step further by designing the brightness of the display to automatically adjust to lighting conditions. The mirror itself is equipped with an automatic dimming feature.

The belt-mic® belt microphone is another technical highlight of our extensive product portfolio. We have been able to weave high-quality microphones into the seat belt for use with mobile phones. A first of its kind, the belt-mic® is optimally positioned near the driver's mouth and features previously unachievable voice quality compared with conventional microphones. We will already generate our first revenues in the current year and have been able to acquire an ideal reference customer for this product. In the years to come, we anticipate a considerable amount of follow-up orders from this and other manufacturers as the trend toward hands-free communication in vehicles becomes more dynamic.

Mobility is another megatrend. Portable DVD and MP3 players such as the Apple iPod are enjoying increasing popularity. In this context, we have developed the Media Device Interface (MDI) in cooperation with Audi. Among other things, MDI makes it possible to connect MP3 players to the vehicle's audio system while also clearly and conveniently showing playlists from the MP3 player on the vehicle display and allowing users to operate the MP3 player via a multimedia interface. Based on our order situation, we anticipate MDI sales volumes to triple in 2008.

Instrumentation and Control Systems

Our intelligent instrumentation and control systems offer convenient and easy-to-use devices for vehicles. We place high priority on the perfect interaction of state-of-the-art electronics with precision engineering, maximum functionality, a stylish look and feel and sophisticated design. We apply these principles in developing reliable base technologies for many safety and comfort systems in the automobile. Our engineers always have one thing in mind: optimizing how passengers use the products.

Our instrumentation systems are based on stepper motors that we manufacture exclusively in Germany. In addition to reflecting our commitment to corporate citizenship, these systems are a testament to our specialized expertise in producing precision products that fulfill the highest standards of accuracy and quality. Our expertise has allowed us to rise to the position of the world's third largest supplier of stepper motors for display systems. We increased our market share by more than 20 % in the past year alone.

Greater functionality and higher quality give our products a key competitive advantage. For example, our new dual stepper motor makes it possible to display the speed and RPMs via one shaft. Among other features, the pointer color can vary to signal certain conditions such as when RPM limits have been reached depending on the engine oil temperature. We intend to further expand our market share and strengthen our position as a leading supplier in this sector.

Our innovative leadership is demonstrated throughout our entire product portfolio. For example, we have a technological competitive edge in high-quality car clocks. We offer intelligent switches that detect who is operating them. In 2007, we filed a new patent for contactless precision route sensors that revolutionize the technology of conventional contact systems. These new sensors not only reduce mechanical components, but also avoid indirect and therefore error-prone measurements. Our contactless precision sensors are also virtually unaffected by outside interferences.

We made significant improvements to our shift-by-wire technology. Our new sensor is the first with three-dimensional detection capability and above all is freely programmable. This provides automobile manufacturers with a cost advantage because they need only to reprogram the sensors rather than purchase a new product (e.g. when models are updated).

Our goal is not only to recognize trends early, but to set them. Our high development standards and technological leadership in all three automotive segments put us in an excellent position to continue to gain market share, even for products that are mass produced by low-cost manufacturers.

Reference project Artega® GT

Regardless whether paragon products are visible or not, they play an important role in the well-being of vehicle passengers. Our systems can now be experienced in a whole new scope. We initiated a unique reference project for the Artega® GT, the new small series German sports car. The Artega® GT is equipped with many integrated paragon components and modules,

but most importantly it also includes complete paragon systems. For the first time, a single supplier – paragon – will supply all the cockpit systems in a mass-produced vehicle. This vehicle, which rolls off the assembly line in mid 2008, unites paragon's three automotive segments in a single product. Artega GmbH & Co. KG equipped the new sports car with all of the latest paragon innovations, including our successful AQS® air quality sensor and paragon's shift-by-wire technology, multifunctional steering wheel, reverse camera system, innovative navigation mirror, Integra head unit system solution with sensor switches and digital/analog instrument panel. The Artega® GT will generate a great deal of interest in paragon, and this will allow us to more rapidly move up in the supply chain and position ourselves as a system supplier. The first signs of success in this effort are already apparent.

Research and Development (R&D) at paragon is the central pillar in our successful corporate strategy. The expertise we have gained and our extensive know-how are reflected in our many innovations and our strong market position. We are the world's number one supplier of solutions for automotive air quality. We have been recognized as a tier-one supplier among automotive manufacturers, and we also have a significant competitive edge in Car Media Systems.

Research and Development will remain an important component of our strategic focus. Our sites in Delbrück and Cadolzburg have state-of-the-art research and lab facilities that provide optimal conditions to continuously develop new products and further expand our position as an innovation leader. All of our development teams have one central objective: How can we make driving cars safer and more pleasant? The AQI® system to actively improve air quality, the belt-mic® belt microphone to optimize voice quality in the vehicle and the MirrorPilot® rearview mirror navigation system to improve driving safety represent only a few examples of our development competence and ingenuity.

Protecting the environment and conserving resources are two objectives that our engineers pursue at all times during the development process. For example, we filed a new patent in 2007 for an application with high-precision sensors that enables the direct and precise detection of routing and positional changes. Our solutions are more precise, lighter and more economical than those of our competitors.

But this is only one of the many patents and patent applications that protect our innovations and ensure our continued competitive advantage. A total of 258 national and international patents are currently registered to paragon.

Both the number of employees working in R&D and the high level of investments in this area demonstrate its significance for the Company. During the period under review, 91 employees were engaged in R&D throughout the Group, representing 15.3 % of our entire workforce. In 2007, expenditures for research and development were nearly at the same level as in the prior year at € 10.7 million (2006: € 11.4 million). In proportion to Group sales, the R&D ratio was 9.8 %.

Innovation highlights in 2007

In line with our strategic focus, paragon concentrated its research & development activities on the Automotive division in the reporting year. The Company's strategy to become a solution-driven system supplier is reflected in many of our products.

Headunit integra

In 2007, we completed the development of the new headunit integra system. The new solution makes it possible to easily connect external devices in addition to controlling on-board functions such as the air conditioning or navigation systems. Moreover, mobile players such as the Apple iPod® can be connected to the vehicle entertainment system and operated via the headunit's multimedia interface. This product integrates components from all three segments of the Automotive division and effectively demonstrates how paragon can successfully combine various competences in a single system.

Digital/analog instrument

Our new instrument serves as an impressive example of perfectly combined analog and digital technology in instrumentation. This trendsetting information system consists of a high-resolution, 10.2-inch color display and a digitally controlled dual pointer analog instrument with a high-quality metal dial. The display of both speed and engine RPMs via only one shaft with concentrically arranged pointers represents a global innovation. As another highlight, the pointer color can be independently configured to signal certain conditions such as when RPM limits have been reached depending on the engine oil temperature.

On-board clocks

A new generation of high-quality on-board clocks will be ready for the market in 2008 and will be integrated into a variety of full-size and luxury vehicles. A few years ago, on-board clocks consisted of nothing more than a dial with pointers and a decorative ring. In contrast, high-quality on-board clocks from paragon are highly intelligent instruments. For example, when the vehicle enters a new time zone the clock automatically adjusts itself to time signals transmitted by GPS satellites.

MirrorPilot® Navigator

In 2008, we will continue to enhance our rearview mirror navigation system and equip it with additional functions. This system is the first of its kind worldwide. Already equipped with a speaker, our navigation mirror will enable hands-free communication via mobile phone in the future using an integrated state-of-the-art microphone and a Bluetooth® interface. Video applications are also in development.

AQI®

Our AQI® air quality improver has already been well received on the market. AQI® technology currently uses small ions to bind micro-particles, gases and odors, thereby further reducing the level of germs inside the vehicle. We are currently researching AQI®'s ability to provide filtration support.

Dear Shareholders,

In fiscal 2007, paragon AG succeeded in asserting its position and advancing its strategic development despite the increasingly difficult market environment.

In the reporting period, the Managing Board informed the Supervisory Board of the situation of the Company and the entire paragon Group on the basis of detailed written and oral reports. In addition to information on financial, investment, and human resources planning, the reports also covered important performance indicators such as sales, new orders, and net income for the period.

Resolutions were adopted for transactions requiring the approval of the Supervisory Board. The Supervisory Board performed its duties in compliance with legal and statutory provisions and the Corporate Governance Code. We continually supervised and advised the Managing Board. In this context, the Supervisory Board consistently fulfilled its reporting obligations without any restrictions. Cooperation between the Managing Board and Supervisory Board has been positive and trusting at all times.

Activities of the Supervisory Board

In the past fiscal year, the Supervisory Board convened four regular meetings. At each meeting, all members were present and the emphasis of discussions was on the economic performance of the Company, its overall situation, and significant strategic developments. In addition, the Supervisory Board regularly reviewed the monthly and quarterly figures. The Supervisory Board also conducted five telephone conferences, and two resolutions were adopted by written consent in lieu of a meeting. The chairmen of the Supervisory Board and Managing Board maintained close contact outside of meetings as well in order to discuss important business events and significant developments as they arose and consult each other with regard to decisions of fundamental importance. One of the key aspects of the Supervisory Board's activities was to confer with the Managing Board on the prospective strategic alignment. This included the deliberations regarding the sale of the Electronic Solutions division. Another central topic was the composition of the Managing Board. Following the resignation of Hans-Jürgen John, Volker Brinkmann was appointed as the new CFO. In addition, the Managing Board was expanded with new member Golo Alexander Wahl as Chief Marketing and Sales Officer. The Supervisory Board also addressed at length the irregularities related to a subsidiary's sales of merchandise (goods for resale) in 2006. The Managing Board had informed the Supervisory Board of the incident as soon as it had been discovered. The measures initiated to avoid financial damages were coordinated with the Supervisory Board. These measures included refraining from merchandise sales in 2007 and hence forfeiting a portion of projected sales. In December the Supervisory Board reviewed the plans and targets for fiscal 2008 together with the Managing Board.

Annual financial statements and consolidated financial statements 2007

The consolidated financial statements were prepared in accordance with International Financial Reporting Standards (IFRS). The auditor examined the annual financial statements, consolidated financial statements, management report, and consolidated management report in detail with reference to the accounts and the early risk recognition system and issued an unqualified audit opinion. In accordance with the resolution adopted by the shareholders at the Annual General Meeting on May 22, 2007, the Supervisory Board appointed Rödl & Partner GmbH Wirtschaftsprüfungsgesellschaft as auditor, and the auditor confirmed its independence in writing in advance pursuant to 7.2.1 of the German Corporate Governance Code. All of the financial statements and management reports of the auditor were presented to the members of the Supervisory Board in advance of the Supervisory Board meeting on March 31, 2008 and discussed in detail with the auditor at this meeting. Based on extensive information provided by the auditor, and in the auditor's presence, the Supervisory Board approved of the results of the audit after conducting its own review of the annual financial statements, consolidated financial statements, management reports, and audit reports, and adopted the annual financial statements and consolidated financial statements prepared by the Managing Board. Accordingly, the financial statements of paragon AG have been confirmed. The Supervisory Board concurs with the proposal of the Managing Board to distribute a dividend of € 0.10 per share for the year 2007.

Corporate governance

The Supervisory Board welcomes the recommendations and continuous refinement of the Corporate Governance Code by the Government Commission. Please refer to pages 18 to 20 of this annual report for the complete report and detailed information on corporate governance.

In analogous application of § 312 of the German Stock Corporate Act (AktG), the auditor issued an unqualified audit opinion for the voluntary report submitted by the Managing Board of paragon AG concerning the relationship between paragon AG and Mr. Klaus Dieter Frers and persons and companies close to him. According to this report, the payments made by the Company were not unduly high and any disadvantages were compensated. In addition, the auditor confirmed the accuracy of the information contained in the report and the assessment of the Managing Board. After the report of the Managing Board and the audit report of the auditor were duly submitted to the Supervisory Board, we examined the report of the Managing Board in depth and had no reservations concerning the final declaration of the Managing Board and the assessment of the auditor. In accordance with § 314 AktG, the auditor was also present at this meeting and explained the results of the audit in detail.

Despite the increasingly difficult market environment in 2007, paragon AG was able to successfully assert its position and made important progress in the pursuit of its strategic objectives. This would not have been possible without the dedicated commitment and outstanding contributions of all employees and the Managing Board. The Supervisory Board of paragon AG would like to express its thanks and wishes the best of success to all stakeholders for the challenges that lie ahead in 2008.

Delbrück, March 2008

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

General market environment

It was a very volatile year on the German stock market. The first half of the year was very successful as a result of the continued positive trend and prospects in the German economy. The DAX, Germany's index of 30 top stocks, set a new record. The second half of the year was marked by a significant correction, which began in connection with the crisis in the US subprime market as more and more borrowers with poor credit were no longer able to make their mortgage payments. However, the DAX managed to recover from this setback by the end of the year.

The SDAX, which tracks small and medium companies, mirrored the fluctuations of the DAX in the first half of the year, hitting its highest point of 6,683 points in July. It then fell to its lowest level of 4,939 points in November as a result of the subprime crisis. The SDAX was unable to fully recover, closing the year at 5,191 points and therefore a 7.8 % decline for the year. This was due to the fact that market uncertainty primarily affected small- and mid-cap stocks and investors shifted some accounts to larger securities.

Share performance

The performance of paragon shares did not correspond to the favorable business trend in the course of the fiscal year, but instead echoed the general market situation for small- and mid-caps. The share price was € 11.09 per share at the beginning of the year and reached its highest point of € 13.95 on July 17, 2007, only to fall again to € 9.39 by the end of the year as a result of the volatile market environment. This

represents an overall decline of 15.3 % for the year. The shareholder structure remained unchanged. Our free float is still high at 48 %.

Security ID number:	555 869
ISIN:	DE 000 555 869 6
Ticker symbol:	PGN
Level of transparency:	Prime Standard
Indices:	• Prime All Share • Technology All Share • GEX • CDAX
Stock capital:	€ 4,114,788
Amount of shares:	4,114,788
Designated sponsors:	• Close Brothers Seydler AG • Lang & Schwarz Wertpapierhandel AG • Landesbank Baden-Württemberg
Shareholder structure (current):	52 % Klaus Dieter Frers (Chairman of the Board) 48 % Free Float

Financial market communications

The Managing Board of paragon AG actively cultivates close relationships with the financial community. The goal of investor relations is to have an open and continuous exchange of information with investors, analysts and journalists as well as the general interested public. In addition to publishing comprehensive quarterly reports, paragon provides up-to-date corporate information and discusses Company affairs in great detail with stockholders at the Annual General Meeting. At the 2007 Annual General Meeting, CEO Klaus Dieter Frers summarized the past fiscal year to the shareholders and outlined the Company's future strategy. The shareholders expressed satisfaction with the Company's development to date and voted 99 % in favor of all points of the agenda. The highlight of the meeting included a presentation of the new Artega® GT project. Shareholders were quite impressed with the innovative interior systems in the Artega® GT.

In the reporting year, paragon also attended many investor and analyst conferences. After a presentation at the DVFA Small Cap Conference and the German Equity Forum, the year culminated with a visit by investors to the IAA.

Outlook for 2008

The Managing Board will continue to maintain close relations with the financial community in 2008. Given the planned investor relations activities and a somewhat friendlier equity market environment for small- and mid-caps, the Managing Board is convinced that the paragon's sustained growth potential and our long-term, positive track record will cause our stock to rebound again in the medium term.

2008 financial calendar	
04/01/08	Annual Press Conference (Delbrück, GER)
04/02/08	DVFA Analysts' Conference (Frankfurt, GER)
05/06/08	Publication of First Quarter Statements
05/14/08	Annual Meeting (City Hall, Delbrück, GER)
08/05/08	Publication of Second Quarter Statements
11/04/08	Publication of Third Quarter Statements

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 national investors, customers and employees as well as the general financial community. The Company conforms to the principles of the German Corporate Governance Code to the greatest extent possible. However, there are some exceptions due to the individual circumstances of the Company with respect to its size, structure and economic situation. The Managing Board and the Supervisory Board issued a joint Declaration of Compliance on December 6, 2007 and made it permanently available to stockholders on the Company's website under "Investor Relations." The Declaration of Compliance is also reproduced at the end of the Corporate Governance Report on page 20.

Shareholders and Annual General Meeting

In advance of the Annual General Meeting on May 22, 2007, shareholders were once again able to review and download all relevant documents, such as the meeting agenda, from the Company website (www.paragon-online.de). If countermotions had been received prior to the Annual General Meeting, the Company would have published them on the website as well. More than 200 shareholders, journalists and guests were in attendance, representing 56.99 % of the share capital. Each of the nine points on the agenda was approved with more than 99 % of the vote. Shareholders were quite impressed with the innovative interior systems in the Artega® GT that were presented as a special highlight of the meeting. Following the Annual General Meeting, all speeches made by the Managing Board as

well as the presentation given at the Annual General Meeting were made available to all shareholders and other interested parties on the Internet.

Cooperation between the Managing Board and Supervisory Board

The cooperation between the Managing Board and the Supervisory Board is distinguished by an open and honest relationship. The Managing Board reports to the Supervisory Board regularly and in a timely manner on all subjects related to planning, business development, risks, risk management and compliance. The Managing Board was present at all Supervisory Board meetings. The Supervisory Board may, however, meet without the Managing Board if necessary. For additional details regarding the relationship between the two boards, please refer to the Report of the Supervisory Board on pages 14 / 15.

Managing Board

The Managing Board of paragon AG consists of three members. The Managing Board's rules of procedure remained unchanged in 2007. The Managing Board voluntarily prepares an audited report on the relationship between paragon AG and Mr. Klaus Dieter Frers and closely connected persons and companies in accordance with Section 312 of the German Stock Corporation Act (AktG). The report received an unqualified audit opinion.

Compensation received by the Managing Board in accordance with the provisions of the German Corporate Governance Code includes components that are based on performance and components that are independent of performance. The Supervisory Board regularly reviews both the fixed and the variable components of remuneration to determine if they are in line with market standards.

Supervisory Board

The Supervisory Board of paragon AG still consists of three members. The Supervisory Board continuously monitors the Managing Board and provides consultation when necessary. Approval by the Supervisory Board is required for important decisions of the Managing Board that go beyond routine dialogue. Members of the Supervisory Board may not make decisions based on self-interest. The independent nature of the Supervisory Board is essential in its role as supervisor and consultant to the Managing Board. The Supervisory Board reports all conflicts of interest at the Annual General Meeting. There were no conflicts of interest in the period under review. No remuneration was paid for personal services. The Supervisory Board conducts a self-assessment once a year to review its efficiency.

Transparency

Open and timely communication with our shareholders, analysts, the financial press and the general interested public is a central component of our corporate culture. We routinely provide comprehensive annual and quarterly reports on our business development and the Company's position. Ad hoc reports and press releases are also used to provide timely communication. In the year under review, for example, we published six press releases and five ad-hoc reports. A financial calendar with all relevant events is published at the beginning of the year and is continuously updated. We make all information available for review and download on our website.

Directors' Holdings

As of December 31, 2007, members of the Managing Board held 51.32 % of the shares of paragon AG and members of the Supervisory Board held 0.15 %.

Accounting

The 2007 Annual General Meeting followed the recommendation of the Supervisory Board to appoint the auditing firm Rödl & Partner GmbH, Wirtschaftsprüfungsgesellschaft, based in Nuremberg, Germany, as our external auditor. The Supervisory Board subsequently awarded the auditing contract. paragon AG prepares its accounts according to International Financial Reporting Standards (IFRS). Publication occurs within the statutory periods. paragon AG aims to routinely report before the deadlines in order to provide information as early as possible.

2007 Declaration of the Managing Board and the Supervisory Board of paragon AG on the German Corporate Governance Code

In accordance with Section 161 of the German Stock Corporation Act (AktG), the Managing Board and Supervisory Board of paragon AG issue the following Declaration of Compliance with the recommendations of the Government Commission of the German Corporate Governance Code: The Managing Board and Supervisory Board of paragon AG welcome the recommendations and rules of the German Corporate Governance Code. They commit themselves to transparent, responsible corporate management and control 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 June 14, 2007 with the following exceptions:

- A deductible in accordance with No. 3.8 of the Code has not been included in the Directors & Officers insurance policy that the Company took out for the Managing and Supervisory Boards.
- The Supervisory Board has not set a cap for extraordinary unforeseen developments in accordance with No. 4.2.3 of the Code.
- According to the resolution of the Annual General Meeting in 2006, information on the remuneration of the members of the Managing Board is not shown individually in accordance with No. 4.2.4 of the Code.
- No remuneration report is prepared as a part of the Corporate Governance report in accordance with Nos. 4.2.5 and 7.1.3 of the Code.
- The Supervisory Board did not form any committees in accordance with Nos. 5.3.1 and 5.3.3 of the Code.
- An age limit has not been set for Supervisory Board and Managing Board members in accordance with Nos. 5.1.2 and 5.4.1 of the Code.
- Information regarding remuneration of members of the Supervisory Board is not itemized in the financial statements as required by No. 5.4.7 of the Code.
- paragon AG meets its obligation to publish the purchase and sale of Company shares and options by members of the Managing and Supervisory Boards. However, separate entries on such directors' dealings are not made in the Corporate Governance report in the consolidated financial statements as required by No. 6.6 of the Code.

Delbrück, December 6, 2007

paragon AG

The Managing Board The Supervisory Board

Declaration pursuant to § 297(2)(4) of the German Commercial Code (HGB)

To the best of our knowledge we affirm that in accordance with applicable accounting principles the consolidated financial statements give a true and fair view of the net assets, financial position, and results of operations of the Group, that the consolidated management report gives a true and fair view of the business trend including the net operating profit and position of the Group, and, finally, that the most important risks and opportunities relating to the anticipated performance of the Group have been described.

Delbrück, March 31, 2008

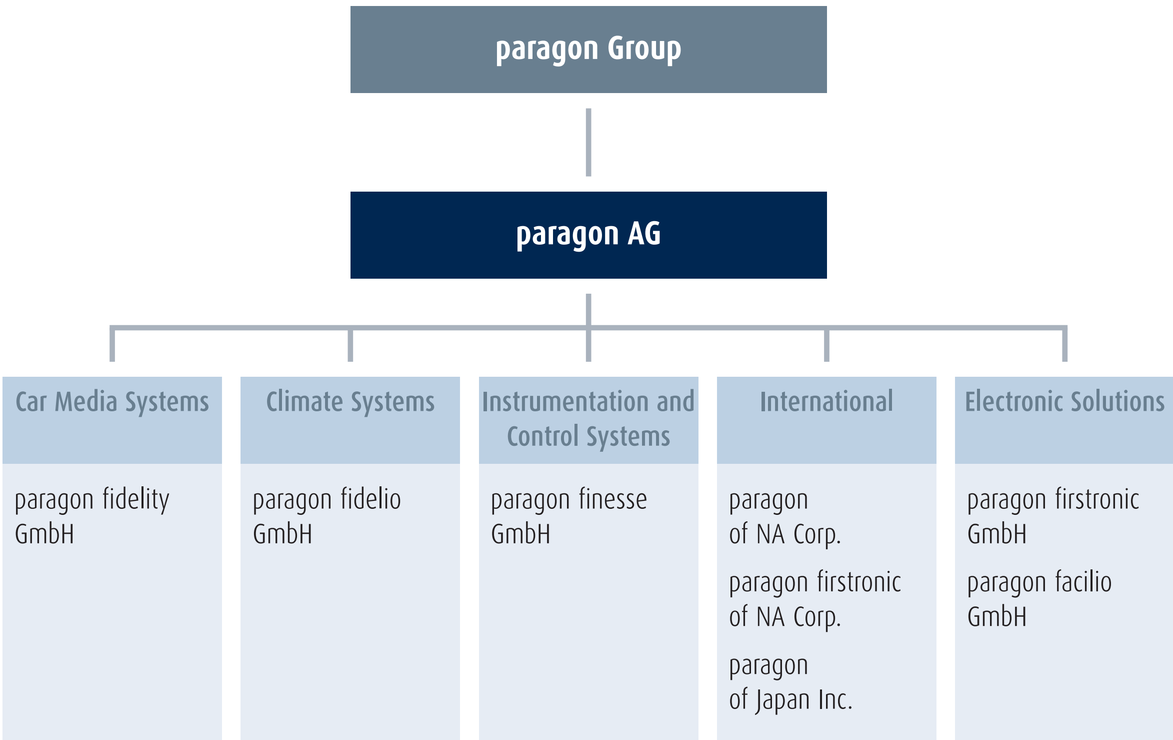
Frers Member of Managing Board	Brinkmann Member of Managing Board	Wahl Member of Managing Board

In fiscal year 2007, paragon successfully asserted itself in a more difficult market environment. The Group made significant progress toward achieving its strategic goal of positioning itself as an innovative system supplier for the automotive industry. The first successes of the Artega® project clearly resulted in a higher positioning in the market. The strengthening of the management structure in 2007 was another step toward preparing the Group for the future.

Group structure

Together with its subsidiaries, paragon AG is a group that operates internationally. In recent years, the Automotive business segment has developed into the Group's core business area with an approximately 80 % share in sales. In addition to the German sites of Delbrück, Suhl, Cadolzburg, St. Georgen and Heidenheim, the Group has a production facility and a sales company in the United States. Sales subsidiaries or sales companies in France and Japan and, since February 2008 also in Italy, round out the structure.

As the parent company, paragon AG is involved in operations and is responsible for the control of the subsidiaries or business segments through higher level divisions such as Corporate Strategy and Production and Sales Coordination. The subsidiaries have autonomy in expanding the existing market shares and developing further innovations. The Group benefits from synergy effects through interdepartmental project groups that supply new ideas, develop solutions and set trends.



Management systems

The paragon Group has a comprehensive planning and control system which reviews compliance with the annual planning targets through a timely and precise controlling system. The focus is on the traditional financial and profitability indicators such as cash flow, expense ratios, EBIT margin and contribution margin.

paragon's international business activities make it very important to identify risks early and counteract them, if necessary. The Company has long established a risk management system for this purpose. The risk reports prepared regularly by all divisions keep the Managing Board informed of the probability of occurrence as well as the possible extent of the damage of risks and offer proposals for appropriate countermeasures. Significant risks are also reported to management on an informal basis, so that the Managing Board can act speedily whenever necessary. When appropriate, possible risks can be effectively ameliorated and potential opportunities in particular can be identified early and taken advantage of.

The Company's risk reporting follows the monthly reporting on the business performance of paragon AG and its subsidiaries. In these sessions, the Managing Board and the Supervisory Board discuss actual vs. budgeted figures as well as possible variances and develop adequate solutions. In addition, top management of the paragon Group meets on a regular basis to discuss the course of business, the outlook for the Group, and other business events of particular note.

Economic conditions

Global economic development was again very positive in 2007. According to preliminary figures, the fourth consecutive year of the global economic upturn ended with an above-average gain of 5.1 % (2006: 5.4 %). Nonetheless, the Kiel Institute for the World Economy (IfW) saw an increasingly gloomy economic outlook as the year went on.

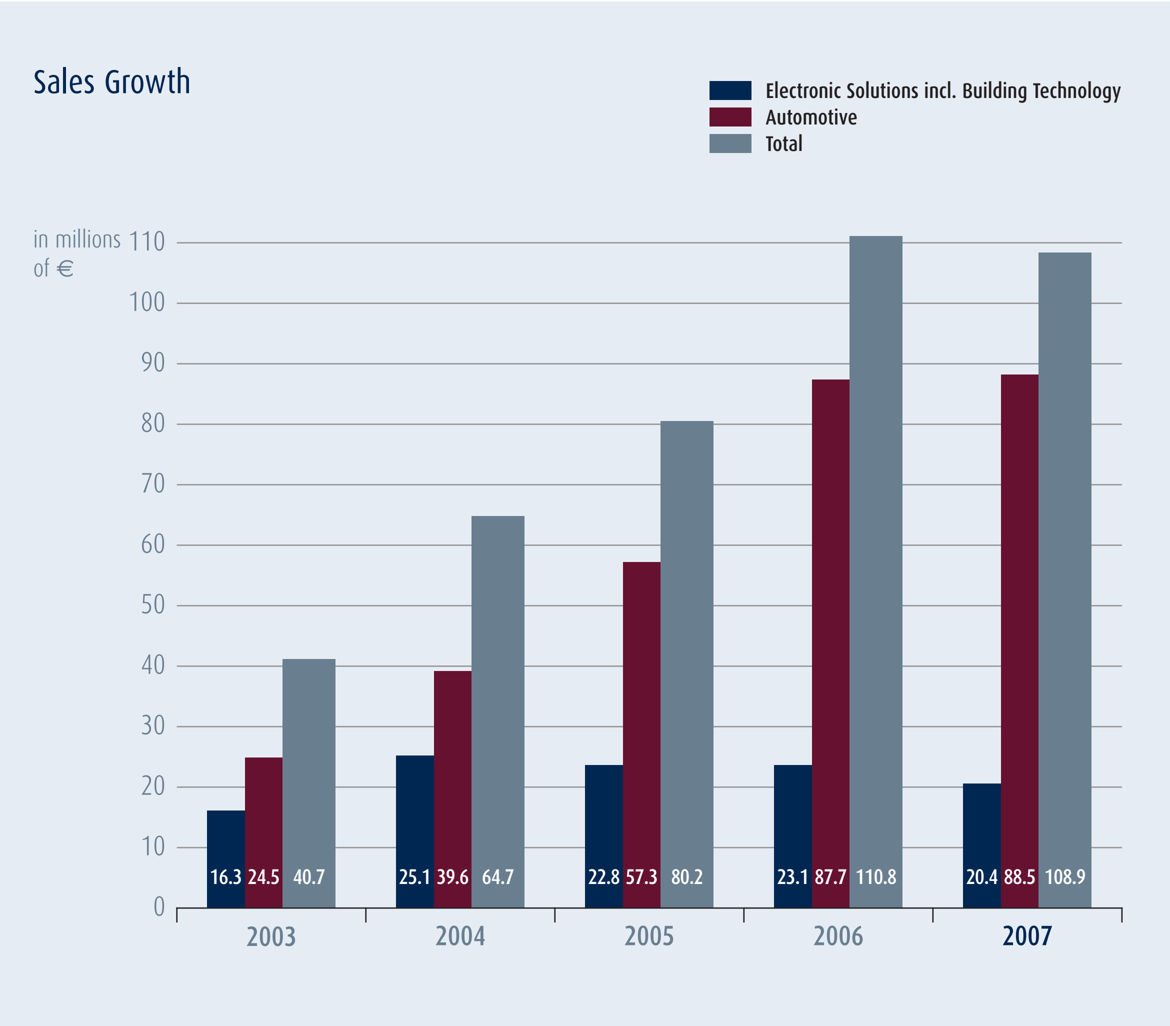
The eurozone's economic output also grew robustly at 2.6 % in the year under review, although the ifo Institute for Economic Research reported a slight softening of growth by 0.3 percentage points compared to 2006. The key stimulus for the positive development within the EU was the increase in private consumption. In particular, job creation and a constant decline in the unemployment rate made the sustained upturn possible.

The German economy continued to be robust in 2007, although the momentum for growth softened somewhat. While gross domestic product still grew by approximately 3.4 % in the first quarter, growth in the fourth quarter was down to approximately 1.6 %. According to information from the Federal Statistics Office, the price-adjusted gross domestic product rose overall by 2.5 %, thus falling short of the 2.9 % growth in 2006 by 0.4 percentage points. In particular, the increased export surplus (current account surplus) and the dynamic investing activity of companies in Germany led to the sustained economic upturn. On the other hand, private consumer spending declined in 2007 and in contrast to the eurozone, did not contribute to the economic growth. The primary causes for the consumer restraint were the significantly increased price level due to the increase in the value added tax and energy prices. The consumer price index rose in Germany by 2.3 %, the highest annual inflation rate since 1994.

Automotive industry

The slight growth in demand for passenger cars and commercial vehicles worldwide was primarily due to the very positive market trend in the emerging countries China, India, Russia and Brazil where growth rates were in the double digits. Both the Japanese market for passenger cars and the North American market for passenger cars and light commercial vehicles may have fallen short of the 2006 level. According to data from the German Association of the Automotive Industry (VDA), 16 million passenger cars were registered in Europe, roughly 1.0% more than in 2006. While sales of passenger cars in Western Europe were unchanged from 2006 at 14.8 million, the new EU countries saw growth of 15.0 % to 1.2 million passenger cars, although the starting basis was significantly lower. The demand for new cars was supported by vigorous consumption and investment activity combined with increased purchasing power.

In contrast, development in the German domestic market was restrained. While sales declined by 9 % from 2006 to 3.15 million passenger cars, the German manufacturers increased their market share slightly to approximately 70.0 %. Exports increased by 11.0 % to 4.3 million passenger cars in 2007.



Business development in the paragon Group

Sales

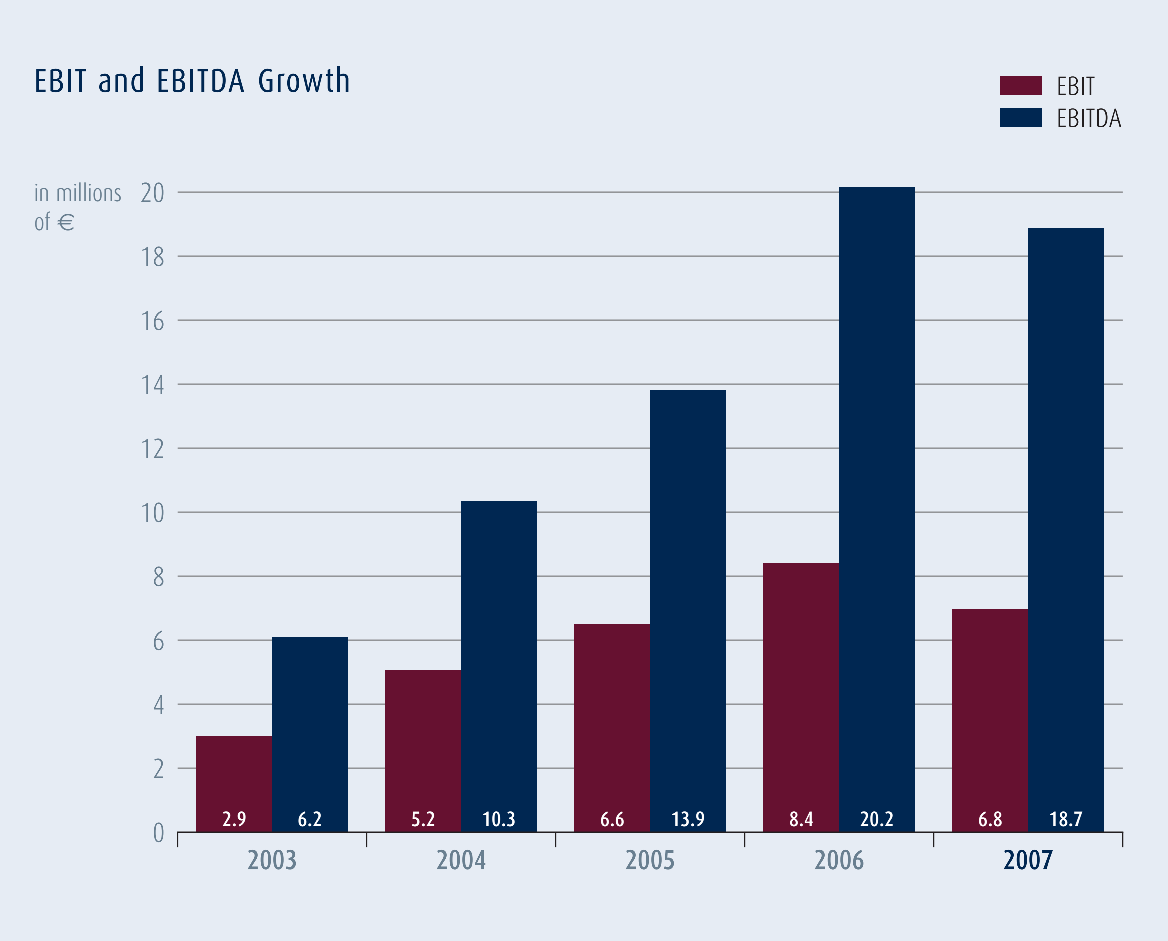
In a market environment characterized by increased pricing pressure on the part of OEMs and intensified competition, paragon further improved the sales of its own automotive products by 6.7 % compared to the record year 2006. Sales of the Company's own products overall grew by 2.6 % compared to 2006. Even taking into account the sales of trading goods in 2006, sales in 2007 were nearly unchanged due to the fact that the Group sold almost no trading goods at all in the year under review. Automotive's percentage of total sales continues to be approximately 80 %, again making it the most important business segment by far in 2007. Products from the Car Media division increased at a slightly higher rate than those from Climate Systems and Instrumentation and Control Systems. In contrast, sales in the Electronic Solutions segment decreased by 11.8 % to € 20.4 million (2006: € 23.1 million). While this division grew in Europe, sales in the U.S. declined significantly. Phase-outs of major projects, whose follow-up orders were not started immediately, and the elimination of minor projects from the sales portfolio contributed to the decline. The change in the dollar exchange rate further intensified this trend. Overall, paragon generated sales of € 108.9 million (2006: € 110.8 million). Of that amount, € 7.5 million was realized at the U.S. site (2006: € 11.2 million) and paragon increased its sales in Europe from € 99.7 million to € 101.4 million.

Income and expens

In 2007, paragon did not quite reach the level of record operating earnings achieved in the previous year. In contrast, net income clearly surpassed the 2006 figure due to tax effects.

As paragon did not continue to build up inventories, the income statement – in contrast to 2006 – did not report any income from changes of inventory. This factor, and the cancellation of the trading goods business led to a decline of total operating revenue to € 120.5 million (2006: € 124.7 million). Cost of materials declined by 8.0 % from € 66.0 million to € 60.6 million primarily due to the elimination of trading goods. In contrast to the 2006 Annual Report, the previous year's figure has been adjusted by the expenses for contract labor, which are now assigned to personnel costs (please refer to the explanatory notes on employees). At € 59.8 million, gross income was higher than in 2006 (€ 58.7 million). The gross margin at 55.0 % was also higher than the 2006 figure of 53.0 %. The new allocation of contract labor also increased paragon's personnel costs by 3.9 % to € 27.6 million (2006: € 26.6 million). This rate of increase, which was slightly higher than that of sales, raised the ratio of personnel expenses to sales to 25.4 % compared to 24.0 % in 2006. This led to a reduction in earnings before interest, taxes, depreciation and amortization (EBITDA) to € 18.7 million (2006: € 20.2 million).

At € 11.9 million, depreciation and amortization resulting primarily from the development work on new products but also from investments in property, plant and equipment was nearly unchanged from the 2006 level of € 11.7 million. The 12.5 % increase in other operating expenses reduced earnings before interest and taxes (EBIT) to € 6.8 million (2006: € 8.4 million). In addition to significantly higher energy costs and sharply increased legal and consultancy fees, the high expenses for the biannual International Automobile Exhibition (IAA) in Frankfurt reduced EBIT. The automobile exhibition is one of paragon's most significant possibilities for presentation. The exhibition costs thus have the nature of an investment and pay for themselves through higher follow-up orders in subsequent years.



For the purpose of reducing interest expenses in the future, paragon repurchased high-interest profit-sharing rights in fiscal 2007 and replaced them with instruments having a lower interest rate. Non-recurring expenses in the amount of approximately € 0.9 million were incurred in the year under review for this debt conversion. The net financial loss came to € 6.5 million (2006: net financial loss of € 4.7 million). This disproportionate burden caused earnings before taxes to decline to € 0.3 million. The conversion of the deferred taxes to the reduced tax rate of approximately 29 % and additional tax effects resulted in tax proceeds of € 2.2 million in the year under review. The Group's net income grew by 11.7 % to € 2.5 million (2006: € 2.2 million). Earnings per share (EPS) for fiscal 2007 increased by 11.4 % to € 0.60, with 4.115 million (as of December 31, 2007) shares outstanding (2006: € 0.54, with 4.113 million shares outstanding).

Taking account of the variance between the separate financial statements of the parent company and the consolidated financial statements as well as the influencing factors on earnings growth in the Group, the Managing and Supervisory Boards of paragon AG intend to recommend a dividend payment of € 0.10 per share (2006: € 0.30) to the Annual General Meeting.

Automotive segment

With its three divisions, Car Media Systems, Climate Systems and Instrumentation and Control Systems, the Automotive business segment has established itself as the paragon Group's most important segment. A large number of innovations have enabled paragon to achieve a top position in the automotive industry and achieve tier 1 status. In air quality sensors, the Company is clearly the market leader. However, not only in Climate Systems does paragon have a solid market position. Many technological developments and enhancements have enabled the Company to gain a solid market share with considerable growth potential in the Car Media and Instrumentation and Control Systems divisions as well. paragon benefits from the increasing shift of added value from the automobile manufacturers to the suppliers.

In addition to the intensive research and development activities in 2006, the Managing Board initiated the Artega® project in 2006, which since year-end 2006 is being continued by Artega® Automobil GmbH & Co. KG. This project will enable paragon to equip the Artega® GT, a new German sports car, which is to be delivered in low volumes starting in 2008, with a large number of paragon products and use it to enhance visibility for paragon without having to bear all of the business risk. For the first time, a vehicle interior will be entirely equipped by a supplier. In addition to the generally higher level of attention that paragon will attract, the Company will also be increasingly perceived as a system supplier. All of the products developed for the Artega® in 2007 can also be produced on a large scale for other manufacturers, so that the Managing Board expects a broader customer base as well as additional sales and higher margin potential. Roadshows with vehicle manufacturers have already produced initial orders.

In the year under review, paragon increased sales of its own products in the Automotive segment by 6.7 % to € 88.5 million (2006: € 83.0 million). Products from the Car Media division contributed to this growth at a slightly higher rate than the other divisions. At approximately 80 %, the division's percentage in Group sales remained at a very high level. The trading goods business was almost entirely canceled in 2007 after an internal audit revealed evidence of irregularities at a subsidiary in connection with a trading goods transaction in 2006. In order to protect the Company from financial harm, the Managing Board canceled planned sales in the amount of € 7.0 million to € 10.0 million for 2007.

The primary contributor to sales in the Car Media Systems division continued to be hands-free equipment in 2007. In addition, the Media Device Interface (MDI) has gone into series production. The MDI can be used to connect an MP3 player in the vehicle so it can be used like a CD changer with the vehicle-side control and display units. The acceptance of the product is outstanding, so that the numbers of units will more than triple starting in 2008 and the secured order volume will come to more than € 25 million in the next few years.

At Climate Systems, the trend is in the direction of increasingly complex and higher-quality sensors that offer a greater margin potential for paragon. Since 2007, the air quality sensor AQS® MK IV has been offered in a combined version that measures harmful substances, temperature and humidity.

In the Instrumentation and Control Systems division, paragon has reinforced its outstanding world market position through the new dual stepper motor that makes it possible to display two parameters of information via a single axis. It is already used, for example, in the instrument cluster for the Artega® GT; additional orders have already been received from OEMs for this modern solution.

Due to the effects explained in the disclosures on income and expense, EBIT in the Automotive business segment of € 6.2 million did not reach the record value of 2006 (€ 7.9 million).

Electronic Solutions segment

In the Electronic Solutions business segment, paragon develops and produces high-quality electronic components and systems for a variety of industries. The segment has a history of approximately 20 years, and during that time it has asserted itself as one of the leading electronic service providers in the German market with customized solutions. At its sites in Suhl, Germany and Grand Rapids, Michigan, USA, the business segment has employees with a high level of expertise and very modern production facilities. Both sites offer the entire value creation chain, from the initial idea to the completed system.

The customers include significant companies from the telecommunications, medicine and building and security technology industries. In the year under review, the generated sales of € 20.4 million (2006: € 23.1 million). Growth in Europe could not compensate for the decline in sales in the U.S., where in addition to the phase-out of major projects, for which follow-up orders were not started immediately, the elimination of minor projects from the sales portfolio also had an impact. The change in the dollar exchange rate further intensified this development. EBIT, at € 0.6 million, was kept at the level of the prior year (2006: € 0.6 million) in the Electronic Solutions business segment.

In an ad hoc announcement of May 21, 2007, paragon reported that all strategic options including a possible sale of the Electronic Solutions segment were under review. Since that time, the Managing Board has deliberated this issue intensively; however, no conclusive decision has been reached. The business development of Germany-based paragon firstronic GmbH specifically is seen as very pleasing. The Managing Board is continuing to observe the market and will make a decision at the appropriate time – with consideration of the planned reduction of liabilities.

Financial position and cash flow

At € 136.1 million, total assets as of December 31, 2007 were slightly below the prior year's level (December 31, 2006: € 137.8 million). In contrast, non-current assets rose significantly to € 95.3 million (2006: € 90.2 million). The share of non-current assets in total assets was 70.0 % (2006: 65.4 %). This increase is primarily due to the increase in deferred tax assets from € 0.4 million as of December 31, 2006 to € 3.9 million as of December 31, 2007. On the other hand, current assets declined from € 47.6 million to € 40.9 million as of the balance sheet date, with the greatest change in trade receivables. In connection with an asset backed securities (ABS) structure, the paragon Group in December 2007 significantly increased its sales of accounts receivable, thus flexibly adapting its financing structure to the needs of current financing. This reduced the trade receivables from € 19.9 million to € 6.3 million. In contrast, other assets rose significantly from € 1.6 million to € 9.6 million. In addition to value added tax assets, the compensatory damages claims from the above-mentioned suspected fraud case contributed to this increase. Furthermore, this item contains receivables from the cooperation agreement with Artega® Automobil GmbH & Co. KG. At € 6.4 million as of December 31, 2007 (2006: € 8.8 million), cash and cash equivalents remained at a high level.

Taking into account the profit sharing rights, shareholders' equity rose to € 43.6 million (2006: € 40.8 million) as of the balance sheet date. At 32.1 %, the equity-to-assets ratio was slightly higher than on December 31, 2006 (29.6 %). As explained above, high-interest profit sharing rights were converted to instruments having a lower interest rate in 2007; an additional repayment from this refinancing arrangement was made on January 15, 2008.

In accordance with the provisions of IFRS, certain items were transferred from other provisions to other current liabilities. This resulted in an adjustment of the 2006 figures in the amount of € 5.0 million. As a result of payments, other provisions, at € 1.0 million, were reduced to half their amount year-on-year. Other current liabilities declined by € 4.1 million to € 6.1 million as of the reporting date in response to payments. In contrast, current and non-current financial liabilities rose slightly to € 50.0 million (2006: € 47.1 million). There were no significant changes in other items.

The suspected fraud case also had an adverse impact on operating cash flow. In the first half, this situation led to a net outflow of € 2.2 million. After evaluating the current situation, the Managing Board is convinced that the relevant compensatory damages claim is recoverable and an inflow of funds can be expected from it in the future. Thus no great harm will accrue to paragon. Despite this burden, with a cash inflow of € 6.2 million (2006: € 4.2 million), paragon generated strong operating cash flow for the entire year 2007. The Company's capital expenditure was € 12.5 million after € 21.0 million in 2006. The financing activity brought the Group an inflow of cash and cash equivalents of € 4.3 million (2006: € 21.1 million).

Taking all aspects into account, the Managing Board feels that the paragon Group's financial position is very satisfactory. Furthermore, various measures were initiated in the year under review and will continue to be initiated in the current year that can be expected to lead to further improvements in 2008 and in particular in subsequent years.

Employees

Thanks to our profitable business model and the high motivation and innovative strength of our committed employees, paragon has been on the success track since its founding. In order to achieve the planned growth targets in the future as well, the primary goal of human resources is to retain, expand and support the existing knowledge and the experience of each employee for the Group.

As of December 31, 2007, a total of 594 employees were employed with paragon worldwide (2006: 564); of that number, 527 worked in Germany and 67 abroad. The new employees reinforce both production and research and development, which is a very important department for paragon. In addition, paragon employed a total of 60 temporary workers as of December 31, 2007 (December 31, 2006: 85). As of fiscal 2007, the expense incurred for these persons is no longer recognized in cost of materials but is instead reported in personnel costs. The previous year's figures were adjusted accordingly. Personnel expenses have risen correspondingly, from € 26.6 million to € 27.6 million. This figure is composed of salaries and wages in the amount of € 21.4 million, social security contributions of € 3.4 million and pension expenses of € 0.2 million. Additional expenses of € 2.6 million were incurred for the contract employees.

Employees by site (not including temporary workers)	
Delbrück	98
Suhl	287
Cadolzburg	69
St. Georgen	67
Heidenheim	3
USA	65
Paris, France	3
Osaka, Japan	2

Status: 12/31/2007

High innovative power and professional and technical expertise are among the most important success factors of the paragon products. For that reason, the Company invests in the continuing education of its employees and in succession planning. At year-end 2007, paragon had a total of 20 trainees in industrial and commercial occupations at the Delbrück and Suhl locations. In addition to the opportunity to prepare academic papers and theses, the Company also offered internships for secondary school students. Both offers were used intensively. paragon performs pioneering work through the project "School-Business" that provides secondary school students profound insights into the world of work through projects supported by the Company. For the first time, paragon has also offered an advancement award to the University of Paderborn, which was awarded in February 2008 for outstanding achievement in the field of automotive engineering.

Remuneration of the Managing Board

The composition of the Managing Board changed significantly in fiscal 2007. The former Chief Financial Officer, Hans-Jürgen John, resigned in August. His successor, Volker Brinkmann, took over the position on November 15, 2007. In addition, Golo Alexander Wahl joined the top layer of management on October 1, 2007 by taking over the Managing Board position of Marketing & Sales.

Due to these changes and severance packages or benefits in connection with severance packages, the total remuneration of the Managing Board is not directly comparable with the previous year and came to € 2.0 million in the year under review (2006: € 1.6 million). The fixed remuneration included therein came to € 0.7 million (2006: € 0.6 million). The performance-related bonus totaled € 0.6 million (2006: € 0.5 million) and depends on the financial developments in the past fiscal year, particularly EBIT. Furthermore, total remuneration of the Managing Board also included contributions to pension plans and non-cash benefits for vehicle use as well as direct insurance and similar items of € 0.7 million (2006: € 0.5 million). As in 2006, no stock option benefits were incurred.

Capital Expenditure

Capital expenditure declined by 10.5 % to € 14.4 million (2006: € 16.0 million) and was thus at the 2005 level. The largest single investment in the year under review was the acquisition of the Company headquarters at Schwalbenweg 29 in Delbrück on June 30, 2007 for a purchase price of € 2.0 million which was agreed on the basis of a certified appraisal. The acquisition will eliminate future rental costs for this building. In addition to the expenses for capitalized development costs, paragon made specific investments for replacement and expansion.

Research & Development

Innovative and high-quality products are one of the critical differentiating features for paragon. For that reason, research and development has a high priority for the Group. At € 10.7 million, expenditures in this area in fiscal 2007 nearly equaled the previous year's figure of € 11.4 million.

Purchasing

In order to achieve the production and earnings targets, purchasing in the paragon Group selects the most competent suppliers. In addition to optimal quality, the efficiency and reliability of the deliveries must always be assured. At the same time, the supplier should demonstrate high innovativeness. The price competition in the national and international purchasing markets for electronic and electromechanical components and plotters persisted in 2007, making it possible to purchase the needed materials at generally more economical conditions than in the previous year. However, the reduction of the use of material from € 66.0 million in 2006 to € 60.6 is primarily due to the cancellation of the trading goods business. The ratio of the cost of materials to sales declined to 55.7 % (2006: 59.5 %).

International

High innovative capacity and professional and technical expertise are important success factors of paragon products. This makes it impractical to outsource the complete production to low wage countries even in the future; however, paragon continuously increases its procurement quota with regard to components from low-wage countries. On the other hand, new markets are penetrated by agencies which have technical specialists in addition to sales employees. The specialists can adapt paragon products to vehicle-specific requirements with the help of direct dialogue with the customers' technicians. The resulting increase in customer loyalty ensures that paragon will have lasting business relationships and is a mainstay of our growth strategy.

In addition to the production in Germany, the Company is also active in production in the U.S. through the subsidiary paragon firstronic of NA Corp. In the period under review, paragon generated sales of € 7.5 million (2006: € 11.2 million) in the U.S. with 65 employees. The decline in sales resulted from the phase-outs of several major projects, whose follow-up orders were not started immediately. In addition, extremely minor projects were eliminated from the sales portfolio. The change of the dollar exchange rate further intensified this development which primarily affected the Electronic Solutions segment.

Furthermore, paragon AG has branches in the important markets of France and Japan. In France, paragon successfully continued the positive trend of 2006. Together with the location in the U.S., the branch in Japan rounds out the Group's global presence. This offers paragon two opportunities, one of which is the maintenance of regional contacts for obtaining products produced in the region. Secondly, the acceptance of the automobile manufacturers as global partners for globally awarded projects is increasingly rising. Through the sales office opened in Turin in February 2008, paragon has transferred the model which was successful in France to Italy. This step underscores the significance of our relations with the Italian vehicle manufacturers and strengthens the Group's export opportunities.

Events after the balance sheet date

On January 15, 2008, paragon repaid an additional € 3.0 million in connection with the refinancing of high-interest profit sharing rights. Special expenses incurred in this connection were taken into account in the budgeting.

In connection with the possible compensatory damage claims explained in the risk report shown below, the subsidiary MONAWI Handels-GmbH, which was established in 2007 for trading goods business, was reported for insolvency as a precaution in January 2008. This firm had only one business transaction to report in the form of a trading goods transaction, which ultimately did not come to fruition. Since no profit transfer agreement was concluded between MONAWI and paragon AG, there is no threat of an enforcement of liability for paragon AG from this insolvency.

In February 2008, paragon AG opened a sales office in Turin, Italy, which should more intensively take advantage of the growth opportunities in the Italian market and further increase exports.

We are not aware of any other events of special significance subsequent to year-end 2007.

Risk report

The significance of the long-established risk management system in the paragon Group has increased with the growing internationalization. The focus is on early risk identification and control as well as reasonable risk avoidance. Management is informed concerning the probability of occurrence and possible extent of damage of risks in risk reports prepared on a regular basis by all business segments. Furthermore, the risk reports contain recommendations for appropriate countermeasures. Significant risks are reported to management on an informal basis, so that the Managing Board can act speedily whenever necessary. When appropriate, possible risks can be effectively ameliorated and potential opportunities in particular can be identified early and taken advantage of.

However, paragon AG has learned that even the best risk management and internal control system cannot always prevent fraud if sufficient criminal activity is involved. An internal audit revealed that irregularities in the amount of € 4.7 million have arisen in connection with a trading goods transaction in 2006 in one subsidiary. paragon still has € 2.7 million outstanding in the form of receivables from this transaction. In the opinion of legal experts, paragon has been the victim of intentional fraud and paragon AG supports the criminal prosecuting authorities in their investigations without reservation. The suspected employee was dismissed without notice. Existing rules of internal control were not complied with. paragon has taken various measures to secure the receivables. For that reason, the Managing Board is confident that the company will not incur a greater loss since insurance policies concluded prior to the event may apply.

Due to these events, the Managing Board almost entirely canceled the trading goods business for 2007 and passed up the sales resulting from it. The orders already initiated for these trading goods transactions were reversed. From the present perspective, possible compensatory damage claims by the affected supplier may not affect paragon AG, because the subsidiary involved, MONAWI Handels-GmbH, as a new establishment, did not conclude a profit transfer agreement with paragon AG.

The additional critical risks for the paragon Group are explained below.

Market and industry

In the last few years, paragon has successfully positioned itself as a recognized and innovative automotive supplier. The economic development of the automotive industry therefore has a great impact on the Company's sales and earnings situation. However, even declining registrations can lead to higher incoming orders for paragon, since the automobile manufacturers compete more intensively for customers with greater numbers of features. The trend in the direction of increased use of electronics in the automobile will further increase our independence from the automotive economy.

The Company identifies sales risks and opportunities through comprehensive and timely sales monitoring. 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 an increasing degree of internationalization, the expansion of the product range and the customer base. The Company views Asia as a region with special opportunities to attract new customers and additional sales and earnings potential. The loss of a significant customer could nonetheless have a major impact, although, due to lengthy contract terms associated with vehicle series, this would be known at an early stage. paragon counters this risk by means of in-depth development work, new innovations and outstanding customer service. Already at the research and development stage of new products, paragon collaborates closely with its customers, further reinforcing the already very close and stable customer relations.

Purchasing and production

With the upturn of the global economy, many raw materials became more expensive in 2007. Additional price increases are possible in several areas in the current year. The global competition in the segments of relevance to paragon on the one hand as well as master contracts, annual agreements and long-term supplier relations enable paragon to guarantee a major portion of the purchasing costs. More than 80 % of all goods purchased come from Europe; the remaining goods come from the USA and Asia. Payment terms are those common to the industry. The major purchasing currency is the euro, with a small share also in US dollars.

Furthermore, paragon 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 to the same degree increased the information technology risks, such as 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 to protect data and IT infrastructure.

Liquidity and financing

The paragon Group operates internationally, for which reason currency risks cannot be entirely ruled out on the purchasing and sales side. Risks are hedged with appropriate financing instruments if necessary, based on exchange rate expectations that are reviewed on an ongoing basis.

paragon safeguards its solvency through comprehensive liquidity planning and control. This planning is prepared on a long, medium and short range basis. Furthermore, in connection with the aforementioned ABS transaction, the Company has consistent accounts receivable management to ensure a timely cash inflow. 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 long-term liabilities are secured by fixed-rate contracts.

For some of the financing arrangements of the paragon Group, hedging covenants were agreed. A breach of these ratios would grant the financial institution a right of termination. From the present perspective, the Managing Board sees no problems in this regard.

Overall risk

Based on the evaluation of the explained risks and the strategies developed by paragon to limit them, no risks are identifiable that could imperil the Company. Due to the positive operating development in the period under review and the stable net assets, financial position and results of operations, the overall risk situation is therefore not problematic. No risk can be identified at present or in the foreseeable future that might jeopardize the existence of the paragon Group. By focusing on the Automotive segment and the progress on the way to becoming a system provider, paragon has in addition to its innovative products a good starting position to profitably benefit from the available market potential.

Capital Structure, Managing Board and Change of Control

Pursuant to the provisions of sections 289 (4) German Commercial Code (HGB) and 315 (4) German Commercial Code, paragon AG provides the following explanations:

Capital

At the end of the past fiscal year, paragon AG's share capital comprised 4,114,788 shares with a par value of € 1. The company's subscribed capital was also € 4,114,788. As of January 1, 2007, these shares are entitled to dividend payments. The Managing Board is not aware of any transfer or voting rights limitations.

The Chairman of the Managing Board, Klaus Dieter Frers, has direct holdings in paragon AG in excess of 10 % at roughly 52 %. No shares with special rights granting authority to control exist.

Employees of the company or of the paragon Group do not hold an interest in the capital of the company in such a way that they do not directly exercise their control rights.

Managing Board

The Company's Managing Board consists of at least two members, who appoint the Supervisory Board, according to the statutes. In other respects, the provisions of sections 84, 85 of the German Stock Corporation Act apply. An authorization to repurchase treasury stock in amounts up to 10 % of equity and to increase capital up to 2 million shares (authorized capital) is in force. Furthermore, the capital is conditionally increased by up to 2,040,012 shares (conditional capital I, II and III). Portions of the aforementioned authorizations had not yet been recorded in the Commercial Register as of December 31, 2007.

Subject to the condition of a change of control resulting from a takeover bid, stipulations exist within the Company's Managing Board contracts that they contain indemnification under certain conditions.

Environmental protection and occupational safety

In recent years, the paragon Group has been successful in integrating environmental protection and occupational safety into the work processes not only as a social obligation but also as a basis for business success. This has resulted in in-depth actions and training sessions in occupational safety, which reduces the risk of accidents, worker stress and absence from work due to illness. Furthermore, paragon is active in environmental protection. All production processes are reviewed regularly and optimized and compliance with legal regulations is monitored. Production subsidiaries in Germany are certified in accordance with the environmental standard DIN EN ISO 140001:2005. In addition, resources such as energy and raw materials are protected through the use of advanced production technologies. In addition to aspects of environmental protection, quality and environmental management make an important contribution to paragon's economic success in view of the sharp increases in prices for all materials and energy.

Report on related parties

The report that the Managing Board of paragon AG prepared concerning the relationships of Mr. Klaus Dieter Frers, the majority shareholder, to affiliated companies in accordance with section 312 German Stock Corporation Act also includes Artega® Automobil GmbH & Co. KG for the first time for fiscal 2007. Since

August 2007, Mr. Klaus Dieter Frers has been the chairman of this company's advisory board. The report contains the following concluding statement:

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

Outlook

Development of the general economy and industries

The World Bank and economists of the United Nations expect the growth of the global economy to weaken by 3.4 % to 3.6 % in the current year. In particular, the reduced demand for imports in the U.S. as result of the credit crisis is responsible for a downturn of global trade. According to data from ifo, the economic climate in all countries of the eurozone has again significantly worsened in the first quarter of 2008 and has reached its lowest level since mid-2005. A less positive assessment is given for the current economic situation as well as for the coming months. In Germany, optimism has diminished; however, the current economic situation continues to be assessed as very positive. Experts from the Organization for Economic Cooperation and Development (OECD) expect the upturn in Germany to remain intact and predict growth of 1.8 %.

A stable trend is expected for the automotive industry in 2008. While a slight decline is expected in Western Europe and the U.S., the demand for passenger cars in Asia and Eastern Europe is likely to continue to rise. According to data from the German Association of the Automotive Industry (VDA), the industry started the year on a positive note in Germany. Passenger car registrations exceeded the previous year's level by approximately 11 %. Incoming orders from Germany also increased by 11 % in January. Supported by a relatively robust export business and a stabilizing domestic market, the German automobile manufacturers again in January slightly exceeded the already very high production volume of 2006 and thus achieved the best production results for any month of January on record.

Corporate development

In 2007, paragon successfully asserted itself in a more difficult market environment. The measures taken for the continued growth of sales and earnings and the strategic objectives will already show results in the current fiscal year. The positioning as an innovative system supplier will be supported on a sustained basis by the start of the Artega® project. The project will gain new orders for paragon from OEM customers and expand existing contracts because the products produced for the Artega® in low volumes can be scaled up with little development expense. The Artega® will enable us to convince our customers of our total production capacity and establish ourselves faster as a system partner. Concurrent with that, we will be able to specifically expand our product range in the HMI segment (human machine interface). The Artega® project serves equally as a "blueprint" for integration of all HMI aspects of the three business segments.

In fiscal 2008, paragon expects sales growth of between 5 and 10 %, an estimate that is supported by the current order situation. According to estimates, earnings will improve at a higher rate than sales on all earnings levels. Only the positive tax effect from 2007 will not be repeated.

One focus of the current fiscal year is the optimization of internal process and the leveraging of synergy potentials. The objective is to improve the bundling of the enormous possibilities in development offered by the employees' expertise and guide them more effectively and to optimize the integration of newly developed products into production. As a result, the customers will be better served and cost benefits will be achieved. The savings in interest costs produced by the debt conversions will increase earnings even further starting in 2009 when the lower interest rates become fully effective.

The bundling of development activities is accompanied by the systematic further development of paragon as a systems supplier in the car cockpit. The amalgamation of the system technology of the three divisions of Instrumentation and Control Systems, Climate Systems and Car Media Systems into Cockpit Systems will be advanced further. All activities relating to user interface and guidance will be merged into a powerful system competence. The Headunit developed by paragon, the new instrument and the MirrorPilot® are the first examples of this. The business with components for cockpit systems, for example climate sensors or stepper motors, is constantly being expanded. Through these measures, paragon takes into account the trend in the direction of innovative HMI systems and expects it to result in additional momentum for further growth.

Concurrently, sales activities are being redirected to an even higher customer orientation within the context of key account management. The German OEM customers will be regionally assigned to the Sales Center South in Cadolzburg and the Sales Center North in Delbrück in order to be able to serve them even better.

The opening of the sales office in Italy in February 2008 will provide further support for the international expansion. The successful model from France with a combination of sales and technical experts will also be applied there.

For that reason, the Managing Board expects that the positive development will continue in the years to come. Due to the order level and the estimation of new projects, we anticipate that the momentum for growth will increase and income will rise in the years to come. paragon is thus well equipped for the future.

Forward-looking statements contain risks

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

Delbrück, March 2008

Klaus Dieter Frers   Volker Brinkmann   Golo Alexander Wahl

Consolidated Financial Statements

Consolidated Balance Sheet as of December 31, 2007 (paragon AG, Delbrück)

in € (000)	Notes	12/31/2007	12/31/2006
Assets			
Non-current assets			
Intangible assets	(10)	31,530	30,527
Goodwill	(10)	27,430	27,664
Property, plant and equipment	(11)	32,130	31,406
Financial assets	(12)	266	200
Deferred tax assets	(13)	3,901	392
Total non-current assets		**95,257**	**90,189**
Current assets			
Inventories	(14)	17,709	17,340
Trade receivables	(15)	6,259	19,880
Income tax claims		867	0
Other assets	(15)	9,606	1,649
Cash and cash equivalents	(16)	6,443	8,758
Total current assets		**40,884**	**47,627**
Total assets		**136,141**	**137,816**

in € (000)	Notes	12/31/2007	12/31/2006
Liabilities and equity			
Equity	(17)		
Subscribed capital		4,115	4,113
Capital reserves		7,753	7,748
Distributable profit		2,464	2,206
Retained earnings		5,642	4,670
Reserve for currency translation differences		- 1,824	- 1,166
Equity (since December 31, 2006 before minority interests)		**18,150**	**17,571**
Non-current liabilities			
Long-term financial lease liabilities	(18)	225	595
Long-term loans	(18)	29,111	32,329
Profit sharing capital	(19)	25,494	23,277
Investment grants	(20)	9,147	10,012
Deferred tax liabilities	(13)	6,691	5,229
Provisions for pensions	(22)	959	1,049
Other non-current liabilities		1,898	3,795
Total non-current liabilities		**73,525**	**76,286**
Current liabilities			
Current portion of financial lease liabilities	(18)	521	919
Short-time loans and current portion of long-term loans	(18)	20,109	13,238
Trade liabilities	(18)	13,753	14,344
Other provisions	(21)	1,012	1,840
Income tax liabilities		2,929	3,413
Other current liabilities	(18)	6,142	10,205
Total current liabilities		**44,466**	**43,959**
Total equity and liabilities		**136,141**	**137,816**

Consolidated Income Statement for the year ended December 31, 2007 (paragon AG, Delbrück)

in € (000)	Notes	2007	2006
Revenue	(1)	**108,882**	**110,823**
Other operating income	(2)	5,034	5,617
Changes in inventory of finished goods and work in progress		- 158	2,622
Other own work capitalized	(3)	6,717	5,619
Total operating revenue		**120,475**	**124,681**
Cost of materials	(4)	- 60,648	- 65,950
Gross income		**59,827**	**58,731**
Personnel expense	(5)	- 27,608	- 26,573
Depreciation/amortization/impairment of property, plant and equipment and financial assets		- 11,931	- 11,742
Other operating expenses	(6)	- 13,490	- 11,990
Earnings before interest and taxes (EBIT)		**6,798**	**8,426**
Financial income		442	75
Financing expenses		- 6,929	- 4,761
Financial result	(7)	**- 6,487**	**- 4,686**
Income before taxes		**311**	**3,740**
Income taxes	(8)	2,153	- 1,534
Net income		**2,464**	**2,206**
Earnings per share (basic)	(9)	0.60	0.54
Earnings per share (diluted)		0.60	0.54
Average number of shares outstanding (basic)		4,113,862	4,103,186
Average number of shares outstanding (diluted)		4,128,383	4,120,502

Consolidated Cash Flow Statement (paragon AG, Delbrück)

in € (000)	Notes	2007		2006	
Cash flow from operating activities					
Income before taxes and deferred taxes		**311**		**3.740**	
Adjustment for:					
Impairment losses		11,931		11,742	
Financial result		6,487		4,686	
Losses from the disposal of non-current assets		304		210	
Change of the other provisions and provisions for pensions		- 918		1,898	
Income from reversal of special account for grants		- 2,108		- 2,183	
Other non-cash income and expense		0		136	
Change in trade receivables, other receivables and other assets		5,664		- 9,278	
Change in inventory level		- 369		- 3,359	
Change in trade payables and other liabilities		- 6,935		1,935	
Interest paid		- 6,929		- 4,761	
Income taxes		- 1,245		- 559	
Net cash from operating activities	(27)		**6,193**		**4,207**
Cash flow from investing activities					
Payments for investment		- 14,264		- 16,016	
Payments for investments in long-term financial assets (prior year: for the purchase of subsidiaries)		- 91		- 7,305	
Additions of cash and cash equivalents from the acquisition of subsidiaries		125		240	
Funds from investment grants		1,243		1,958	
Interest received		442		75	
Net cash from investing activities	(28)		**- 12,545**		**- 21,048**
Cash flow from financing activities					
Dividend distribution to shareholders		- 1,234		- 818	
Repayment of (financial) credits		- 3,103		- 11,894	
Proceeds from (financial) credits taken		6,589		32,909	
Proceeds from equity additions		7		111	
Net cash outflow from redemption of silent equity holding		0		- 4,925	
Net cash inflow from the issuance of profit-sharing capital		7,000		5,760	
Net cash inflow from redemption of profit-sharing capital		- 5,000		0	
Net cash from financing activities	(29)		**4,259**		**21,143**
Exchange rate changes			- 222		- 376
Change in cash and cash equivalents			**- 2,315**		**3,926**
Cash and cash equivalents at the beginning of the period			**8,758**		**4,832**
Cash and cash equivalents at the end of the period	(30)		**6,443**		**8,758**

Consolidated Segment Report (paragon AG, Delbrück)

According to business segments

in € (000)	Auto-motive 2007	Auto-motive 2006	Electronic Solutions 2007	Electronic Solutions 2006	**Total 2007**	Total 2006
Revenues from third parties	88,497	87,719	20,385	23,104	108,882	110,823
Earnings before interest and taxes (EBIT)	**6,245**	**7,868**	**553**	**558**	**6,798**	**8,426**
Segment assets	104,095	113,722	11,468	13,295	115,563	127,017
Segment liabilities	11,398	11,182	1,608	3,162	13,006	14,344
Capital expenditure	13,754	32,047	575	1,213	14,329	33,260
Depreciation, amortization and impairment losses	10,619	10,678	1,312	1,064	11,931	11,742

According to geographical segments

in € (000)	Europe 2007	Europe 2006	USA 2007	USA 2006	Japan 2007	Japan 2006	**Total 2007**	Total 2006
Revenues from third parties	101,368	99,660	7,490	11,163	24	0	108,882	110,823
Earnings before interest and taxes (EBIT)	**6,525**	**10,197**	**457**	**- 1,690**	**- 184**	**- 81**	**6,798**	**8,426**
Segment assets	109,632	123,235	5,926	3,854	5	- 72	115,563	127,017
Segment liabilities	12,396	12,231	603	2,108	7	5	13,006	14,344
Capital expenditure	14,098	32,039	224	1,221	7	0	14,329	33,260
Depreciation, amortization and impairment losses	11,883	11,464	44	277	4	1	11,931	11,742

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

in € (000)	Subscribed capital	Exchange rate difference	Capital reserves	Profit carried forward	Net income	Minority interests	Total
Balance Jan. 01, 2006	**4,086**	**- 790**	**7,565**	**4,224**	**1,264**	**3,695**	**20,044**
Net income					2,206		2,206
Profits carried forward				1,264	- 1,264		0
Dividend distribution				- 818			- 818
Capital increase (exercise of stock options)	27		84				111
Addition due to stock option valuation			99				99
Change due to acquisition of shares from other shareholders						- 3,695	- 3,695
Currency translation changes		- 376					- 376
Balance Dec. 31, 2006	**4,113**	**- 1,166**	**7,748**	**4,670**	**2,206**	**0**	**17,571**
Balance Jan. 01, 2007	**4,113**	**- 1,166**	**7,748**	**4,670**	**2,206**	**0**	**17,571**
Net income					2,464		2,464
Profits carried forward				2,206	- 2,206		0
Dividend distribution				- 1,234			- 1,234
Capital increase (exercise of stock options)	2		5				7
Currency translation changes		- 658					- 658
Balance Dec. 31, 2007	**4,115**	**- 1,824**	**7,753**	**5,642**	**2,464**	**0**	**18,150**

Notes to the Consolidated Financial Statements

Basis of presentation (IFRS)

paragon Aktiengesellschaft's (hereinafter: "paragon AG" or "paragon") consolidated financial statements as of December 31, 2007, were prepared using the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB), London, Great Britain, applicable on the balance sheet date. All mandatory International Financial Reporting Standards (IFRSs) and interpretations of the International Financial Reporting Interpretations Committee/Standing Interpretations Committee (IFRIC/SIC) applicable in the European Union for fiscal 2007 were adopted. The standards and interpretations of the IASB considered by paragon AG in preparing the consolidated financial statements had been fully adopted by the EU by the time of release for publication. Accordingly, no differences exist between the IFRS as adopted by the EU and the IFRS published by the IASB. Additional explanations as required by section 315a of the HGB (German Commercial Code) were added to the consolidated financial statements. The previous year's figures were determined following the same principles.

paragon AG's shares are traded on the Frankfurt Stock Exchange in the Prime Standard segment of the regulated market.

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

The consolidated financial statements and the Group Management Report prepared pursuant to section 315a of the HGB are submitted to and printed in the electronic version of the German Federal Gazette.

During 2007, the following revised and new standards and interpretations of the IASB/IFRIC became binding; except for IAS 1 "Presentation of Financial Statements" and IFRS 7 "Financial Instruments: Disclosures," they had no significant impact on paragon's consolidated financial statements:

- IAS 1 - Capital Management Disclosures
- IFRS 7 - Financial Instruments: Disclosures
- IFRIC 11 - IFRS 2 - Group and Treasury Share Transactions

In connection with the publication of IFRS 7 "Financial Instruments: Disclosures," an amendment of IAS 1 was announced in August 2005. Accordingly, information must be published in the financial statements enabling the reader to evaluate the goals, methods and processes of the management of capital. In the year under review, the appropriate disclosures were included in the Notes to the Consolidated Financial Statements.

The first-time application of IFRS 7 led to a fundamental restructuring of the disclosure obligations for financial instruments in the year under review. The new standard does not have a substantial influence on the classification and measurement of financial instruments in paragon's consolidated financial statements.

Application of IFRS 8 will convert segment reporting from the so-called 'risk and reward approach' under IAS 14 to the 'management approach' with respect to segment identification. The information regularly provided to the so-called 'chief operating decision maker' for decision-making is of key significance in this approach. At the same time, measurement of segments will change from the 'financial accounting approach' under IAS 14 to the 'management approach' under IFRS 8.

The use of IFRS 8 is mandatory for fiscal years starting on or after January 1, 2009. Earlier application is permitted. IFRS 8 will not result in a change in disclosures in segment reporting in its first-time application by paragon AG for fiscal 2009.

Moreover, additional standards and interpretations as well as changes to existing standards of the IASB whose endorsement by the EU is still pending have been published and have entered into force in the meantime.

The Managing Board of paragon AG forwarded the consolidated financial statements to the Supervisory Board on March 26, 2008. It is the responsibility of the Supervisory Board to review the consolidated financial statements and to decide if it will approve them.

Scope of consolidation of paragon AG

	Shareholding	Consolidation	Sales in local currency (pre-consolidation)	
Germany				
paragon AG, Delbrück		**parent company**	**€**	**73,502,928**
paragon fidelio GmbH, Suhl	100 %	full	€	1,464,435
paragon firstronic GmbH, Suhl	100 %	full	€	15,859,052
paragon facilio GmbH, Delbrück	100 %	full	€	0
paragon finesse GmbH, Delbrück	100 %	full	€	13,648,391
paragon fidelity GmbH, Cadolzburg	100 %	full	€	21,718,826
Cullmann GmbH, Cadolzburg	100 %	unsconsolidated	€	16,976
USA				
paragon of North America Corp., Grand Rapids / Michigan	100 %	full	USD	5,407,707
paragon firstronic of North America Corp., Grand Rapids / Michigan	100 %	full	USD	11,537,508
(previously Miquest Corp.)	(via paragon of North America Corp.)			
Chipco Inc., Elkhart / Indiana	100 %	full	USD	0
	(via paragon of North America Corp.)			
Japan				
paragon of Japan K.K., Tokyo	100 %	full	JPY	3,945,383

Scope of consolidation

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

paragon finesse GmbH, Delbrück, under the merger agreement dated May 23, 2007 and the resolutions of the General Meeting of the same date, was merged with paragon forstep GmbH, St. Georgen im Schwarzwald, with retroactive effect to January 1, 2007. The merger was recorded in the Commercial Register of the company receiving the assets at Local Court Freiburg im Breisgau on June 28, 2007. Under a resolution dated May 23, 2007, paragon forstep GmbH, St. Georgen im Schwarzwald, was renamed as paragon finesse GmbH. This action was recorded in the Commercial Register on June 28, 2007. Moreover, under a resolution of the General Meeting of August 14, 2007, the Company's registered offices were moved from St. Georgen im Schwarzwald to Delbrück. This action was recorded in the Commercial Register of the Local Court Freiburg i.Br. on October 30, 2007 and in the Commercial Register of the Local Court Paderborn on October 24, 2007.

Subject to the resolution of the General Meeting of May 22, 2007, paragon AG concluded a profit transfer and control agreement with paragon fidelity GmbH, which took effect as of January 1, 2007.

In view of the IFRS principle on materiality, Cullman GmbH, Delbrück which was consolidated in the year under review and provided with share capital of € 25 thousand, was not included in the consolidated financial statements.

Principles of consolidation

The consolidated financial statements are based on the separate financial statements of the subsidiaries included in the consolidated Group which are prepared according to uniform accounting policies in accordance with IFRS as of December 31, 2007, and audited and certified by independent auditors.

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

Furthermore, a debt consolidation and an income and expense consolidation were performed. The differences arising from the income and expense consolidation were recognized in the income statement.

Results arising from intercompany deliveries are eliminated from the asset categories of non-current assets and inventory.

The prerequisites for classification under IFRS 5 were not met for paragon firstronic GmbH, Suhl as of the balance sheet date.

Currency translation

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

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

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

Exchange rate losses from operations in the amount of € 165 thousand (2006: € 40 thousand) and exchange rate gains in the amount of € 111 thousand (2006: € 78 thousand) are recognized in the income statement under other operating expenses or other operating income.

As of the balance sheet date, the balance of the currency translation differences, which was recognized as a separate item in equity, is € 1,824 thousand (2006: € 1,166 thousand). The changes in exchange rate differences in equity in the amount of € - 658 thousand (2006: € - 376 thousand) relate primarily to the differences from the currency translation of the financial statements of the U.S. subsidiaries, which were prepared in U.S. dollars.

The table below shows the exchange rates used for currency translation:

	1 € =	2007 Middle rate on December 31	2006	2007 Average rate for the period	2006
USA	$	1.4748	1.3214	1.3728	1.2586
Japan	Yen	165.340	156.940	161.441	146.234

Summary of significant accounting policies

The consolidated financial statements were prepared in euros as of December 31, 2007. All amounts – unless stated otherwise – were disclosed in thousands of euros (€ '000).

The accounting policies based on IFRS applicable to the Group were uniformly applied to the assets and liabilities of the companies included in the consolidation. Appropriate **deferred taxes** were recognized for measurement differences in relation to the statements for tax purposes.

The income statement has been prepared using the cost of production method. **Non-current and current assets** 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.

Intangible assets (industrial property rights and software acquired for a consideration, capitalized development costs and other intangible assets) are measured at cost less straight-line method amortization and any impairment losses. The useful lives for internal development costs of the 2007 reporting year amount to between three and four years. For licenses, patents and software, the useful life is taken to be between three and ten years and up to 20 years for acquired brand names.

The accounting policies relating to **goodwill** are explained in the section "Principles of consolidation."

Property, plant and equipment is measured at cost less straight-line method depreciation and any impairment losses. The depreciation period is based on the anticipated useful economic life.

Financial assets are recognized at cost plus ancillary acquisition costs due to the fact that fair value cannot be determined.

Inventories are measured at cost at the time of addition in accordance with IAS 2; interest on debt capital is not capitalized. Measurement on the reporting date is based on the lower of weighted average value and net realizable value.

Trade receivables are allocated as financial assets to 'loans and receivables' and carried at amortized cost in accordance with IAS 39.9. Amortized cost is calculated to include necessary allowances. Allowances are undertaken based on individual observation, posted in allowance accounts and reported as other operating expenses in the income statement. As soon as a receivable becomes uncollectible, it is derecognized and removed from the allowance account.

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), according to IAS 39.9, they are allocated to the 'loans and receivables' category.

Cash and cash equivalents include cash, checks 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 liquidity is consistent with total cash and cash equivalents.

Trade payables, other current liabilities and non-current loan and finance lease liabilities and the profit-sharing rights are carried at amortized cost (foreign currency positions at fair value).

Pension provisions exist for pension commitments to members of the Managing Board and former employees of companies of the paragon Group and their survivors. According to IAS 19, they are determined based on actuarial principles using the projected-unit-credit-method. The 10% corridor is not used; instead the actuarial gains according to IAS 19.95 are immediately recognized in the income statement. Valuation was based on the actuarial tables 'Richttafeln 2005G' by Prof. Dr. Klaus Heubeck.

According to IAS 37, **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. The evaluation of the probability that pending proceedings will be successful or the qualification of the possible amount of the payment obligations is based on an estimate of the current situation. 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.

paragon AG uses **derivative financial instruments** to reduce market risks from exchange rate fluctuations in transactions in USD by means of forward contracts and to reduce interest rate risks from variable interest components in bank loans by interest rate swaps. paragon AG measures these derivative financial instruments at fair value, as it does not use hedge accounting.

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

Income taxes contain both income taxes to be paid immediately and deferred taxes. Deferred taxes are recognized using the balance sheet liability method. Deferred tax assets and liabilities are recognized for differences arising from the different treatment of specific balance sheet items in the IFRS consolidated financial statements and the tax accounts. Deferred taxes on loss carry-forwards 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. Deferred taxes are measured using the tax rates applicable at the time of realization based on the current legal situation in the individual countries as of the balance sheet date. Deferred tax assets and liabilities are not discounted applying the rules of IAS 12. The calculation of actual and deferred taxes is based on judgments and estimates made by paragon AG. If the actual events deviate from these estimates, this could have positive and negative impacts on the net assets, financial position and results of operations.

For more information, please refer to the notes on balance sheet and income statement items.

In compiling the consolidated financial statements, **assumptions** have been made, and **estimates** used, which have affected the value and reporting of capitalized assets and liabilities, of income and expenditure and of contingent liabilities. These assumptions and estimates mainly relate to the assumptions made with respect to future cash flows from the business planning and the discount interest rate used in the impairment calculation of goodwill, Group-wide determination of useful lives, the number of claims for compensatory damages in litigation, the measurement of provisions, the assessment of litigation risks and the ability to realize future tax benefits. The actual values may vary in individual instances from the assumptions and estimates made. Changes are incorporated, with a corresponding impact on income, once improved knowledge is obtained.

Change of estimates

In connection with the **measurement of pension provisions**, the discount rate was raised from 4.50 % to 5.25 % as of December 31, 2007 to reflect the anticipated long-range change in market interest rate. The resulting effect in the amount of € 215 thousand was recognized in current earnings in the year under review as actuarial gain in the defined benefit obligation.

Until fiscal 2006, the **deferred taxes** on the German companies of the paragon Group were measured using a uniform income tax rate of 37.6 %. Based on the German business tax reform adopted in July 2007, an income tax rate of approximately 29.0 % will apply to the German paragon companies starting in 2008. The remeasurement of deferred taxes resulted in a one-time effect of € 1,367 thousand in the year under review.

Notes on the income statement

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

(1) Revenue

Revenue includes sales of products and services less any sales reductions. Of the sales revenues for the fiscal year of € 108,882 thousand (2006: € 110,823 thousand), domestic sales accounted for € 76,963 thousand (2006: € 90,409 thousand) and foreign sales for € 31,919 thousand (2006: € 20,414 thousand).

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

(2) Other operating income

Other operating income includes income from the reversal of the special account for subsidies of € 2,108 thousand (2006: € 2,183 thousand) and income from the release of other provisions of € 293 thousand (2006: € 708 thousand). This item also contains other income from grants from the federal employment office, exchange rate differences, use of company cars by employees and the disposal of assets. Income from currency translation amounts to € 111 thousand (2006: € 78 thousand).

(3) Other own work capitalized

Own work performed includes project-related development expenses of € 6,244 thousand (2006: € 5,619 thousand), which fulfill the criteria under IAS 38.45. Moreover, this item includes capitalized costs of conversion of test equipment for automotive products in the amount of € 473 thousand (2006: € 0 thousand), a significant scope of which was self produced for the first time in 2007.

The capitalized amounts are recognized under intangible assets.

(4) Cost of materials

in € (000)	2007	2006
Raw materials and supplies	56,825	61,840
Purchased services	3,823	4,110
Total	**60,648**	**65,950**

Due to business considerations, the expense for personnel leasing of € 2,624 thousand (2006: € 2,463 thousand) has been recognized in personnel expenses since the year under review. In prior years it was recognized in purchased services. The 2006 disclosures for cost of materials (€ 68,413 thousand) and personnel expense (€ 24,110 thousand) were adjusted accordingly in the income statement for the year under review.

(5) Personnel expense

Expenses related to wages and salaries amounted to € 21,596 thousand (2006: € 20,067 thousand). The sum of € 3,388 thousand (2006: € 4,043 thousand) was expended on social security contributions and pensions. This amount included expenses for pensions of € 447 thousand (2006: € 492 thousand). As of fiscal 2007, the expense for personnel leasing of € 2624 thousand (€ 2,463 thousand) is reported as personnel expense. Until 2006, this expense was reported as purchased services within cost of materials.

(6) Other operating expenses

Other operating expenses are comprised primarily of legal and consultancy fees, investor relations expenses, advertising and marketing, vehicle costs, costs related to EDP fees and EDP training, costs related to building rentals and energy, as well as leasing and corporate insurance expenses. Expenses from currency translation amount to € 165 thousand (2006: € 40 thousand).

Other operating expenses in the reporting year amounted to € 13,325 thousand (2006: € 11,950 thousand).

In conformity with the international reporting system, the expense for other taxes of € 46 thousand (2006: € 65 thousand) was recognized in the year under review as a component of other operating expenses and no longer as a separate item in the income statement. The 2006 disclosure of other operating expenses (€ 11,925 thousand) was adjusted accordingly in the income statement.

(7) Financial result

The financial result includes interest and similar income amounting to € 442 thousand (2006: € 75 thousand) and interest expense of € 6,929 thousand (2006: € 4,761 thousand).

(8) Income taxes

Income taxes contain reimbursement claims in the amount of € 135 thousand for a tax loss carryback to 2006, income tax liabilities of subsidiaries in the United States (€ 36 thousand) and Japan (€ 1 thousand), and deferred taxes. Tax expenses included € - 97 thousand (2006: € 2,405 thousand) in income taxes and € 2,056 thousand (2006: € 871 thousand) in deferred taxes.

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

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

Domestic deferred taxes were computed as of December 31, 2007 in the amount of a combined income tax rate of approximately 29 %, including a corporate tax rate of 15.0 % in solidarity surcharge of 5.5 %.

A combined income tax rate of 34% was used in calculating deferred taxes in the U.S. and 41% in Japan.

Deferred tax assets amounting to € 3,901 thousand (€ 3,394 thousand) involve € 2,501 thousand (2006: € 3,010 thousand) related to domestic taxes and € 1,400 thousand (2006: € 384 thousand) related to foreign taxes. Deferred tax liabilities amounting to € 6,691 thousand (2006: € 8,231 thousand) relate only to domestic taxes. Domestic deferred tax assets of € 2,501 thousand (2006: € 3,010 thousand) relate to deferred tax claims arising from timing differences in valuation.

in € (000)	12/31/2007		12/31/2006	
	Deferred tax assets	Deferred tax liabilities	Deferred tax assets	Deferred tax liabilities
Intangible assets	1,584	6,281	2,385	7,498
Property, plant and equipment	190	0	96	311
Receivables and other assets	987	34	252	58
Provisions for pensions	147	0	178	0
Other provisions	0	44	99	0
Liabilities	0	175	0	167
Profit sharing rights	61	157	0	197
Tax loss carryforwards	932	0	384	0
	3,901	**6,691**	**3,394**	**8,231**
Net balance	0	0	- 3,002	- 3,002
	3,901	**6,691**	**392**	**5,229**

The increase in deferred tax assets is primarily attributable to losses of the year 2007. The deferred tax liabilities on intangible assets relate primarily to the capitalization of development expenses as well as additional intangible assets acquired in connection with the acquisition of the remaining 49 % of the shares in paragon fidelity GmbH. The reduction in deferred tax liabilities results primarily from the amortization of the development costs and intangible assets in fiscal 2007.

Domestic corporate tax loss carry forwards in the amount of € 2,509 thousand primarily resulted from the domestic tax income in 2007, for which deferred tax assets in the amount of € 394 thousand were recognized as well as for the trade tax loss carryforwards arising in the year under review. Loss carryforwards in Germany may be used at any time provided the minimum taxation is considered, whereas in the U.S. their use is limited to 20 years.

Foreign deferred tax claims of € 1,400 thousand relate to the subsidiaries in the U.S. and Japan as of December 31, 2007. Tax loss carry forwards in the amount of USD 1,820 thousand exist for the subgroup paragon of North America Corp. as of the balance sheet date.

Deferred tax claims relating to the loss carryforwards of paragon of Japan K.K. amount to € 118 thousand and constitute the current loss from fiscal 2007, translated at € 286 thousand. Based on current positive earnings forecasts, in particular with regard to the manufacture of new products in the telecommunications division in the U.S., the Managing Board assumes that the tax losses available as of December 31, 2007, can be utilized in the medium term.

Deferred tax liabilities in the amount of € 6,629 thousand reflect temporary differences in valuation and chiefly apply to intangible assets capitalized under IFRS but which may not be capitalized under German tax law. € 2,770 thousand in deferred tax liabilities were recorded without impact on income as a consequence of the acquisition of 49% of the shares in paragon fidelity Verwaltungsgesellschaft mbH and the related purchase price allocation.

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

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

Of the income taxes for fiscal 2007 in the amount of € - 97 thousand (2006: € 1,534 thousand), domestic taxes accounted for € - 135 thousand (2006: € 1,918 thousand) and foreign taxes for € 38 thousand (2006: € - 384 thousand). Income taxes are composed of current income taxes of € - 135 thousand (2006: € 2,405 thousand), fully attributable to domestic taxes and resulting from a loss carryback after 2006, as well as deferred income taxes of € - 2,056 thousand (2006: € - 871 thousand), of which € - 1,040 thousand (2006: € - 487 thousand) relate to domestic taxes and € - 1,016 thousand (2006: € - 384 thousand) to foreign taxes.

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

in € (000)	2007	2006
Group net income before tax	**311**	**3.740**
Theoretical tax expense at a tax rate of 37.6 %	117	1.406
Tax effects of subsidiary with negative contributions to consolidated income	0	- 140
Differences arising from disparity in tax rates	- 131	14
Tax effects from non-deductible expenses and tax-exempt income	- 210	86
Differences resulting from consolidation measures	0	- 138
Tax expense from previous years	- 135	369
Loss carryback	135	0
Effect of change in tax rate	- 1,367	–
Miscellaneous	- 562	- 63
Actual income tax expense	**- 2,153**	**1,534**

Until December 31, 2007, paragon's deferred taxes were based on an income tax rate of 37.6 %. As of the third quarter of 2007, an income tax rate of approximately 29.0 % is recognized due to the business tax reform adopted in 2007.

The tax rate change resulted in an impact on earnings of € 1,367 thousand in the year under review.

(9) Earnings per share

Basic earnings per share are calculated by dividing Group net income by the weighted average number of shares issued. The weighted average number of shares issued was 4,113,862 in the year under review (2006: 4,103,186).

With Group net income of € 2,464 thousand (2006: € 2,206 thousand), the basic earnings per share is € 0.60 (2006: € 0.54) To calculate diluted earnings per share, the number of all potentially diluting shares is added to the weighted average number of shares issued.

paragon AG's stock option plans create the basis for a potential dilution of earnings per share. Under these plans, management receives option rights for the purchase of paragon AG shares.

Exercising these subscription rights depends on the price movement of the paragon share. During 2007, based on an average share price of € 11.57 (2006: € 13.93) and a strike price of € 7.98 (first tranche), € 3.78 (second tranche), € 3.88 (third tranche) and € 15.09 (fourth tranche), dilution by 14,521 shares occurred (2006: 17,317).

The following formula was used for calculating the diluting shares:

Potentially diluting common shares [each] =

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

1st tranche

$$1{,}079 = 3{,}477 \times \left(1 - \frac{€\ 7.98}{€\ 11.57}\right)$$

2nd tranche

$$2{,}809 = 4{,}172 \times \left(1 - \frac{€\ 3.78}{€\ 11.57}\right)$$

3rd tranche

$$10{,}633 = 15{,}998 \times \left(1 - \frac{€\ 3.88}{€\ 11.57}\right)$$

4th tranche

$$0 = 30{,}000 \times \left(1 - \frac{€\ 15.09}{€\ 11.57}\right)$$

The number of shares to be used in calculating the diluted earnings thus rose to 4,128,383 (2006: 4,120,502). The diluted earnings per share figure is rounded to € 0.60 (2006: € 0.54). The diluted earnings per share figure was calculated according to IAS 33.24 et seqq.

Further explanation concerning the stock option program can be found in Item (34).

Notes to the consolidated balance sheet

Assets

Changes in non-current assets are presented in a separate fixed asset schedule which is appended to the notes.

(10) Goodwill and other intangible assets

Intangible assets acquired for a consideration are reported at cost. They are amortized over their useful life using straight-line depreciation. For licenses, patents and software, the useful life is between three and ten years; for acquired trademark rights it is up to 20 years. To the extent necessary, impairment losses are recognized. These can be reversed at a later date, if reasons for the original impairment loss are permanently eliminated. Due to the voluntary earlier application of IFRS 3 (2004), goodwill has not been amortized since January 1, 2004. Goodwill refers exclusively to the Automotive business segment. An impairment test as defined in IAS 36 (2004) must be performed at least annually. A review showed that there were no events and circumstances in fiscal 2007 that led to impairment. Goodwill from the companies included in the U.S. subgroup amounts to € 2,015 thousand (USD 2,971 thousand) as of December 31, 2006.

Goodwill of € 9.9 million has arisen as a result of the acquisition of the remaining 49% of the shares in paragon fidelity Verwaltungs-GmbH, Suhl, during 2006. Together with the goodwill from the 51% shareholding acquired in 2005, goodwill attributable to the cash-generating unit paragon fidelity GmbH, Cadolzburg, now amounts to € 23.8 million.

Pursuant to IAS 36, goodwill must be annually tested for impairment by comparing the carrying amount of a cash-generating unit with the recoverable amount. Each individual legal entity is regarded as a cash-generating unit. The recoverable amount corresponds to the value in use determined according to the discounted cash flow method. The basis for determining future cash flows is the data from the detailed corporate planning for the fiscal years until 2011 with a subsequent transition to perpetual annuity (two-phase model). The free cash flows are discounted at an appropriate interest rate to determine the present value of the cash flows. The interest rate for the impairment test determined according to the Capital Asset Pricing Model (CAPM) amounted to 9.1% in fiscal 2007 (2006: 7.1%). The growth rates on which the budgeting is based are derived from the sales planning.

If the recoverable amount of a business division is less than its carrying amount, an impairment loss in the amount of the difference is recognized in goodwill.

An intangible asset produced in the development or during the development phase of an internal project is to be capitalized at cost, providing criteria (a) to (f) IAS 38.45 are met, and amortized over the anticipated useful life of from three to four years.

Total development costs for the period amounted to € 10,020 thousand (2006: € 11,350 thousand). Of that amount, € 6,244 thousand (2006: € 5,619 thousand) in internal development costs were capitalized as intangible assets; amortization during the fiscal year amounted to € 2,531 thousand (2006: € 2,571 thousand). This includes an impairment loss of € 138 thousand (2006: € 528 thousand) in accordance with IAS 38.97 in conjunction with IAS 36. As of the balance sheet date, total internal development costs have been capitalized as intangible assets with a residual carrying amount of € 10,643 thousand (2006: € 6,940 thousand). Development has been focused on the communications division with Car Media Systems, air quality sensors and air quality treatment for automobiles, as well as in the area of instrumentation and control.

(11) Property, plant and equipment

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

In the case of buildings, the useful life is considered to be 20 to 25 years, for technical plant five to ten years, and for other plant

Fixed asset schedule 2006

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

Fixed asset schedule 2007

in € (000)	COST						ACCUMULATED DEPRECIATION / AMORTIZATION / IMPAIRMENT					RESIDUAL CARRYING AMOUNT	
	01/01/2007	Exchange rate changes	Additions (third party)	Disposals (third party)	Re-classifications	12/31/2007	01/01/2007	Exchange rate changes	Depreciation/ amortization impairment during the fiscal year	Disposals (third party)	12/31/2007	21/31/2007	12/31/2006
Intangible assets													
Licenses, patents, software	33,066	- 37	871	819	0	33,081	9,479	- 44	3,576	816	12,195	20,886	23,587
Capitalized development costs	11,255	- 19	6,244	0	0	17,480	4,315	- 9	2,531	0	6,837	10,643	6,940
- thereof impairment pursuant to IAS 36									138				
Goodwill	27,977	- 244	0	0	0	27,733	313	- 10	0	0	303	27,430	27,664
Total	**72,298**	**- 300**	**7,115**	**819**	**0**	**78,294**	**14,107**	**- 63**	**6,107**	**816**	**19,335**	**58,959**	**58,191**
Property, plant and equipment													
Land and buildings	18,358	- 108	2,149	16	943	21,326	2,832	- 27	1,021	16	3,810	17,516	15,526
Technical plant and machinery	21,127	- 120	1,901	1,007	1,599	23,500	11,767	- 119	3,358	992	14,014	9,486	9,360
Other plant, office furniture and equipment	9,159	- 18	885	1,300	700	9,426	5,802	- 12	1,420	1,249	5,961	3,465	3,357
Prepayments and equipment under construction	3,162	- 109	2,213	361	- 3,242	1,663	0	0	0	0	0	1,663	3,162
Total	**51,806**	**- 355**	**7,148**	**2,684**	**0**	**55,915**	**20,401**	**- 158**	**5,799**	**2,257**	**23,785**	**32,130**	**31,405**
Financial assets													
Shares in affiliated companies	0	0	25	0	0	25	0	0	25	0	25	0	0
Investments	200	0	66	0	0	266	0	0	0	0	0	266	200
Total	**200**	**0**	**91**	**0**	**0**	**291**	**0**	**0**	**25**	**0**	**25**	**266**	**200**
Total	**124,304**	**- 655**	**14,354**	**3,503**	**0**	**134,500**	**34,508**	**- 221**	**11,931**	**3,073**	**43,145**	**91,355**	**89,796**

and office furniture and equipment three to ten years. To the extent necessary, impairment losses are recognized pursuant to IAS 36, which can be reversed at a later date if reasons for the original impairment are permanently eliminated. The terms used for depreciation and useful life are reviewed on a yearly basis.

Where items are rented or leased and beneficial ownership lies with the Group company concerned (finance lease), they are capitalized at the lower of the net present value of lease installments or their fair value in accordance with IAS 17 and depreciated over their useful life. Portions of movable fixed assets are financed under lease contracts that normally run for four years. Payments corresponding to future lease installments are recorded as liabilities. The net carrying amount of capitalized lease objects as of December 31, 2007 amounts to € 1,812 thousand (2006: € 2,680 thousand). Corresponding payment obligations from future lease installments amount to € 746 thousand (2006: € 1,514 thousand) and are recorded as liabilities. Capitalized lease objects are without exception technical plant and machinery.

(12) Financial assets

Shares in the amount of € 266 thousand (2006: € 200 thousand) relate primarily to the unconsolidated investment in Paderborner Stadiongesellschaft mbH, Paderborn. The shares are recognized at cost of € 266 thousand (2006: € 200 thousand), since no different present value is available.

In addition, they still contain the shares of Cullmann GmbH which were impaired to a residual value of € 1 in the year under review.

(13) Deferred taxes

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

(14) Inventories

Inventories consist of the following:

in € (000)	12/31/2007	12/31/2006
Raw materials and supplies	8,838	8,056
Work in progress and finished goods	8,517	8,901
Advance payments on inventory	354	383
Total	**17,709**	**17,340**

Inventories are valued at cost. In accordance with IAS 2, costs include, in addition to direct costs, overhead costs that can be attributed to the production process including appropriate depreciation on production equipment (costs of conversion). Pursuant to IAS 23.7, financing costs are directly recognized as an expense. If lower, the net realizable value is recorded. Write-downs of inventory to the lower net realizable value as of the balance sheet date amount to € 301 thousand (2006: € 877 thousand). As in the prior year, there were no grounds for reversals of impairment losses. As in 2006, no inventories were used to secure liabilities as of the balance sheet date.

Orders that would need to be reported under IAS 11 (long-term construction contracts) did not exist on the balance sheet date.

(15) Trade receivables and other assets

in € (000)	12/31/2007	12/31/2006
Trade receivables	6,259	19,880
Other assets	9,606	1,649
Total	**15,865**	**21,529**

Trade receivables and other assets are recognized at amortized cost. The reduction in trade receivables compared to the previous year results primarily from sales of accounts receivable to two factoring companies. Since all substantial opportunities and risks are transferred to the buyer, the trade receivables were completely de-recognized. Unless covered by insurance, the default and transfer risks are taken into account by adequate allowances in the amount of € 236 thousand (2006: € 407 thousand). Receivables in foreign currency are translated at the exchange rate applicable at the time of the transaction. As of the balance sheet date, receivables in foreign currency are converted at the closing rate.

The increase in other assets results primarily from a claim arising from a loan agreement and claims for compensatory damages (€ 5,826 thousand). Please refer to the details in the Management Report with regard to the claim for compensatory damages.

(16) Cash and cash equivalents

Changes in cash and cash equivalents that constitute financing funds according to IAS 7 are shown in the appended cash flow statement. Cash on hand and bank deposits are shown at nominal value. Cash and cash equivalents include € 19 thousand (2006: € 7 thousand) in cash on hand and € 6,424 thousand (2006: € 8,751 thousand) in bank deposits.

Liabilities and equity

(17) Equity

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

paragon AG's share capital as of December 31, 2007 amounts to € 4,114,788 (2006: € 4,113,063) and is divided into 4,114,788 bearer shares with a notional share in capital of € 1.00 each. The capital increase is the result of the exercise of 1,725 options under paragon AG's stock option plan no. 1.

The capital reserve includes additional cash payments for the issue of shares. It rose during fiscal 2007 due to the exercise of option rights – by € 5 thousand (2006: € 84 thousand) and the granting of share-based payments in accordance with IFRS 2 – by € 0 thousand (2006: € 99 thousand). The capital reserve thus changed during fiscal 2007 from € 7,748 thousand to € 7,753 thousand.

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

Further explanation concerning the stock option plan can be found in Item (34).

Authorized capital

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

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

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

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

Moreover, in accordance with the resolution of the Annual General Meeting on May 22, 2007, the Managing Board is authorized to acquire shares of the Company as intended under section 71 (1) no. 8 of the AktG (German Stock Corporation Act). The authorization for the purchase of treasury shares resolved at the Annual General Meeting of May 17, 2006, was rescinded from the moment at which the new authorization became effective.

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

- offer such shares to third parties in the event of mergers or the acquisition of companies or interests in companies,

- sell them at a price not significantly lower that the Company's share price as quoted on the stock exchange at the time of the sale,

- them to fulfill conversion rights and options granted at the time the bonds were issued, or

- to withdraw them.

The new authorization is in effect until November 21, 2008. It may not be exercised to trade in treasury shares.

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

Conditional capital

A conditional capital increase of up to € 284,874.00 by issue of 284,874 common shares was resolved (Stock option plan no. 1) by resolution of the Annual General Meeting of October 17, 2000, modified by the Annual General Meeting resolution of May 15, 2002, and supplemented by the resolution of the Annual General Meeting of May 12, 2004. The conditional capital increase is to be used only for granting option rights to the Managing Board and employees of paragon AG and to directors and employees of its subsidiaries. As of the balance sheet date, conditional capital I relating to the exercise of options amounted to € 175,012.

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

A conditional capital increase of € 1,750,000 by issue of 1,750,000 no par-value shares was resolved (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 pursuant to the bond terms. The authorization is effective 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 bond terms 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 can 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. Counted toward this limitation to 10% of the share capital are 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) No. 8 sentence 5 in conjunction with section 186 (3) sentence 4 AktG, with exclusion of subscription rights.

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

Dividend distribution

For fiscal year 2007, a proposal will be made to the Annual General Meeting to distribute a dividend of € 0.10 (2006: € 0.30) per share. For 4,114,788 shares (2006: 4,113,063 shares), this implies a total dividend payment of € 411,478.80 (2006: € 1,233,918.90)

Interest expense from amortization of discounts during fiscal 2007 amounted to € 132 thousand (2006: € 83 thousand).

For some of the financing through bank credits of the paragon Group, hedging covenants were agreed (€ 22,629 thousand). Non-compliance with these financial covenants would entitle the financial institutions to a right of termination. From the present perspective, the Managing Board sees no problems in this regard.

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

(18) Liabilities

in € (000)	12/31/2007	12/31/2006
Current liabilities		
Current portion of financial lease liabilities	521	919
Short-time loans and current portion of long-term loans	20,109	13,238
Trade liabilities	13,753	14,344
Other current liabilities	6,142	10,205
Non-current liabilities		
Long-term financial lease liabilities	225	595
Long-term loans	29,111	32,329
– including those with a remaining term of one to five years –	22,910	23,090
– including those with a remaining term in excess of five years –	6,201	9,239
Other non current liabilities	1,898	3,795

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

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

Liabilities under finance leases (in particular lease agreements) normally have a term of four years. Repayments for the following years amount to € 746 thousand (2006: € 1,515 thousand), of which € 521 thousand will come due during the 2008 calendar year. Future interest payments related to lease agreements amount to a total of € 35 thousand of which € 27 thousand will come due during 2008. Liabilities under finance leases are recorded at their present value or amortized cost in accordance with IAS 17.

Current and non-current liabilities to banks total € 49,220 thousand (2006: € 45,567 thousand); collateral for liabilities to banks exists in the amount of € 10,722 thousand (2006: € 11,389 thousand).

Liabilities to banks are secured by property charges for loan liabilities in the amount of € 9,895 thousand (2006: € 11,149 thousand), collateral assignment of property, plant and equipment of € 827 thousand (2006: € 240 thousand) and by the cession of rights and claims under a subsidy notice of the Thüringer Aufbaubank concerning € 5,027 thousand dated June 21, 2005.

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

The term of non-current financial liabilities is up to 14 years. The interest rates for liabilities to banks are between 4.00 % and 9.00 % and are fixed for the contract term for the major portion of the loans and thereby not exposed to any significant risk of change. Individual risks relating to variable-interest loans are hedged by derivative financial instruments in the form of interest rate swaps. Please refer to Note (23).

Other current liabilities chiefly refer to payment for profit-sharing rights recorded in the amount of € 775 thousand (2006: € 1,679 thousand), as well as the remaining liability of € 1,898 thousand relating to IKB Private Equity GmbH, Düsseldorf, in connection with the silent equity holding reported until 2005. The remaining liability to IKB Private Equity GmbH, Düsseldorf in the amount of € 3,795 thousand will be repaid in two installments on June 30, 2008 and June 30, 2009.

Other liabilities include liabilities from transport taxes or other indirect taxes in the amount of € 2,786 thousand (2006: € 2,050 thousand), social security liabilities of € 0 thousand (2006: € 1 thousand) and salary and wage liabilities of € 4 thousand (2006: € 892 thousand).

(19) Profit sharing rights

By resolution of the Annual General Meeting of May 12, 2004, paragon AG was authorized, with the consent of the Supervisory Board, to issue profit-sharing rights in the period up to December 31, 2008, on one or more occasions, excluding shareholders' subscription rights. paragon AG granted profit-sharing rights at a par value of one euro each as part of a private placement against payment of a total of € 8.0 million as provided for in the profit sharing rights agreement dated June 3, 2004.

Of that amount, € 5.0 million profit-sharing rights at a par value of one euro each were issued to IKB Private Equity GmbH, Düsseldorf, and € 3.0 million profit-sharing rights at a par value of one euro each were issued to DKB Deutsche Kreditbank AG, Suhl. The term of all acquired profit-sharing rights was originally to end by no later than Dec. 31, 2010.

Through a partial cancellation agreement dated June 28, 2007, the profit-sharing rights of IKB Private Equity GmbH, Düsseldorf, were repaid in the amount of € 5.0 million. A cancellation payment was stipulated as part of the cancellation agreement.

In a profit-sharing rights agreement dated October 27, 2005, paragon AG issued additional profit-sharing rights totaling € 6.0 million at a par value of one euro each to Force 2005-1 Ltd. Partnership, St. Helier, Jersey, Channel Islands as part of the private placement. The term of these acquired profit-sharing rights will end no later than January 15, 2013.

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

Holders of profit-sharing rights receive compensation consisting of a fixed amount independent of profit and a component that varies with profit for the profit-sharing rights they have been granted. Compensation including the cancellation payment totals € 1,886 thousand (2006: € 1,726 thousand) for fiscal 2007 with respect to the profit-sharing rights of € 9.0 million (institutional tranche) reported as of the balance sheet date.

By resolution of the Annual General Meeting held on May 12, 2004, the Managing Board was further authorized to offer profit sharing rights in the aggregate par value of up to a maximum of

€ 15 million on one or several occasions until December 31, 2008 to the shareholders for subscription. Based on this resolution paragon AG's Managing Board decided to issue profit-sharing rights with a total par value of € 14,511,016.80 to paragon AG shareholders, divided into 12,092,514 equivalent profit-sharing rights with a par value of € 1.20 each. The shareholders of paragon AG were given preference in acquiring profit-sharing rights through exercise of the subscription right in the period from November 4, 2004, to December 3, 2004. The subscription right ratio was 1:3; one paragon share entitled the shareholder to purchase three profit-sharing rights. The minimum subscription sum is € 120. The profit-sharing rights are traded neither on the floor of the stock exchange nor over the counter; they can only be transferred by assignment with the consent of the Company. For the minimum term until December 31, 2010, annual fixed compensation of six percent plus a profit-dependent compensation of up to three percent, depending on the EBITDA margin, will be paid. Shareholders and interested investors were able to subscribe to additional profit-sharing rights by way of oversubscription until December 31, 2005. As of the balance sheet date, a total of 3,363,584 profit sharing rights at a par value of € 1.20 per profit-share were subscribed. The profit-sharing rights therefore continue to amount to € 4,036,300.80. Profit-sharing rights carry an entitlement to compensation from the date on which they were granted. For fiscal 2007, compensation amounts to € 282,541.07 (public tranche).

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

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

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

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

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

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

Holders of profit-sharing rights receive compensation consisting of a fixed amount independent of profit and a component that varies with profit for the profit-sharing rights they have been granted. Compensation totals € 445,571.37 in fiscal 2007 for profit-sharing rights of € 6.0 million issued in 2006.

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

paragon AG granted new profit-sharing rights in the amount of € 7.0 million at a par value of one euro each to PREPS 2007-1 plc, Ireland, as part of a private placement as provided for in the profit-sharing rights agreement dated January 10, 2007. The term of these acquired profit-sharing rights will end no later than January 10, 2014. No ordinary termination of these profit-sharing rights is anticipated. The Managing Board made use of its authorization to exclude shareholders' subscription rights in relation to these profit-sharing rights.

Holders of profit-sharing rights receive compensation consisting of a fixed amount independent of profit and a component that varies with profit for the profit-sharing rights they have been granted. Compensation totals € 445,900 in fiscal 2007 for new profit-sharing rights of € 7.0 million issued in 2007.

Due to the contractual form, these profit-sharing rights must be recognized as a financial liability according to the provisions of IAS 32. Directly attributable transaction costs amounting to € 250 thousand have reduced the value of the addition of the profit-sharing rights as defined by IAS 39.43 and will be recorded as expenses over the term of the profit-sharing rights.

(20) Investment subsidies

This represents government investment allowances. Accounting for government subsidies is undertaken in accordance with IAS 20, that is, only if there is reasonable assurance that the conditions attaching to them will be complied with and the grants will be received. Government grants and subsidies are accounted for as deferred liabilities and liquidated over the average useful life of the asset subsidized. The liquidation amounts are recognized in other operating income with impact on the income statement. Government assistance during the year under review amounted to € 1,462 thousand (2006: € 2,141 thousand), of which € 1,462 thousand (2006: € 2,133 thousand) consists of asset-related subsidies.

Provisions

Provisions developed as follows during the year under review:

in € (000)	01/01/2007	Amount utilized	Reversal	Increase	12/31/2007
Other provisions	1,840	1,002	293	467	1,012
Provisions for pensions and similar obligations	1,049	0	90	0	959
Total:	**2,889**	**1,002**	**383**	**467**	**1,971**

(21) Other provisions

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

Other provisions are created with respect to risks arising from director's fees, bonuses, warranties as well as legal and consulting fees and other obligations from ongoing business operations. Other provisions include tax provisions of € 50 thousand (2006: € 207 thousand) for risks arising from claims pending for withholding tax under liability principal status pursuant to section 50a of the German Income Tax Act (EStG). The remaining terms of all other provisions amounting to a total of € 1,012 thousand (2006: € 1,840 thousand) are less than one year.

As of fiscal 2007, the provisions of a liability nature in the amount of € 2,188 thousand (2006: € 5,011 thousand) are reported as other liabilities. Until 2006, they were reported as other provisions. The 2006 disclosure of other provisions (€ 6,851 thousand) was adjusted accordingly.

(22) Provisions for pensions

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

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

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

The paragon Group finances pension commitments by endowing provisions.

A provision for a defined benefit pension plan was created in accordance with IAS 19. This relates to a commitment of a fixed amount at age 65 based on an individual contract. In addition to this existing pension agreement, a new commitment was made in fiscal year 2005. This concerns a commitment at age 65 established under an individual contract, which is based on length of employment and salary level. The provision was valued based on actuarial expert opinion using the projected unit credit method' pursuant to IAS 19. The calculation is based on assumptions of an interest rate of 5.25 % (2006: 4.50 %), annual benefits indexing of 0 % (2006: 0 %) for the previous commitment and of 10% for the new commitment (for service years up to 2009, afterwards 0 %) and annual pension indexing of 2.0 % (2006: 1.5 %). The retirement age is assumed to be 65 years for purposes of calculation. Mortality and morbidity statistics are based on Prof. Dr. Klaus Heubeck's tables RT 2005 G. The anticipated return on plan assets is 4.5 % (2006: 4.0 %) p. a.

The increase in the pension provision totals € 178 thousand (2006: € 462 thousand) not taking into account any changes in plan assets. This reflects service costs recognized as personnel expenses amounting to € 291 thousand (2006: € 255 thousand), interest of € 72 thousand (2006: € 48 thousand) and an actuarial loss of € 185 thousand (2006: € 159 thousand). The corridor provision was not applied. The option to offset actuarial gains and losses in full against retained earnings as provided for in IAS 19.93A was not elected.

The fair value of plan assets is derived as follows:

The carrying amount of the reinsurance claim deducted as plan assets from the obligation amounts to € 1,072 thousand (2006: € 830 thousand). The present value of the pension liability as of the balance sheet date is € 1,771 thousand (2006: € 1,592 thousand). After deducting reinsurance claims a reportable obligation of € 699 thousand (2006: € 762 thousand) remains.

Another portion of the pension provision relates to obligations of paragon finesse GmbH, Delbrück for benefits under the group relief fund of the former Andreas Haller Fabrik für Feinmechanik GmbH & Co. KG and was valued based an actuarial expert opinion using the projected unit credit method pursuant to IAS 19. The calculations are based on the benefit plan of the group relief fund. An interest rate of 5.25 % (prior year: 4.50%) and pension indexing of 2.0 % (prior year: 1.5%) were used in the calculation. 32 projected benefits with a present value of earned pension claims of active and inactive employees in the amount of € 136 thousand (2006: € 138 thousand), as well as € 25 thousand (2006: € 29 thousand) current benefits with a present value of € 124 thousand (2006: € 149 thousand) were calculated and are reflected in the provision.

The reversal of the pension provision totals € 26 thousand (2006: addition of € -3 thousand). This reflects service costs recognized as personnel expenses amounting to € 2 thousand (2006: € 3 thousand), interest of € 13 thousand (2006: € 19 thousand) and an actuarial gain of € 30 thousand (2006: actuarial loss of € 30 thousand). The corridor provision was not applied. The option to offset actuarial gains and losses in full against retained earnings as provided for in IAS 19.93A was not elected.

in € (000)		12/31/2007	12/31/2006
	Fair value of plain assets at the beginning of the year	830	592
+	Anticipated return on plain assets	39	24
+/-	Actuarial gains and losses	- 105	- 94
+	Employer contributions	308	308
=	**Fair value of plan assets on balance sheet date**	**1,072**	**830**

(23) Additional information on financial instruments

This section summarizes the significance of paragon AG's financial instruments. The table below shows the carrying amounts and fair values of the financial assets and liabilities as of December 31, 2007 in € (000).

Valuation:	Nominal value		Amortized costs		Fair value			
Valuation category:	**Cash and cash equivalents**		**Loans and receivables**		**Trading**		**Available for sale**	
Assets in € (000)	Carrying amount	Fair value	Carrying amount	Fair value	Carrying amount	Fair value	Carrying amount	Fair value
Financial assets							266	266
Trade receivables			6,259	6,259				
Positive fair values deriving from derivative financial instruments					158	158		
Other assets			9,606	9,606				
Cash and cash equivalents	6,443	6,443						
Total assets	**6,443**	**6,443**	**15,865**	**15,865**	**158**	**158**	**266**	**266**
Liabilities and equity								
Loans			49,220	49,418				
Profit-sharing rights			25,494	25,609				
Trade liabilities			13,753	13,753				
Finance lease liabilities			746	726				
Negative fair values deriving from derivative financial instruments					35	35		
Other liabilities			8,040	8,040				
Total equity and liabilities			**97,253**	**97,546**	**35**	**35**		

The fair value of **cash and cash equivalents**, of **short-term receivables**, of **trade liabilities** and **other liabilities** roughly reflects the carrying amount. The reason for this lies in the short term nature of these financial instruments.

The Company measures long-term receivables 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 to banks and liabilities from finance leases and profit-sharing rights** by discounting the anticipated cash flows using the interest rates applicable for similar financial liabilities with a comparable remaining term.

The **financial assets available for sale** 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 fair value if such a price is available. The only financial asset held for trading involves the shareholding in Paderborner Stadiongesellschaft mbH, Paderborn. The shares are measured at cost, since no different present value is available. Please refer to Note (12).

The Company generally concludes **derivative financial instruments** with financial institutions of high credit standing as contracting partners. The determination of present value depends on the type of the financial instrument.

Interest rate derivatives

- The fair value of interest rate derivatives (interest rate swaps) is determined from the discounting of the expected future cash flows over the remaining term of the contract based on current market interest rates and the interest rate structure curve. paragon recognizes interest rate swaps based on an estimated value calculated using an option pricing model.

Currency derivatives

- The fair value of currency forwards 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 and net losses from financial instruments are realized as shown below:

Net gains / losses

in € (000)	12/31/2007	12/31/2006
Receivables	40	- 87
Financial assets and financial liabilities held for trading	340	- 263

Net gains and net losses from **receivables** include changes in allowances, gains and losses from the recognition as well as payment inflows and reversals of impairment losses on receivables originally written down.

Net gains and losses from **financial assets and financial liabilities held for trading** include all fair value changes of the derivative financial instruments. The Company does not use hedge accounting as defined in IAS 39.85.

(24) Derivative financial instruments

In addition to the primary financial instruments, paragon employs various derivative financial instruments. As part of risk management, the Company primarily limits the risk from interest rate and exchange rate fluctuations by employing derivative financial instruments. For additional information on the risk management strategies please refer to item (25).

Derivative financial instruments for currency hedging

- As of the balance sheet date, financial derivatives existed in the form of currency hedging transactions. The paragon Group is exposed to a number of financial risks due to its international activities. These include in particular the impacts of changes in exchange rates. paragon employs an integrated approach to hedge the risks from fluctuating exchange rates. The Group-wide risks are managed centrally and hedged through the use of derivative financial instruments. Only forward contracts are used for this purpose.

Currency derivatives

Bank	Product	Contract	Due on	Reference amount USD	Exchange rate EUR	Trigger price EUR	Fair value 12/31/2007 EUR	Fair value 12/31/2006 EUR
Commerzbank AG, Bielefeld	Forward Contract	11/22/2006	03/16/2007	250,000.00	1.2800	1.3280	–	- 4,505.18
Commerzbank AG, Bielefeld	Forward Contract	11/22/2006	03/16/2007	250,000.00	1.2825	1.3380	–	- 4,528.58
Commerzbank AG, Bielefeld	Forward Contract	10/19/2007	01/28/2008	375,000.00	1.4400	1.4721	- 6,627.19	–
Commerzbank AG, Bielefeld	Forward Contract	10/19/2007	01/28/2008	250,000.00	1.4000	1.4721	120.15	–
Commerzbank AG, Bielefeld	Forward Contract	10/19/2007	02/11/2008	250,000.00	1.4000	1.4640	- 9,053.78	–
Commerzbank AG, Bielefeld	Forward Contract	10/19/2007	02/11/2008	250,000.00	1.4000	1.4640	263.65	–
Commerzbank AG, Bielefeld	Forward Contract	10/19/2007	02/11/2008	250,000.00	1.4000	1.4640	1,735.75	–
Commerzbank AG, Bielefeld	Forward Contract	10/19/2007	05/21/2008	300,000.00	1.3500	1.4721	- 18,859.11	–
Commerzbank AG, Bielefeld	Forward Contract	10/19/2007	05/21/2008	300,000.00	1.4000	1.4721	679.38	–
Commerzbank AG, Bielefeld	Forward Contract	10/19/2007	05/21/2008	300,000.00	1.4000	1.4721	1,215.60	–
Total:							**- 30,525.55**	**- 9,033.76**

The Company's hedging strategy does not meet the requirements for hedge accounting as defined by IAS 39.85. Accordingly, paragon recognizes all derivatives at fair value and reports them under current financial assets or other current liabilities. The changes in fair value are recognized in the income statement.

Derivative financial instruments for interest rate hedging

- Interest rate risk results from the sensitivity of financial liabilities to change of the market interest. The Company hedges these risks by employing interest rate derivatives. paragon 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 recording.

To hedge interest rate risk, the company follows an approach geared to individual variable-interest financial liabilities. With regard to amount and term, the swap contracts are tailored to the hedged variable borrowings.

Interest rate derivatives

Contract with	Product	Closing date	End date	Primary reference amount EUR	Fair value 12/31/2007 EUR	Fair value 12/31/2006 EUR
Commerzbank AG, Bielefeld	Swap	04/30/2004	03/15/2007	208,333.00	expired	- 4,332.00
IKB Financial Products S.A., Luxemburg	Swap	08/05/2004	03/30/2007	208,333.00	expired	- 379.79
Commerzbank AG, Bielefeld	Swap	04/14/2005	03/30/2015	825,000.00	25,367.00	9,961.00
IKB Financial Products S.A., Luxemburg	Swap	07/10/2006	12/30/2013	12,500,000.00	56,079.69	- 127,232.72
Commerzbank AG, Bielefeld	Swap	07/10/2006	12/30/2013	12,500,000.00	52,494.00	- 128,352.00
Postbank S.A., Luxemburg	Swap	12/07/2006	09/30/2010	2,025,000.00	8,891.67	- 686.81
HypoVereinsbank AG, Munich	Swap	12/07/2006	09/30/2011	2,000,000.00	10,974.28	- 2,698.83
Total:					**123,281.09**	**- 262,754.91**

The Company's hedging strategy does not meet the requirements for hedge accounting as defined by IAS 39.85. Accordingly, paragon recognizes all interest rate derivatives at fair value and reports them under current financial assets or other current liabilities. The changes in fair value are recognized in the income statement. The balance of payments received and paid under interest rate swaps used for hedging is also recognized in the financial result.

(25) Management of financial market risks

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

As a part of the overall risk management system, the management of financial market risks 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 Chief Financial Officer. The Managing Board bears total responsibility for the overall risk management process at the highest level.

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

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

The potential impacts from the sensitivity analysis represent estimates and are based on the assumption that the negative market changes will occur. The actual impacts can be significantly different due to different market developments.

The market-sensitive assets in connection with pension plans (plan assets) are not the subject of quantitative and qualitative statements. Please refer in this regard to Item (22).

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. Each paragon business unit 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. The Company limits the risk by primarily settling purchases and sales of merchandise and services in the particular local currency.

paragon assesses sensitivity to foreign currency fluctuations by aggregating the net currency position of the operating activities. Sensitivity is calculated by simulating a 10 percent devaluation of the euro in relation to all foreign currencies. The simulated rise of the euro would have resulted in a reduction of future payment inflows in the amount of € 5 thousand as of December 31, 2007. A reduction of € 6 thousand would have resulted for the previous year. To the extent future purchases are not hedged against currency risks, a devaluation of the euro against other currencies would have adverse impacts on the financial position and results of operations because of higher foreign currency outflows than foreign currency inflows in the Company.

The following table shows the net foreign currency risk of the individual primary currencies as of December 31, 2007 and 2006.

in € (000)	12/31/2007			12/31/2006		
	USD	CHF	Total	USD	CHF	Total
Foreign currency risk from balance sheet items						
thereof: financial assets	433	0	433	61	0	61
thereof: financial liabilities	1,904	49	1,953	263	64	327
Foreign currency risk from pending transactions	0	0	0	0	0	
Transaction-related foreign currency position (gross)	**1,471**	**49**	**1,520**	**324**	**64**	**388**
Position hedged by derivatives	2,275	0	2,275	500	0	500
Net exposure to foreign currency position	**0**	**49**	**49**	**0**	**64**	**64**
Change in cash flows after hedging measures based on a 10 % risk of the euro	0	5	5	0	6	6

Two paragon business units are located outside of the euro currency zone. Since the Company's functional currency is the euro, the Company translates the financial statements of these subsidiaries into euros for the consolidated financial statements. The investments in foreign companies are generally of a long-term character and the income is to be continuously reinvested. Should paragon sell a foreign company, the Company incorporates the impacts of the transaction-related foreign currency risk into the sensitivity analysis. paragon recognizes translation-related impacts that arise when the value of the net asset position, translated into euros, changes due to fluctuations of the foreign currencies in the equity of the consolidated financial statements.

Interest rate risks

Interest rate risks result from the sensitivity of financial liabilities to change of the market interest rate. The Company hedges these risks by employing interest rate derivatives. paragon uses non-exchange-traded interest rate swaps to hedge interest rates. To hedge interest rate risk, the company follows an approach geared to individual financial liabilities at variable interest. With regard to amount and term, the swap contracts are tailored to the hedged variable borrowings.

Depending on whether the corresponding instrument has a fixed or variable interest rate, paragon measures the interest rate risks based either on fair value or cash flow sensitivity. Since the Company uses neither a fair value hedge nor the fair value option according to IAS 39, no fair value risk exists for its fixed interest financial instruments. The changes in fair value of the financial instruments at variable interest are not exposed to a fair value risk but they are exposed to a cash flow risk. In determining the fair value sensitivities of financial instruments at variable interest, the current interest rates of the balance sheet date are shifted upward and downward by 100 basis points. The following table shows the resulting opportunities (positive values) and risks (negative values).

The interest rate derivatives of the Company are not in a designated hedging relationship with the variable-interest loans. The table shows the impacts of an interest rate curve shifted upward and downward by 100 basis points in parallel:

in € (000)	Change in all interest rate curves as of Dec. 31, 2007 by	
	+ 100 basis points	- 100 basis points
Cash flow risk		
Variable-interest financial instruments	- 264	265
Cash/non-cash risks from interest rate derivatives		
Interest rate derivatives not in a hedging relationship		
Gain / loss	634	- 671
Equity	634	- 671

The following table shows the opportunities (positive values) and risks (negative values) derived from the analysis in 2006.

in € (000)	Change in all interest rate curves as of Dec. 31, 2006 by	
	+ 100 basis points	- 100 basis points
Cash flow risk		
Variable-interest financial instruments	- 126	126
Cash/non-cash risks from interest rate derivatives		
Interest rate derivatives not in a hedging relationship		
Gain / loss	676	- 686
Equity	676	- 686

Liquidity risks

The possibility that paragon may not be able to meet its financial obligations constitutes the liquidity risk. These financial obligations relate, for example to the repayment of financial liabilities, the payment of purchase commitments and liabilities arising from finance leases. paragon limits this risk through effective cash management and having access to credit lines at financial institutions with very good credit standing. The Company had at its disposal credit lines in the amount of € 21.0 million as of December 31, 2007.

In addition to the aforementioned instruments for liquidity hedging, paragon continuously follows the developments in the financial markets in order to be able to take advantage of emerging advantageous financing possibilities.

in € (000)	2008	2009	2010 – 2012	2013 and thereafter
Non-derivative financial liabilities				
Liabilities to banks	16,031	13,753	21,723	6,338
Profit sharing rights	4,845	1,825	8,866	19,527
Liabilities from finance leases	548	166	68	0
Trade liabilities	13,753	0	0	0
Other financial liabilities	6,142	1,898	0	0
Derivative financial liabilities	35	0	0	0

The following table shows all contractually fixed payments for redemptions, repayments and interest from recognized financial liabilities, including derivative financial instruments having a negative fair value, as of December 31, 2007. For the remaining obligations, the Company discloses the non-discounted cash out-flows for the next few years. The derivative financial instruments are reported at fair value:

The general overview of liquidity and borrowing is determined by calculating net liquidity and net borrowing. Net liquidity and net borrowing is derived from the sum of cash equivalents minus liabilities to banks, profit-sharing rights and liabilities from finance leases, as shown in the balance sheet.

in € (000)	12/31/2007	12/31/2006
Cash and cash equivalents	6,443	8,758
Total liquidity	**6,443**	**8,758**
Short-term debt and components of long-term debt due on short notice	23,630	19,157
Long-term debt	51,830	51,201
Total debt	**75,460**	**70,358**
Net borrowing	**- 69,017**	**- 61,600**

Credit risks

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 risks is a major responsibility of the risk management system. paragon reviews the credit-worthiness of all customers with borrowing requirements that exceed specifically defined limits. The Company continuously monitors credit risk.

As of December 31, 2007, there was no reason to believe that significant defaults in payment would occur with respect to trade receivables and other receivables and loans.

	Trade receivables	
in € (000)	12/31/2007	12/31/2006
Neither overdue nor impaired		
Low-risk category	4,297	11,281
Observation list category	0	30
Carrying amount:	**4,297**	**11,311**
Overdue but not impaired		
Low-risk category	1,115	8,562
Observation list category	53	6
Carrying amount:	**1,168**	**8.568**
Aging analysis		
0 – 30 days	590	7.263
30 – 60 days	322	160
60 – 90 days	169	371
> 90 days	87	774
Specific allowances		
Total amount	1,119	153
Risk provisioning	- 325	-153
Carrying amount:	**794**	**0**

(26) Capital management

The goal of capital management is to guarantee the continued existence of the Company, thus enabling it to continue to pay dividends to its shareholders. According to the Company's risk situation, adequate yield must be generated for the shareholders. Furthermore, benefit should continue to be generated for all other interest groups.

The capital management of paragon AG is based on ratios of net borrowing and adjusted capital.

in € (000)		12/31/2007	12/31/2006
	Total borrowing (not including subordinated debt)	92,497	96,968
./.	cash and cash equivalents	- 6,443	- 8,758
=	**net borrowing**	**86,054**	**88,210**
	Total equity	18,150	17,571
+	subordinated debt	25,494	23,277
=	**Adjusted capital**	**43,644**	**40,848**
	Ratio of net borrowing to adjusted capital	**2.0**	**2.2**

Notes on the cash flow statement

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

(27) Net cash used for operating activities

Cash and cash equivalents used for operating activities include interest paid in the amount of € 6.9 million (2006: € 4.8 million). The higher interest payments reflect interest expenses for new profit-sharing rights of € 7.0 million issued in the year under review, on which interest in the previous year was paid only pro rata temporis, and expenses for cancellation fees due to the early repayment of profit-sharing rights (€ 5.0 million) in the year under review. Moreover, the interest expenses for short-term loans rose year-on-year due to the increased borrowings.

(28) Net cash used for investing activities

At € 2.1 million, investments in land and buildings relate to the formerly leased property at Schwalbenweg 29. In this connection, € 1.4 million in loan liabilities was taken over and applied to the purchase price of € 2.0 million.

Additional significant cash outflows in 2007 include investments in machinery of the paragon Group of € 1.9 million (2006: € 1.5 million) and payments for equipment under construction and advance payments for property, plant and equipment of € 2.2 million (2006: € 3.1 million).

(29) Net cash from financing activities

Additional borrowings in the amount of € 6.6 million were raised for the expansion of the product business. Additional cash inflows resulted from issuing profit-sharing rights at a nominal value of € 7.0 million. Significant cash outflows resulted from the repayment of profit-sharing rights of € 5.0 million and the repayment of loans in the amount of € 3.1 million.

Net cash inflows in fiscal 2007 were € 4.3 million. For information on the changes in profit-sharing rights, please refer to Note (19).

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

Cash and cash equivalents include € 19 thousand in cash on hand and € 6,424 thousand in bank deposits.

Notes on the segment report

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

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

Segment assets are reflected as follows in the segment report:

in € (000)	12/31/2007	12/31/2006
Total assets	136,141	137,816
Less monetary assets	- 6,443	- 8,758
Less deferred taxes	- 3,901	- 392
Less other non-segment-specific assets	- 10,234	- 1,649
Segment assets	**115,563**	**127,017**

Segment liabilities are reflected as follows in the segment report:

in € (000)	12/31/2007	12/31/2006
Total liabilities	136,141	137,816
Less equity	- 18,150	- 17,571
Less special item	- 9,147	- 10,012
Less loans and other liabilities	- 95,838	- 95,889
Segment liabilities	**13,006**	**14,344**

Write-downs include an impairment loss as defined by IAS 38.97, in conjunction with IAS 36, amounting to € 138 thousand (2006: € 528 thousand) which is attributable to the Automotive business segment. Non-cash expenses and income are not shown explicitly in segment reporting, as it is not possible to allocate them specifically to the segments generating them.

Only an insignificant number of intersegment sales were transacted in fiscal 2007.

As of year under review, the former segments "Electronic Solutions" and "Building Technology" were combined into one segment "Electronic Solutions." The 2006 disclosures were adjusted accordingly in the segment report in the year under review.

Please see attachment 4 for segment reporting.

Other notes

(31) Contingent liabilities

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

(32) Other financial liabilities

Other financial liabilities amount to € 40,416 thousand (2006: € 6,161 thousand), of which € 31,056 thousand (2006: € 1,939 thousand) are due in calendar year 2008. Other financial liabilities include € 6,859 thousand (2006: € 3,390 thousand) for the next two to five years and € 2,501 thousand (2006: € 832 thousand) for terms exceeding five years.

Other financial liabilities include the open purchase order amounting to € 29,300 thousand (2006: € 5,786 thousand), of which € 300 thousand has a term exceeding one year.

In addition, other financial liabilities exist from lease agreements. The liabilities under operating leases total € 1,111 thousand (2006: € 1,555 thousand), of which € 626 thousand are due in 2008. Lease obligations with a term from two to five years account for € 481 thousand and those with a term exceeding five years account for € 4 thousand. Lease objects in the main consist of vehicles that are returned to the lessor after the uncancellable basic lease period has expired. Expenses from leases amount to € 234 thousand (2006: € 93 thousand) in fiscal 2007.

The liabilities under rental leases total € 7,505 thousand (2006: € 3,013 thousand), of which € 931 thousand are due in 2008. The liabilities amount to € 4,078 thousand for the next two to five years and € 2,496 thousand for terms exceeding five years.

The building at Bösendamm 11-13, 33129 Delbrück, is rented by paragon AG. The building's landlord is Frers Grundstücksverwaltungs GmbH, Delbrück. The expense for the calendar year came to € 127 thousand (2006: € 127 thousand).

Other financial liabilities account for € 2,500 thousand (2006: € 0 thousand), of which € 2,000 thousand has a term exceeding one year.

As in the previous year, no contingent assets or liabilities of note exist as at the balance sheet date.

Please refer also to Note (31).

(33) Related parties

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

Total compensation of the Managing Board is € 2.0 million (2006: € 1.6 million). This includes a fixed component of € 0.7 million (2006: € 0.6 million). The amount of € 0.6 million (2006: € 0.5 million) was recognized as expense for performance-related components. Short-term performance-related components are linked to group EBIT.

Total remuneration of the Managing Board, moreover, includes a non-cash benefit for automobile use, stock options, retirement benefits and other remuneration for members of the Managing Board in the amount of € 0.7 million (2006: € 0.5 million). For 2007, the above amount of € 0.7 million also includes severance payments or expenses in connection with severance payments. Please refer to details in the section "Share-based payment" under item (34) for information on the performance-related components providing long-term incentives.

More detailed explanations of the pension provisions can be found in Note (22).

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), no. 9a, (5-9) and sections 315a, 314 (1), no. 6a (5-9) of the German Commercial Code.

In the past calendar year, the members of the Supervisory Board received fixed compensation as well as variable compensation through stock appreciation rights. Please refer to Item (31) in this regard. Total compensation of the Supervisory Board in the year under review was € 42 thousand (2006: € 45 thousand). Of that amount, € 41 thousand (2006: € 41 thousand) was fixed compensation; the variable compensation component totaled € 1 thousand (2006: € 4 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 in the hands of Mr. Klaus Dieter Frers. The Supervisory Board holds 6,000 shares.

In 2007, rental payments totaling € 237 thousand were paid to the Frers family based on existing agreements; € 202 thousand related to the two company buildings in Delbrück. In the current fiscal year, the Frers family sold the company building in Delbrück, Schwalbenweg 29, to paragon AG for a total purchase price of € 2.0 million. The selling price was determined by an external appraisal and is broken down by land (€ 115 thousand), building (€ 1,805 thousand) and outside facilities (€ 80 thousand).

As of the balance sheet date, a directly enforceable fixed guarantee without consideration on the part of Mr. Klaus Dieter Frers existed for paragon AG's obligations to banks in the amount of € 153 thousand (2006: € 153 thousand).

Moreover, on the balance sheet date, an agreement was in existence between the State of Thuringia (represented by the Thüringer Aufbaubank, Erfurt) and Mr. Klaus Dieter Frers concerning a co-debtor obligation under public law, according to which Mr. Frers, in addition to paragon AG, assumes the liability for reimbursement as recipient of grants. This liability would arise if the State of Thuringia requested the Company to reimburse an investment subsidy in the amount of € 4,898 thousand (2006: € 4,898 thousand) of which € 4,898 thousand (2006: € 4,898 thousand) have been paid out as of the balance sheet date.
Please refer to Note (31).

Artega Automobil GmbH & Co. KG (Artega) is included for the first time in the report on related parties for fiscal 2007. Since August 2007, Mr. Klaus Dieter Frers has been the chairman of this company's advisory board.

Under the cooperation agreement concluded on January 1, 2007, the following items were charged to Artega:

- € 1.1 million for development services
- € 115 thousand for costs advanced, thereof € 77 thousand for rent
- € 164 thousand for interest

As of December 31, 2007, receivables resulting from the charges of 2006 and 2007 were due from Artega. The cooperation agreement concluded with Artega provides clear terms for these receivables with respect to due date and possible collateralization.

(34) Share-based payments

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

Stock option plan 1

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

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

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

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

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

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

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

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

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

In fiscal 2007, personnel expense totaling € 0 thousand (2006: € 99 thousand) was allocated to capital reserve for the granting of stock options of the third and fourth tranche of stock option plan 1.

Stock option plan 2

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

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

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

Stock Appreciation Rights Program (STAR Program)

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

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

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

Total term of the option plan	4 years
Blocking period	1 year
Anticipated term to end of blocking period	1.5 years
Share price on December 30, 2006	€ 9.17
Strike price of the option	
2005 tranche	€ 16.43
2004 tranche	€ 15.09
Anticipated dividend yield	1.60 %
Risk-free rate 2003	4.07 %
Risk-free rate 2004	3.86 %
Risk-free rate 2005	4.12 %
Volatility of the share	39.10 %
Option value as of December 31, 2005	
2005 tranche	€ 0.65
2004 tranche	€ 0.10

The 2003 tranche expired according to plan in November 2007.

A provision in the amount of € 1 thousand was set up as of December 31, 2007 for the 9,000 outstanding stock appreciation rights of the Supervisory Board.

By resolution of the Managing Board of April 2, 2004, the stock appreciation rights program No. 2 of paragon AG was adopted for the granting of stock appreciation rights to employees of paragon AG, as well as to employees and members of management of affiliated companies. STAR Program No. 2 includes a total of 100,000 stock appreciation rights for the period up to December 31, 2005, and a total of 250,000 stock appreciation rights in the period from January 1, 2006, to December 31, 2008, which the Managing Board can offer to the eligible individuals. Each appreciation right confers to the participant the right to receive, on the day the stock appreciation right is exercised, a cash payment in the amount of the difference between the basis price and the share price on the day the stock appreciation right is exercised. By the balance sheet date no stock appreciation rights had been offered from the STAR Program No. 2.

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

Stock options and stock appreciation rights

	Stock option plan 1				STAR plan 1		
	1st tranche	2nd tranche	3rd tranche	44th tranche	1st tranche	2nd tranche	3rd tranche
Issue date	Jan. 2001	Apr. 2002	Apr. 2003	Nov. 2004	Nov. 2003	Nov. 2004	Nov. 2005
Stock options granted	46,365	47,990	71,469	30,000			
Stock granted Appreciation Rights (SAR)					4,000	4,000	4,000
Strike price in €	7.98	3.78	3.88	15.09	8.24	15.09	16.43
Expiration of waiting time	Jan. 2003	Apr. 2004	Apr. 2005	Nov. 2006	Nov. 2004	Nov. 2005	Nov. 2006
in units							
Options outstanding at start of year	3,477	4,867	17,028	30,000			
SARs outstanding at start of year					1,000	4,000	4,000
Options granted	0	0	0	0			
SARs granted					0	0	0
Options exercised	0	695	1,030	0			
SARs exercised					0	0	0
Expired options	0	0	0	0			
Expired SARs					1,000	0	0
Options outstanding at year-end	3,477	4,172	15,998	30,000			
SARs outstanding at year-end					0	4,000	4,000
Options exercisable at year-end	3,477	4,172	15,998	30,000			
SARs exercisable at year-end					0	4,000	4,000
in €							
Valuation per option			0.94	5.52			
Valuation per SAR as of Dec. 31, 2007						0.1	0.0016
Previous year						0.10	0.65

(35) Events after the Balance Sheet Date

On January 15, 2008, paragon repaid an additional € 3.0 million in connection with the refinancing of high-interest profit-sharing rights. Special expenses incurred in this connection were taken into account in the budgeting.

In connection with the possible compensatory damage claims explained in the risk report, the subsidiary MONAWI Handels-GmbH (formerly Cullmann GmbH, Delbrück), which was established in 2007 for trading goods business, was reported for insolvency as a precaution in January 2008. This firm had one business transaction to report in the form of a trading goods transaction, which ultimately did not come to fruition. Since no profit transfer agreement was concluded between MONAWI and paragon AG, there is no threat of an enforcement of liability for paragon AG from this insolvency.

In February 2008, paragon AG opened a sales office in Turin, Italy, which should more intensively take advantage of the growth opportunities in the Italian market and further increase exports.

We are not aware of any other events of special significance subsequent to year-end 2007.

(36) Risk management

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

(37) Employee benefits

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

AVIVA, plc., London, in order to fulfill associated claims.

During the reporting year, paragon AG paid an amount of € 63 thousand (2006: € 77 thousand) into the reinsured relief fund.

(38) Board members

During the period under review, paragon AG's Managing Board consisted of the Chairman of the Managing Board, Mr. Klaus D. Frers, graduate engineer, responsible for the Technology, Corporate Development, and Sales & Marketing departments; the Chief Financial Officer, Mr. Volker Brinkmann, responsible for the Finance and Investor Relations departments; and since October 1, 2007, Mr. Golo Alexander Wahl, responsible for the Marketing and Sales department. Mr. Hans-Jürgen John, Verl-Kaunitz, was responsible for the Finance and Investor Relations departments until August 23, 2007.

Members of the Supervisory Board

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

(39) Employees

The average number of employees engaged in the companies included in the consolidation during 2007 was 547 (2006: 526), of which 220 were industrial workers (2006: 204).

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

The German Corporate Governance Code (DCGK) defines the essential recommendations for the management and supervision of German exchange-listed companies and contains standards for responsible corporate management as revised on June 14, 2007.

The statement stipulated in Section 161 of the AktG was submitted on December 6, 2007; shareholders have permanent access to this statement at the Company's website (www.paragon-online.de).

(41) Exemption pursuant to section 264 (3) No. 4a German Commercial Code

Under a resolution of the Annual General Meetings of paragon firstronic GmbH, Suhl, paragon finesse GmbH, Delbrück, paragon fidelity GmbH, Cadolzburg, paragon fidelio GmbH, Delbrück and paragon facilio GmbH, Delbrück of July 31, 2007 and December 29, 2007, these companies, through the consent of the sole shareholder paragon AG, Delbrück, were exempted from disclosure obligation and from the obligation to prepare a management report and notes. The exemption for these subsidiaries was published in the electronic version of the German Federal Gazette on February 28, 2008.

(42) Fees

Total fees paid to the independent auditor during the fiscal year were € 305 thousand. The amount contains the costs of the audit of € 250 thousand, costs for other certification and valuation services of € 33 thousand and costs for tax consulting and preparation of tax returns of € 22 thousand. No costs for other services by the independent auditor were incurred in 2007.

Delbrück, March 31, 2008

Klaus Dieter Frers	Volker Brinkmann	Golo Alexander Wahl

We have audited the consolidated financial statements of paragon AG, Delbrück, consisting of the balance sheet, the income statement, the statement of changes in shareholders' equity, the cash flow statement and the notes – as well as the group management report – for the fiscal year January 1 through December 31, 2007. Preparation of the consolidated financial statements and the group management report in accordance with the IFRS, as adopted by the EU, and the requirements of German commercial law pursuant to Section 315a (1) HGB is the responsibility of the Company's legal representatives. It is our responsibility to submit an assessment of the consolidated accounts based on our audit examination.

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

Our audit has not led to any reservations.

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

Nuremberg, March 31, 2008

Rödl & Partner GmbH
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Dr. Keller
Accountant

Vörg
Accountant

2007	Implementation of Artega® GT as reference object Expansion and reinforcement of management organization Expansion of international sales network
2006	Complete take-over of the paragon fidelity GmbH (Car Media Systems) Further major orders for automotive products
2005	Acquisition of Cullmann GmbH and entering into the business with Car Media Systems Opening of new production facility for Electronic Solutions
2004	Acquisition of the Andreas Haller GmbH & Co. KG (Instrumentation and Control Systems) Formation of the sensor element plant paragon fidelio GmbH
2003	Take-over of the air quality sensor sector of Robert Bosch GmbH
2002	Company-wide introduction of the quality standard ISO/TS 16949
2001	Acquisition of the Miquest Corp. (Grand Rapids, MI, USA)
2000	World market leader in air quality sensors for automobiles Formation of the paragon of North America Corp. paragon AG goes public at German Stock Exchange (Börse)
1999	First patents in communication electronics in the automobile Introduction of the quality standards QS 9000, VDA 6.1 and ISO 9001
1998	Start of the production of components of operating elements in the automobile
1997	Concentration of production in Suhl Large series application of paragon air quality sensors in automobiles
1995	First application of paragons` air quality sensors in automobiles
1994	Start of the development of air quality sensors
1993	Company-wide introduction of the quality standard ISO 9002
1991	Construction of a plant for Electronic Services in Zella-Mehlis (formerly robotron)
1988	Formation as electronic manufacturer in Delbrück by Klaus Dieter Frers

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