

Edgar Filing: ARGAN INC - Form 10QSB

ARGAN INC
Form 10QSB
June 13, 2006

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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended April 30, 2006

or

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

For the transition period from _____ to _____

Commission File Number 001-31756

Argan, Inc.

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

Delaware

13-1947195

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

One Church Street, Suite 302, Rockville MD 20850

(Address of principal executive offices)

(301) 315-0027

(Issuer's telephone number)

N/A

(Former name, former address and former fiscal year,
if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15 (d) of the Exchange Act during the past twelve months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes No

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 \$.15 per share, outstanding at June 8, 2006: 4,574,010.

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

Edgar Filing: ARGAN INC - Form 10QSB

ARGAN, INC.

INDEX

	Page No.
PART I. FINANCIAL INFORMATION.....	3
Item 1. Financial Statements (unaudited).....	3
Condensed Consolidated Balance Sheets - April 30, 2006 and January 31, 2006...	3
Condensed Consolidated Statements of Operations for the Three Months Ended April 30, 2006 and 2005.....	4
Condensed Consolidated Statements of Cash Flows for the Three Months Ended April 30, 2006 and 2005.....	5
Notes to Condensed Consolidated Financial Statements.....	6
Item 2. Management's Discussion and Analysis or Plan of Operation.....	17
Item 3. Controls and Procedures.....	28
PART II. OTHER INFORMATION.....	28
Item 1. Legal Proceedings.....	28
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.....	29
Item 3. Defaults Upon Senior Securities.....	29
Item 4. Submission of Matters to a Vote of Security Holders.....	29
Item 5. Other Information.....	29
Item 6. Exhibits.....	29
SIGNATURES.....	30

=====

PART I - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
ARGAN, INC.
Condensed Consolidated Balance Sheets
(Unaudited)

Edgar Filing: ARGAN INC - Form 10QSB

	April 30, 2006 =====	January 31, 2006 =====
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 93,000	\$ 5,000
Accounts receivable, net of allowance for doubtful accounts of \$86,000 at 4/30/2006 and \$50,000 at 1/31/2006	4,390,000	3,351,000
Receivable from affiliated entity	146,000	157,000
Escrowed cash	300,000	300,000
Estimated earnings in excess of billings	170,000	675,000
Inventories, net of reserves of \$83,000 at 4/30/2006 and \$95,000 at 1/31/06	3,270,000	3,410,000
Prepaid expenses and other current assets	482,000	458,000
	-----	-----
TOTAL CURRENT ASSETS	8,851,000	8,356,000
	-----	-----
Property and equipment, net of accumulated depreciation of \$1,636,000 at 4/30/2006 and \$1,418,000 at 1/31/2006	3,349,000	3,324,000
Issuance cost for subordinated debt	129,000	257,000
Other assets	36,000	46,000
Contractual customer relationships, net	1,768,000	1,894,000
Trade name	224,000	224,000
Proprietary formulas, net	611,000	726,000
Non-compete agreement, net	1,200,000	1,290,000
Goodwill	7,505,000	7,505,000
	-----	-----
TOTAL ASSETS	\$ 23,673,000	\$ 23,622,000
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 3,484,000	\$ 3,205,000
Due to affiliates	--	121,000
Accrued expenses	2,143,000	1,801,000
Billings in excess of cost and earnings	31,000	--
Deferred income tax liability	25,000	49,000
Line of credit	993,000	1,243,000
Current portion of long-term debt	270,000	421,000
	-----	-----
TOTAL CURRENT LIABILITIES	6,946,000	6,840,000
	-----	-----
Deferred income tax liability	1,603,000	1,618,000
Deferred rent	12,000	10,000
Long-term debt	152,000	176,000
Subordinated note due former owner of Vitarich Laboratories, Inc.	3,292,000	3,292,000
STOCKHOLDERS' EQUITY		
Preferred stock, par value \$.10 per share - 500,000 shares authorized- issued - none	--	--
Common stock, par value \$.15 per share 12,000,000 shares authorized -3,817,243 shares issued at 4/30/2006 and 1/31/2006 and 3,814,010 shares outstanding at 4/30/2006 and 1/31/2006	572,000	572,000
Warrants outstanding	849,000	849,000
Additional paid-in capital	25,336,000	25,336,000
Accumulated deficit	(15,056,000)	(15,038,000)
Treasury stock at cost: - 3,233 shares at 4/30/2006 and 1/31/2006	(33,000)	(33,000)
	-----	-----
TOTAL STOCKHOLDERS' EQUITY	11,668,000	11,686,000

Edgar Filing: ARGAN INC - Form 10QSB

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY

\$ 23,673,000
=====

\$ 23,622,000
=====

See Accompany Notes

3

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

	Three months ended April 30,	
	2006	2005
	=====	=====
Net sales		
Nutraceutical products	\$ 5,829,000	\$ 4,728,000
Telecom infrastructure services	3,133,000	2,428,000
	-----	-----
Net Sales	8,962,000	7,156,000
Cost of sales		
Nutraceutical products	4,386,000	3,430,000
Telecom infrastructure services	2,323,000	1,907,000
	-----	-----
Gross profit	2,253,000	1,819,000
Selling, general and administrative expenses	1,976,000	1,840,000
	-----	-----
Income (loss) from operations	277,000	(21,000)
Interest expense	261,000	56,000
Other income, net	2,000	27,000
	-----	-----
Income (loss) from operations before income taxes	18,000	(50,000)
Income tax provision (benefit)	36,000	(28,000)
	-----	-----
Net loss	\$ (18,000)	\$ (22,000)
	=====	=====
Basic and diluted loss per share	--	\$ (0.01)
	=====	=====
Weighted average number of shares outstanding - basic and diluted	3,814,000	2,992,000
	=====	=====

See Accompany Notes

4

Edgar Filing: ARGAN INC - Form 10QSB

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

	Three Months April 2006 =====
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net loss	\$ (18,000)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:	
Depreciation and amortization	376,000
Amortization of purchase intangibles	331,000
Deferred income taxes	(39,000)
Unrealized gain on liability for derivative financial instruments	--
Gain on sale of property and equipment	(2,000)
Changes in operating assets and liabilities:	
Accounts receivable, net	(1,039,000)
Receivable from affiliated entity	11,000
Estimated earnings in excess of billings	505,000
Inventories, net	140,000
Prepaid expenses and other current assets	(24,000)
Accounts payable and accrued expenses	620,000
Billings in excess of estimated earnings	31,000
Due to affiliates	(121,000)
Other	12,000
Net cash provided by (used in) operating activities	783,000
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of property and equipment	(273,000)
Proceeds from sale of property and equipment	3,000
Net cash used in investing activities	(270,000)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from escrowed cash	--
Proceeds from line of credit	1,605,000
Proceeds from long-term debt	--
Payments on line of credit	(1,855,000)
Principal payments on long-term debt	(175,000)
Net cash (used in) provided by financing activities	(425,000)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	5,000
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	88,000
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 93,000

See Accompany Notes

Edgar Filing: ARGAN INC - Form 10QSB

5

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

NOTE 1- ORGANIZATION

NATURE OF OPERATIONS

Argan, Inc. ("AI" or the "Company") conducts its operations through its wholly owned subsidiaries Vitarich Laboratories, Inc. ("VLI") which it acquired in August 2004 and Southern Maryland Cable, Inc. ("SMC") which it acquired in July 2003. 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 electric utilities primarily in the Mid-Atlantic region.

AI was organized as a Delaware corporation in May 1961 and operates in two reportable segments. (See Note 9)

MANAGEMENT'S PLANS, LIQUIDITY AND BUSINESS RISKS

As of April 30, 2006, the Company had an accumulated deficit of \$15.1 million. At April 30, 2006, the Company had \$3.3 million available under its revolving line of credit with the Bank of America, N.A. (the Bank). The Company operates in two distinct and separate reportable segments. The market for nutritional products is highly competitive and the telecom and infrastructure services industry is fragmented, but also very competitive. The successful execution of the Company's business plan is dependent upon the Company's ability to integrate acquired businesses and their related assets into its operations, its ability to increase and retain its customers, the ability to maintain compliance with significant government regulation, the ability to attract and retain key employees and the Company's ability to manage its growth and expansion, among other factors.

On May 4, 2006, the Company completed a private offering of 760,000 shares of common stock at a price of \$2.50 per share for aggregate proceeds of \$1.9 million. The Company used \$1.8 million of the proceeds to pay down an equal notional amount of the subordinated note due the former owner of VLI. The remainder of the proceeds was used for general corporate purposes. (See Notes 5 and 7)

The Company's line of credit was due to expire on May 31, 2006. On May 5, 2006, the Company renewed its line of credit with the Bank, extending the maturity date to May 31, 2007. Concurrent with the renewal, the Bank has agreed to provide a new \$1.5 million term loan facility (New Term Loan) designed to refinance a portion of the existing subordinated note with the former owner of VLI that had an outstanding balance of \$3,292,000 at April 30, 2006. The Company must be in compliance with its debt covenants to draw on the New Term Loan. (See Note 6)

The financing arrangement with the Bank requires the Company to comply with certain financial covenants. At January 31, 2006, the Company failed to comply with financial covenants requiring that the ratio of debt to pro forma earnings before interest, taxes, depreciation and amortization not exceed 2.5 to 1 and requiring a pro forma fixed charge coverage ratio of not less than 1.25 to 1.

Edgar Filing: ARGAN INC - Form 10QSB

The Bank waived the failure for the measurement period ended January 31, 2006. For future measurement periods, the Bank revised the definitions of certain components of the financial covenants to specifically exclude the impact of VLI's impairment loss at January 31, 2006.

6

The subordinated debt due the former owner of VLI was originally due on August 1, 2006. On May 5, 2006, the Company entered into an agreement with the former owner of VLI to delay the timing of the payment on the subordinated debt to August 1, 2007. The former owner of VLI will be paid prior to this date if the Company were to raise additional equity having an aggregate purchase price of more than \$1 million. The Company also has the option to draw on the aforementioned New Term Loan to pay the former owner of VLI if the Company is in compliance with their debt covenants. (See Note 6)

Management believes that capital resources available under its renewed line of credit combined with cash generated from the Company's operations is adequate to meet the Company's future operating cash needs. Accordingly, the carrying value of the assets and liabilities in the accompanying balance sheet do not reflect any adjustments should the Company be unable to meet its future operating cash needs in the ordinary course of business. The Company continues to take various actions to align its cost structure to appropriately match its expected revenues, including limiting its operating expenditures and controlling its capital expenditures. 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.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation - The condensed consolidated balance sheet as of April 30, 2006 and the condensed consolidated statements of operations and cash flows for the three months ended April 30, 2006 and 2005, respectively, are unaudited. In the opinion of management, the accompanying financial statements contain all adjustments, which are of a normal and recurring nature, considered necessary to present fairly the financial position of the Company as of April 30, 2006 and 2005 and the results of its operations and its cash flows for the periods presented. The Company prepares its interim financial information using the same accounting principles as it does for its annual financial statements.

These financial statements do not include all disclosures associated with annual financial statements and, accordingly, should be read in conjunction with the footnotes contained in the Company's consolidated financial statements for the year ended January 31, 2006, 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. 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.

Reclassifications - Certain amounts in the prior year financial statements have been reclassified to conform with the presentation in the current year financial statements.

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.

Edgar Filing: ARGAN INC - Form 10QSB

Appropriate consideration is given to obsolescence, excessive inventory levels, product deterioration, and other factors in evaluating net realizable value.

Inventories at April 30, 2006 consist of the following:

Raw materials	\$ 2,930,000
Work-in process	278,000
Finished goods	145,000

	3,353,000
Less: Reserves	(83,000)

Inventories, net	\$ 3,270,000
	=====

7

The Company entered into an agreement with one of its major customers, whereby the customer made an advanced payment to the Company for a significant portion of raw material at cost. The raw material is held at the Company's premises and is used in the production of product for the customer. The Company is accounting for this as an inventory financing arrangement and recognizes revenue from the sale of the raw material when the finished product is shipped to the customer. At April 30, 2006, the Company had customer deposits and inventories related to this arrangement of \$463,000.

Earnings Per Share - Income per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding for the period. Dilutive earnings per share represent net income divided by the weighted average number of common shares outstanding inclusive of the effects of dilutive securities. Outstanding stock options and warrants for the purchase of shares of common stock were not included in the weighted average shares outstanding during the three months ended April 30, 2006 and 2005 because the market price of the Company's common stock was significantly below the exercise prices for the stock options and warrants and as such were antidilutive.

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

Stock Option Plans - Prior to February 1, 2006, the Company measured compensation costs for stock based compensation plans using the intrinsic value method of accounting as prescribed in Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB No. 25") and related interpretations. In electing to follow APB No. 25 for expense recognition purposes for the three months ended April 30, 2005, the Company has provided below the expanded disclosures required under Statement of Financial Accounting

Edgar Filing: ARGAN INC - Form 10QSB

Standards No. 148 "Accounting for Stock Based Compensation" ("SFAS No. 148") for stock-based compensation granted including, if materially different from reported results, disclosure of pro forma net income and net income per share had compensation expense relating to grants been measured under the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"). All options issued and outstanding at April 30, 2005 had an exercise price greater than the market price of the Company's stock on the date of grant. The fair value of the options granted have been estimated at the date of grant using a Black-Scholes option-pricing model. Option valuation models require the use of subjective assumptions and changes in these assumptions can materially impact the fair value of the options.

The following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to options granted and unvested under the Plan for the three months ended April 30, 2005. For purposes of this pro forma disclosure, the value of options is estimated using a Black-Scholes option-pricing formula and amortized over the options' vesting periods.

8

Pro Forma Disclosures For the three months ended April 30, 2005

Net loss, as reported	\$(22,000)
Add: Stock based compensation recorded in the financial statements	--
Deduct: Total stock-based employee compensation expense determined under fair value based methods	20,000

Pro forma net loss	\$(42,000)
	=====
Basic and diluted per share:	
Basic and diluted - as reported	\$ (0.01)
	=====
Basic and diluted - pro forma	\$ (0.01)
	=====

NOTE 3 - STOCK BASED COMPENSATION

At April 30, 2006, 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. The Plan was amended in April 2003 to authorize the grant of options for up to 250,000 shares of common stock.

Prior to February 1, 2006, the Company accounted for the Plan under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB No. 25"), and related interpretations, as permitted by Statements of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock Based Compensation" ("SFAS No. 123"). No stock-based employee compensation cost was recognized in the Statement of Operations for the three months ended April 30, 2005, as all options granted under the Plan had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant. Effective February 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R),

Edgar Filing: ARGAN INC - Form 10QSB

"Share-Based Payment" (SFAS No. 123(R)), using the modified-prospective transition method. Under that transition method, compensation cost recognized in the three months ended April 30, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of February 1, 2006, based on grant date fair value estimated in accordance with the original provisions of SFAS No. 123 and (b) compensation cost for all share-based payments granted on or subsequent to February 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Results for prior periods have not been restated.

As a result of adopting SFAS No. 123(R) on February 1, 2006, the Company's income before income taxes for the three months ended April 30, 2006, was approximately \$11,000 lower than if it had continued to account for share based compensation under APB No. 25. Basic and diluted net income per share for the three months ended April 30, 2006 would have been the same as if the Company had not adopted SFAS No. 123(R).

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 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.

9

The fair value of each option award is estimated on the date of grant using a Black-Scholes option-pricing formula that uses the assumptions noted in the table and discussion that follows:

	Three Months Ended April 30, 2006	2005(1)
	=====	=====
Dividend yield	--	--
Expected volatility	58%	--
Risk-free interest rate	5.12%	--
Expected life in years	5	--

(1) No options were granted during the three months ended April 30, 2005.

A summary of option activity under the Plan as of April 30, 2006, and changes in the period then ended is presented below:

	Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contract Term
	-----	-----	-----
Outstanding at beginning of period	73,000	\$ 7.84	--
Granted	50,000	\$ 2.15	--
Exercised	--		

Edgar Filing: ARGAN INC - Form 10QSB

Forfeited or expired	--			

Outstanding at end of period	123,000	\$	5.53	7.6
	=====			
Vested or expected to vest at end of period	123,000	\$	5.53	7.6
Exercisable at end of period	58,000	\$	7.86	6.4

The weighted average grant date fair value of options granted during the three months ended April 30, 2006 was \$1.17. No options were granted during the three months ended April 30, 2005.

No options were exercised during the three months ended April 30, 2006 and 2005. At April 30, 2006, there was \$61,000 of total unrecognized compensation cost related to stock options issued under the Plan. That cost is expected to be recognized during the next six months which represents the vesting period of options granted during the six months ended April 30, 2006.

A summary of the status of the Company's nonvested shares as of April 30, 2006, and changes during the three months then ended, is present below:

	Shares		Aggregate Intrinsic Value	
	-----		-----	
Nonvested at beginning of period	16,000	\$	1.95	
Granted	50,000	\$	1.17	
Vested	--		--	
Forfeited	--		--	
	-----		-----	
Nonvested at end of period	66,000	\$	1.35	
	=====			

10

The fair value of nonvested shares is determined based on the opening trading price of the Company's shares on the grant date. The weighted average grant date fair value of shares granted during the three months ended April 30, 2006 was \$1.17. As of April 30, 2006, there was \$61,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements under the Plan. The cost is expected to be recognized over the next six months. No shares vested during the three months ended April 30, 2006.

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 April 30, 2006, there were 353,000 shares of the Company's common stock reserved for issuance upon exercise of stock options and warrants.

NOTE 4- SUMMARY OF INTANGIBLE ASSETS

Edgar Filing: ARGAN INC - Form 10QSB

The Company's intangible assets consist of the following at April 30, 2006.

	Estimated Useful Life	Gross Carrying Amount	Accumulated Amortization	SMC Impairment Loss (1)
	-----	-----	-----	-----
Goodwill	Indefinite	\$14,055,000 (3)	--	740,000 (1)
Contractual Customer Relationships	5-7 years	3,600,000	1,086,000	746,000 (1)
Proprietary Formulas	3 years	2,500,000	1,202,000	--
Non-Compete Agreement	5 years	1,800,000	600,000	--
Trade Name	Indefinite	680,000	--	456,000 (1)
		-----	-----	-----
		\$22,635,000	\$ 2,888,000	1,942,000 (1)
		=====	=====	=====

(1) During the twelve months ended January 31, 2005, the Company recorded an impairment loss with respect to goodwill and intangibles at SMC.

(2) During the twelve months ended January 31, 2006, the Company recorded an impairment loss with respect to goodwill and proprietary formulas at VLI.

(3) Amounts recorded as goodwill are not deductible for tax reporting purposes.

Amortization expense for the three months ended April 30, 2006, aggregated \$126,000, \$115,000 and \$90,000 for Contractual Customer Relationships, Proprietary Formulas and Non-Compete Agreement, respectively.

NOTE 5 - RELATED PARTY TRANSACTIONS

On May 4, 2006, the Company completed a private offering of 760,000 shares of common stock at a price of \$2.50 per share for aggregate proceeds of \$1.9 million. The Company used \$1.8 million of the proceeds to pay down an equal notional amount of the subordinated note due Kevin Thomas ("Thomas"). The remainder of the proceeds was used for general corporate purposes.

One of the investors, MSRI SBIC, L.P., which acquired 240,000 shares in the offering, is controlled by Daniel Levinson, a director of the Company. In addition, James Quinn, a director of the Company acquired 40,000 shares for his own account.

On January 28, 2005, the Company sold and issued to MSR I SBIC, L.P., a Delaware limited partnership ("Investor"), 129,032 shares of common stock of the Company pursuant to a Subscription Agreement between the Company and Investor ("Subscription Agreement"). These Shares were issued at a purchase price of \$7.75 per share, yielding aggregate proceeds of \$999,998 (See Note 7). These Shares were issued pursuant to the exemption provided by Section 4(2) of the Securities Act of 1933, as amended. The Investor is an entity controlled by Daniel Levinson, a director of the Company.

Pursuant to the Subscription Agreement, the Company agreed to issue additional shares of the Company's common stock to Investor in accordance with the Subscription Agreement under certain conditions upon the earlier of (i) the Company's issuance of additional shares of common stock having an aggregate purchase price of at least \$2,500,000, at a price per share less than \$7.75

Edgar Filing: ARGAN INC - Form 10QSB

subject to certain exclusions, or (ii) ninety percent of the average bid price of the Company's common stock for the thirty days ended July 31, 2005 if the price was less than \$7.75, less the 129,032 shares previously issued. The Company settled the liability for issuance of additional shares in a non-cash transaction at July 31, 2005 with the issuance of 95,321 shares of the Company's common stock.

The provision in the Subscription Agreement which allows the Investor to receive additional shares under certain conditions represents a derivative under Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities." Accordingly, \$139,000 of the proceeds received at issuance was accounted for as a liability for a derivative financial instrument. This liability relates to the obligation to issue Investor additional shares under certain conditions. The derivative financial instrument was subject to adjustment for changes in fair value subsequent to issuance. During the three months ended April 30, 2005, the Company recorded a fair value adjustment of a \$1,000 gain which is recorded in other income, net.

On January 31, 2005, the Company entered into a debt subordination agreement with Thomas, the former owner of VLI, for the cash portion of the additional consideration the Company owes Thomas. The subordinated debt had an original maturity of August 1, 2006 and had an interest rate of 10%. On May 5, 2006, the Company entered into an extension with Thomas of the maturity date of the subordinated note to August 1, 2007.

On January 28, 2005, the Company entered into a Letter Agreement with Thomas in consideration for his agreement to delay the timing of the payment of contingent cash consideration and for entering into a Debt Subordination Agreement (Subordination Agreement), reconstituting such additional cash consideration as subordinated debt. The Letter Agreement includes certain concessions to Thomas allowing him to receive additional consideration based on the market price of the Company's common stock. The concessions provide that in addition to providing Thomas additional shares if the Company issued additional shares at a price less than \$7.75, if the Company did not issue additional shares at a price less than \$7.75 per share, then the Company would issue additional shares to Thomas based on the average closing price of the Company's common stock for the 30 days ended July 31, 2005, if the price was below \$7.75 per share less 1,173,147 shares previously issued. These concessions allowing Thomas to receive additional shares under certain conditions represent a freestanding financial instrument and were accounted for in accordance with EITF 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in a Company's Own Stock."

At issuance, \$501,000 of the charge related to the liability for derivative financial instruments was recorded as deferred issuance cost for subordinated debt which will be amortized over the life of the subordinated debt. The amortization of the deferred loan issuance cost increases the Company's interest expense through August 1, 2007, the maturity date of the note, and reduces net income. The derivative financial instrument was subject to adjustment for changes in fair value subsequent to issuance. The fair value adjustment of a \$22,000 gain during the three months ended April 30, 2005 was reflected as a change in liability for the derivative financial instruments and as a credit to the Company's other expenses or income and net loss. The liability for the derivative financial instrument was settled as a non-cash transaction by the issuance of 535,052 shares of the Company's common stock on September 1, 2005.

The Company leases administrative, manufacturing and warehouse facilities from

Edgar Filing: ARGAN INC - Form 10QSB

individuals who are officers of SMC and VLI. The total expense under these arrangements was \$76,000 and \$69,000 for the three months ended April 30, 2006 and 2005, respectively.

The Company has also 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 \$17,000 and \$24,000 in purchases under the supply agreement during the three months ended April 30, 2006 and 2005, respectively.

The Company also sells its products in the normal course of business to an entity in which the former owner of VLI has an ownership interest. VLI had approximately \$129,000 and \$149,000 in sales with this entity for three months ended April 30, 2006 and 2005, respectively. At April 30, 2006, the affiliated entity owed \$146,000 to VLI.

NOTE 6 - DEBT

In May 2006, the Company agreed to amend the existing financing arrangements with the Bank of America (Bank). Under this arrangement, the Company has a revolving line of credit of \$4.25 million in maximum availability and a term loan with an original balance of \$1.2 million. The May 2006 amendment extended the expiration of the revolving line of credit to May 31, 2007. Under the amended financing arrangements, amounts outstanding under the revolving line of credit and the three year term note bear interest at LIBOR plus 3.25% and 3.45% respectively. Availability on a monthly basis under the revolving line is determined by reference to accounts receivable and inventory on hand which meet certain Bank criteria (Borrowing Base). The aforementioned term note remains in effect and the final monthly scheduled payment of \$33,000 is due on July 31, 2006. As of April 30, 2006, the Company had \$100,000 outstanding under the term note. At April 30, 2006, the Company also had \$993,000 outstanding under the revolving line of credit at an interest rate of 8.2% with \$3.3 million of additional availability under its Borrowing Base.

The amended financing arrangements provides for a new \$1.5 million term loan facility (New Term Loan). The proceeds of the New Term Loan are designated to refinance a portion of the existing subordinated note with Thomas that at April 30, 2006 had an outstanding balance of \$3,292,000. Advances under the New Term Loan are subject to the Company being in compliance with its debt covenants with the Bank. The New Term Loan will be repaid in thirty-six equal monthly principal payments and bears interest at LIBOR plus 3.25%. If the Company draws on the New Term Loan, the Company's Borrowing Base will be reduced by \$750,000 for maximum availability under the revolving line of credit.

The financing arrangements provide for the measurement at the Company's fiscal year end and at each of the Company's fiscal quarter ends of certain financial covenants including requiring that the ratio of debt to pro forma earnings before interest, taxes, depreciation and amortization (EBITDA) not exceed 2.5 to 1 (with the next measurement date on July 31, 2006) and requiring a pro forma fixed charge coverage ratio of not less than 1.25 to 1 (with the next measurement date on July 31, 2006). The amended financings also require that the Company meet minimum EBITDA covenants equal to or exceeding (on a rolling four quarter basis) \$1.2 million for July 31, 2006, \$1.3 million for October 31, 2006 and \$1.8 million for January 31, 2007 and for each successive quarter end thereafter. 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.

Edgar Filing: ARGAN INC - Form 10QSB

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

NOTE 7 - PRIVATE OFFERINGS OF COMMON STOCK

On May 4, 2006, the Company completed a private offering of 760,000 shares of common stock at a price of \$2.50 per share for aggregate proceeds of \$1.9 million. The Company used \$1.8 million of the proceeds to pay down an equal notional amount of the subordinated note due Kevin Thomas. The remainder of the proceeds was used for general corporate purposes.

One of the investors, MSRI SBIC, L.P., which acquired 240,000 shares in the offering, is controlled by Daniel Levinson, a director of the Company. In addition, James Quinn, a director of the Company acquired 40,000 shares for his own account.

On January 28, 2005, the Company sold and issued to MSR I SBIC, L.P., a Delaware limited partnership ("Investor"), 129,032 shares of the Company's common stock, pursuant to a Subscription Agreement between the Company and Investor ("Subscription Agreement"). These shares were issued at a purchase price of \$7.75 per share, yielding aggregate proceeds of \$999,998. These shares were issued pursuant to the exemption provided by Section 4(2) of the Securities Act of 1933, as amended. The Investor is an entity controlled by Daniel Levinson, a director of the Company. (See Note 5) Pursuant to the Subscription Agreement, the Company has agreed to issue additional shares of the Company's common stock to Investor in accordance with the Subscription Agreement based upon the earlier of (i) the Company's issuance of additional shares of common stock having an aggregate purchase price of at least \$2,500,000 at a price per share less than \$7.75, or (ii) July 31, 2005. The additional shares of common stock to be issued would equal the price paid by Investor divided by the lower of (i) the weighted average of all stock sold by the Company prior to July 31, 2005 or; (ii) ninety percent of the average bid price of the Company's common stock for the thirty days ended July 31, 2005 if the price was less than \$7.75, less the 129,032 shares previously issued. The Company settled the liability for issuance of additional shares in a non-cash transaction at July 31, 2005 with the issuance of 95,321 shares of the Company's common stock.

The provision in the Subscription Agreement which allows the Investor to receive additional shares under certain conditions represents a derivative under Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities." Accordingly, at January 31, 2005, \$139,000 of the proceeds was accounted for as a liability for a derivative financial instrument. This liability related to the obligation to issue Investor additional shares under certain conditions. The derivative financial instrument was subject to adjustment for changes in fair value subsequent to issuance. During the three months ended April 30, 2005, the Company recorded a fair value adjustment of a \$1,000 gain which is recorded in other income, net.

Edgar Filing: ARGAN INC - Form 10QSB

NOTE 8 - INCOME TAXES

The Company had an effective income tax rate of 200% for the three months ended April 30, 2006 and an effective income tax benefit rate of 56% for the three months ended April 30, 2005. During the three months ended April 30, 2006, the Company's effective income tax rate was increased by the impact of the amortization of issuance cost for subordinated debt which is treated as a permanent difference for income tax reporting purposes. During the three months ended April 30, 2005, the Company's income tax benefit rate was increased by the impact of the fair value adjustment for liability for derivative instruments which is a permanent difference for income tax reporting purposes.

NOTE 9 - SEGMENT REPORTING

The Company has two 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 two operating segments are nutraceutical products and telecom infrastructure services. The Company conducts its operations through its wholly owned subsidiaries - 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 and Note 2 in this filing. Summarized financial information concerning the Company's operating segments is shown in the following tables:

	For the Three Months Ended April 30, 2006			
	Nutraceutical Products	Telecom Infrastructure Services	Other	Consolidated
	-----	-----	-----	-----
Net sales	\$ 5,829,000	\$ 3,133,000	\$ --	\$ 8,962,000
Cost of sales	4,386,000	2,323,000	--	6,709,000
	-----	-----	-----	-----
Gross profit	1,443,000	810,000	--	2,253,000
Selling, general and administrative expenses	1,087,000	414,000	475,000	1,976,000
	-----	-----	-----	-----
Income (loss) from operations	356,000	396,000	(475,000)	277,000
Interest expense	127,000	19,000	115,000	261,000
Other income, net	--	2,000	--	2,000
	-----	-----	-----	-----
Income (loss) before income taxes	\$ 229,000	\$ 379,000	\$ (590,000)	18,000
	= =====	= =====	=====	-----
Income tax provision				36,000

Edgar Filing: ARGAN INC - Form 10QSB

Net loss				\$ (18,000)
Depreciation and amortization	\$ 134,000	\$ 112,000	\$ 130,000	\$ 376,000
Amortization of intangibles	\$ 305,000	\$ 26,000		\$ 331,000
Goodwill	\$ 6,565,000	\$ 940,000	--	\$ 7,505,000
Total assets	\$ 17,959,000	\$ 5,165,000	\$ 549,000	\$ 23,673,000
Fixed asset additions	\$ 96,000	\$ 177,000	--	\$ 273,000

15

	For the Three Months Ended April 30, 2006			
	Nutraceutical Products	Telecom Infrastructure Services	Other	Consolidated
Net sales	\$ 4,728,000	\$ 2,428,000	\$ --	\$ 7,156,000
Cost of sales	3,430,000	1,907,000	--	5,337,000
Gross profit	1,298,000	521,000	--	1,819,000
Selling, general and administrative expenses	1,086,000	354,000	400,000	1,840,000
Income (loss) from operations	212,000	167,000	(400,000)	(21,000)
Interest expense (income)	58,000	11,000	(13,000)	56,000
Other income, net	--	2,000	25,000	27,000
Income (loss) before income taxes	\$ 154,000	\$ 158,000	\$ (362,000)	(50,000)
Income tax benefit				(28,000)
Net loss				\$ (22,000)
Depreciation and amortization	\$ 77,000	\$ 98,000	\$ 20,000	\$ 195,000
Amortization of intangibles	\$ 399,000	\$ 25,000	--	\$ 424,000
Goodwill	\$ 11,339,000	\$ 940,000	--	\$ 12,279,000
Total assets	\$ 23,817,000	\$ 5,204,000	\$ 928,000	\$ 29,949,000
Fixed asset additions	\$ 106,000	\$ 12,000	--	\$ 118,000

=====

NOTE 10 - CONTINGENCIES

On September 17, 2004, Western Filter Corporation (WFC) notified the Company that WFC believes that the Company breached certain representations and warranties under the stock purchase agreement dated October 31, 2003 by and between AI and WFC ("Stock Purchase Agreement"). WFC asserts damages in excess of the \$300,000 escrow which is being held by a third party in connection with the Stock Purchase Agreement.

On March 22, 2005, WFC filed a complaint in Los Angeles Superior Court alleging the Company and its executive officers, individually, committed breach of contract, intentional misrepresentation, concealment and non-disclosure, negligent misrepresentation and false promise. WFC seeks declaratory relief and compensatory and punitive damages in an amount to be proven at trial as well as the recovery of attorney's fees.

Although the Company has reviewed WFC's claim and believes that substantially all of the claims are without merit, at April 30, 2006, the Company has recorded an accrual related to this matter of \$360,000 for estimated payments and legal fees related to the claims of WFC that it considers to be probable and that can be reasonably estimated. Although the ultimate amount of liability that may result from this matter is not ascertainable, the Company believes that any amounts exceeding the aforementioned accrual should not materially affect the Company's financial condition. 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. The Company will vigorously contest WFC's claim.

16

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 OR PLAN OF OPERATION

This Form 10-QSB contains certain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, which are intended to be covered by the safe harbor created thereby. These statements relate to future events or our future financial performance, including statements relating to our products, customers, suppliers, business prospects, financings, investments and effects of acquisitions. In some cases, forward looking statements can be identified by terminology such as "may," "will," "should," "expect," "anticipate," "intend," "plan," "believe," "estimate," "potential," or "continue," the negative of these terms or other comparable terminology. These statements involve a number of risks and uncertainties, including preliminary information; the effects of future acquisitions and/or investments; competitive factors; business and economic conditions generally; changes in government regulations and policies, our dependence upon third-party suppliers; continued acceptance of our products in the marketplace; technological changes; and other risks and uncertainties that could cause actual events or results to differ materially from any forward-looking statement.

GENERAL

Argan, Inc. (the "Company," "we," "us," or "our") conduct our operations through our wholly owned subsidiaries, Vitarich Laboratories, Inc. ("VLI") that we

Edgar Filing: ARGAN INC - Form 10QSB

acquired in August 2004 and Southern Maryland Cable, Inc. ("SMC") that we acquired in July 2003. Through VLI, we develop, manufacture and distribute premium nutritional products. 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.

RECENT EVENTS

Private Offering of Common Stock

On May 4, 2006, the Company completed a private offering of 760,000 shares of common stock at a price of \$2.50 per share for aggregate proceeds of \$1.9 million. The Company used \$1.8 million of the proceeds to pay down an equal notional amount of the subordinated note due Kevin Thomas. The remainder of the proceeds was used for general corporate purposes.

One of the investors, MSRI SBIC, L.P., which acquired 240,000 shares in the offering, is controlled by Daniel Levinson, a director of the Company. In addition, James Quinn, a director of the Company acquired 40,000 shares for his own account.

Subordination of Certain Debt

On January 31, 2005, the Company entered into a Debt Subordination Agreement ("Subordination Agreement") with Kevin J. Thomas ("Thomas"), Southern Maryland Cable, Inc., a wholly owned subsidiary of the Company ("SMC," and together with the Company, the "Debtor") and Bank of America, N.A. ("Lender") to reconstitute as subordinated debt certain additional cash consideration ("Additional Cash Consideration") that Debtor will owe to Thomas in connection with the Agreement and Plan of Merger dated August 31, 2004 as amended, by and among the Company, AGAX/VLI Acquisition Corporation, a subsidiary of the Company, VLI and Thomas ("Merger Agreement").

17

Pursuant to the Subordination Agreement, Debtor and Thomas have agreed to reconstitute the Additional Cash Consideration as subordinated debt and in furtherance thereof, the Company has agreed to execute and deliver to Thomas a Subordinated Promissory Note in an amount equal to the amount that would otherwise be due Thomas as Additional Cash Consideration under the Merger Agreement. Accordingly, under the Subordination Agreement, Debtor subordinated all of the Junior Debt (as such term is defined in the Subordination Agreement) to the full extent provided in the Subordination Agreement, and Thomas transferred and assigned to Lender all of his rights, title and interest in the Junior Debt and appointed Lender as his attorney-in-fact for the purposes provided in the Subordination Agreement for as long as any of the Superior Debt (as such term is defined in the Subordination Agreement) remains outstanding. Except as otherwise provided in the Subordination Agreement and until such time that the Superior Debt is satisfied in full, Debtor shall not, among other things, directly or indirectly, in any way, satisfy any part of the Junior Debt, nor shall Thomas, among other things, enforce any part of the Junior Debt or accept payment from Debtor or any other person for the Junior Debt or give any subordination in respect of the Junior Debt.

The subordinated debt due the former owner of VLI was originally due on August 1, 2006. On May 5, 2006, the Company entered into an agreement with the former owner of VLI to delay the timing of the payment on the subordinated debt to

Edgar Filing: ARGAN INC - Form 10QSB

August 1, 2007. The former owner of VLI will be paid prior to this date if the Company were to raise additional equity having an aggregate purchase price of more than \$1 million. The Company also has the option to draw on the New Term Loan (as defined below) to pay the former owner of VLI if we are in compliance with our debt covenants with the Bank of America, N.A.

Amendment of Financing Arrangements

In May 2006, the Company agreed to amend the existing financing arrangements with the Bank of America, N.A. (Bank). Under this arrangement, the Company has a revolving line of credit of \$4.25 million in maximum availability and a term loan with an original balance of \$1.2 million. The May 2006 amendment extended the expiration of the revolving line of credit to May 31, 2007. Under the amended financing arrangements, amounts outstanding under the revolving line of credit and the three-year note bear interest at LIBOR plus 3.25% and 3.45% respectively. Availability on a monthly basis under the revolving line is determined by reference to accounts receivable and inventory on hand which meet certain Bank criteria (Borrowing Base). The aforementioned three-year note remains in effect and the final monthly scheduled payment of \$33,000 is due on July 31, 2006. As of April 30, 2006, the Company had \$100,000 outstanding under the term note. At April 30, 2006, the Company also had \$993,000 outstanding under the revolving line of credit at an interest rate of 8.2% with \$3.3 million of additional availability under its Borrowing Base.

The amended financing arrangements provides for a new \$1.5 million term loan facility (New Term Loan). The proceeds of the New Term Loan are designated to refinance a portion of the existing subordinated note with Kevin Thomas that at April 30, 2006 had a current outstanding balance of \$3,292,000 which is due on August 1, 2007. Advances under the New Term Loan are subject to the Company being in compliance with its debt covenants with the Bank. The New Term Loan will be repaid in thirty-six equal monthly principal payments and bears interest at LIBOR plus 3.25%. If the Company draws on the New Term Loan, the Company's Borrowing Base will be reduced by \$750,000 for maximum availability under the revolving line of credit.

The amended financing arrangements provides for the measurement of certain financial covenants including requiring the ratio of debt to pro forma earnings before interest, taxes, depreciation and amortization (EBITDA) not to exceed 2.5 to 1 (with the next measurement date being July 31, 2006) and requiring pro forma fixed charge coverage ratio not less than 1.25 to 1 (with the next measurement date being July 31, 2006). The amended financings also require that the Company meet minimum EBITDA covenants equal to or exceeding (on a rolling four quarter basis) \$1.2 million for July 31, 2006, \$1.3 million for October 31, 2006 and \$1.8 million for January 31, 2007 and for each successive quarter end thereafter. 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 arrangement due and payable if certain material adverse changes occur. We believe that we will continue to comply with our financial covenants under our financing arrangement. If our performance does not result in compliance with any of our financial covenants, or if the Bank seeks to exercise its rights under the subjective acceleration clause referred to above, we would seek to modify our financing arrangement, but there can be no assurance that the Bank would not exercise their rights and remedies under our financing arrangement including

Edgar Filing: ARGAN INC - Form 10QSB

accelerating payment of all outstanding senior and subordinated debt due and payable.

HOLDING COMPANY STRUCTURE

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

We are a holding company with no operations other than our investments in VLI and SMC. At April 30, 2006, there were no restrictions with respect to dividends or other payments from VLI and SMC to the Company.

NUTRITIONAL PRODUCTS

We are dedicated to the research, development, manufacture and distribution of premium nutritional supplements, whole-food dietary supplements and personal care products. Several of these products have garnered honors including the National Nutritional Foods Association's prestigious Peoples Choice Awards for best products of the year in its respective category.

We provide nutrient-dense, super-food concentrates, vitamins and supplements. Our customers include health food store chains, mass merchandisers, network marketing companies, pharmacies and major retailers.

We intend to enhance our position in the fast growing global nutrition industry through our innovative product development and research. We believe that we will be able to expand our distribution channels by providing continuous quality assurance and by focusing on timely delivery of superior nutraceutical products.

We are focused on efficiently utilizing the strong cash flow potential from manufacturing nutritional products. To ensure that working capital is effectively allocated, we closely monitor our inventory turns as well as the number of days sales that we have in our accounts receivable.

TELECOM INFRASTRUCTURE SERVICES

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

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

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

Edgar Filing: ARGAN INC - Form 10QSB

customers' needs for high quality and on-time service. We are committed to invest in our repair and maintenance capabilities to maintain the quality and life of our equipment. Additionally, we invest annually in new vehicles and equipment.

Critical Accounting Policies

Management is required to make judgments, assumptions and estimates that affect the amounts reported when we prepare financial statements and related disclosures in conformity with generally accepted accounting principles. Note 2 contained in the Company's consolidated financial statements for the year ended January 31, 2006 included in the Company's Annual Report contained in Form 10-KSB, as filed with the Securities and Exchange Commission describes the significant accounting policies and methods used in the preparation of our consolidated financial statements. Estimates are used for, but not limited to our accounting for revenue recognition, allowance for doubtful accounts, inventory valuation, long-lived assets and deferred income taxes. Actual results could differ from these estimates. The following critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of our consolidated financial statements. If future conditions and results are different than our assumptions and estimates, materially different amounts could be reported.

Revenue Recognition

Vitarich Laboratories, Inc.

We manufacture products for our customers based on their orders. We typically ship the orders immediately after production keeping relatively little on-hand as finished goods inventory. We recognize customer sales at the time title and the risks and rewards of ownership passes to our customer which is generally when orders are shipped. Sales are recognized on a net basis which reflect reductions for certain product returns and discounts. Cost of goods sold and finished goods inventory sold include materials and direct labor as well as other direct costs combine with allocations of indirect operational costs.

Southern Maryland Cable, Inc.

We generate revenue under various arrangements, including contracts under which revenue is based on a fixed price basis and on a time and materials basis. Revenues from time and materials contracts are recognized when the related service is provided to the customer. Revenues from fixed price contracts, including a portion of estimated profit, are recognized as services are provided, based on costs incurred and estimated total contract costs using the percentage of completion method.

The timing of billing to customers varies based on individual contracts and often differs from the period of revenue recognition. Estimated earnings in excess of billings and billings in excess of estimated earnings totaled \$170,000 and \$31,000, respectively, at April 30, 2006.

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

Edgar Filing: ARGAN INC - Form 10QSB

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.

Impairment of Long-Lived Assets, Including Definite Lived Intangible Assets

Long-lived assets, consisting primarily of property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount should be assessed pursuant to SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." We determine whether any impairment exists by comparing the carrying value of these long-lived assets to the undiscounted future cash flows expected to result from the use of these assets. In the event we determine that an impairment exists, a loss would be recognized based on the amount by which the carrying value exceeds the fair value of the assets, which is generally determined by using quoted market prices or valuation techniques such as the discounted present value of expected future cash flows, appraisals, or other pricing models as appropriate.

Goodwill and Other Indefinite Lived Intangible Assets

In connection with the acquisitions of VLI and SMC, the Company has substantial goodwill and intangible assets including contractual customer relationships, proprietary formulas, non-compete agreements and trade names. In accordance with SFAS 142 "Goodwill and Other Intangible Assets," the Company reviews for impairment, at least annually, goodwill and intangible assets deemed to have an indefinite life.

Goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is to identify a potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill. The estimates of fair value of a reporting unit, generally a Company's operating segment, is determined using various valuation techniques, with the principal techniques being a discounted cash flow analysis and market multiple valuation. A discounted cash flow analysis requires making various judgmental assumptions, including assumptions about future cash flows, growth rates and discount rates. Developing assumptions for the Company's entrepreneurial business requires significant judgment and to a great extent relies on the Company's ability to successfully determine trends with respect to customers, industry and regulatory environment. The assumptions, including assumptions about future flows and growth rates, are based on the Company's budget and business plans as well as industry trends with respect to customers and other manufacturers' and distributors' sales and margins. The Company reviews trends for publicly traded companies which either compete with the Company to provide services or the types of products the Company produces or are users of the types of services and products provided by the Company. Changes in economic and operating conditions impacting these assumptions could result in goodwill impairment in future periods. Discount rate assumptions are based on the Company's subjective assessment of the risk inherent in the respective reporting units. Risks which the Company faces in its business include the public's perception of our integrity and the safety and quality of our products and services. In addition, in the industries that we operate we are subject to rapidly changing consumer demands and preferences. The Company also operates in competitive industries. We are not assured that customers or potential customers will regard our products and services as sufficiently distinguishable from our competitors' product and service offerings. If after taking into consideration industry and Company trends, the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not deemed impaired and the second step of the impairment test is not performed. If the carrying amount of a reporting unit

Edgar Filing: ARGAN INC - Form 10QSB

exceeds its fair value, the second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. Accordingly, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit.

21

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

Contractual Customer Relationships

Southern Maryland Cable, Inc. - The fair value of the Contractual Customer Relationships (CCR's) was determined at the time of the acquisition of SMC by discounting the cash flows expected from SMC's continued relationships with three customers - General Dynamics Corp. (GD), Verizon Communications (VZ) and Southern Maryland Electric Cooperative (SMECO). Expected cash flows were based on historical levels, current and anticipated projects and general economic conditions. In some cases, the estimates of future cash flows reflect periods beyond those of the current contracts in place. While SMC's relationship with GD is relatively recent, SMC has performed work for VZ and SMECO for approximately twenty years and ten years, respectively. The long-term relationship with VZ and SMECO affected the discount rate used to discount cost of capital and SMC's asset mix. We are amortizing the CCR's over a seven year weighted average life given the long standing relationships SMC has with Verizon and SMECO.

Vitarich Laboratories, Inc. - The fair value of the Contractual Customer Relationships at VLI (VCCR's) was determined at the time of the acquisition of VLI by identifying long established customer relationships in which VLI has a pattern of recurring purchase and sales orders. The Company estimated expected cash flows attributable to these existing customer relationships factoring in market place assumptions regarding future contract renewals, customer attrition rates and forecasted expenses to maintain the installed customer base. These cash flows were then discounted based on a rate that reflects the perceived risk of the VCCR's, the Company's estimated weighted average cost of capital and VLI's asset mix. VLI has had a relationship of five years or more with most of its currently significant customers. We are amortizing VCCR's over a five year life based on our expectations of continued cash flows from these relationships and our history of maintaining relationships.

Trade Name

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

We are using the relief-from-royalty method described above to test the trade

Edgar Filing: ARGAN INC - Form 10QSB

name for impairment annually on November 1 and on an interim basis if events or changes in circumstances between annual tests indicate the trade name might be impaired.

Proprietary Formulas

The Fair Value of the Proprietary Formulas (PFs) was determined at the time of the acquisition of VLI by discounting the cash flows expected from developed formulations based on relative technology contribution and estimates regarding product lifecycle and development costs and time. The expected cash flows were discounted based on a rate that reflects the perceived risk of the PFs, the estimated weighted average cost of capital and VLI's asset mix. We are amortizing the PFs over a three year life based on the estimated contributory life of the proprietary formulations utilizing estimated historical product lifecycles and changes in technology.

22

Non-Compete Agreement

The fair value of the Non-Compete Agreement (NCA) was determined at the time of acquisition of VLI by discounting the estimated reduction in the cash flows expected if one key employee, the former sole shareholder of VLI, were to leave. The key employee signed a non-compete clause prohibiting the employee from competing directly or indirectly for five years. The estimated reduced cash flows were discounted based on a rate that reflects the perceived risk of the NCA, the estimated weighted average cost of capital and VLI's asset mix. We are amortizing the NCA over five years, the length of the non-compete agreement.

Derivative Financial Instruments

The Company accounts for derivative financial instruments in accordance with Statement of Financial Accounting Standards ("SFAS") No. 133 "Accounting for Derivative Instruments and Hedging Activities" and Emerging Issues Task Force Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in a Company's Own Stock." The derivative financial instruments are carried at fair value with changes in fair value recorded as other expense, net. The determination of fair value for our derivative financial instruments is subject to the volatility of our stock price as well as certain underlying assumptions which include the probability of raising additional capital.

Deferred Tax Assets and Liabilities

We account for income taxes under the asset and liability method. The approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax basis of assets and liabilities. Developing our provision for income taxes requires significant judgment and expertise in Federal and state income tax laws, regulations and strategies, including the determination of deferred tax assets and liabilities and, if necessary, any valuation allowances that may be required for deferred tax assets.

Western Filter Corporation Litigation

On September 17, 2004, Western Filter Corporation ("WFC") notified the Company that WFC believes that the Company breached certain representations and warranties under the stock purchase agreement dated October 31, 2003 by and between Argan, Inc. and WFC ("Stock Purchase Agreement"). WFC asserts damages in

Edgar Filing: ARGAN INC - Form 10QSB

excess of the \$300,000 escrow which is being held by a third party in connection with the Stock Purchase Agreement.

On March 22, 2005, WFC filed a complaint in Los Angeles Superior Court alleging the Company and its executive officers, individually, committed breach of contract, intentional misrepresentation, concealment and non-disclosure, negligent misrepresentation and false promise. WFC seeks declaratory relief and compensatory and punitive damages in an amount to be proven at trial as well as the recovery of attorneys' fees.

Although the Company has reviewed WFC's claim and believes that substantially all of the claims are without merit, at April 30, 2006, the Company had an accrual related to this matter of \$360,000 for estimated payments and legal fees related to the claims of WFC that it considers to be probable and that can be reasonably estimated. Although the ultimate amount of liability that may result from this matter is not ascertainable, the Company believes that any amounts exceeding the aforementioned accrual should not materially affect the Company's financial condition. 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. The Company will vigorously contest WFC's claim.

23

Results of Operations for the Three Months Ended April 30, 2006 Compared to the Results of Operations for the Three Months ended April 30, 2005

	Three Months Ended April 30,	
	2006	2005
Statement of Operations		
Net sales		
Nutraceutical products	\$ 5,829,000	\$ 4,728,000
Telecom infrastructure services	3,133,000	2,428,000
	-----	-----
Net Sales	8,962,000	7,156,000
	-----	-----
Cost of sales		
Nutraceutical products	4,386,000	3,430,000
Telecom infrastructure services	2,323,000	1,907,000
	-----	-----
Gross profit	2,253,000	1,819,000
Selling general and administrative expenses	1,976,000	1,840,000
	-----	-----
Income (loss) from operations	277,000	(21,000)
Interest expense	261,000	56,000
Other income, net	2,000	27,000
	-----	-----
Income (loss) from operations before income taxes	18,000	(50,000)
Income tax provision (benefit)	36,000	(28,000)
	-----	-----
Net loss	\$ (18,000)	\$ (22,000)
	=====	=====

Net sales

Edgar Filing: ARGAN INC - Form 10QSB

Net sales of nutraceutical products were \$5,829,000 for the three months ended April 30, 2006 compared to net sales of nutraceutical products of \$4,728,000 for the three months ended April 30, 2005, an increase of \$1,101,000 or 23%. The increase in net sales of nutraceutical products was due primarily to increased sales to several of our largest customers, TriVita Corporation (TVC) and Rob Reiss Companies (RRC) as well as to two new customers.

Net sales of telecommunications infrastructure services were \$3,133,000 for the three months ended April 30, 2006 compared to net sales of telecommunications infrastructure services of \$2,428,000 for the three months ended April 30, 2005, an increase of \$705,000 or 29%. The increase is due primarily to increased sales to VZ, SMECO and Electronic Data Systems Corp. (EDS) which offset the decline in business with GD whose contract with SMC was completed last year.

Cost of sales

For the three months ended April 30, 2006, cost of sales for nutraceutical products was \$4,386,000, or 75% of net sales for nutraceutical products compared to \$3,430,000 or 73% of net sales of nutraceutical products for the three months ended April 30, 2005. VLI experienced a higher percentage of cost of sales during the three months ended April 30, 2006 due to increased costs of non-nutritional materials whose cost was affected by the rise in oil prices. VLI has begun to pass along price increases during the three months ended April 30, 2006. In addition, during the three months ended April 30, 2006, VLI outsourced certain manufacturing processes at higher costs which it had originally planned to perform in-house at lower costs.

24

For the three months ended April 30, 2006, cost of sales for telecommunications infrastructure services were \$2,323,000 or 74% of net sales of telecommunications infrastructure services compared to \$1,907,000 or 79% of net sales of telecommunications infrastructure services. SMC experienced improved percentage margin performance due primarily to more effective utilization of construction personnel and equipment assigned to VZ and SMECO as the net sales to both customers increased.

Selling general and administrative expenses

Selling, general and administrative expenses were \$1,976,000 or 22% of net sales for the three months ended April 30, 2006 compared to \$1,840,000 or 26% of net sales for the three months ended April 30, 2005, an increase of \$136,000. SMC increased its selling, general and administrative expenses by \$60,000 due to the hiring of additional sales support personnel. In addition, corporate expenses as a percentage of net sales increased from 6% to 7% due to increased corporate costs due to higher professional accounting services.

Interest Expense

We had an increase of interest expense to \$261,000 for the three months ended April 30, 2006 from \$56,000 for the three months ended April 30, 2005 due primarily to the interest expense for subordinated debt of \$82,000 and amortization of issuance cost for the subordinated debt of \$129,000 for the three months ended April 30, 2006.

Other income, net

We had other income, net of \$2,000 for the three months ended April 30, 2006 compared to other income, net of \$27,000 for the three months ended April 30,

Edgar Filing: ARGAN INC - Form 10QSB

2005.

Income tax (benefit) provision

The Company's effective income tax rate was 200% for the three months ended April 30, 2006 compared to a 56% effective income tax benefit rate for the three months ended April 30, 2005.

During the three months ended April 30, 2006, the Company's effective income tax rate was increased by the impact of the amortization of issuance cost for subordinated debt which is treated as a permanent difference for income tax reporting purposes.

For the three months ended April 30, 2005, the Company's effective income tax benefit rate was increased by the impact of the fair value adjustment for liability for derivative financial instruments which is a permanent difference for income tax reporting purposes.

LIQUIDITY AND CAPITAL RESOURCES

Cash Position and Indebtedness

We had \$1.9 million in working capital at April 30, 2006, including \$93,000 of cash and cash equivalents. In addition we had \$3.3 million available under credit facilities.

Working capital increased by \$400,000 to \$1.9 million at April 30, 2006 from \$1.5 million at January 31, 2006. Components of the Company's cash flow provided by operations during the three months ended April 30, 2006 contributed to the increase in working capital. Estimated earnings in excess of billings decreased by \$505,000, inventories decreased by \$140,000, accounts payable and accrued expenses increased by \$620,000 which was offset, in part by the increase in accounts receivable of \$1,039,000. The Company had income before taxes of \$18,000 for the three months ended April 30, 2006. The Company's non-cash expenses included in the determination of income before taxes included \$331,000 for amortization of purchase intangibles and \$376,000 for depreciation and amortization.

25

Cash Flows

Net cash provided by operations for the three months ended April 30, 2006 was \$783,000 compared with \$24,000 of cash used in operations for the three months ended April 30, 2005 due to the improved financial performance of both SMC and VLI. For the three months ended April 30, 2006, SMC had income from operations of \$396,000 compared to income from operations of \$167,000 for the three months ended April 30, 2005. Net sales from VZ increased by \$830,000 due to SMC reestablishing a contractual relationship with VZ which had been previously discontinued. In July 2004, SMC lost a significantly profitable contract with VZ. In September 2005, SMC commenced work on an underground telecommunications infrastructure services contract with VZ which had been previously awarded to a third party which did not perform to VZ's satisfaction. In addition, SMC experienced strong revenue growth from SMECO. During the three months ended April 30, 2006, VLI had income from operations of \$356,000 compared to income from operations of \$212,000 for the three months ended April 30, 2005. VLI experienced strong revenue growth from two of its most significant customers, TVC and RRC as well as from two new customers.

Edgar Filing: ARGAN INC - Form 10QSB

During the three months ended April 30, 2006, accounts receivable used cash of \$1,039,000. Strong revenue performance at both SMC and VLI resulted in the substantial increase in accounts receivable. During the three months ended April 30, 2006, estimated earnings in excess of billings, inventories, net and accounts payable and accrued expenses provided cash flow of \$505,000, \$140,000 and \$620,000, respectively. Improved processing of invoices reduced SMC's estimated earnings in excess of billings. VLI exercised tighter controls over inventory levels as it experienced strong revenue growth. Accounts payable and accrued expenses increased as SMC experienced substantial increase in work performed by subcontractors which resulted in increased amounts payable to subcontractors at April 30, 2006. Since subcontractors are paid on terms consistent with SMC's terms with its customers, subcontractors are not paid until invoices are paid by our customers which contributes to a higher level of accounts payable.

During the three months ended April 30, 2006, net cash used for investing activities was \$270,000 compared to net cash used for investing activities of \$118,000 for the three months ended April 30, 2005. SMC paid for new drilling equipment and trucks to respond to opportunities for additional customer work.

For the three months ended April 30, 2006, net cash used by financing activities was \$425,000 compared to cash provided by financing activities of \$82,000 for the three months ended April 30, 2005. The change in net cash provided during the three months ended April 30, 2005 to net cash used during the three months ended April 30, 2006 is due to payments made on the line of credit and the term loan by the Company during the three months ended April 30, 2006 from cash provided by operating activities. During the three months ended April 30, 2005, the Bank of America, N.A. released \$304,000 in previously escrowed funds in accordance with the amended financing arrangements of April 2005 which offset the net paydown of the Company's line of credit and long term debt.

In May 2006, the Company agreed to amend the existing financing arrangements with the Bank of America, N.A. (Bank). Under this arrangement, the Company has a revolving line of credit of \$4.25 million in maximum availability and a term loan with an original balance of \$1.2 million. The May 2006 amendment extended the expiration of the revolving line of debt to May 31, 2007. Under the amended financing arrangements, amounts outstanding under the revolving line of credit and the three-year note bear interest at LIBOR plus 3.25% and 3.45%, respectively. Availability on a monthly basis under the revolving line is determined by reference to accounts receivable and inventory on hand which meet certain Bank criteria (Borrowing Base). The aforementioned three-year note remains in effect and the final monthly scheduled payment of \$33,000 is due on July 31, 2006. As of April 30, 2006, the Company had \$100,000 outstanding under the term note. At April 30, 2006, the Company also had \$993,000 outstanding under the revolving line of credit at an interest rate of 8.2% with \$3.3 million of additional availability under its Borrowing Base.

The amended financing arrangements provides for a new \$1.5 million term loan facility (New Term Loan). The proceeds of the New Term Loan are designated to refinance a portion of the existing subordinated note with Kevin Thomas that had at April 30, 2006 an outstanding balance of \$3,292,000 which is due on August 1, 2007. Advances under the New Term Loan are subject to the Company being in compliance with its debt covenants with the Bank. The New Term Loan will be repaid in thirty-six equal monthly principal payments and bear interest at LIBOR plus 3.25%. If the Company draws on the New Term Loan, the Company's Borrowing Base will be reduced by \$750,000 for maximum availability under the revolving line of credit.

Edgar Filing: ARGAN INC - Form 10QSB

The amended financing arrangements provides for the measurement of certain financial covenants including requiring the ratio of debt to pro forma earnings before interest, taxes, depreciation and amortization (EBITDA) not to exceed 2.5 to 1 (with the next measurement period of July 31, 2006) and requiring pro forma fixed charge coverage ratio not less than 1.25 to 1 (with the next measurement period of July 31, 2006). The amended financing arrangements also provide a requirement that the Company meet minimum EBITDA covenants equal to or exceeding (on a rolling four quarter basis) \$1.2 million for July 31, 2006, \$1.3 million for October 31, 2006 and \$1.8 million for January 31, 2007 and for each successive quarter end thereafter. Bank 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 arrangement due and payable if certain material adverse changes occur. We believe that we will continue to comply with our financial covenants under our financing arrangement. If our performance does not result in compliance with any of our financial covenants, or if the Bank seeks to exercise its rights under the subjective acceleration clause referred to above, we would seek to modify our financing arrangement, but there can be no assurance that the Bank would not exercise their rights and remedies under our financing arrangement including accelerating payment of all outstanding senior and subordinated debt due and payable.

At April 30, 2006, the Company was in compliance with the covenants of its amended financing arrangements.

Management believes that cash generated from the Company's operations combined with capital resources available under its renewed 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.

Customers

During the three months ended April 30, 2006, we provided 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 Electronic Data Systems Corp. (EDS). Certain of our more significant customer relationships are 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 22%, 13%, 6% and 5% of consolidated net sales during the three months ended April 30, 2006. VZ, SMECO and EDS accounted for approximately 11%, 11% and 6% of consolidated net sales during the three months ended April 30, 2006. Combined TVC, RRC, VZ, SMECO, EDS, C and OPE accounted for approximately 74% of consolidated net sales during the three months ended April 30, 2006.

Seasonality

Edgar Filing: ARGAN INC - Form 10QSB

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

IMPACT OF CHANGES IN ACCOUNTING STANDARDS

ITEM 3. CONTROLS AND PROCEDURES

(a) Disclosure Controls and Procedures

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15 of the Securities Exchange Act of 1934). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that the Company's current disclosure controls and procedures are effective in timely alerting them of material information relating to the Company that is required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934.

(b) Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) under the Securities Exchange Act of 1934 and for the assessment of the effectiveness of internal control over financial reporting.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting that occurred during the quarter ended April 30, 2006 that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

PART 11

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On September 17, 2004, Western Filter Corporation (WFC) notified the Company that WFC believed that the Company breached certain representations and warranties under the stock purchase agreement dated October 31, 2003 by and between Argan, Inc. and WFC ("Stock Purchase Agreement"). WFC asserts damages in excess of the \$300,000 escrow which is being held by a third party in connection with the Stock Purchase Agreement.

Edgar Filing: ARGAN INC - Form 10QSB

On March 22, 2005, WFC filed a complaint in Los Angeles Superior Court alleging the Company and its executive officers, individually, committed breach of contract, intentional misrepresentation, concealment and non-disclosure, negligent misrepresentation and false promise. WFC seeks declaratory relief and compensatory and punitive damages in an amount to be proven at trial as well as the recovery of attorneys' fees.

Although the Company has reviewed WFC's claim and believes that substantially all of the claims are without merit, as of April 30, 2006, the Company had an accrual related to this matter of \$360,000 for estimated payments and legal expenses related to the claim of WFC that it considers to be probable and that can be reasonably estimated. Although the ultimate amount of liability that may result from this matter is not ascertainable, the Company believes that any amounts exceeding the aforementioned accrual should not materially affect the Company's financial condition. 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. The Company will vigorously contest WFC's claim.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

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

Edgar Filing: ARGAN INC - Form 10QSB

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

ARGAN, INC.

June 13, 2006

By: /s/ Rainer Bosselmann

Rainer Bosselmann
Chairman of the Board and Chief
Executive Officer

June 13, 2006

By: /s/ Arthur F. Trudel

Arthur F. Trudel
Chief Financial Officer