

Edgar Filing: ARGAN INC - Form 10QSB

ARGAN INC
Form 10QSB
June 10, 2004

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED APRIL 30, 2004 COMMISSION FILE NUMBER 001-31756

ARGAN, INC.

(Exact name of small business issuer as specified in its charter)
Formerly Puroflow Incorporated

DELAWARE

13-1947195

(State or other jurisdiction of incorporation (IRS Employer identification No.)
or organization)

ONE CHURCH STREET, SUITE 302, ROCKVILLE MD

20850

(Address of principal executive offices)

(ZIP Code)

Issuer's telephone number, including area code: (301) 315-0027

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15 (d) of the Exchange Act during the past twelve months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Securities registered pursuant to Section 12(b) of the Act:

Common Stock
COMMON STOCK, \$.15 PAR VALUE

Shares outstanding
1,803,000 AS OF JUNE 9, 2004

Transitional Small Business Disclosure Format (Check One): Yes No

ARGAN, INC.

Edgar Filing: ARGAN INC - Form 10QSB

INDEX

	Page No. -----
PART I. FINANCIAL INFORMATION.....	3
Item 1. Financial Statements.....	3
Condensed Consolidated Balance Sheets - April 30, 2004 and January 31, 2004...	3
Condensed Consolidated Statements of Operations for the Three Months Ended April 30, 2004 and 2003.....	4
Condensed Consolidated Statements of Cash Flows for the Three Months Ended April 30, 2004 and 2003.....	5
Notes to Condensed Consolidated Financial Statements.....	6
Item 2. Management's Discussion and Analysis or Plan of Operation.....	10
Item 3. Controls and Procedures.....	18
PART II. OTHER INFORMATION.....	19
Item 1. Legal Proceedings.....	19
Item 2. Changes in Securities, and Small Business Issuer Purchases of Equity Securities.....	19
Item 3. Defaults upon Senior Securities.....	19
Item 4. Submission of matters to a vote of security holders.....	19
Item 5. Other Information.....	19
Item 6. Exhibits and Reports on Form 8-K.....	19
SIGNATURES.....	21

=====

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ARGAN, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

Edgar Filing: ARGAN INC - Form 10QSB

	April 30, 2004 =====	January 31, 2004 =====
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 2,173,000	\$ 5,212,000
Investments	5,500,000	3,000,000
Accounts receivable	883,000	1,523,000
Escrowed cash	602,000	601,000
Estimated earnings in excess of billings	504,000	514,000
Prepaid expenses and other current assets	261,000	150,000
	-----	-----
TOTAL CURRENT ASSETS	9,923,000	11,000,000
	-----	-----
Property and equipment, net	1,838,000	1,913,000
Contractual customer relationships, net	1,419,000	1,476,000
Trade name	680,000	680,000
Goodwill	1,680,000	1,680,000
	-----	-----
TOTAL ASSETS	\$ 15,540,000	\$ 16,749,000
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 502,000	\$ 918,000
Billings in excess of estimated earnings	30,000	20,000
Accrued expenses	382,000	488,000
Deferred income tax liability, net	204,000	188,000
Current portion of long-term debt	990,000	1,092,000
	-----	-----
TOTAL CURRENT LIABILITIES	2,108,000	2,706,000
	-----	-----
Deferred income tax liability, net of current portion	826,000	1,064,000
Long-term debt	88,000	109,000
STOCKHOLDERS' EQUITY		
Preferred stock, par value \$.10 per share - 500,000 shares authorized- issued - none		
Common stock, par value \$.15 per share - 12,000,000 shares authorized -1,806,046 shares issued at April 30, 2004 and January 31, 2004 and 1,802,813 shares outstanding at April 30, 2004 and January 31, 2004	270,000	270,000
Warrants outstanding	849,000	849,000
Additional paid-in capital	14,121,000	14,121,000
Accumulated deficit	(2,689,000)	(2,337,000)
Treasury stock at cost: 3,233 shares at April 30, 2004 and January 31, 2004	(33,000)	(33,000)
	-----	-----
TOTAL STOCKHOLDERS' EQUITY	12,518,000	12,870,000
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 15,540,000	\$ 16,749,000
	=====	=====

See accompanying notes.

Edgar Filing: ARGAN INC - Form 10QSB

CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	\$ (352,000)	\$ 26,000
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	156,000	
Deferred income taxes	(222,000)	
Changes in operating assets and liabilities:		
Accounts receivable	640,000	
Estimated earnings in excess of billings	10,000	
Prepaid expenses and other current assets	(117,000)	(6,000)
Accounts payable and accrued expenses	(522,000)	
Billings in excess of estimated earnings	8,000	
Non-cash charges and working capital changes of discontinued Operations	--	102,000
Net cash (used in) provided by operating activities	(394,000)	122,000
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(19,500,000)	
Redemptions of investments	17,000,000	
Purchases of property and equipment	(22,000)	
Investing activities of discontinued operations	--	(53,000)
Net cash used in investing activities	(2,522,000)	(53,000)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from private placement of common stock, net of offering costs	--	\$ 10,059,000
Principal payments on credit lines	(123,000)	
Financing activities of discontinued operations	--	(69,000)
Net cash used in financing activities	(123,000)	9,990,000
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	5,212,000	
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(3,039,000)	10,059,000
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 2,173,000	\$ 10,059,000

See accompanying notes.

5

ARGAN, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 - ORGANIZATION AND BASIS OF PRESENTATION

NATURE OF OPERATIONS

Argan, Inc. (AI or the Company) conducts its operations through its wholly owned subsidiary, Southern Maryland Cable, Inc. (SMC) which it acquired in July 2003. Through SMC, the Company provides telecommunications infrastructure services

Edgar Filing: ARGAN INC - Form 10QSB

including project management, construction and maintenance to the Federal Government, telecommunications and broadband service providers, as well as electric utilities primarily in the mid-Atlantic region.

AI was organized as a Delaware corporation in May 1961. On October 23, 2003, our shareholders approved a plan providing for the internal restructuring of the Company whereby AI became a holding company and its operating assets and liabilities relating to its former Puroflow business were transferred to a newly-formed, wholly owned subsidiary. The subsidiary then changed its name to "Puroflow Incorporated" (PI) and AI changed its name from Puroflow Incorporated to "Argan, Inc." At the time of the transfer, SMC was the other wholly owned operating subsidiary.

On October 31, 2003, the Company completed the sale of PI to Western Filter Corporation (WFC) for approximately \$3.5 million in cash of which \$300,000 is being held in escrow for one year to indemnify WFC from any damages resulting from the breach of representations and warranties under the Stock Purchase Agreement.

After the disposition of PI, the Company operates in one reportable segment.

BASIS OF PRESENTATION

The condensed consolidated balance sheet as of April 30, 2004 and the condensed consolidated statements of operations and cash flows for the three months ended April 30, 2004 and 2003, respectively, are unaudited. In the opinion of management, the accompanying financial statements contain all adjustments, which are of a normal and recurring nature, considered necessary to present fairly the financial position of the Company as of April 30, 2004 and the results of its operations and its cash flows for the periods presented. The Company prepares its interim financial information using the same accounting principles as it does for its annual financial statements.

These financial statements do not include all disclosures associated with annual financial statements and, accordingly, should be read in conjunction with the footnotes contained in the Company's consolidated financial statements for the year ended January 31, 2004, together with the auditors' report, included in the Company's Annual Report on Form 10-KSB, as filed with the Securities and Exchange Commission. The results of operations for any interim period are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year.

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144 "Accounting for Impairment or Disposal of Long-Lived Assets," the Company classified the operating results of PI as discontinued operations in the accompanying financial statements.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

Income Per Share - (Loss) income per share is computed by dividing (loss) income from continuing operations, income from discontinued operations and net (loss)

6

income by the weighted average number of common shares outstanding for the period. Outstanding stock options and warrants were anti-dilutive during the three months ended April 30, 2004 and 2003 due to the Company's loss from continuing operations.

Seasonality - The Company's telecom infrastructure services operations are

Edgar Filing: ARGAN INC - Form 10QSB

expected to have seasonally weaker results in the first and fourth quarters of the year, and may produce stronger results in the second and third quarters. This seasonality is primarily due to the effect of winter weather on outside plant activities as well as reduced daylight hours and customer budgetary constraints. Certain customers tend to complete budgeted capital expenditures before the end of the year, and postpone additional expenditures until the subsequent fiscal period.

Stock Issued to Employees -The Company follows Accounting Principles Board Opinion 25, Accounting for Stock Issued to Employees, to account for stock option plans, which generally does not require income statement recognition of options granted at the market price on the date of issuance.

The Pro Forma disclosures required by Statement of Financial Accounting Standards No. 148 "Accounting for Stock Based Compensation" are reflected below:

PRO FORMA DISCLOSURES FOR THE THREE MONTHS APRIL 30,

	2004
Net loss, as reported	\$ (352,000)
Add: Stock based compensation recorded in the financial statements	--
Deduct: Total stock-based employee compensation expense determined under fair value based methods	(18,000)
Pro forma net loss	\$ (370,000)
Basic and diluted per share:	
Basic and diluted - as reported	\$ (0.20)
Basic and diluted - pro forma	\$ (0.21)

During the three months ended April 30, 2003, stock options issued did not have a material effect.

NOTE 3- ACQUISITION OF SOUTHERN MARYLAND CABLE, INC.

On July 17, 2003, the Company acquired all of the common stock of SMC, a provider of telecommunications and other infrastructure services including project management, construction and maintenance to the Federal Government, telecommunications and broadband service providers, as well as electric utilities. The Company's purchase of SMC was focused on acquiring SMC's long-standing customer relationships and its well established reputation in a strategic geographic area, which supported the premium paid over the fair value of the tangible assets.

The results of operations of the acquired company are included in the consolidated results of the Company from July 17, 2003, the date of the acquisition. The estimated purchase price was approximately \$3.8 million in cash, plus the assumption of approximately \$971,000 in debt. The Company also leases the SMC headquarters at an annual rent of \$75,000 from the former owners of SMC. The lease term is through January, 2006.

The Company acquired SMC as part of its acquisition strategy. SMC was viewed as an attractive business because of its highly trained workforce, strong reputation and long standing customer relationships. In addition, SMC presented

Edgar Filing: ARGAN INC - Form 10QSB

a strategic value because of its recent growth in the area of inside plant premise wiring. The Company also identified several areas where significant cost savings could be realized. The aforementioned strategic strengths of SMC supported the premium paid over fair value of tangible assets.

The Company accounted for the acquisition of SMC using the purchase method of accounting whereby the excess of cost over the net amounts assigned to assets acquired and liabilities assumed is allocated to goodwill and intangible assets based on their estimated fair values. Such intangible assets included \$1,600,000 and \$680,000 allocated to Contractual Customer Relationships ("CCR") and Trade Name, respectively, and \$1,680,000 to Goodwill. The Company is amortizing the CCR over a weighted average life of seven years. Amortization expense has been recorded since July 17, 2003 (the date of acquisition). As of April 30, 2004, accumulated amortization was \$181,000. The Trade Name was determined to have an indefinite useful life and is not being amortized.

The following unaudited pro forma statement of operation of SMC and continuing operations of AI does not purport to be indicative of the results that would have actually been obtained if the aforementioned acquisition had occurred on February 1, 2003, or that may be obtained in the future. The pro forma presentation also excludes the discontinued operations of PI. SMC previously reported its results of operations using a calendar year-end. No material events occurred subsequent to this reporting period that would require adjustment to our unaudited pro forma statement of operations. The number of shares outstanding used in calculating pro forma earnings per share assume that the private offering discussed in Note 6 was consummated at February 1, 2003.

	Three Months Ended April 30, 2003

Pro Forma Statement of Operation	
Net sales	\$ 2,458,000
Cost of goods sold	1,842,000

Gross profit	616,000
Selling, general and administrative expenses	435,000

Income from operations	181,000
Other expense	(9,000)

Income from continuing operations before income taxes	172,000
Income tax provision	69,000

Income from continuing operations	\$ 103,000

Income per share	
- basic	\$ 0.06
- diluted	\$ 0.06
Weighted average shares outstanding	
- basic	1,798,000
- diluted	1,800,000

Edgar Filing: ARGAN INC - Form 10QSB

On October 31, 2003, AI, as part of its plan to reallocate its capital to its acquisition program, sold PI to WFC. The sales price of approximately \$3,500,000 was satisfied in cash of which \$300,000 is being held in escrow for one year to indemnify WFC from any damages resulting from a breach of representations and warranties under the Stock Purchase Agreement. AI recognized a gain on sale of approximately \$167,000, net of income taxes of \$506,000. The Company utilized net operating losses to offset the gain on sale and thus, has no current tax liability. The \$506,000 is the amount of the deferred tax assets related to the PI which has been sold. In accordance with SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets", the Company classified the operating results of PI as discontinued operations in the accompanying statements of operations.

The results of the discontinued operations are as follows for the three months ended April 30, 2003.

Net sales	\$ 1,690,000
Cost of goods sold	1,132,000

Gross profit	558,000
Selling, general and administrative expenses	451,000

Operating income from discontinued operations	107,000
Other expense	(7,000)

Income from discontinued operations before income taxes	100,000
Income tax expense	17,000

Income from discontinued operations	\$ 83,000
	=====

The Company has restated its previously issued financial statements to reflect, as discontinued operations, the operations of its wholly owned subsidiary, PI. Because of the reclassification of PI as discontinued operations, the Company was required to retroactively restate its financial statements for the three months ended April 30, 2003 according to Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

NOTE 5 - DEBT

In August, 2003, the Company entered into a financing arrangement with Bank of America ("Bank") aggregating \$2,950,000 in available financing in two tranches - a revolving line of credit with \$1,750,000 in availability, expiring July 31, 2004 and bearing interest at LIBOR plus 2.75%, and a three year term note with an original outstanding balance of \$1,200,000, expiring July 31, 2006 and bearing interest at LIBOR plus 2.95%. The proceeds from the term note were used to payoff the SMC lines of credit and for working capital. As of April 30, 2004 the Company had \$900,000 outstanding under the term note. AI has not drawn on the revolving line of credit.

The financing arrangement contains financial as well as nonfinancial covenants including the ratios of debt to pro forma earnings before interest, taxes, depreciation and amortization ("EBITDA") of 2.5 to 1, liabilities to tangible

Edgar Filing: ARGAN INC - Form 10QSB

net worth of 1.5 to 1, fixed charge coverage ratio of 1.25 to 1, as well as requirements for bank consent for acquisitions and divestitures. The Company pledged the majority of the Company's assets to secure the financing arrangement. At April 30, 2004, the Company was not in compliance with the ratio of debt to EBITDA and the fixed charge coverage ratio. The Company received a waiver from the Bank with respect to the breach of the covenants through October 31, 2004. The Company agreed to additional covenants whereby it would maintain at least \$2 million in liquidity, increase the interest rate by 50 basis points to LIBOR plus 3.45% and maintain positive net income during the second and third quarters. The Company reached an agreement with the Bank to extend the financing agreement beyond its current expiration to December 31, 2004. The Company has classified the entire note as current. Subsequent to the sale of PI, the Company deposited \$300,000 as additional collateral in a restricted cash account with the Bank.

NOTE 6 - PRIVATE OFFERING OF COMMON STOCK

On April 29, 2003, the Company completed a private offering of approximately 1,304,000 shares of common stock at a price of \$7.75 per share. The proceeds of the private offering were approximately \$10,107,000 prior to giving effect to offering costs of \$472,000 and the proceeds which may be derived from 230,000 warrants, issued in connection with the private placement. A portion of the net proceeds of the private placement was used in the acquisition of SMC and in final payment of the Company's credit facility with U.S. Bancorp. The remaining net proceeds are expected to be used for acquisitions in growth-oriented industries and for working capital. The private offering was approved by shareholder vote on April 15, 2003.

NOTE 7 - SUBSEQUENT EVENTS

Subsequent to April 30, 2004, the Company entered into a letter of intent with OTC Packaging, Inc. and ProActive Labs, Inc. ("OTC") to acquire all of the common stock of OTC. The consummation of the transaction is contingent upon the completion of the Company's due diligence, the signing of a definitive purchase and sale agreement, approval of both companies' board of directors and other conditions.

Subsequent to April 30, 2004, the Company entered into a letter of intent with Vitarich Laboratories, Inc. (VLI) to acquire all of the common stock of VLI. The consummation of the transaction is contingent upon the completion of the Company's due diligence, the signing of a definitive purchase and the sale agreement, approval of both companies' board of directors and other conditions.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

This Form 10-QSB contains certain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, which are intended to be covered by the safe harbor created thereby. These statements relate to future events or our future financial performance, including statements relating to our products, customers, suppliers, business prospects, financings, investments and effects of acquisitions. In some cases, forward looking statements can be identified by terminology such as "may," "will," "should," "expect," "anticipate," "intend," "plan," "believe," "estimate," "potential," or "continue," the negative of these terms or other comparable terminology. These statements involve a number of risks and uncertainties, including preliminary information; the effects of future acquisitions and/or

Edgar Filing: ARGAN INC - Form 10QSB

changes in government regulations and policies, our dependence upon third-party suppliers; continued acceptance of our products in the marketplace; technological changes; and other risks and uncertainties that could cause actual events or results to differ materially from any forward-looking statement.

GENERAL

We conduct our operations through our wholly owned subsidiary, Southern Maryland Cable, Inc. (SMC) that we acquired in July 2003. Through SMC, we provide telecommunications infrastructure services including project management, construction and maintenance to the Federal Government, telecommunications and broadband service providers as well as electric utilities.

We were organized as a Delaware corporation in May 1961. On October 23, 2003, our shareholders approved a plan providing for the internal restructuring of the Company whereby we became a holding company, and our operating assets and liabilities relating to our Puroflow business were transferred to a newly-formed, wholly owned subsidiary. The subsidiary then changed its name to "Puroflow Incorporated" and we changed our name from Puroflow Incorporated to "Argan, Inc." At the time of the transfer, we also held another wholly owned operating subsidiary (SMC) which we acquired in July, 2003.

On October 31, 2003, we completed the sale of Puroflow Incorporated (our new wholly-owned subsidiary) to Western Filter Corporation (WFC) for approximately \$3.5 million in cash, of which \$300,000 is being held in escrow for one year to indemnify WFC from losses resulting from a breach of the representations and warranties made by us in connection with that sale.

HOLDING COMPANY STRUCTURE

We intend to make additional acquisitions and/or investments. We intend to have more than one industrial focus and to identify those companies that are in industries with significant potential to grow profitably both internally and through acquisitions. We expect that companies acquired in each of these industrial groups will be held in separate subsidiaries that will be operated in a manner that best provides cashflow and value for the Company.

We are a holding company with no operations other than our investment in SMC. At April 30, 2004, there were no restrictions with respect to dividends or other payments from SMC to Argan.

TELECOM INFRASTRUCTURE SERVICES

We currently provide inside plant, premise wiring services to the Federal Government and have plans to expand that work to commercial customers who regularly need upgrades in their premise wiring systems to accommodate improvements in security, telecommunications and network capabilities.

We continue to participate in the expansion of the telecommunications industry by working with various telecommunications providers. We provide maintenance and upgrade services for their outside plant systems that increase the capacity of existing infrastructure. We also provide outside plant services to the power industry by providing maintenance and upgrade services to utilities.

We intend to emphasize our high quality reputation, outstanding customer base and highly motivated work force in competing for larger and more diverse contracts. We believe that our high quality and well maintained fleet of vehicles and construction machinery and equipment is essential to meet

Edgar Filing: ARGAN INC - Form 10QSB

customers' needs for high quality and on-time service. We are committed to invest in our repair and maintenance capabilities to maintain the quality and life of our equipment. Additionally, we invest annually in new vehicles and equipment. We further intend to seek acquisitions to evolve into a geographically diverse telecom and utility infrastructure services entity with a reputation for high quality and on-time performance.

CRITICAL ACCOUNTING POLICIES

Management is required to make judgments, assumptions and estimates that affect the amounts reported when we prepare financial statements and related disclosures in conformity with generally accepted accounting principles. Note 1 contained in the Company's consolidated financial statements for the year ended January 31, 2004 included in the Company's Annual Report contained in Form 10-KSB, as filed with the Securities and Exchange Commission describes the significant accounting policies and methods used in the preparation of our consolidated financial statements. Estimates are used for, but not limited to our accounting for revenue recognition, allowance for doubtful accounts, long-lived assets and deferred income taxes. Actual results could differ from these estimates. The following critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of our consolidated financial statements.

REVENUE RECOGNITION

We generate revenue under various arrangements, including contracts under which revenue is based on a fixed price basis and on a time and materials basis. Revenues from time and materials contracts are recognized when the related service is provided to the customer. Revenues from fixed price contracts, including a portion of estimated profit, is recognized as services are provided, based on costs incurred and estimated total contract costs in accordance with Statement of Position 81-1, Accounting for Performance of Construction Type and Certain Production-Type Contracts, using the percentage of completion method.

The timing of billing to customers varies based on individual contracts and often differs from the period of revenue recognition. Estimated earnings in excess of billings and billings in excess of estimated earnings totaled \$504,000 and \$30,000, respectively, at April 30, 2004.

Contract costs are recorded when incurred and include direct labor and other direct costs combined with allocations of operational indirect costs. Management periodically reviews the costs incurred and revenue recognized from contracts and adjusts recognized revenue to reflect current expectations. Provisions for estimated losses on incomplete contracts are provided in full in the period in which such losses become known.

IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets, consisting primarily of property and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount should be assessed pursuant to SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." We determine impairment by comparing the carrying value of these long-lived assets to the undiscounted future cash flows expected to result from the use of these assets. In the event we determine that an impairment exists, a loss would be recognized based on the

amount by which the carrying value exceeds the fair value of the assets, which is generally determined by using quoted market prices or valuation techniques

Edgar Filing: ARGAN INC - Form 10QSB

such as the discounted present value of expected future cash flows, appraisals, or other pricing models as appropriate.

IMPAIRMENT OF GOODWILL

We periodically evaluate the net realizable value of intangible assets relying on a number of factors including operating results, economic projections, and anticipated cash flows. In connection with our acquisition of SMC, the excess of cost over the net amounts assigned to tangible assets acquired and liabilities assumed was allocated to goodwill and intangible assets recognized separately such as Trade Name and Contractual Customer Relationships.

In accordance with SFAS No. 142, we will conduct annually during our fiscal fourth quarter, a review of our goodwill and intangible assets with an indefinite useful life to determine whether their carrying value exceeds their fair market value. Should this be the case, a detailed analysis will be performed to determine if the goodwill and other intangible assets are impaired. We will review the finite intangible assets when events or changes in circumstances indicate that the carrying amount may not be recovered.

We will test for impairment of Goodwill and indefinite lived intangible assets more frequently if events or changes in circumstances indicate that the asset might be impaired.

CONTRACTUAL CUSTOMER RELATIONSHIPS ("CCR's")

The fair value of the Contractual Customer Relationships (CCR's) was determined at the time of the acquisition of SMC by discounting the cash flows expected from SMC's continued relationships with three customers - General Dynamics, Verizon Communications and Southern Maryland Electric Cooperative. Expected cash flows were based on historical levels, current and anticipated projects and general economic conditions. In some cases, the estimates of future cash flows reflect periods beyond those of the current contracts in place. The expected cash flows were discounted based on a rate that reflects the perceived risk of the CCR, the estimated weighted average cost of capital and SMC's asset mix. We are amortizing the CCR's over a seven year weighted average life given the long standing relationships SMC has with Verizon and SMECO.

TRADE NAME

The fair value of the SMC Trade Name was estimated using a relief-from-royalty methodology. We determined that the useful life of the Trade Name was indefinite since it is expected to contribute directly to future cash flows in perpetuity. The Company has also considered the effects of demand and competition including its customer base. While SMC is not a nationally recognized Trade Name, it is a regionally recognized name in Maryland and the mid-Atlantic region.

Using the relief-from-royalty method described above, we test the Trade Name for impairment annually in our fiscal fourth quarter and on an interim basis if events or changes in circumstances between annual tests indicate the Trade Name might be impaired. Based on the annual impairment test, no impairment was recorded.

DEFERRED TAX ASSETS AND LIABILITIES

We account for income taxes under the asset and liability method. The approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts

Edgar Filing: ARGAN INC - Form 10QSB

and the tax basis of assets and liabilities. Developing our provision for income taxes requires significant judgment and expertise in Federal and state income tax laws, regulations and strategies, including the determination of deferred tax assets and liabilities and, if necessary, any valuation allowances that may be required for deferred tax assets.

At April 30, 2004, we have cumulatively recorded a net operating loss carry forward aggregating \$1,044,000 which expires in 2024 and 2025.

SALE OF MANUFACTURING OPERATIONS

On October 31, 2003, as part of our plan to reallocate our capital to our acquisition program, we sold PI to WFC. The sales price of approximately \$3,500,000 was satisfied in cash of which \$300,000 is being held in escrow for one year to indemnify WFC from any damages resulting from a breach of representations and warranties under the Stock Purchase Agreement. We recognized a gain on sale of approximately \$167,000, net of income taxes of \$506,000. We utilized net operating losses to offset the gain on sale and thus, have no current tax liability in connection with the sale. The \$506,000 is the amount of the deferred tax assets at the date of sale related to Puroflow (which has been sold). In accordance with SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets," we classified the operating results of PI as discontinued operations in the accompanying statements of operations.

The results of the discontinued operations are as follows for the three months ended April 30, 2003.

Net sales	\$ 1,690,000
Cost of goods sold	1,132,000

Gross profit	558,000
Selling, general and administrative expenses	451,000

Operating income from discontinued operations	107,000
Other expense	(7,000)

Income from discontinued operations before income taxes	100,000
Income tax expense	17,000

Income from discontinued operations	\$ 83,000
	=====

ACQUISITION OF SOUTHERN MARYLAND CABLE, INC.

We are actively pursuing acquisitions in the telecom infrastructure services industry. On July 17, 2003, we acquired all of the common stock of SMC, a provider of telecommunications and other infrastructure services including

project management, construction and maintenance to the Federal Government, telecommunications and broadband service providers, as well as electric utilities. Our purchase of SMC was focused on acquiring SMC's long-standing customer relationships and its well established reputation in a strategic geographic area, which supported the premium paid over the fair value of the tangible assets.

Edgar Filing: ARGAN INC - Form 10QSB

The results of operations of SMC are included in the consolidated results of the Company from July 17, 2003, the date of the acquisition. The estimated purchase price was approximately \$3.8 million in cash, plus the assumption of approximately \$971,000 in debt.

We accounted for the acquisition of SMC using the purchase method of accounting whereby the excess of cost over the net amounts assigned to assets acquired and liabilities assumed is allocated to goodwill and intangible assets based on their estimated fair values. Such intangible assets include \$1,600,000 and \$680,000 allocated to Contractual Customer Relationships ("CCR") and Trade Name, respectively, and \$1,680,000 to Goodwill. We are amortizing the CCR over a weighted average life of seven years. The Trade Name was determined to have an indefinite useful life and is not being amortized.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED APRIL 30, 2004 COMPARED TO THE THREE MONTHS (PRO FORMA) ENDED APRIL 30, 2003

The following summarizes the actual results of our operations for the three months ended April 30, 2004 compared to the pro forma results for the three months ended April 30, 2003, as if the acquisition of SMC was completed on February 1, 2003. The unaudited pro forma statements of operations do not include the operating results of PI which have been reclassified as discontinued operations in the condensed consolidated statements of operations (See Note 4). The unaudited statements of operations do not purport to be indicative of the results that would have actually been obtained if the aforementioned acquisition and disposition had occurred on February 1, 2003, or that may be obtained in the future. SMC previously reported its results of operations using a calendar year-end. No material events occurred subsequent to these reporting periods that would require adjustment to our unaudited pro forma results in the pro forma statement of operations.

Statements of Operations	THREE MONTHS ENDED APRIL 30,	
	2004	2003
	-----	-----
		(Pro forma)
Net sales	\$ 1,807,000	\$ 2,458,000
Cost of goods sold	1,608,000	1,842,000
	-----	-----
Gross profit	199,000	616,000
Selling general and administrative expenses	791,000	435,000
	-----	-----
(Loss) income from operations	(592,000)	181,000
Other income (expense)	22,000	(9,000)
	-----	-----
(Loss) income from continuing operations before income taxes	(570,000)	172,000
Provision for income tax (benefit) provision	(218,000)	69,000
	-----	-----
Net (loss) income from continuing operations	\$ (352,000)	\$ 103,000
	=====	=====
Net (loss) income per share	\$ (0.20)	\$.06
Weighted average shares outstanding	1,803,000	1,798,000

Edgar Filing: ARGAN INC - Form 10QSB

We have restated our previously issued financial statements to reflect, as discontinued operations, the disposition of our wholly owned subsidiary, PI. Because of the reclassification of PI as a discontinued operation, we are required to retroactively restate our financial statements for the three months ended April 30, 2003.

As disclosed above, we acquired SMC on July 17, 2003. Because of the sale of PI, substantially all of the Company's historical business has been reclassified as discontinued operations. As a consequence, the Company has compared the actual results of operations of AI for the three months ended April 30, 2004 to AI's pro forma statement of operations for the three months ended April 30, 2003 as presented above.

NET SALES

AI, through its wholly owned subsidiary, SMC, had net sales of \$1,807,000 for the three months ended April 30, 2004 compared to pro forma net sales of \$2,458,000 for the three months ended April 30, 2003. The decrease of \$651,000 or 27% is due primarily to the decrease in volume of infrastructure services provided to SMC's customers under fixed-priced contracts. AI expects that the level of activity will increase under such contracts during the three months ended July 31, 2004.

COST OF GOODS SOLD

For the three months ended April 30, 2004, cost of goods sold was \$1,608,000 or 89% of net sales compared to \$1,842,000 or 75% of pro forma net sales for the three months ended April 30, 2003. Increased costs as a percent of net sales is due to inefficiencies experienced as the Company's volume and number of fixed-priced contracts decreased during the three months ended April 30, 2004. AI retained its core group of technicians in anticipation of a rebound in the level of activity under fixed-price contracts which it expects will begin in the three months ended July 31, 2004.

SELLING GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses were \$791,000 or 44% of net sales for the three months ended April 30, 2004 compared to \$435,000 or 18% of pro forma net sales for the three months ended April 30, 2003 an increase of \$356,000. General and administrative expenses incurred for general corporate expenses and for the new corporate management team whose efforts are focused on expansion into infrastructure services and other industries aggregated \$362,000 for the three months ended April 30, 2004 compared to \$57,000 in corporate costs from continuing operations for the three months ended April 30, 2003.

OTHER EXPENSE, NET

We had other income, net of \$22,000 for the three months ended April 30, 2004 compared to pro forma other expense of \$9,000 for the three months ended April 30, 2003. Other income arises from the excess of interest income on AI's cash equivalents and short-term investments over interest expense on AI's Bank debt.

LIQUIDITY AND CAPITAL RESOURCES

At April 30, 2004 and January 31, 2004, the Company had \$7,673,000 and \$8,212,000 respectively available in cash, cash equivalents and short-term investments. On April 29, 2003, the Company completed a private offering of

Edgar Filing: ARGAN INC - Form 10QSB

approximately 1,304,000 shares of common stock at a price of \$7.75 per share. The net proceeds from the private placement aggregated approximately \$9,634,000. A portion of the proceeds were used in the acquisition of SMC. The Company plans to use the remaining proceeds for acquisitions in growth-oriented industries and for working capital.

On October 31, 2003, AI sold its subsidiary, PI, to Western Filter Corporation (WFC). The sale price of approximately \$3,500,000 was satisfied in cash of which \$300,000 is being held in escrow for one year.

Net cash used in operations for the three months ended April 30, 2004 was \$394,000 compared with \$122,000 cash provided by operations for the three months ended April 30, 2003. The decrease in cash provided by operations is primarily due to the reduced performance of SMC's revenue with the related loss from continuing operations.

Cash used for investing activities was \$2,522,000 for the three months ended April 30, 2004 compared to investing activities of \$53,000 from the discontinued operations for the three months ended April 30, 2003 due to net purchases of short-term investments.

Net cash used in financing activities was \$123,000 for the three months ended April 30, 2004 compared to net cash provided by financing activities of \$9,990,000 for the same period one year ago. The aforementioned private placement accounted for \$10,059,000 of the cash provided during the three months ended April 30, 2003.

In August, 2003, the Company entered into a financing arrangement with Bank of America ("Bank") aggregating \$2,950,000 in available financing in two tranches - a revolving line of credit with \$1,750,000 in availability, expiring July 31, 2004 and bearing interest at LIBOR plus 2.75% and a three year term note with an original outstanding balance of \$1,200,000, expiring July 31, 2006 and bearing interest at LIBOR plus 2.95%. The proceeds from the term note were used to payoff the SMC lines of credit and for working capital. As of April 30, 2004 the Company had \$900,000 outstanding under the term note. AI has not drawn on the revolving line of credit.

The financing arrangement contains financial as well as nonfinancial covenants including the ratios of debt to pro forma earnings before interest, taxes, depreciation and amortization ("EBITDA") of 2.5 to 1, liabilities to tangible net worth of 1.5 to 1, fixed charge coverage ratio of 1.25 to 1 as well as requirements for bank consent for acquisitions and divestitures. The Company pledged the majority of the Company's assets to secure the financing arrangement. At April 30, 2004, the Company was not in compliance with the ratio of debt to EBITDA and the fixed charge coverage ratio financial covenants. The Company received a waiver from the Bank with respect to the breach of these covenants through October 31, 2004. The Company agreed to additional covenants whereby it would maintain at least \$2 million in liquidity, increase the interest rate by 50 basis points to LIBOR plus 3.45% and maintain positive net income during the second and third quarters. The Company reached an agreement with the Bank to extend the financing agreement beyond its current expiration to December 31, 2004. The Company has classified the entire note as current. Subsequent to the sale of PI, because of the disposition of PI, the Company deposited \$300,000 as additional collateral in a restricted cash account with the Bank.

With its present capital resources and cash flow from operations, the Company believes it should have sufficient resources to meet its operating needs for the next twelve months and to provide for debt maturities and capital expenditures.

CUSTOMERS

During the three months ended April 30, 2004, we provided services to telecommunications and utilities customers as well as to the Federal Government, through a contract with General Dynamics Corp. ("General Dynamics"). Certain of our more significant customer relationships were with General Dynamics, Southern Maryland Electrical Cooperative (SMECO) and Verizon Communications, Inc. General Dynamics accounted for approximately 25% of consolidated net sales during the three months ended April 30, 2004. The Federal Government, through our contract with General Dynamics, has been a major customer for two years. SMECO accounted for approximately 55% of consolidated net sales during the three months ended April 30, 2004. SMECO has been a major customer for several years. Verizon accounted for approximately 11% of consolidated net sales during the three months ended April 30, 2004. Verizon has been a major customer for many years, but has indicated its intention to decrease its volume of business with us. An increase in SMECO's level of business for the twelve months ended January 31, 2005 is expected to substantially offset the Verizon decrease. Combined General Dynamics, SMECO and Verizon accounted for approximately 91% of consolidated net sales during the three months ended April 30, 2004.

SEASONALITY

The Company's telecom infrastructure services operations are expected to have seasonally weaker results in the first and fourth quarters of the year, and may produce stronger results in the second and third quarters. This seasonality is primarily due to the effect of winter weather on outside plant activities as well as reduced daylight hours and customer budgetary constraints. Certain customers tend to complete budgeted capital expenditures before the end of the year, and postpone additional expenditures until the subsequent fiscal period.

SUBSEQUENT EVENTS

Subsequent to April 30, 2004, the Company entered into a letter of intent with OTC Packaging, Inc. and ProActive Labs, Inc. ("OTC") to acquire all of the common stock of OTC. The consummation of the transaction is contingent upon the completion of the Company's due diligence, the signing of a definitive purchase and sale agreement, approval of both companies' board of directors and other conditions.

Subsequent to April 30, 2004, the Company entered into a letter of intent with Vitarich Laboratories, Inc. (VLI) to acquire all of the common stock of VLI. The consummation of the transaction is contingent upon the completion of the Company's due diligence, the signing of a definitive purchase and the sale agreement, approval of both companies' board of directors and other conditions.

ITEM 3. CONTROLS AND PROCEDURES

The Company carried out an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as of the end of the period covered by this report. Based upon this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective in timely alerting them to material information required to be included in the Company's periodic SEC reports. There have been no changes in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal

Edgar Filing: ARGAN INC - Form 10QSB

control over financial reporting.

18

PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. CHANGES IN SECURITIES AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a) Exhibits:

EXHIBIT NO. -----	TITLE -----
Exhibit: 31.1	Certification of Chief Executive Officer, pursuant to Rule 13a-14(c) under the Securities Exchange Act of 1934
Exhibit: 31.2	Certification of Chief Financial Officer, pursuant to Rule 13a-14(c) under the Securities Exchange Act of 1934
Exhibit: 32.1	Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350
Exhibit: 32.2	Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350

a) Reports on Form 8-K:

In a report on Form 8-K/A dated March 15, 2004, the Company amended its Form 8-K dated October 23, 2003 that was filed on November 14, 2003 reported under Item 7. "Financial Statements, Pro Forma Financial Information and Exhibits" the correction of an error in the calculation and classification of the deferred tax liability associated with the intangible assets recorded in the purchase accounting of its acquisition of Southern Maryland Cable,

Edgar Filing: ARGAN INC - Form 10QSB

Inc.

19

In a report on Form 8-K/A dated March 15, 2004, the Company amended its Form 8-K dated July 17, 2003, that was filed on July 29, 2003, was amended by a Current Report on Form 8K/A on September 24, 2003 and was further amended by a Current Report on Form 8-K/A on January 27, 2004. The purpose of the amendment was to report under Item 7. "Financial Statements, Pro Forma Financial information and Exhibits" the correction of an error in the calculation and classification of the deferred tax liability associated with the intangible assets recorded in the purchase accounting of its acquisition of Southern Maryland Cable, Inc.

20

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto, duly authorized.

ARGAN, INC.

June 9, 2004

By: /s/ Rainer Bosselmann

Rainer Bosselmann
Chairman of the Board and Chief
Executive Officer

June 9, 2004

By: /s/ Arthur F. Trudel

Arthur F. Trudel
Chief Financial Officer

21