

ARGAN INC  
Form 10-Q  
September 12, 2007

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **July 31, 2007**

or

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number **001-31756**

**Argan, Inc.**

(Exact Name of registrant as Specified in Its Charter)

**Delaware**

(State or other Jurisdiction of Incorporation  
or Organization)

**13-1947195**

(I.R.S. Employer Identification No.)

**One Church Street, Suite 401, Rockville MD 20850**

(Address of Principal Executive Offices) (Zip Code)

**(301) 315-0027**

(Registrant's telephone number, including area code)

\_\_\_\_\_  
(Former Name, Former Address and Former Fiscal Year,  
if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Exchange Act of 1934 during the preceding 12 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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (check one):

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Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

Common Stock, par value \$0.15 per share, outstanding at September 12, 2007: 11,094,012.

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**ARGAN, INC.****INDEX**

|   | Page No.  |
|---|-----------|
| <b>PART I. FINANCIAL INFORMATION</b>  | <b>3</b>  |
| Item 1. Financial Statements (unaudited)  | 3         |
| Condensed Consolidated Balance Sheets - July 31, 2007 and January 31, 2007                                | 3         |
| Condensed Consolidated Statements of Operations for the Three and Six Months Ended July 31, 2007 and 2006 | 4         |
| Condensed Consolidated Statements of Cash Flows for the Six Months Ended July 31, 2007 and 2006           | 5         |
| Notes to Condensed Consolidated Financial Statements  | 6         |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation              | 15        |
| Item 3. Quantitative and Qualitative Disclosures about Market Risk  | 27        |
| Item 4. Controls and Procedures   | 27        |
| <b>PART II. OTHER INFORMATION</b>   | <b>27</b> |
| Item 1. Legal Proceedings   | 27        |
| Item 1a. Risk Factors   | 28        |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds                                       | 28        |
| Item 3. Defaults Upon Senior Securities   | 28        |
| Item 4. Submission of Matters to a Vote of Security Holders   | 28        |
| Item 5. Other Information   | 29        |
| Item 6. Exhibits  | 29        |
| <b>SIGNATURES</b>   | <b>30</b> |

**ARGAN, INC.**  
**Condensed Consolidated Balance Sheets**  
**(Unaudited)**

|   | July 31,<br>2007      | January 31,<br>2007   |
|---|-----------------------|-----------------------|
| <b>ASSETS</b>   |                       |                       |
| <b>CURRENT ASSETS:</b>  |                       |                       |
| Cash and cash equivalents   | \$ 49,140,000         | \$ 25,393,000         |
| Accounts receivable, net of allowance for doubtful accounts of \$88,000 at 7/31/07 and \$137,000 at 1/31/2007   | 30,397,000            | 23,030,000            |
| Receivable from affiliated entity   | -                     | 155,000               |
| Investments available for sale  | -                     | 2,283,000             |
| Escrowed cash   | 15,034,000            | 15,031,000            |
| Estimated earnings in excess of billings  | 3,919,000             | 12,003,000            |
| Current deferred tax asset  | 435,000               | -                     |
| Inventories, net of reserves of \$143,000 at 07/31/2007 and \$104,000 at 01/31/2007   | 2,442,000             | 2,387,000             |
| Prepaid expenses and other current assets   | 1,512,000             | 643,000               |
| <b>TOTAL CURRENT ASSETS</b>   | <b>102,879,000</b>    | <b>80,925,000</b>     |
| Property and equipment, net of accumulated depreciation of \$2,922,000 at 7/31/2007 and \$2,379,000 at 1/31/2007  | 2,887,000             | 3,250,000             |
| Other assets  | 235,000               | 313,000               |
| Goodwill  | 23,981,000            | 23,981,000            |
| Other intangible assets, net  | 8,572,000             | 12,661,000            |
| <b>TOTAL ASSETS</b>   | <b>\$ 138,554,000</b> | <b>\$ 121,130,000</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                       |                       |
| <b>CURRENT LIABILITIES:</b>   |                       |                       |
| Accounts payable  | \$ 33,020,000         | \$ 44,248,000         |
| Due to affiliates   | -                     | 7,000                 |
| Accrued expenses  | 6,794,000             | 5,873,000             |
| Estimated loss on uncompleted contracts   | 74,000                | -                     |
| Billings in excess of cost and earnings   | 46,223,000            | 15,705,000            |
| Current portion of long-term debt   | 2,584,000             | 2,586,000             |
| <b>TOTAL CURRENT LIABILITIES</b>  | <b>88,695,000</b>     | <b>68,419,000</b>     |
| Deferred income tax liability   | 495,000               | 1,471,000             |
| Other liabilities   | 21,000                | 14,000                |
| Long-term debt  | 5,423,000             | 6,715,000             |
| <b>TOTAL LIABILITIES</b>  | <b>94,634,000</b>     | <b>76,619,000</b>     |
| <b>STOCKHOLDERS' EQUITY</b>   |                       |                       |
| Preferred stock, par value \$0.10 per share; 500,000 shares authorized; no shares issued and outstanding  | -                     | -                     |
| Common stock, par value \$0.15 per share; 30,000,000 shares authorized; 11,097,245 shares issued and 11,094,012 shares outstanding at 7/31/2007 and 1/31/2007 | 1,664,000             | 1,664,000             |
| Warrants outstanding  | 849,000               | 849,000               |
| Additional paid-in capital  | 57,285,000            | 57,190,000            |

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|   |                |                |
|---|----------------|----------------|
| Accumulated other comprehensive loss                            | (13,000)       | (8,000)        |
| Accumulated deficit   | (15,832,000)   | (15,151,000)   |
| Treasury stock at cost; 3,233 shares at 7/31/2007 and 1/31/2007 | (33,000)       | (33,000)       |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>                               | 43,920,000     | 44,511,000     |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>               | \$ 138,554,000 | \$ 121,130,000 |

The accompanying notes are an integral part of the condensed consolidated financial statements.

**ARGAN, INC.**  
**Condensed Consolidated Statements of Operations**  
**(Unaudited)**

|   | Three months ended July 31, |              | Six months ended July 31, |              |
|---|-----------------------------|--------------|---------------------------|--------------|
|   | 2007                        | 2006         | 2007                      | 2006         |
| Net sales   |                             |              |                           |              |
| Power industry services   | \$ 45,599,000               | \$ -         | \$ 88,953,000             | \$ -         |
| Nutraceutical products  | 5,036,000                   | 5,211,000    | 9,985,000                 | 11,040,000   |
| Telecom infrastructure services                                       | 2,502,000                   | 3,349,000    | 4,631,000                 | 6,482,000    |
| Net Sales   | 53,137,000                  | 8,560,000    | 103,569,000               | 17,522,000   |
| Cost of sales   |                             |              |                           |              |
| Power industry services   | 40,590,000                  | -            | 83,835,000                | -            |
| Nutraceutical products  | 4,122,000                   | 3,940,000    | 8,288,000                 | 8,326,000    |
| Telecom infrastructure services                                       | 1,858,000                   | 2,678,000    | 3,701,000                 | 5,001,000    |
| Gross profit  | 6,567,000                   | 1,942,000    | 7,745,000                 | 4,195,000    |
| Selling, general and administrative expenses                          |                             |              |                           |              |
|   | 4,773,000                   | 1,944,000    | 9,334,000                 | 3,920,000    |
| (Loss) income from operations   | 1,794,000                   | (2,000)      | (1,589,000)               | 275,000      |
| Interest expense and amortization of subordinated debt issuance costs |                             |              |                           |              |
|   | 181,000                     | 216,000      | 385,000                   | 477,000      |
| Interest Income   | (653,000)                   | (1,000)      | (1,286,000)               | (3,000)      |
| (Loss) income from operations before                                  |                             |              |                           |              |
| income taxes  | 2,266,000                   | (217,000)    | (688,000)                 | (199,000)    |
| Income tax benefit (expense)  | (932,000)                   | 62,000       | 7,000                     | 26,000       |
| Net income (loss)   | \$ 1,334,000                | \$ (155,000) | \$ (681,000)              | \$ (173,000) |
| Earnings per share:   |                             |              |                           |              |
| Basic earnings per share  | \$ 0.12                     | \$ (0.03)    | \$ (0.06)                 | \$ (0.04)    |
| Diluted earnings per share  | \$ 0.12                     | \$ (0.03)    | \$ (0.06)                 | \$ (0.04)    |
| Weighted average number of shares:                                    |                             |              |                           |              |
| Basic   | 11,094,000                  | 4,549,000    | 11,094,000                | 4,179,000    |
| Diluted   | 11,196,000                  | 4,549,000    | 11,094,000                | 4,179,000    |

The accompanying notes are an integral part of the condensed consolidated financial statements.

ARGAN, INC.  
Condensed Consolidated Statements of Cash Flows  
(Unaudited)

|   | Six Months ended July 31, |                     |
|---|---------------------------|---------------------|
|   | 2007                      | 2006                |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                           |                     |
| Net loss  | \$ (681,000)              | \$ (173,000)        |
| Adjustments to reconcile net loss to net cash provided by operating activities:         |                           |                     |
| Depreciation and other amortization   | 644,000                   | 518,000             |
| Amortization of debt issuance costs   | -                         | 257,000             |
| Amortization of purchased intangibles   | 4,089,000                 | 660,000             |
| Deferred income taxes   | (1,411,000)               | (246,000)           |
| Non-cash stock option compensation expense  | 100,000                   | 80,000              |
| Gain on sale of property and equipment  | 9,000                     | 8,000               |
| Gain on sale of investments   | 11,000                    | -                   |
| Changes in operating assets and liabilities:  |                           |                     |
| Accounts receivable, net  | (7,212,000)               | (537,000)           |
| Restricted cash for surety bond   | (3,000)                   | -                   |
| Estimated earnings in excess of billings  | 8,084,000                 | 94,000              |
| Inventories, net  | (55,000)                  | 543,000             |
| Prepaid expenses and other current assets   | (869,000)                 | (337,000)           |
| Accounts payable and accrued expenses   | (10,307,000)              | 164,000             |
| Billings in excess of cost and earnings   | 30,518,000                | 7,000               |
| Due from affiliates   | (7,000)                   | (99,000)            |
| Estimated loss on uncompleted contracts   | 74,000                    | -                   |
| Other   | (9,000)                   | 14,000              |
| Net cash provided by operating activities   | 22,975,000                | 953,000             |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                           |                     |
| Proceeds from sale of investments   | 2,272,000                 | -                   |
| Proceeds from sale of property and equipment  | 18,000                    | 4,000               |
| Purchases of property and equipment   | (224,000)                 | (612,000)           |
| Net cash provided by (used in) investing activities                                     | 2,066,000                 | (608,000)           |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                           |                     |
| Net proceeds from sale of stock   | -                         | 1,863,000           |
| Proceeds from debt  | 3,292,000                 | 2,855,000           |
| Principal payments on debt  | (4,586,000)               | (3,107,000)         |
| Principal payments on subordinated note due former owner of Vitarich Laboratories, Inc. | -                         | (1,800,000)         |
| Net cash (used in) provided by financing activities                                     | (1,294,000)               | 1,611,000           |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>  | <b>23,747,000</b>         | <b>1,956,000</b>    |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>                                 | <b>25,393,000</b>         | <b>5,000</b>        |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>                                       | <b>\$ 49,140,000</b>      | <b>\$ 1,961,000</b> |

**SUPPLEMENTAL CASH FLOW INFORMATION**

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Cash paid for interest and income taxes is as follows:

|              |    |           |    |         |
|--------------|----|-----------|----|---------|
| Interest     | \$ | 729,000   | \$ | 128,000 |
| Income taxes | \$ | 2,700,000 | \$ | 8,000   |

Non-cash investing and financing activities are as follows:

|   |    |       |    |   |
|---|----|-------|----|---|
| Net increase in fair value of interest rate swaps | \$ | 9,000 | \$ | - |
|---|----|-------|----|---|

The accompanying notes are an integral part of the condensed consolidated financial statements.



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

**NOTE 1- DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION**

***Business***

Argan, Inc. (AI or the Company) conducts its operations through its wholly owned subsidiaries, Gemma Power Systems, LLC and affiliates (GPS) which was acquired in December 2006, Vitarich Laboratories, Inc. (VLI) which was acquired in August 2004, and Southern Maryland Cable, Inc. (SMC) which was acquired in July 2003. Through GPS, the Company provides a full range of development, consulting, engineering, procurement, construction, commissioning, operating and maintenance services to the power energy market for a wide range of customers including public utilities, independent power project owners, municipalities, public institutions and private industry. Through VLI, the Company develops, manufactures and distributes premium nutritional supplements, whole-food dietary supplements and personal care products. Through SMC, the Company provides telecommunications infrastructure services including project management, construction and maintenance to the Federal Government, telecommunications and broadband service providers, as well as to electric utilities primarily in the Mid-Atlantic region.

AI operates in three reportable segments.

***Basis of presentation***

The condensed consolidated balance sheet as of July 31, 2007, the condensed consolidated statements of operations for the three and six months ended July 31, 2007 and 2006, and the condensed consolidated statements of cash flows for the six months ended July 31, 2007 and 2006 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 July 31, 2007 and the results of its operations and its cash flows for the interim 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, 2007, together with the independent registered public accounting firm's report, included in the Company's Annual Report on Form 10-KSB, as filed with the Securities and Exchange Commission (SEC). 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.

**NOTE 2 - RECENT ACCOUNTING STANDARDS**

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("FAS") No. 157, "Fair Value Measurements." This Standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The Company plans to adopt FAS 157 on February 1, 2008, as required. The adoption of FAS 157 is not expected to have a material impact on the Company's financial condition and results of operations.

In February 2007, the FASB issued FAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." FAS 159 permits companies to measure many financial instruments and certain other items at fair value at specified election dates. The provisions of FAS 159 will be effective for the Company beginning February 1, 2008.

The Company does not expect FAS 159 to have a significant impact on the consolidated financial statements.

6

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**NOTE 3 - ESTIMATED LOSS ON UNCOMPLETED CONTRACTS**

During the six months ended July 31, 2007, the Company experienced an unexpected increase in costs related to one of the GPS contracts. Unexpected costs included labor productivity being below expectations and previous experience, labor rate increases due to overtime requirements to meet the completion date, and engineering issues resulting in considerable rework and additional materials. The Company anticipates, that upon completion of the contract, which is 99% complete at July 31, 2007, it expects to incur a loss of approximately \$8.2 million, which as of July 31, 2007, has been recognized. The Company has recorded an estimated loss for this contract as of July 31, 2007 of \$74,000.

**NOTE 4 - INVENTORIES**

Inventories are stated at the lower of cost or market (net realizable value). Cost is determined on the first-in, first-out (FIFO) method. Appropriate consideration is given to obsolescence, excessive inventory levels, product deterioration, and other factors in evaluating net realizable value.

Inventories consist of the following:

|                  | July 31,<br>2007 | January 31,<br>2007 |
|------------------|------------------|---------------------|
| Raw materials    | \$ 2,285,000     | \$ 2,264,000        |
| Work-in process  | 145,000          | 100,000             |
| Finished goods   | 155,000          | 127,000             |
| Less: Reserves   | (143,000)        | (104,000)           |
| Inventories, net | \$ 2,442,000     | \$ 2,387,000        |

**NOTE 5- INTANGIBLE ASSETS**

The Company's intangible assets consist of the following at July 31, 2007:

|  | Estimated<br>Useful Life | Gross Carrying<br>Amount | Accumulated<br>Amortization | Net Carrying<br>Amount |
|--|--------------------------|--------------------------|-----------------------------|------------------------|
| Intangible Assets Being Amortized:             |                          |                          |                             |                        |
| Contractual Customer Relationships - VLI & SMC |                          |                          |                             |                        |
|  | 5-7 years                | \$ 2,854,000             | \$ 1,715,000                | \$ 1,139,000           |
| Customer Relationships - GPS                   |                          |                          |                             |                        |
|  | 1-2 years                | 6,678,000                | 4,209,000                   | 2,469,000              |
| Proprietary Formulas - VLI                     |                          |                          |                             |                        |
|  | 3 years                  | 1,813,000                | 1,775,000                   | 38,000                 |
| Non-Compete Agreement - GPS & VLI              |                          |                          |                             |                        |
|  | 5 years                  | 2,334,000                | 1,118,000                   | 1,216,000              |
| Trade Name - GPS                               |                          |                          |                             |                        |
|  | 15 years                 | 3,643,000                | 157,000                     | 3,486,000              |
| Intangible Assets Not Being Amortized:         |                          |                          |                             |                        |
| Trade Name - SMC                               |                          |                          |                             |                        |
|  | Indefinite               | 224,000                  | —                           | 224,000                |
| Total other intangible assets                  |                          |                          |                             |                        |
|  |                          | \$ 17,546,000            | \$ 8,974,000                | \$ 8,572,000           |
| Goodwill                                       |                          |                          |                             |                        |
|  | Indefinite               | \$ 23,981,000            | —                           | \$ 23,981,000          |

Amortization expense totaling \$4,089,000 for the six months ended July 31, 2007, consisted of \$3,505,000, \$230,000, \$232,000 and \$122,000 for Contractual Customer Relationships, Proprietary Formulas, Non-Compete Agreement and Trade Name, respectively. Amortization expense totaling \$660,000 for the six months ended July 31, 2006, consisted of \$251,000, \$229,000 and \$180,000 for Contractual Customer Relationships, Proprietary Formulas and Non-Compete Agreement, respectively.

## **NOTE 6 - RELATED PARTY TRANSACTIONS**

The Company leases administrative, manufacturing and warehouse facilities for VLI from an individual who was the former officer and shareholder of VLI. The lease costs through March 2007, the date of his termination, are included as related party expenses below. SMC's administrative and maintenance facilities were rented from a former officer through July 2006. The total expense under these arrangements was \$45,000 for the six months ended July 31, 2007, and \$64,000 and \$140,000 for the three and six months ended July 31, 2006, respectively.

The Company entered into a supply agreement with an entity owned by the former shareholder of VLI whereby the supplier committed to sell to the Company and the Company committed to purchase on an as-needed basis, certain organic products. VLI made \$47,000 in purchases under the supply agreement through March 2007, the date that the former officer and shareholder of VLI was terminated and \$38,000 and \$55,000 in purchases under the supply agreement for the three and six months ended July 31, 2006, respectively.

The Company also sold its products in the normal course of business to an entity in which the former officer and owner of VLI has an ownership interest. VLI had approximately \$117,000 in sales with this entity through the aforementioned termination in March 2007, and \$157,000 and \$286,000 in sales with this entity for the three and six months ended July 31, 2006, respectively. At July 31, 2007 and January 31, 2007, the previously affiliated entity owed \$156,000 and \$155,000, respectively, to VLI.

## **NOTE 7 - DEBT**

On December 11, 2006, Argan amended its financing arrangements with the Bank. The amended financing arrangement includes an amended 3-year term loan for VLI in the amount of \$1.4 million with interest at LIBOR (5.32% at July 31, 2007) plus 3.25%; a new 4-year term loan that was used to acquire GPS in the amount of \$8.0 million with interest at LIBOR plus 3.25%; and a revolving loan with a maximum amount of \$4.25 million available until May 31, 2008, with interest at LIBOR plus 3.25%.

The financing arrangements provide for measurement at the Company's fiscal year end and at each of the Company's fiscal quarter ends (using a rolling 12-month period) of certain financial covenants including requiring that the ratio of total funded debt to EBITDA not to exceed 2.25 to 1 for the year ending January 31, 2007 and not to exceed 2 to 1 for future quarters, requiring a fixed charge coverage ratio of not less than 1.25 to 1, and requiring the ratio of senior funded debt to EBITDA not to exceed 1.75 to 1 for the year ended January 31, 2007 and not to exceed 1.50 to 1 for future quarters. The Bank's consent continues to be required for acquisitions and divestitures. The Company continues to pledge the majority of the Company's assets to secure the financing arrangements.

The amended financing arrangement contains a subjective acceleration clause which allows the Bank to declare amounts outstanding under the financing arrangements due and payable if certain material adverse changes occur. The Company believes that it will continue to comply with its financial covenants under the financing arrangement. If the Company's performance does not result in compliance with any of its financial covenants, or if the Bank seeks to exercise its rights under the subjective acceleration clause referred to above, the Company would seek to modify its financing arrangement, but there can be no assurance that the Bank would not exercise their rights and remedies under the financing arrangement including accelerating payment of all outstanding senior debt due and payable.

At July 31, 2007, the Company was in compliance with the covenants of its amended financing arrangements.

## **NOTE 8 - INCOME TAXES**

The estimated effective income tax rate for the six months ended July 31, 2007 was 1%. For the six months ended July 31, 2006, the effective income tax benefit rate was 13%.



The Company's income tax benefit for the six months ended July 31, 2007 and 2006 differs from the "expected" tax benefit computed by applying the U.S. Federal corporate income tax rate of 34% to the loss from operations before income taxes for the six months ended July 31, 2007 and 2006.

|                                     | 2007       | 2006      |
|-------------------------------------|------------|-----------|
| Computed "expected" tax benefit     | \$ 234,000 | \$ 68,000 |
| Increase (decrease) resulting from: |            |           |
| State income taxes, net             | (203,000)  | (16,000)  |
| Permanent differences               | (24,000)   | (26,000)  |
|                                     | \$ 7,000   | \$ 26,000 |

During the six months ended July 31, 2007, the Company's effective tax benefit rate was impacted by its inability to utilize certain current operating losses for state income tax reporting purposes.

The Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"), on February 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement 109, "Accounting for Income Taxes," and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company has concluded that there is no material effect as a result of adopting this standard.

The Company is subject to income taxes in the U.S. federal jurisdiction and various state jurisdictions. Tax regulations within each jurisdiction are subject to the interpretation of the related tax laws and regulations and require significant judgment to apply. With few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for the years before 2003.

#### NOTE 9 - STOCK BASED COMPENSATION

The Company has a stock option plan which was established in August 2001 (Plan). Under the Plan, the Company's Board of Directors may grant stock options to officers, directors and key employees. In June 2007, the Shareholders voted to amend the Plan to authorize the grant of options for up to 650,000 shares of the Company's common stock.

Stock options granted may be "Incentive Stock Options" ("ISOs") or "Nonqualified Stock Options" ("NSOs"). ISOs have an exercise price at least equal to the stock's fair market value at the date of grant, a ten year term and vest and become fully exercisable one year from the date of grant. NSOs may be granted at an exercise price equal to the stock's fair market value at the date of grant or at a price other than the stock's fair market value at the date of grant and have up to a ten year term, and vest and become fully exercisable as determined by the Board.

The fair value of each stock option award is estimated on the date of grant using a Black-Scholes option-pricing model based on the following weighted average assumptions:

|                         | Six Months Ended July 31,<br>2007 | 2006  |
|-------------------------|-----------------------------------|-------|
| Dividend yield          | —                                 | —     |
| Expected volatility     | 71%                               | 57%   |
| Risk-free interest rate | 4.85%                             | 5.11% |
| Expected life in years  | 5                                 | 5     |





A summary of stock option activity under the Plan during the six months ended July 31, 2007 is presented below:

| Options                                  | Shares  | Weighted-Average Exercise Price | Weighted-Average Remaining Contract Term | Aggregate Intrinsic Value |
|--|---------|---------------------------------|--|---------------------------|
| Outstanding at January 31, 2007          | 244,000 | \$ 4.20                         |  |                           |
| Granted                                  | 107,000 | \$ 6.27                         |  |                           |
| Exercised                                | —       |                                 |  |                           |
| Forfeited or expired                     | (3,000) | \$ 7.79                         |  |                           |
| Outstanding at July 31, 2007             | 348,000 | \$ 4.81                         | 5.7                                      | \$ 962,000                |
| Vested or expected to vest July 31, 2007 | 348,000 | \$ 4.81                         | 5.7                                      | \$ 962,000                |
| Exercisable at July 31, 2007             | 225,000 | \$ 4.05                         | 7.7                                      | \$ 411,000                |

The per share weighted average grant date fair value of options granted during the six months ended July 31, 2007 and 2006 was \$4.61 and \$1.34, respectively. No options were exercised during the six months ended July 31, 2007 and 2006. At July 31, 2007, there was \$444,000 unrecognized compensation cost related to stock options granted under the Plan. The weighted-average period over which the compensation expense for these awards is expected to be recognized is through June 2008.

A summary of the status of the Company's nonvested shares as of July 31, 2007, and changes during the year then ended, is present below:

|                               | Shares  | Aggregate Intrinsic Value |
|-------------------------------|---------|---------------------------|
| Nonvested at January 31, 2007 | 16,000  |                           |
| Granted                       | 107,000 |                           |
| Vested                        | —       |                           |
| Forfeited                     | —       |                           |
| Nonvested at July 31, 2007    | 123,000 | \$ 4.50                   |

The fair value of nonvested shares is determined using the Black-Scholes option-pricing model based on the excess of the opening trading price of the Company's shares on the grant date in excess of exercise price.

In connection with the Company's private placement in April 2003, the Company issued warrants to purchase shares of the Company's common stock at a price of \$7.75 per share with a ten year term. 180,000 of the warrants were granted to three individuals who became the executive officers of the Company upon completion of the offering. In addition, MSR Advisors, Inc. (MSR) received warrants to purchase 50,000 shares of the Company's stock. A director of the Company is the Chief Executive Officer of MSR. The fair value of the warrants of \$849,000 was recognized as offering costs. All warrants are exercisable.

At July 31, 2007, there were 874,000 shares of the Company's common stock available for issuance upon exercise of stock options and warrants.

#### NOTE 10 - INCOME (LOSS) PER SHARE

Basic and diluted net loss per share information is presented in accordance with SFAS No. 128, *Earnings Per Share*. Basic loss per share is calculated by dividing the net loss attributable to common shares outstanding which includes common stock equivalents. The Company's common stock equivalents consist of outstanding stock options and warrants.

Weighted average shares outstanding used in the calculation of earnings per share:

|   | Three months ended July 31, |              | Six months ended July 31, |              |
|---|-----------------------------|--------------|---------------------------|--------------|
|   | 2007                        | 2006         | 2007                      | 2006         |
| Net Income (Loss)   | \$ 1,334,000                | \$ (155,000) | \$ (681,000)              | \$ (173,000) |
| Weighted average number of shares outstanding - basic   | 11,094,000                  | 4,549,000    | 11,094,000                | 4,179,000    |
| Effect of the increase of stock options and warrants  | 102,000                     | -            | -                         | -            |
| Weighted average number of shares outstanding - diluted   | 11,196,000                  | 4,549,000    | 11,094,000                | 4,179,000    |
| Basic Income (Loss) Per Share   | \$ 0.12                     | \$ (0.03)    | \$ (0.06)                 | \$ (0.04)    |
| Diluted Income (Loss) Per Share   | \$ 0.12                     | \$ (0.03)    | \$ (0.06)                 | \$ (0.04)    |
| Shares excluded from the computation of diluted weighted average number of shares, since their inclusion would be anti-dilutive | -                           | 4,000        | 100,000                   | 2,000        |

#### NOTE 11 - SEGMENT REPORTING

The Company has three reportable operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and assessing performance.

The Company's three reportable segments are power industry services, telecom infrastructure services and nutraceutical products. The Company conducts its operations through its wholly owned subsidiaries - GPS, VLI and SMC. The "Other" column includes the Company's corporate and unallocated expenses.

The Company's operating segments are organized in separate business units with different management, customers, technology and services. The respective segments account for the respective businesses using the accounting policies in Note 2 to the Company's Form 10-KSB.

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The following information is for the three months ended July 31, 2007, except for total assets and goodwill which is as of July 31, 2007:

|   | Power Industry<br>Services | Nutraceutical<br>Products | Telecom<br>Infrastructure<br>Services | Other        | Consolidated   |
|---|----------------------------|---------------------------|---------------------------------------|--------------|----------------|
| Net sales                                       | \$ 45,599,000              | \$ 5,036,000              | \$ 2,502,000                          | —            | \$ 53,137,000  |
| Cost of sales                                   | 40,590,000                 | 4,122,000                 | 1,858,000                             | —            | 46,570,000     |
| Gross profit                                    | 5,009,000                  | 914,000                   | 644,000                               | —            | 6,567,000      |
| Selling, general and<br>administrative expenses | 2,553,000                  | 1,015,000                 | 340,000                               | 865,000      | 4,773,000      |
| Income (loss) from operations                   | 2,456,000                  | (101,000)                 | 304,000                               | (865,000)    | 1,794,000      |
| Interest expense                                | (149,000)                  | (141,000)                 | (7,000)                               | 116,000      | (181,000)      |
| Other income, net                               | 722,000                    | —                         | 10,000                                | (79,000)     | 653,000        |
| Income (loss) before income<br>taxes            | \$ 3,029,000               | \$ (242,000)              | \$ 307,000                            | \$ (828,000) | 2,266,000      |
| Income tax expense                              |                            |                           |                                       |              | 932,000        |
| Net Income                                      |                            |                           |                                       |              | \$ 1,334,000   |
| Depreciation and amortization                   | \$ 41,000                  | \$ 149,000                | \$ 126,000                            | \$ 4,000     | \$ 320,000     |
| Amortization of intangibles                     | \$ 1,695,000               | \$ 304,000                | \$ 26,000                             | —            | \$ 2,025,000   |
| Goodwill  | \$ 16,476,000              | \$ 6,565,000              | \$ 940,000                            | —            | \$ 23,981,000  |
| Total Assets                                    | \$ 116,531,000             | \$ 14,850,000             | \$ 4,484,000                          | \$ 2,689,000 | \$ 138,554,000 |
| Fixed asset<br>additions                        |                            | —\$ 39,000                | \$ 85,000                             | —\$          | \$ 124,000     |

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The following information is for the six months ended July 31, 2007, except for total assets and goodwill which is as of July 31, 2007:

|   | Power Industry<br>Services | Nutraceutical<br>Products | Telecom<br>Infrastructure<br>Services | Other          | Consolidated    |
|---|----------------------------|---------------------------|---------------------------------------|----------------|-----------------|
| Net sales                                       | \$ 88,953,000              | \$ 9,985,000              | \$ 4,631,000                          |                | —\$ 103,569,000 |
| Cost of sales                                   | 83,835,000                 | 8,288,000                 | 3,701,000                             |                | 95,824,000      |
| Gross profit                                    | 5,118,000                  | 1,697,000                 | 930,000                               |                | 7,745,000       |
| Selling, general and<br>administrative expenses | 5,105,000                  | 2,185,000                 | 698,000                               | 1,346,000      | 9,334,000       |
| (Loss) income from operations                   | 13,000                     | (488,000)                 | 232,000                               | (1,346,000)    | (1,589,000)     |
| Interest expense                                | (316,000)                  | (176,000)                 | (9,000)                               | 116,000        | (385,000)       |
| Other income, net                               | 1,348,000                  | —                         | 10,000                                | (72,000)       | 1,286,000       |
| (Loss) income before income<br>taxes            | \$ 1,045,000               | \$ (664,000)              | \$ 233,000                            | \$ (1,302,000) | (688,000)       |
| Income tax benefit                              |                            |                           |                                       |                | 7,000           |
| Net loss  |                            |                           |                                       |                | (\$681,000)     |
| Depreciation and amortization                   | \$ 94,000                  | \$ 293,000                | \$ 249,000                            | \$ 8,000       | \$ 644,000      |
| Amortization of intangibles                     | \$ 3,428,000               | \$ 609,000                | \$ 52,000                             |                | —\$ 4,089,000   |
| Goodwill  | \$ 16,476,000              | \$ 6,565,000              | \$ 940,000                            |                | —\$ 23,981,000  |
| Total Assets                                    | \$ 116,531,000             | \$ 14,850,000             | \$ 4,484,000                          | \$ 2,689,000   | \$ 138,554,000  |
| Fixed asset additions                           | \$ 4,000                   | \$ 124,000                | \$ 96,000                             |                | —\$ 224,000     |

The following information is for the three months ended July 31, 2006, except for total assets and goodwill which is as of July 31 2006:

|  | Nutraceutical<br>Products | Telecom<br>Infrastructure<br>Services | Other        | Consolidated  |
|--|---------------------------|---------------------------------------|--------------|---------------|
| Net sales  | \$ 5,211,000              | \$ 3,349,000                          |              | —\$ 8,560,000 |
| Cost of sales  | 3,940,000                 | 2,678,000                             |              | — 6,618,000   |
| Gross profit   | 1,271,000                 | 671,000                               |              | — 1,942,000   |
| Selling, general and administrative<br>expenses                          | 1,070,000                 | 424,000                               | 450,000      | 1,944,000     |
| Income (loss) from operations  | 201,000                   | 247,000                               | (450,000)    | (2,000)       |
| Interest expense and amortization of<br>subordinated debt issuance costs | 81,000                    | 10,000                                | 125,000      | 216,000       |
| Other income, net  | —                         | 1,000                                 |              | — 1,000       |
| Income (loss) before income taxes  | \$ 120,000                | \$ 238,000                            | \$ (575,000) | (217,000)     |
| Income tax benefit   |                           |                                       |              | 62,000        |
| Net loss   |                           |                                       |              | \$ (155,000)  |
| Depreciation and amortization  | \$ 139,000                | \$ 119,000                            | \$ 141,000   | \$ 399,000    |
| Amortization of intangibles  | \$ 304,000                | \$ 25,000                             |              | —\$ 329,000   |
| Goodwill   | \$ 6,565,000              | \$ 940,000                            |              | —\$ 7,505,000 |
| Total assets   | \$ 17,315,000             | \$ 5,427,000                          | \$ 418,000   | \$ 23,160,000 |
| Fixed asset additions  | \$ 93,000                 | \$ 238,000                            | \$ 8,000     | \$ 339,000    |



The following information is for the six months ended July 31, 2006, except for total assets and goodwill which is as of July 31 2006:

|   | Nutraceutical<br>Products | Telecom<br>Infrastructure<br>Services | Other          | Consolidated  |
|---|---------------------------|---------------------------------------|----------------|---------------|
| Net sales   | \$ 11,040,000             | \$ 6,482,000                          | \$ —           | \$ 17,522,000 |
| Cost of sales   | 8,326,000                 | 5,001,000                             | —              | 13,327,000    |
| Gross profit  | 2,714,000                 | 1,481,000                             | —              | 4,195,000     |
| Selling, general and administrative expenses                          | 2,157,000                 | 838,000                               | 925,000        | 3,920,000     |
| Income (loss) from operations   | 557,000                   | 643,000                               | (925,000)      | 275,000       |
| Interest expense and amortization of subordinated debt issuance costs | 208,000                   | 29,000                                | 240,000        | 477,000       |
| Other income, net   | —                         | 3,000                                 | —              | 3,000         |
| Income (loss) before income taxes                                     | \$ 349,000                | \$ 617,000                            | \$ (1,165,000) | (199,000)     |
| Income tax benefit  |                           |                                       |                | 26,000        |
| Net loss  |                           |                                       |                | \$ (173,000)  |
| Depreciation and amortization   | \$ 273,000                | \$ 231,000                            | \$ 271,000     | \$ 775,000    |
| Amortization of intangibles   | \$ 609,000                | \$ 51,000                             | \$ —           | \$ 660,000    |
| Goodwill  | \$ 6,565,000              | \$ 940,000                            | \$ —           | \$ 7,505,000  |
| Total assets  | \$ 17,315,000             | \$ 5,427,000                          | \$ 418,000     | \$ 23,160,000 |
| Fixed asset additions   | \$ 189,000                | \$ 415,000                            | \$ 8,000       | \$ 612,000    |

## NOTE 12 - CONTINGENCIES

On March 22, 2005, WFC filed a civil action against the Company, and its executive officers. The suit was filed in the Superior Court of the State of California for the County of Los Angeles. WFC purchased the capital stock of the Company's wholly owned subsidiary, Puroflow Incorporated, pursuant to the terms of the Stock Purchase Agreement dated October 31, 2003. WFC alleged that the Company and its executive officers breached the Stock Purchase Agreement between WFC and the Company and engaged in misrepresentations and negligent conduct with respect to the Stock Purchase Agreement. WFC sought declaratory relief, compensatory and punitive damages in an amount to be proven at trial as well as the recovery of attorney's fees. This action was removed to the United States District Court for the Central District of California.

This case was scheduled for trial on April 10, 2007. On March 15, 2007, the District Court granted the Company and its executive officers' motion for summary judgment, thereby dismissing WFC's lawsuit against the Company and its executive officers in its entirety. WFC has filed a notice of appeal and the Company will vigorously contest WFC's appeal.

Although the Company has reviewed WFC's claim and believes that substantially all of the claims are without merit, the Company has recorded an accrual of approximately \$100,000 and \$286,000 at July 31, 2007 and January 31, 2007, respectfully, for subsequent legal services and estimated legal fees related to potential ongoing legal costs of the WFC claim that it considers to be probable and that can be reasonably estimated. It is possible however, that the ultimate resolution of WFC's claim could result in a material adverse effect on the Company's results of operations for a particular reporting period.

On August 27, 2007, Kevin Thomas filed a lawsuit against the Company, VLI and Rainer Bosselmann in the Circuit Court of Florida. Mr. Thomas was the former owner of VLI and alleges that the Company has breached various agreements with, and violated its fiduciary duty to him. The Company believes that Mr. Thomas' claims are

groundless, that it has defenses to those claims and that it intends to contest his charges vigorously. The Company believes that Mr. Thomas has previously executed releases of many of his claims. In addition, the Company believes it has significant counterclaims against Mr. Thomas.



In the normal course of business, the Company has pending claims and legal proceedings. It is the opinion of the Company's management, based on information available at this time, that none of the other current claims and proceedings will have a material effect on the Company's consolidated financial statements.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion summarizes the financial position of Argan, Inc. and its subsidiaries as of July 31, 2007, and the results of operations for the three and six months ended July 31, 2007 and 2006, and should be read in conjunction with (i) the unaudited condensed consolidated financial statements and notes thereto included elsewhere in this Quarterly Report on Form 10-Q and (ii) the consolidated financial statements and accompanying notes to our Annual Report on Form 10-KSB for the fiscal year ended January 31, 2007 filed with the Securities and Exchange Commission on April 26, 2007.

### **Cautionary Statement Regarding Forward Looking Statements**

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for certain forward-looking statements. We have made statements in this Quarterly Report on Form 10-Q that may constitute "forward-looking statements". The words "believe," "expect," "anticipate," "plan," "intend," "foresee," "should," "would," "could," or other similar expressions are used to identify forward-looking statements. These forward-looking statements are based on our current expectations and beliefs concerning future developments and their potential effects on us. There can be no assurance that future developments affecting us will be those that we anticipate. All comments concerning our expectations for future revenues and operating results are based on our forecasts for our existing operations and do not include the potential impact of any future acquisitions. These forward-looking statements involve significant risks and uncertainties (some of which are beyond our control) and assumptions. They are subject to change based upon various factors, including but not limited to the risks and uncertainties summarized below:

- cyclical changes in demand for our products and services;
- cyclical nature of the individual markets in which our customers operate;
- That the dollar amount of our backlog, as stated at any given time, is not indicative of our future earnings;
- delays or difficulties related to our projects including additional costs, reductions in revenues or the payment of liquidated damages;
- the effect of our percentage-of-completion accounting policies;
- changes in the estimates and assumptions we use to prepare our financial statements;
- our ability to obtain surety bonds or other means of credit support for projects;
- our ability to obtain waivers or amendments with our lenders or sureties, or to collateralize letters of credit or surety bonds upon non-compliance with covenants in our Credit Facility or surety indemnity agreements;
- compliance with certain debt covenants, which as a result, may interfere with our ability to successfully execute our business plan;
-

our indebtedness, which could adversely affect our financial condition and impair our ability to fulfill our obligations under our financing arrangements;

- various legal, regulatory and litigation risk including but not limited to, class action lawsuits, regulatory activities and associated periodic reviews of the SEC and Public Company Accounting Oversight Board;

- the nature of our contracts, particularly fixed-price contracts;
- the failure to meet schedule or performance requirements of our contracts;
- our dependence on subcontractors;
- possible cost escalations associated with our fixed-price contracts;
- our ability to obtain new contracts for large-scale projects and the timing of the performance of these contracts;
- The effect on our reputation and financial exposure due to the failure of our partners to perform their contractual obligations;
- our dependence on a few significant customers;
- delays and/or defaults in customer payments;
- potential professional liability, product liability, warranty and other potential claims, which may not be covered by insurance;
- the presence of competitors with greater financial resources and the impact of competitive products, services and pricing;
- work stoppages and other labor problems;
- our liquidity position;
- a determination to write-off a significant amount of our intangible assets;
- our ability to successfully identify, integrate and complete acquisitions;
- our failure to attract and retain qualified personnel;
- our ability to retain key members of our management;
- our competitors' ability to develop or otherwise acquire equivalent or superior technology;
- general economic conditions;
- future changes in accounting standards or interpretations;
- inability to maintain an effective system of internal control, which could result in inaccurate reporting of our financial results or an inability to prevent fraud;
- provisions in our articles of incorporation and by-laws and rights agreement could make it more difficult to acquire us and may reduce the market price of our common stock;

- changes in the U.S. economy and global markets as a result of terrorists' actions;
- increases in employee-related costs and expenses including healthcare and other employee benefits such as unemployment insurance and workers' compensation; and
- our dependency on technology in our operations and the possible impact of system and information technology interruptions.

Should one or more of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, actual results may vary in material respects from those projected in the forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. For a more detailed discussion of some of the foregoing risk and uncertainties, see "Item 1 — Description of Business — Risk Factors" in our Annual Report on Form 10-KSB as filed with the Securities and Exchange Commission on April 26, 2007, as well as the other reports and registration statements filed by us with the SEC and under "Forward Looking Statements" on our website. These documents are available free of charge from the SEC or from our corporate headquarters. Our annual, quarterly, and current reports and amendments thereto, filed with the SEC are available on our website. For more information about us and the announcements we make from time to time, visit our website at [www.arganinc.com](http://www.arganinc.com).

## **GENERAL**

Argan, Inc. (the "Company," "we," "us," or "our") conduct our operations through our wholly owned subsidiaries, Gemma Power Systems, LLC ("GPS") that we acquired in December 2006, Vitarich Laboratories, Inc. ("VLI") that we acquired in August 2004 and Southern Maryland Cable, Inc. ("SMC") that we acquired in July 2003. Through GPS, we provide a full range of development, consulting, engineering, procurement, construction, commissioning, operating and maintenance services to the energy market for a wide range of customers including public utilities, independent power project owners, municipalities, public institutions and private industry. 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. Through VLI, we develop, manufacture and distribute premium nutritional products.

## **CRITICAL ACCOUNTING POLICIES**

The preparation of our consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities and equity and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates, particularly estimates relating to revenue recognition, valuation of net deferred tax assets, and litigation and contingencies, have a material impact on our financial statements and are discussed in detail throughout our analysis of the results of operations discussed below.

In addition to evaluating estimates relating to the items discussed above, we also consider other estimates and judgments, including, but not limited to, those related to our allowance for doubtful accounts, inventory valuation, and whether there has been an impairment to our long lived assets and intangibles. We base our estimates on historical experience and various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets, liabilities and equity that are not readily apparent from other sources. Actual results and outcomes could differ from these estimates and assumptions.

As discussed in the Note 8 to the Condensed Consolidated Financial Statements, we have adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). Other than this change, there have been no significant changes to our critical accounting estimates during the six months ended July 31, 2007.

For a more detailed explanation of the judgments made in these areas and a discussion of our accounting estimates and policies, refer to "Critical Accounting Policies" included in Item 6 and "Summary of Significant Accounting Policies" (Note 2) included in our Annual Report on Form 10-KSB for the year ended January 31, 2007.

## **BACKLOG**

Backlog represents the total accumulation of new work awarded less the amount of revenue recognized to date on contracts at a specific point in time. We believe backlog is an indicator of future earnings potential. Although backlog reflects business that we consider to be firm, cancellations or reductions may occur and may reduce backlog and future revenue. We have a significant number of customers that consistently extend or add to the scope of existing contracts. We do not include any estimate of this ongoing work in backlog until awarded.

At July 31, 2007, the Company had entered into power industry service contracts for the construction of seven facilities, representing a total backlog of \$205 million compared to contracts of six facilities representing a total backlog of \$171 million at January 31, 2007. Management anticipates these facilities will be completed at various dates through fiscal year 2009.

## **CONSOLIDATED RESULTS OF OPERATIONS**

The following summarizes the results of our operations for the three and six months ended July 31, 2007 compared to the three and six months ended July 31, 2006.

**ARGAN, INC.**  
**Condensed Consolidated Statements of Operations**  
**(Unaudited)**

|   | Three months ended July 31, |              | Six months ended July 31, |              |
|---|-----------------------------|--------------|---------------------------|--------------|
|   | 2007                        | 2006         | 2007                      | 2006         |
| Net sales   |                             |              |                           |              |
| Power industry services   | \$ 45,599,000               | \$ -         | \$ 88,953,000             | \$ -         |
| Nutraceutical products  | 5,036,000                   | 5,211,000    | 9,985,000                 | 11,040,000   |
| Telecom infrastructure services                                       | 2,502,000                   | 3,349,000    | 4,631,000                 | 6,482,000    |
| Net Sales   | 53,137,000                  | 8,560,000    | 103,569,000               | 17,522,000   |
| Cost of sales   |                             |              |                           |              |
| Power industry services   | 40,590,000                  | -            | 83,835,000                | -            |
| Nutraceutical products  | 4,122,000                   | 3,940,000    | 8,288,000                 | 8,326,000    |
| Telecom infrastructure services                                       | 1,858,000                   | 2,678,000    | 3,701,000                 | 5,001,000    |
| Gross profit  | 6,567,000                   | 1,942,000    | 7,745,000                 | 4,195,000    |
| Selling, general and administrative expenses                          | 4,773,000                   | 1,944,000    | 9,334,000                 | 3,920,000    |
| (Loss) income from operations   | 1,794,000                   | (2,000)      | (1,589,000)               | 275,000      |
| Interest expense and amortization of subordinated debt issuance costs | 181,000                     | 216,000      | 385,000                   | 477,000      |
| Interest Income   | (653,000)                   | (1,000)      | (1,286,000)               | (3,000)      |
| (Loss) income from operations before income taxes                     | 2,266,000                   | (217,000)    | (688,000)                 | (199,000)    |
| Income tax benefit (expense)  | (932,000)                   | 62,000       | 7,000                     | 26,000       |
| Net income (loss)   | \$ 1,334,000                | \$ (155,000) | \$ (681,000)              | \$ (173,000) |
| Earnings per share:   |                             |              |                           |              |
| Basic earnings per share  | \$ 0.12                     | \$ (0.03)    | \$ (0.06)                 | \$ (0.04)    |
| Diluted earnings per share  | \$ 0.12                     | \$ (0.03)    | \$ (0.06)                 | \$ (0.04)    |
| Weighted average number of shares:                                    |                             |              |                           |              |
| Basic   | 11,094,000                  | 4,549,000    | 11,094,000                | 4,179,000    |
| Diluted   | 11,196,000                  | 4,549,000    | 11,094,000                | 4,179,000    |

**Comparison of the Results of Operations for the three months ended July 31, 2007 to the Results of Operations for the three months ended July 31, 2006.**

The following analysis provides information as to the results of our operations since our acquisition of GPS which represents a significant acquisition and the creation of our power industry services segment to our operations prior to this acquisition. Following this analysis, we also present a comparison of our current results to pro forma results as though the acquisition occurred on February 1 2006.

**Net Sales**

Net sales of power industry services were \$45.6 million for the three months ended July 31, 2007. We had no sales to power industry services for the three months ended July 31, 2006.

Net sales of nutraceutical products were \$5.0 million for the three months ended July 31, 2007, compared to net sales of nutraceutical products of \$5.2 million for the three months ended July 31, 2006. The decrease in net sales of nutraceutical products of \$175,000 or 3% is due primarily to decreased sales to one of VLI's largest customers, which was offset in part by sales increases to a new large customer.

Net sales of telecommunications infrastructure services were \$2.5 million for the three months ended July 31, 2007 compared to \$3.3 million for the three months ended July 31, 2006 for a decrease in net sales of telecommunications infrastructure services of \$847,000 or 25%. The decrease is due primarily to decreased revenues for services to SMC's three largest customers.

### **Cost of Sales**

For the three months ended July 31, 2007, cost of sales for power industry services were \$40.6 million or 89% of net sales for power industry services compared to no cost of sales related to power industry services for the three months ended July 31, 2006.

During the three months ended July 31, 2007, the Company experienced an unexpected increase in costs related to one of the GPS contracts. Unexpected costs include labor productivity being below expectations and previous experience, labor rate increases due to overtime requirements to meet the completion date, and engineering issues resulting in considerable rework and additional materials. The Company anticipates that upon completion of the contract which is 99% complete at July 31, 2007, it will incur an expected loss of approximately \$8.2 million as of July 31, 2007 which has been recognized. The Company has recorded an estimated loss for this contract as of July 31, 2007 of \$74,000 for additional costs to be incurred as the project is completed.

For the three months ended July 31, 2007, cost of sales for nutraceutical products were \$4.1 million or 81.9% of net sales for nutraceutical products compared to \$3.9 million or 75.6% of net sales for nutraceutical products for the three months ended July 31, 2006. VLI experienced a higher percentage of cost of sales during the three months ended July 31, 2007 due to increased cost for raw materials as well as increases in obsolescence reserves for inventory.

For the three months ended, July 31, 2007, cost of sales for telecommunications infrastructure services was \$1.9 million or 74.3% of net sales of telecommunications infrastructure services compared to \$2.7 million or 80% of net sales for telecommunications infrastructure services for the three months ended July 31, 2006. SMC experienced a decrease in percentage of cost of sales due to higher margin on certain outside plant projects.

### **Selling, General and Administrative Expenses**

For the three months ended July 31, 2007, selling, general and administrative expenses were approximately \$4.8 million or 9.0% of consolidated net sales compared to approximately \$1.9 million or 23% of consolidated net sales for the three months ended July 31, 2006. An increase of \$2.8 million in expenses was due primarily to the acquisition of GPS which was acquired on December 8, 2006 and had approximately \$2.6 million in selling, general and administrative expenses for the three months ended July 31, 2007, including the amortization of purchased intangibles totaling \$1.7 million.

### **Interest Income**

We had interest income of \$653,000 for the three months ended July 31, 2007 compared to interest income of \$1,000 for the three months ended July 31, 2006. Interest income increased primarily due to an increase in interest and investment income from cash and cash equivalents and investments held for sale. We acquired a significant amount of cash and investments held for sale when we acquired GPS on December 8, 2006.

### **Income Tax Benefit (Expense)**

Our consolidated effective income tax rate was 41% for the three months ended July 31, 2007 compared to a 29% effective income tax benefit rate for the three months ended July 31, 2006.





During the three months ended July 31, 2006, the Company recorded amortization of issuance cost for subordinated debt which is treated as a permanent difference for income tax reporting purposes.

**Comparison of the Results of Operations for the six months ended July 31, 2007 to the Results of Operations for the six months ended July 31, 2006.**

**Net Sales**

Net sales of power industry services were \$89 million for the six months ended July 31, 2007. We had no sales of power industry services for the six months ended July 31, 2006. We acquired GPS on December 8, 2006. The increase in net sales of power industry services is due to the acquisition of GPS on December 8, 2006.

Net sales of nutraceutical products were \$10 million for the six months ended July 31, 2007, compared to net sales of nutraceutical products of \$11 million for the six months ended July 31, 2006. The decrease in net sales of nutraceutical products of \$1.1 million or 10% is due primarily to decreased sales to two of VLI's largest customers, Tri Vita Corporation and Rob Reiss Companies which was offset in part by sales increases to Cyberwise.com, Market America and Renew Life.

Net sales of telecommunications infrastructure services were \$4.6 million for the six months ended July 31, 2007 compared to \$6.5 million for the six months ended July 31, 2006 for a decrease in net sales of telecommunications infrastructure services of \$1.9 million or 29%. The decrease is due primarily to decreased revenues for services to SMC's three largest customers, Verizon communications, Inc., Southern Maryland Electrical Cooperative, and Electronic Data Systems Corp.

**Cost of Sales**

For the six months ended July 31, 2007, cost of sales for power industry services were \$83.8 million or 94.2% of net sales for power industry services compared to no cost of sales related to power industry services for the six months ended July 31, 2006.

During the six months ended July 31, 2007, the Company experienced an unexpected increase in costs related to one of the GPS contracts. Unexpected costs include labor productivity being below expectations and previous experience, labor rate increases due to overtime requirements to meet the completion date, and engineering issues resulting in considerable rework and additional materials. The Company anticipates that upon completion of the contract which is 99% complete at July 31, 2007, it will incur an expected loss of approximately \$8.2 million as of July 31, 2007 which has been recognized. The Company has recorded an estimated loss for this contract as of July 31, 2007 of \$74,000 for additional costs to be incurred as the project is completed.

For the six months ended July 31, 2007, cost of sales for nutraceutical products were \$8.3 million or 83% of net sales for nutraceutical products compared to \$8.3 million or 75.4% of net sales for nutraceutical products for the six months ended July 31, 2006. VLI experienced a higher percentage of cost of sales during the six months ended July 31, 2007 due to higher raw material costs.

For the six months ended July 31, 2007, cost of sales for telecommunications infrastructure services was \$3.7 million or 80% of net sales of telecommunications infrastructure services compared to \$5.0 million or 77.2% of net sales for telecommunications infrastructure services for the six months ended July 31, 2006. SMC experienced an increase in percentage of cost of sales due to lower margin on certain outside plant projects.

**Selling, General and Administrative Expenses**

For the six months ended July 31, 2007, selling, general and administrative expenses were approximately \$9.3 million or 9.0% of consolidated net sales compared to approximately \$3.9 million or 22% of consolidated net sales for the six months ended July 31, 2006. An increase of \$5.4 million in expenses was due primarily to the acquisition of GPS which was acquired on December 8, 2006 and had approximately \$5.1 million in selling, general and administrative expenses for the six months ended July 31, 2007, including the amortization of purchased intangibles totaling \$3.4 million.

**Interest Income**

We had interest income of \$1.3 million for the six months ended July 31, 2007 compared to interest income of \$3,000 for the six months ended July 31, 2006. Interest income increased primarily due to an increase in interest and investment income from cash and cash equivalents and investments held for sale. We acquired a significant amount of cash and investments held for sale when we acquired GPS on December 8, 2006.

**Income Tax Benefit**

Our consolidated effective income tax benefit rate was 1% for the six months ended July 31, 2007 compared to a 13% effective income tax benefit rate for the six months ended July 31, 2006.

The Company's income tax benefit for the six months ended July 31, 2007 and 2006 differs from the "expected" tax computed by applying the U.S. Federal corporate income tax rate of 34% to the loss from operations before income taxes for the six months ended July 31, 2007 and 2006.

|                                     | 2007       | 2006      |
|-------------------------------------|------------|-----------|
| Computed "expected" tax benefit     | \$ 234,000 | \$ 68,000 |
| Increase (decrease) resulting from: |            |           |
| State income taxes, net             | (203,000)  | (16,000)  |
| Permanent differences               | (24,000)   | (26,000)  |
|                                     | \$ 7,000   | \$ 26,000 |

During the six months ended July 31, 2007, the Company's effective tax benefit rate was impacted by its inability to utilize certain current operating losses for state income tax reporting purposes.

**CONSOLIDATED RESULTS OF OPERATIONS COMPARED TO PRO FORMA RESULTS**

The following summarizes the results of our operations for three and six months ended July 31, 2007 compared to unaudited pro forma results of operations for the three and six months ended July 31, 2006 as if the acquisition of GPS, the new bank financing of \$8.0 million and the private offering of 2,853,335 shares, was completed on February 1, 2006.

The unaudited pro forma statement of operations does not purport to be indicative of the results that would have actually been obtained if the acquisition of GPS occurred on February 1, 2006 or that may be obtained in the future. GPS 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 statements of operations. The acquisition of GPS had no impact on the previously reported amounts for our nutraceutical products and telecom infrastructure services segments.

|                                 | Three months ended July 31, |               | Six months ended July 31, |               |
|---------------------------------|-----------------------------|---------------|---------------------------|---------------|
|                                 | 2007                        | 2006          | 2007                      | 2006          |
| Net sales                       |                             |               |                           |               |
| Power industry services         | \$ 45,599,000               | \$ 22,393,000 | \$ 88,953,000             | \$ 37,627,000 |
| Nutraceutical products          | 5,036,000                   | 5,211,000     | 9,985,000                 | 11,040,000    |
| Telecom infrastructure services | 2,502,000                   | 3,349,000     | 4,631,000                 | 6,482,000     |
| Net sales                       | 53,137,000                  | 30,953,000    | 103,569,000               | 55,149,000    |
| Cost of sales                   |                             |               |                           |               |
| Power industry services         | 40,590,000                  | 20,171,000    | 83,835,000                | 35,229,000    |
| Nutraceutical products          | 4,122,000                   | 3,940,000     | 8,288,000                 | 8,326,000     |

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|  |              |              |                |              |
|--|--------------|--------------|----------------|--------------|
| Telecom infrastructure services                    | 1,858,000    | 2,678,000    | 3,701,000      | 5,001,000    |
| Gross profit                                       | 6,567,000    | 4,164,000    | 7,745,000      | 6,593,000    |
| Selling and general and<br>administrative expenses | 4,773,000    | 2,686,000    | 9,334,000      | 5,369,000    |
| (Loss) income from operations                      | \$ 1,794,000 | \$ 1,478,000 | \$ (1,589,000) | \$ 1,224,000 |

21

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**Comparison of the Unaudited Results of Operations for the three months ended July 31, 2007 to the Unaudited Pro Forma Results of Operations for the three months ended July 31, 2006**

**Net Sales**

Net sales of power industry services were \$45.6 million for the three months ended July 31, 2007, compared to \$22.4 million of pro forma net sales of power industry services in the three months ended July 31, 2006. The increase in pro forma net sales of power industry services is primarily due to increased sales from new projects started during the year ended January 31, 2007 in Carleton, Nebraska for an ethanol facility, three biodiesel projects and a peaking facility in Wallingford, CT.

Net sales of nutraceutical products were \$5.0 million for the three months ended July 31, 2007, compared to net sales of nutraceutical products of \$5.2 million for the three months ended July 31, 2006. The decrease in net sales of nutraceutical products of \$175,000 or 3% is due primarily to decreased sales to one of VLI's largest customers, Rob Reiss Companies, which was offset in part by sales increases to Renew Life.

Net sales of telecommunications infrastructure services were \$2.5 million for the three months ended July 31, 2007 compared to \$3.3 million for the three months ended July 31, 2006 for a decrease in net sales of telecommunications infrastructure services of \$847,000 or 25%. The decrease is due primarily to decreased revenues for services to SMC's three largest customers, Verizon Communications, Inc., Southern Maryland Electrical Cooperative, and Electronic Data Systems Corp.

**Cost of Sales**

For the three months ended July 31, 2007, pro forma cost of sales for power industry services were \$40.6 million or 89% of pro forma net sales for power industry services compared to \$20.2 million or 90.1% pro forma net sales related to power industry services for the three months ended July 31, 2006. The increase in the level of construction activity by GPS is the reason for significant dollar increase in cost of sales.

During the three months ended July 31, 2007, the Company experienced an unexpected increase in costs related to one of the GPS contracts. Unexpected costs include labor productivity being below expectations and previous experience, labor rate increases due to overtime requirements to meet the completion date, and engineering issues resulting in considerable rework and additional materials. The Company anticipates that upon completion of the contract which is 99% complete at July 31, 2007, it will incur an expected loss of approximately \$8.2 million as of July 31, 2007 which has been recognized. The Company has recorded an estimated loss for this contract as of July 31, 2007 of \$74,000 for additional costs to be incurred as the project is completed.

For the three months ended July 31, 2007, cost of sales for nutraceutical products were \$4.1 million or 81.9% of net sales for nutraceutical products compared to \$3.9 million or 75.6% of net sales for nutraceutical products for the three months ended July 31, 2006. VLI experienced a higher percentage of cost of sales during the three months ended July 31, 2007 due to increased cost for raw materials as well as increases in obsolescence reserves for inventory.

For the three months ended July 31, 2007, cost of sales for telecommunications infrastructure services was \$1.9 million or 74.3% of net sales of telecommunications infrastructure services compared to \$2.7 million or 80% of net sales for telecommunications infrastructure services for the three months ended July 31, 2006. SMC experienced a decrease in percentage of cost of sales due to higher margin on certain outside plant projects.

### **Selling, General and Administrative Expenses**

For the three months ended July 31, 2007, selling, general and administrative expenses were approximately \$4.8 million or 9.0% of consolidated net sales compared to approximately \$2.7 million or 8.7% of consolidated pro forma net sales for the three months ended July 31, 2006. The increase of \$2.1 million in expenses was due primarily to amortization of purchased intangibles related to GPS.

### **Comparison of the Unaudited Results of Operations for the six months ended July 31, 2007 to the Unaudited Pro Forma Results of Operations for the six months ended July 31, 2006.**

#### **Net Sales**

Net sales of power industry services were \$89 million for the six months ended July 31, 2007, compared to net sales of \$37.7 million for power industry services for the six months ended July 31, 2006. The increase in net sales of power industry services is due to the GPS starting a number of large projects in the second half of fiscal year 2007 which are ongoing.

Net sales of nutraceutical products were \$10 million for the six months ended July 31, 2007, compared to net sales of nutraceutical products of \$11 million for the six months ended July 31, 2006. The decrease in net sales of nutraceutical products of \$1.1 million or 10% is due primarily to decreased sales to two of VLI's largest customers, TRI Vita Corporation and Rob Reiss Companies which was offset in part by sales increases to Cyberwise.com, Market America and Renew Life.

Net sales of telecommunications infrastructure services were \$4.6 million for the six months ended July 31, 2007 compared to \$6.5 million for the six months ended July 31, 2006. A decrease in net sales of telecommunications infrastructure services of \$1.9 million or 29%. The decrease is due primarily to decreased revenues for services to SMC's three largest customers, Verizon Communications, Inc., Southern Maryland Electrical Cooperative, and Electronic Data Systems Corp. Sales decreased due to current lower contractual levels of activity with each of SMC's major customers.

#### **Cost of Sales**

For the six months ended July 31, 2007, cost of sales for power industry services were \$83.8 million or 94.2% of net sales for power industry services compared to pro forma cost of sales of \$35.2 million or 93.6% of proforma net sales related to power industry services for the six months ended July 31, 2006. The dollar increase in cost of sales is due to the aforementioned projects which GPS has commenced.

During the six months ended July 31, 2007, the Company experienced an unexpected increase in costs related to one of the GPS contracts. Unexpected costs include labor productivity being below expectations and previous experience, labor rate increases due to overtime requirements to meet the completion date, and engineering issues resulting in considerable rework and additional materials. The Company anticipates that upon completion of the contract which is 99% complete at July 31, 2007, it will incur an expected loss of approximately \$8.2 million as of July 31, 2007 which has been recognized. The Company has recorded an estimated loss for this contract as of July 31, 2007 of \$74,000 for additional costs to be incurred as the project is completed.

For the six months ended July 31, 2007, cost of sales for nutraceutical products were \$8.3 million or 83% of net sales for nutraceutical products compared to \$8.3 million or 75.4% of net sales for nutraceutical products for the six months ended July 31, 2006. VLI experienced a higher percentage of cost of sales during the six months ended July 31, 2007 due to higher raw material costs.

For the six months ended July 31, 2007, cost of sales for telecommunications infrastructure services was \$3.7 million or 80% of net sales of telecommunications infrastructure services compared to \$5.0 million or 77.2% of net sales for telecommunications infrastructure services for the six months ended July 31, 2006. SMC experienced an increase in percentage of cost of sales due to lower margin on certain outside plant projects.

### **Selling, General and Administrative Expenses**

For the six months ended July 31, 2007, selling, general and administrative expenses were approximately \$9.3 million or 9.0% of consolidated net sales compared to approximately \$5 million or 9.7% of pro forma net sales for the six months ended July 31, 2006. An increase of \$4.3 million in expenses was due primarily to the acquisition of GPS which was acquired on December 8, 2006 and had approximately \$5.1 million in selling, general and administrative expenses for the six months ended July 31, 2007 due to amortization of purchased intangibles totaling \$3.4 million.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Cash Position and Indebtedness**

We had working capital of \$14.2 million at July 31, 2007 compared to working capital of \$12.5 million at January 31, 2007. Cash and cash equivalents as of July 31, 2007 were \$49.1 million compared to \$25.4 million as of January 31, 2007. We also have an available balance of \$4.3 million under our financing arrangements with the Bank.

### **Cash Flows**

Net cash provided by operations for the six months ended July 31, 2007, was \$22.9 million compared with \$953,000 of cash provided by operations for the six months ended July 31, 2006 primarily due to the billing and collection of receivables from five GPS projects.

The Company's non-cash expenses increased during the six months ended July 31, 2007 compared to the six months ended July 31, 2006. Depreciation and amortization increased by \$126,000 to \$644,000 for the six months ended July 31, 2007 from \$518,000 for the same period one year ago. Amortization of purchased intangibles increased by \$3.4 million to \$4.1 million for the six months ended July 31, 2007 from \$660,000 for the six months ended April 30, 2006. All of the aforementioned increases in non-cash expenses are primarily due to the acquisition of GPS.

During the six months ended July 31, 2007, estimated earnings in excess of billings provided cash of \$8.1 million, primarily due to billings processed on several GPS construction projects.





During the six months ended July 31, 2007, billing in excess of estimated earnings provided \$30.5 million in cash flow due primarily from cash GPS collected on projects to cover committed costs for projects in process.

During the six months ended July 31, 2007, accounts payable and accrued expenses used \$10.3 million in cash as GPS paid for costs for various projects in process.

During the six months ended July 31, 2007, net cash provided by investing activities was \$2.1 million compared to net cash used in investing activities of \$608,000 for the six months ended July 31, 2006. The increase is the result of proceeds received from the sale of investments and a decrease in budgeted purchases of property, plant and equipment.

For the six months ended July 31, 2007, net cash used in financing activities was approximately \$1.3 million compared to \$189,000 used in financing activities for the six months ended April 30, 2006. The increase is the result of principal payments on debt due to the term financing arrangements established in December 2006 at the time of the GPS acquisition.

During the six months ended July 31, 2006, the Company received proceeds of \$1,863,000 from sale of stock which were used primarily to pay \$1.8 million in principal payments on a subordinated note due the former owner of VLI.

The financing arrangements provide for the measurement at the Company's fiscal year end and at each of the Company's fiscal quarter ends (using a rolling 12-month period) of certain financial covenants including requiring that the ratio of total funded debt to EBITDA not to exceed 2.25 to 1 for the year ending January 31, 2007 and not to exceed 2 to 1 for future quarters, requiring a fixed charge coverage ratio of not less than 1.25 to 1, and requiring the ratio of senior funded debt to EBITDA not to exceed 1.75 to 1 for the year ended January 31, 2007 and not to exceed 1.50 to 1 for future quarters. The Bank's consent continues to be required for acquisitions and divestitures. The Company continues to pledge the majority of the Company's assets to secure the financing arrangements.

The amended financing arrangement contains a subjective acceleration clause which allows the Bank to declare amounts outstanding under the financing arrangements due and payable if certain material adverse changes occur. The Company believes that it will continue to comply with its financial covenants under the financing arrangement. If the Company's performance does not result in compliance with any of its financial covenants, or if the Bank seeks to exercise its rights under the subjective acceleration clause referred to above, the Company would seek to modify its financing arrangement, but there can be no assurance that the Bank would not exercise their rights and remedies under the financing arrangement including accelerating payment of all outstanding senior debt due and payable.

At July 31, 2007, the Company was in compliance with the covenants of its amended financing arrangements.

Management believes that cash on hand, cash generated from the Company's future operations combined with capital resources available under its line of credit is adequate to meet the Company's future operating cash needs. Any future acquisitions, other significant unplanned costs or cash requirements may require the Company to raise additional funds through the issuance of debt and equity securities. There can be no assurance that such financing will be available on terms acceptable to the Company, or at all. If additional funds are raised by issuing equity securities, significant dilution to the existing stockholders may result.

#### **Earnings before Interest, Taxes, Depreciation and Amortization (Non-GAAP Measurement)**

We present Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) to provide investors with a supplemental measure of our operating performance. The following table shows the reconciliation of EBITDA to our reported net loss:



|   | Six months ended July 31, |              |
|---|---------------------------|--------------|
|   | 2007                      | 2006         |
| Net loss, as reported   | \$ (681,000)              | \$ (173,000) |
| Interest expense and amortization of Subordinated debt issuance costs | 385,000                   | 477,000      |
| Tax benefit   | (7,000)                   | (26,000)     |
| Depreciation and amortization   | 644,000                   | 518,000      |
| Amortization of intangible assets                                     | 4,089,000                 | 660,000      |
| EBITDA  | \$ 4,430,000              | \$ 1,456,000 |

Management uses EBITDA, a non-GAAP financial measure, for planning purposes, including the preparation of operating budgets and to determine appropriate levels of operating and capital investments. Management also believes that EBITDA provides additional insight for analysts and investors in evaluating the Company's financial and operational performance and in assisting investors in comparing the Company's financial performance to those of other companies in the Company's industry. However, EBITDA is not intended to be an alternative to financial measures prepared in accordance with GAAP and should not be considered in isolation from our GAAP results of operations. Pursuant to the requirements of SEC Regulation G, a detailed reconciliation between the Company's GAAP and non-GAAP financial results is provided above and investors are advised to carefully review and consider this information as well as the GAAP financial results that are disclosed in the Company's SEC filings.

### Customers

During the six months ended July 31, 2007, the majority of our revenues were provided by a broad range of engineering, procurement and construction services to the power industry. Certain of our more significant customer relationships included six power industry service customers, Great Earth Fuels of Houston LLC, ALTRA Nebraska, LLC (ALTRA), CMEEC-Pierce (CP), Renewable Bio Fuels, Port Neches (RBF), and Roseville Energy Park (REP) accounted for 26.6%, 19.1%, 18.7%, 12.6% and 8.4% of consolidated net sales for the six months ended July 31, 2007. Total revenues from power industry services accounted for 86% of consolidated net sales. In addition, we had sales from VLI, who provides nutritional and whole-food supplements as well as personal care products to customers in the global nutrition industry. VLI sales accounted for 10% of revenues. No customer at VLI contributed more than 2% to our revenues. SMC provided services to telecommunications and utility customers as well as to the Federal Government, which accounted for in the aggregate, 4% of revenues.

During the six months ended July 31, 2006, we did not have revenues from the power industry. Revenues consisted of sales from the nutritional and whole-food supplements as well as personal care products to customers in the global nutrition industry and services to telecommunications and utilities customers as well as to the Federal Government, through a contract with EDS. Certain of our more significant customers during the six months ended July 31, 2006 were with TriVita corporation (TVC), Rob Reiss Companies (RRC), Verizon Communications, Inc. (VZ), Southern Maryland Electrical Cooperative (SMECO), EDS, CyberWize.com, Inc. (C) and Orange Peel Enterprises, Inc. (OPE). TVC, RRC, C and OPE are VLI customers. SMC's significant customers are VZ, SMECO, and EDS. TVC, RRC, C and OPE accounted for approximately 17%, 15%, 7% and 4% of consolidated net sales during the three months ended July 31, 2006. VZ, SMECO and EDS accounted for approximately 10%, 11% and 9% of consolidated net sales during the six months ended July 31, 2006. Combined TVC, RRC, VZ, SMECO, EDS, C and OPE accounted for approximately 75% of consolidated net sales during the six months ended July 31, 2006.

### Seasonality

The Company's power industry services and 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 construction and 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.

## RECENT ACCOUNTING STANDARDS

In September 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standard (“FAS”) No. 157, “Fair Value Measurements.” This Standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The Company plans to adopt FAS 157 on February 1, 2008, as required. The adoption of FAS 157 is not expected to have a material impact the Company’s financial condition and results of operations.

In February 2007, the FASB issued FAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities.” FAS 159 permits companies to measure many financial instruments and certain other items at fair value at specified election dates. The provisions of FAS 159 will be effective for the Company beginning February 1, 2008. The Company does not expect FAS 159 to have a significant impact on the consolidated financial statements.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have not used any material derivative financial instruments during the three months ended July 31, 2007 and 2006. We are exposed to market risk for changes in interest rates for borrowings under the new financing arrangements as discussed above. Borrowings under the financing arrangement bear interest at LIBOR plus an additional margin and therefore are subject to fluctuations in interest rates.

## ITEM 4. CONTROLS AND PROCEDURES

**Evaluation of disclosure controls and procedures.** Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of July 31, 2007. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of July 31, 2007, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

**Changes in internal controls.** No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended April 30, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II

### OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

On March 22, 2005, WFC filed a civil action against the Company, and its executive officers. The suit was filed in the Superior Court of the State of California for the County of Los Angeles. WFC purchased the capital stock of the Company's wholly owned subsidiary, Puroflow Incorporated, pursuant to the terms of the Stock Purchase Agreement dated October 31, 2003. WFC alleged that the Company and its executive officers breached the Stock Purchase Agreement between WFC and the Company and engaged in misrepresentations and negligent conduct with respect to the Stock Purchase Agreement. WFC sought declaratory relief, compensatory and punitive damages in an amount to be proven at trial as well as the recovery of attorney's fees. This action was removed to the United States District Court for the Central District of California.



This case was scheduled for trial on April 10, 2007. On March 15, 2007, the District Court granted the Company and its executive officers' motion for summary judgment, thereby dismissing WFC's lawsuit against the Company and its executive officers in its entirety. WFC has filed a notice of appeal and the Company will vigorously contest WFC's appeal.

Although the Company has reviewed WFC's claim and believes that substantially all of the claims are without merit, the Company has recorded an accrual of approximately \$100,000 and \$286,000 at July 31, 2007 and January 31, 2007, respectfully, for subsequent legal services and estimated legal fees related to potential ongoing legal costs of the WFC claim that it considers to be probable and that can be reasonably estimated. It is possible however, that the ultimate resolution of WFC's claim could result in a material adverse effect on the Company's results of operations for a particular reporting period.

On August 27, 2007, Kevin Thomas filed a lawsuit against the Company, VLI and Rainer Bosselmann in the Circuit Court of Florida. Mr. Thomas was the former owner of VLI and alleges that the Company has breached various agreements with, and violated its fiduciary duty to him. The Company believes that Mr. Thomas' claims are groundless, that it has defenses to those claims and that it intends to contest his charges vigorously. The Company believes that Mr. Thomas has previously executed releases of many of his claims. In addition, the Company believes it has significant counterclaims against Mr. Thomas.

In the normal course of business, the Company has pending claims and legal proceedings. It is the opinion of the Company's management, based on information available at this time, that none of the other current claims and proceedings will have a material effect on the Company's consolidated financial statements.

#### **ITEM 1A. RISK FACTORS**

Our Annual Report on Form 10-KSB for the year ended January 31, 2007, under Item 1 Description of Business, Risk Factors includes a detailed discussion of our risk factors. There have been no material revisions to the Risk Factors as filed in our Annual Report Form 10-KSB for the year ended January 31, 2007.

#### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

#### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

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

The Company held its annual meeting of stockholders in New York, New York on June 19, 2007. The following sets forth matters submitted to a vote of the stockholders at the annual meeting.

a. Seven members were elected to the Board of Directors, each to serve until the next annual meeting of the Company and until their respective successors have been elected to the Board of Directors and qualified. The following seven individuals were elected to the Board of Directors by the holders of common stock of the Company:

Rainer H. Bosselmann, DeSoto Jordan, William Leimkuhler, Daniel A. Levinson, W. G. Champion Mitchell, James W. Quinn and Peter L. Winslow.

Messrs. Bosselmann, Leimkuhler, Levinson, Quinn and Winslow were elected by a vote of 9,786,235 shares of common stock with 10,714 shares of common stock withheld. Messrs. Mitchell and Jordan were elected by a vote of



9,786,225 shares of common stock with 10,724 shares of common stock withheld.

28

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b. The stockholders approved the amendment to the Certificate of Incorporation to increase the number of authorized shares of common stock from 12,000,000 shares to 30,000,000 shares by a vote of 9,745,642 shares of common stock with 51,145 shares of common stock against and 162 shares of common stock abstained.

c. The stockholders approved the Amendment of the Stock Option Plan to increase the number of shares available for issuance under stock options to 650,000 shares by a vote of 9,341,179 shares voting for, 14,630 shares voting against, 146 shares abstained and 440,994 did not vote.

d. The stockholders ratified the appointment of Grant Thornton LLP to audit the financial statements of the Company and its subsidiaries for the year ended January 31, 2008, by a vote of 9,761,509 shares of common stock voting for, 31,619 shares of common stock voting against and 3,821 shares of common stock abstained.

## ITEM 5. OTHER INFORMATION

None.

## ITEM 6. EXHIBITS

| <b>Exhibit No.</b> | <b>Title</b>   |
|--------------------|--|
| 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                                   |

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto, duly authorized.

**ARGAN, INC.**

September 12, 2007

By: /s/ Rainer Bosselmann

\_\_\_\_\_  
Rainer Bosselmann  
Chairman of the Board and Chief Executive Officer

September 12, 2007

By: /s/ Arthur F. Trudel

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Arthur F. Trudel  
Senior Vice President, Chief Financial Officer and  
Secretary