



## Report

on the first nine months of 2006

### paragon AG

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# Report

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

### The first nine months at a glance

in € (000)	2006 through 9/30	2005 through 9/30	Change in %
Sales	78,117	55,883	39.8 %
EBITDA	14,548	9,484	53.4 %
EBIT	5,043	4,351	15.9 %
Net earnings for period	963	1,370	- 29.7 %
Liquidity*	3,973	4,832	- 17.8 %
Equity ratio*	26.1 %**	38.0 %	-
Employees	570	431	32.3 %

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

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

<b>Securities Identification No.:</b>	555 869
<b>ISIN:</b>	DE0005558696
<b>Ticker symbol:</b>	PGN
<b>Trading segment:</b>	Prime Standard
<b>Sector:</b>	Technology

#### Highlights of the 3rd quarter of 2006 (compared with the 3rd quarter of 2003)

- Sales: + 39.8 % growth to € 78.1 million
- EBITDA: + 53.4 % growth to € 14.5 million
- Breakthrough for air quality sensors in the mid-range category

## Sales

In the first nine months of 2006, the paragon Group increased its sales to € 78.1 million, reflecting a 39.8 % improvement over the same period of 2005 (September 30, 2005: € 55.9 million). Record sales of € 27.5 million were generated by the Company in the third quarter alone.

In the core Automotive division, sales grew 60.7 % to € 62.9 million (previous year: € 39.1 million). This performance illustrates that along with having the largest share of total sales (80.5%; previous year: 70.1 %), this division is also the Group's growth engine. The division's U.S. location contributed € 3.4 million to sales (previous year: € 3.5 million).

The Electronic Solutions division generated sales of € 14.4 million in the period under review (previous year: € 16.1 million). The 11.0 % decline from the previous year is primarily due to a reallocation within the Group in the first quarter of 2006. Sales in the U.S. totaled € 5.0 million (previous year: € 1.7 million). After the first three quarters, Electronic Solutions' contribution to Group sales was 18.4 % (previous year: 28.9 %).

Sales in the Building Technology division rose to € 846 thousand in the period under review (previous year: € 607 thousand).

## Earnings

During the first nine months of 2006, earnings before interest, taxes, depreciation and amortization (EBITDA) climbed to € 14.5 million, an increase of 53.4 % over the same period of the previous year (€ 9.5 million).

Adjusted EBIT increased by 41.6 % to € 6.2 million during the period under review. After writing down intangible assets, the increase was 15.9 %, or € 5.0 million (previous year: € 4.4 million). The EBIT margin reached 6.5 %.

Special tax effects led to a decrease in net income for the period to € 963 thousand (previous year: € 1.4 million). This translates into diluted and undiluted earnings of € 0.23 per share (previous year: € 0.34 undiluted, € 0.33 diluted). By the end of the year, the Managing Board expects earnings per share to have surpassed the previous year's level (December 31, 2005: € 0.55).

## Financial Position

Cash and cash equivalents available to the Group amounted to € 4.0 million as of September 30, 2006 (December 31, 2005: € 4.8 million).

The Company's equity totaled € 16.5 million at the end of the first nine months of 2006 (December 31, 2005: € 20.0 million). As of September 30, 2006, the equity-to-assets ratio, including profit sharing rights, amounted to 26.1% due to the first-time full inclusion of paragon fidelity GmbH.

Capital expenditure amounted to approximately € 15.5 million in the period under review. Investments focused on expanding the production facilities at the Suhl location, which laid the foundation for additional growth. The new facilities will commence operations in the fourth quarter. In addition, the remaining 49% of the shares in paragon fidelity GmbH were acquired.

## Research and Development

paragon concentrated its research and development activities on the Automotive division in the third quarter.

One new addition to the product portfolio is a backup camera system for the aftermarket. The camera is activated automatically when the vehicle is put into reverse. The system can be connected to an existing display or an easy-to-install monitor. Readily accessible connections for DVD players and game consoles make it easy to expand the monitor into an entertainment system, thus providing significant added value.

In addition, paragon's double stepper motor is nearly ready to go into series production. Following the trend toward offering more features for car interiors, this motor enables two control panel indicators to be activated simultaneously, thus increasing the degree of freedom in instrument design. For example, it is possible to combine the speedometer and tachometer into a single instrument.

paragon demonstrates its expertise in the field of software development by means of an optimized LIN-API solution. This system, which was developed in-house, makes it possible to control complex sensor nodes in the automotive field. The benefit for paragon customers lies in a functionality that makes good use of resources and is easy to integrate.

## Employees

As of September 30, 2006, the paragon Group employed a total of 570 persons (previous year: 431). Of that number, 105 were employed at corporate headquarters in Delbrück and 265 in Suhl. Outside of Germany, paragon employed a total of 72 persons (previous year: 44) as of the end of the third quarter.

## Stock Performance

During the third quarter of 2006, paragon's share price traded between € 14.22 and € 10.99. By the end of the quarter, the price had recovered to close at € 12.48 (XETRA) on September 29, 2006. The price rise was accompanied by a road show in Frankfurt in which the Managing Board reported extensively concerning the major orders received and the Group's future perspectives. Moreover, a number of financial magazines carried favorable reports.

Several investor relations activities are also planned for the fourth quarter. Among other things, paragon will present itself to domestic and foreign investors at the German Equity Forum in Frankfurt, the largest investors conference in Germany, on November 29, 2006.

## Outlook

paragon will continue to grow at a dynamic pace in the future. The Managing Board anticipates an upward trend in all divisions for the fourth quarter of 2006 and for the coming year as well.

To make this growth possible, the Company is stepping up its investments in capacity expansion in the current fiscal year. The sixth stage of construction on the production location in Suhl, Thuringia will commence operations in the fourth quarter. In the future, it will be possible to assemble four million electronic components and other items daily on 12,300 square meters of floor area, significantly increasing the production capacity for hands-free speaking systems. In this way, the Company is responding to the surge in demand in Car Media Systems.

The expansion is also a response to the new major orders in the Air Quality Systems division. The agreements signed in 2006 alone will increase annual sales by approximately 50% by 2008. The potential in this area is still far from exhausted. New customers in Europe and Asia and the development of additional vehicle categories and enhancements that will soon be introduced to the market still offer considerable possibilities for growth. As a world market leader in this segment, paragon sees itself in an excellent starting position for taking advantage of the opportunities available.

Based on the supply agreements already on hand, the Managing Board still anticipates that sales will exceed € 110 million in the current fiscal year. The growth course will continue in 2007, which will further improve both sales and earnings.

## Consolidated Income Statement

for the period from January 1 to September 30, 2006

in € (000)	Q-3 2006 07/01/06 – 09/30/06	Q-3 2005 07/01/05 – 09/30/05	first 9 months of 2006 01/01/06 – 09/30/06	first 9 months of 2005 01/01/05 – 09/30/05
<b>Revenue</b>	<b>27,476</b>	<b>19,949</b>	<b>78,117</b>	<b>55,883</b>
Other operating income	1,552	955	2,955	2,230
Changes in inventory of finished goods and work in progress	- 683	- 219	2,778	161
Other own work capitalized	1,351	550	3,208	1,251
<b>Total operating revenue</b>	<b>29,696</b>	<b>21,235</b>	<b>87,058</b>	<b>59,525</b>
Cost of materials	- 17,400	- 11,596	- 48,231	- 31,102
<b>Gross income</b>	<b>12,296</b>	<b>9,639</b>	<b>38,827</b>	<b>28,423</b>
Personnel expense	- 4,203	- 4,261	- 16,164	- 12,681
Depreciation/amortization/impairment of property, plant and equipment and intangible assets	- 2,848	- 1,850	- 8,115	- 5,133
Other operating expenses	- 3,808	- 2,082	- 9,505	- 6,258
<b>Earnings before interest and taxes (EBIT)</b>	<b>1,437</b>	<b>1,446</b>	<b>5,043</b>	<b>4,351</b>
Financial income	24	24	38	78
Financing expenses	- 990	- 635	- 3,080	- 1,918
<b>Financial result</b>	<b>- 966</b>	<b>- 610</b>	<b>- 3,042</b>	<b>- 1,893</b>
<b>Income before taxes</b>	<b>471</b>	<b>836</b>	<b>2,001</b>	<b>2,512</b>
Income taxes	- 280	- 293	- 970	- 1,084
Other taxes	- 24	- 23	- 68	- 58
<b>Net income</b>	<b>167</b>	<b>520</b>	<b>963</b>	<b>1,370</b>
Minority interests	0	0	0	0
<b>Net income attributable to equity holders of the parent</b>	<b>167</b>	<b>520</b>	<b>963</b>	<b>1,370</b>
Earnings per share (basic)	0.04	0.13	0.23	0.34
Earnings per share (diluted)	0.04	0.13	0.23	0.33
Average number of shares outstanding (basic)	4,099,620	4,083,317	4,099,952	4,083,317
Average number of shares outstanding (diluted)	4,131,159	4,095,664	4,131,159	4,095,664

## Segment Report

in € (000)	Exterior sales		Earnings before interest and taxes (EBIT)	
	First 9 months of 2006 01/01/06 – 09/30/06	First 9 months of 2005 01/01/05 – 09/30/05	First 9 months of 2006 01/01/06 – 09/30/06	First 9 months of 2005 01/01/05 – 09/30/05
Automotive	62,919	39,149	4,700	3,777
Electronic Solutions	14,352	16,127	353	548
Building Technology	846	607	- 10	26
<b>Total</b>	<b>78,117</b>	<b>55,883</b>	<b>5,043</b>	<b>4,351</b>

## Consolidated Balance Sheet

as at September 30, 2006

in € (000)	09/30/2006	12/31/2005
<b>Assets</b>		
<b>Non-current assets</b>		
Intangible assets	27,236	23,542
Goodwill	28,517	17,981
Property, plant and equipment	31,441	27,940
Financial assets	200	200
Deferred tax assets	2,115	2,111
<b>Total non-current assets</b>	<b>89,509</b>	<b>71,774</b>
<b>Current assets</b>		
Inventories	18,598	13,981
Trade receivables	15,754	9,704
Income tax claims	56	363
Other assets	2,478	12,371
Cash and cash equivalents	3,973	4,832
<b>Total current assets</b>	<b>40,859</b>	<b>41,251</b>
<b>Total assets</b>	<b>130,368</b>	<b>113,025</b>
<b>Liabilities and equity</b>		
<b>Equity</b>		
Subscribed capital	4,112	4,086
Capital reserves	7,697	7,565
Net income attributable to equity holders of the parent	963	1,264
Retained earnings	4,670	4,224
Reserve for currency translation differences	- 944	- 790
<b>Equity before minority interests</b>	<b>16,498</b>	<b>16,349</b>
Minority interests	0	3,695
<b>Equity after minority interests</b>	<b>16,498</b>	<b>20,044</b>
<b>Non-current liabilities</b>		
Long-term financial lease liabilities	812	1,459
Long-term loans	30,656	10,118
Profit sharing capital	17,565	17,483
Silent equity holding	0	8,754
Investment grants	10,535	10,062
Deferred tax liabilities	6,754	5,048
Provisions for pensions	1,008	853
Other non-current liabilities	5,813	0
<b>Total non-current liabilities</b>	<b>73,143</b>	<b>53,777</b>
<b>Current liabilities</b>		
Current portion of financial lease liabilities	964	1,019
Short-time loans and current portion of long-term loans	15,574	13,899
Trade liabilities	13,704	12,398
Other provisions	3,157	5,149
Income tax liabilities	2,103	1,783
Liabilities to minority shareholders	0	1,081
Other current liabilities	5,225	3,875
<b>Total current liabilities</b>	<b>40,727</b>	<b>39,204</b>
<b>Total equity and liabilities</b>	<b>130,368</b>	<b>113,025</b>

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

Share capital: 4.112.534 Stück	Shares	Options
<b>Executive Board, total</b>	<b>2,115,730</b>	<b>30,000</b>
<b>Supervisory Board, total</b>	<b>6,000</b>	<b>0</b>
<b>Boards, total</b>	<b>2,121,730</b>	<b>30,000</b>
as % of share capital	51.59 %	

## Consolidated Statement of Changes in Equity

in € (000)	Subscribed Capital	Exchange rate differences	Capital reserves	Profit/loss carried forward	Net income	Minority interests	Total
<b>January 1, 2005</b>	<b>4,037</b>	<b>- 987</b>	<b>7,318</b>	<b>1,765</b>	<b>2,863</b>	<b>0</b>	<b>14,996</b>
Income after taxes	0	0	0	0	1,370	0	1,370
Accumulated profits/losses	0	0	0	2,863	- 2,863	0	0
Dividend distribution	0	0	0	- 404	0	0	- 404
Capital increase (exercise of stock options)	46	0	147	0	0	0	193
Addition due to stock option valuation	0	0	63	0	0	0	63
Minority interests	0	0	0	0	0	0	0
Currency translation changes	0	189	0	0	0	0	189
<b>September 30, 2005</b>	<b>4,083</b>	<b>- 798</b>	<b>7,528</b>	<b>4,224</b>	<b>1,370</b>	<b>0</b>	<b>16,407</b>
<b>January 1, 2006</b>	<b>4,086</b>	<b>- 790</b>	<b>7,565</b>	<b>4,224</b>	<b>1,264</b>	<b>3,695</b>	<b>20,044</b>
Income after taxes	0	0	0	0	963	0	963
Accumulated profits/losses	0	0	0	1,263	- 1,264	0	- 1
Dividend distribution	0	0	0	- 817	0	0	- 817
Capital increase (exercise of stock options)	26	0	83	0	0	0	109
Addition due to stock option valuation	0	0	49	0	0	0	49
Minority interests	0	0	0	0	0	- 3,965	- 3,965
Currency translation changes	0	- 154	0	0	0	0	- 154
<b>September 30, 2006</b>	<b>4,112</b>	<b>- 944</b>	<b>7,697</b>	<b>4,670</b>	<b>963</b>	<b>0</b>	<b>16,498</b>

## Consolidated Cash Flow Statement (IFRS)

in € (000)	01/01 - 09/30/2006		01/01 - 09/30/2005	
<b>Cash flow from operating activities</b>				
<b>Income before taxes and deferred taxes</b>	<b>2,001</b>		<b>2,454</b>	
Adjustment for:				
Impairment losses	8,115		5,133	
Financial result	3,042		1,839	
Gains/losses from the disposal of non-current assets	- 3		0	
Change of the other provisions and provisions for pensions	- 1,517		283	
Income from reversal of special account for grants	- 1,573		- 1,244	
Other non-cash income and expense	- 41		0	
Change in trade receivables, other receivables and other asset	248		- 3,255	
Change in inventory level	- 4,618		- 1,503	
Change in trade payables and other liabilities	- 2,908		506	
Interest paid	- 3,080		- 1,918	
Income taxes	- 559		- 761	
<b>Net cash from operating activities</b>		<b>- 893</b>		<b>1,534</b>
<b>Cash flow from investing activities</b>				
Payments for investment minus residual carrying amount of asset disposals	- 15,497		- 8,618	
Payments for the purchase of subsidiaries	- 7,305		- 200	
Additions of cash and cash equivalents from the acquisition of subsidiaries	41		0	
Funds from investment grants	1,642		3,981	
Interest received	38		79	
<b>Net cash from investing activities</b>		<b>- 21,081</b>		<b>- 4,758</b>
<b>Cash flow from financing activities</b>				
Dividend distribution to shareholders	- 817		- 404	
Repayment of (financial) credits	- 9,470		- 4,304	
Proceeds from (financial) credits taken	31,335		6,418	
Proceeds from equity additions	109		193	
Net cash from the issuance of profit-sharing capital	0		3,849	
<b>Net cash from financing activities</b>		<b>21,157</b>		<b>5,752</b>
Exchange rate changes		- 42		15
<b>Change in cash and cash equivalents</b>		<b>- 859</b>		<b>2,543</b>
<b>Cash and cash equivalents at the beginning of the period</b>		<b>4,832</b>		<b>5,432</b>
<b>Cash and cash equivalents at the end of the period</b>		<b>3,973</b>		<b>7,975</b>