

ARGAN INC  
Form 10-Q  
December 17, 2007

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

**FORM 10-Q**

(Mark One)

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

For the Quarterly Period Ended **October 31, 2007**

or

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number **001-31756**

**Argan, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**

(State or Other Jurisdiction of  
Incorporation or Organization)

**13-1947195**

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

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

(Address of Principal Executive Offices) (Zip Code)

**(301) 315-0027**

(Registrant's Telephone Number, Including Area Code)

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(Former Name, Former Address and Former Fiscal Year,  
if Changed since Last Report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

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

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Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒

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

Indicate the number of shares outstanding of each of the Registrant's classes of common stock, as of the latest practicable date: Common stock, \$0.15 par value, 11,104,012 shares at December 14, 2007.

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

|                                                                                                                                                                                                            | October 31,<br>2007   | January 31,<br>2007   |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|-----------------------|
| <b>ASSETS</b>                                                                                                                                                                                              |                       |                       |
| <b>CURRENT ASSETS</b>                                                                                                                                                                                      |                       |                       |
| Cash and cash equivalents                                                                                                                                                                                  | \$ 75,268,000         | \$ 25,393,000         |
| Accounts receivable, net of allowance for doubtful accounts of \$80,000 at 10/31/2007 and \$137,000 at 1/31/2007                                                                                           | 23,974,000            | 23,030,000            |
| Investments available for sale                                                                                                                                                                             | 5,000,000             | 2,283,000             |
| Escrowed cash                                                                                                                                                                                              | 14,406,000            | 15,031,000            |
| Estimated earnings in excess of billings                                                                                                                                                                   | 630,000               | 12,003,000            |
| Current deferred tax asset                                                                                                                                                                                 | 539,000               | -                     |
| Inventories, net of reserves of \$400,000 at 10/31/2007 and \$104,000 at 01/31/2007                                                                                                                        | 1,711,000             | 2,387,000             |
| Prepaid expenses and other current assets                                                                                                                                                                  | 2,194,000             | 798,000               |
| <b>TOTAL CURRENT ASSETS</b>                                                                                                                                                                                | <b>123,722,000</b>    | <b>80,925,000</b>     |
| Property and equipment, net of accumulated depreciation of \$3,037,000 at 10/31/2007 and \$2,379,000 at 1/31/2007                                                                                          | 2,807,000             | 3,250,000             |
| Other assets                                                                                                                                                                                               | 197,000               | 313,000               |
| Deferred tax asset                                                                                                                                                                                         | 385,000               | -                     |
| Goodwill                                                                                                                                                                                                   | 20,155,000            | 23,981,000            |
| Other intangible assets, net                                                                                                                                                                               | 6,531,000             | 12,661,000            |
| <b>TOTAL ASSETS</b>                                                                                                                                                                                        | <b>\$ 153,797,000</b> | <b>\$ 121,130,000</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                                                                                                |                       |                       |
| <b>CURRENT LIABILITIES</b>                                                                                                                                                                                 |                       |                       |
| Accounts payable                                                                                                                                                                                           | \$ 27,966,000         | \$ 44,255,000         |
| Accrued expenses                                                                                                                                                                                           | 9,734,000             | 5,873,000             |
| Estimated loss on uncompleted contracts                                                                                                                                                                    | 68,000                | -                     |
| Billings in excess of cost and earnings                                                                                                                                                                    | 66,479,000            | 15,705,000            |
| Current portion of long-term debt                                                                                                                                                                          | 2,668,000             | 2,586,000             |
| <b>TOTAL CURRENT LIABILITIES</b>                                                                                                                                                                           | <b>106,915,000</b>    | <b>68,419,000</b>     |
| Deferred income tax liability                                                                                                                                                                              | -                     | 1,471,000             |
| Other liabilities                                                                                                                                                                                          | 46,000                | 14,000                |
| Long-term debt                                                                                                                                                                                             | 4,693,000             | 6,715,000             |
| <b>TOTAL LIABILITIES</b>                                                                                                                                                                                   | <b>111,654,000</b>    | <b>76,619,000</b>     |
| <b>STOCKHOLDERS' EQUITY</b>                                                                                                                                                                                |                       |                       |
| Preferred stock, par value \$0.10 per share; 500,000 shares authorized; no shares issued and outstanding                                                                                                   | -                     | -                     |
| Common stock, par value \$0.15 per share; 30,000,000 shares authorized; 11,107,245 and 11,097,245 shares issued and 11,104,012 and 11,094,012 shares outstanding at 10/31/2007 and 1/31/2007, respectively | 1,665,000             | 1,664,000             |
| Warrants outstanding                                                                                                                                                                                       | 849,000               | 849,000               |
| Additional paid-in capital                                                                                                                                                                                 | 57,492,000            | 57,190,000            |
| Accumulated other comprehensive loss                                                                                                                                                                       | (39,000)              | (8,000)               |

|                                                                  |                       |                       |
|------------------------------------------------------------------|-----------------------|-----------------------|
| Accumulated deficit                                              | (17,791,000)          | (15,151,000)          |
| Treasury stock at cost; 3,233 shares at 10/31/2007 and 1/31/2007 | (33,000)              | (33,000)              |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>                                | <b>42,143,000</b>     | <b>44,511,000</b>     |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>                | <b>\$ 153,797,000</b> | <b>\$ 121,130,000</b> |

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

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

|                                                                       | <b>Three months ended<br/>October 31,</b> |              | <b>Nine months ended<br/>October 31,</b> |              |
|-----------------------------------------------------------------------|-------------------------------------------|--------------|------------------------------------------|--------------|
|                                                                       | <b>2007</b>                               | <b>2006</b>  | <b>2007</b>                              | <b>2006</b>  |
| Net sales                                                             |                                           |              |                                          |              |
| Power industry services                                               | \$ 42,017,000                             | \$ -         | \$ 130,970,000                           | \$ -         |
| Nutraceutical products                                                | 4,617,000                                 | 5,248,000    | 14,602,000                               | 16,288,000   |
| Telecom infrastructure services                                       | 2,629,000                                 | 4,361,000    | 7,260,000                                | 10,843,000   |
| Net Sales                                                             | 49,263,000                                | 9,609,000    | 152,832,000                              | 27,131,000   |
| Cost of sales                                                         |                                           |              |                                          |              |
| Power industry services                                               | 35,548,000                                | -            | 119,383,000                              | -            |
| Nutraceutical products                                                | 4,193,000                                 | 4,235,000    | 12,481,000                               | 12,561,000   |
| Telecom infrastructure services                                       | 2,076,000                                 | 3,506,000    | 5,776,000                                | 8,507,000    |
| Gross profit                                                          | 7,446,000                                 | 1,868,000    | 15,192,000                               | 6,063,000    |
| Selling, general and administrative expenses                          | 4,381,000                                 | 2,214,000    | 13,715,000                               | 6,134,000    |
| Impairment of goodwill and other intangible assets                    | 4,666,000                                 | -            | 4,666,000                                | -            |
| Loss from operations                                                  | (1,601,000)                               | (346,000)    | (3,189,000)                              | (71,000)     |
| Interest expense and amortization of subordinated debt issuance costs | (171,000)                                 | (87,000)     | (550,000)                                | (564,000)    |
| Interest income                                                       | 1,074,000                                 | 2,000        | 2,352,000                                | 5,000        |
| Loss from operations before income taxes                              | (698,000)                                 | (431,000)    | (1,387,000)                              | (630,000)    |
| Income tax (expense) benefit                                          | (1,259,000)                               | 176,000      | (1,253,000)                              | 202,000      |
| Net loss                                                              | \$ (1,957,000)                            | \$ (255,000) | \$ (2,640,000)                           | \$ (428,000) |
| Earnings per share:                                                   |                                           |              |                                          |              |
| Basic and diluted loss per share                                      | \$ (0.18)                                 | \$ (0.06)    | \$ (0.24)                                | \$ (0.10)    |
| Weighted average number of shares outstanding:                        |                                           |              |                                          |              |
| Basic and diluted                                                     | 11,096,000                                | 4,574,000    | 11,095,000                               | 4,312,000    |

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

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

|                                                                                 | <b>Nine Months Ended<br/>October 31,</b> |                   |
|---------------------------------------------------------------------------------|------------------------------------------|-------------------|
|                                                                                 | <b>2007</b>                              | <b>2006</b>       |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                    |                                          |                   |
| Net loss                                                                        | \$ (2,640,000)                           | \$ (428,000)      |
| Adjustments to reconcile net loss to net cash provided by operating activities: |                                          |                   |
| Depreciation and other amortization                                             | 968,000                                  | 1,054,000         |
| Amortization of purchased intangibles                                           | 5,290,000                                | 991,000           |
| Impairment of goodwill and other intangible assets                              | 4,666,000                                | -                 |
| Deferred income taxes                                                           | (2,424,000)                              | (491,000)         |
| Non-cash stock option compensation expense                                      | 282,000                                  | 185,000           |
| Provision for inventory obsolescence                                            | 296,000                                  | (33,000)          |
| Provision for losses on accounts receivable                                     | 50,000                                   | 97,000            |
| Loss on disposal of assets                                                      | 69,000                                   | 1,000             |
| Changes in operating assets and liabilities:                                    |                                          |                   |
| Escrowed cash                                                                   | 625,000                                  | -                 |
| Accounts receivable, net                                                        | (994,000)                                | (1,472,000)       |
| Estimated earnings in excess of billings                                        | 11,373,000                               | (30,000)          |
| Inventories, net                                                                | 380,000                                  | 1,241,000         |
| Prepaid expenses and other current assets                                       | (1,396,000)                              | (343,000)         |
| Accounts payable and accrued expenses                                           | (12,428,000)                             | 687,000           |
| Billings in excess of cost and earnings                                         | 50,774,000                               | 3,000             |
| Other                                                                           | 86,000                                   | (108,000)         |
| Net cash provided by operating activities                                       | 54,977,000                               | 1,354,000         |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                    |                                          |                   |
| Purchases of investments                                                        | (19,997,000)                             | -                 |
| Proceeds from sale of investments                                               | 17,271,000                               | -                 |
| Purchases of property and equipment                                             | (507,000)                                | (778,000)         |
| Proceeds from sale of property and equipment                                    | 44,000                                   | 15,000            |
| Net cash used in investing activities                                           | (3,189,000)                              | (763,000)         |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                    |                                          |                   |
| Net proceeds from the exercise of stock options                                 | 27,000                                   | -                 |
| Net proceeds from the private offering of common stock                          | -                                        | 1,862,000         |
| Principal payments on long-term debt                                            | (1,940,000)                              | (478,000)         |
| Proceeds from long-term debt                                                    | -                                        | 1,500,000         |
| Proceeds from line of credit                                                    | -                                        | 4,575,000         |
| Payments on line of credit                                                      | -                                        | (4,530,000)       |
| Principal payments on subordinated note due to a related party                  | -                                        | (3,292,000)       |
| Net cash used in financing activities                                           | (1,913,000)                              | (363,000)         |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>                                | <b>49,875,000</b>                        | <b>228,000</b>    |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>                         | <b>25,393,000</b>                        | <b>5,000</b>      |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>                               | <b>\$ 75,268,000</b>                     | <b>\$ 233,000</b> |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>                                      |                                          |                   |
| Cash paid for interest and income taxes as follows:                             |                                          |                   |

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|                                                             |    |           |    |         |
|-------------------------------------------------------------|----|-----------|----|---------|
| Interest                                                    | \$ | 898,000   | \$ | 315,000 |
| Income taxes                                                | \$ | 3,117,000 | \$ | 14,000  |
| Non-cash investing and financing activities are as follows: |    |           |    |         |
| Net increase in fair value of interest rate swaps           | \$ | 36,000    | \$ | 7,000   |

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



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

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

***Business***

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

AI operates in three reportable segments.

***Basis of presentation***

The condensed consolidated balance sheet as of October 31, 2007, the condensed consolidated statements of operations for the three and nine months ended October 31, 2007 and 2006, and the condensed consolidated statements of cash flows for the nine months ended October 31, 2007 and 2006 are unaudited. In the opinion of management, the accompanying financial statements contain all adjustments, which are of a normal and recurring nature, considered necessary to present fairly the financial position of the Company as of October 31, 2007 and the results of its operations and its cash flows for the interim periods presented. The Company prepares its interim financial information using the same accounting principles as it does for its annual financial statements.

These financial statements do not include all disclosures associated with annual financial statements and, accordingly, should be read in conjunction with the footnotes contained in the Company's consolidated financial statements for the year ended January 31, 2007, together with the independent registered public accounting firm's report, included in the Company's Annual Report on Form 10-KSB, as filed with the Securities and Exchange Commission (SEC). The results of operations for any interim period are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year.

**NOTE 2 - RECENT ACCOUNTING STANDARDS**

In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("FAS") No. 141(R), "Business Combinations". FAS No. 141(R) replaces FAS No. 141 and provides greater consistency in the accounting and financial reporting of business combinations. FAS No. 141(R) requires the acquiring entity in a business combination to recognize all assets acquired and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, establishes principles and requirements for how an acquirer recognizes and measures any non-controlling interest in the acquiree and the goodwill acquired, and requires the acquirer to disclose the nature and financial effect of the business combination. Among other changes, this statement also required that "negative goodwill" be recognized in earnings as a gain attributable to the acquisition, that acquisition-related costs are to be recognized separately from the

acquisition and expensed as incurred and that any deferred tax benefits resulted in a business combination are recognized in income from continuing operations in the period of the combination. FAS 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company will assess the impact that SFAS 141R may have on its financial position and results of operations.

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

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

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

During the nine months ended October 31, 2007, the Company experienced an unexpected increase in costs related to one of the GPS contracts. Unexpected costs included labor productivity being below expectations and previous experience, labor rate increases due to overtime requirements to meet the completion date, equipment defects and engineering issues resulting in considerable rework and additional materials. The Company incurred a total loss of approximately \$10,416,000 on this contract, including amounts recorded in the three and nine months ended October 31, 2007 of \$2,267,000 and \$11,604,000, respectively.

**NOTE 4 - INVENTORIES**

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

|                  | <b>October 31,<br/>2007</b> | <b>January 31,<br/>2007</b> |
|------------------|-----------------------------|-----------------------------|
| Raw materials    | \$ 1,822,000                | \$ 2,264,000                |
| Work-in process  | 109,000                     | 100,000                     |
| Finished goods   | 180,000                     | 127,000                     |
| Less: Reserves   | (400,000)                   | (104,000)                   |
| Inventories, net | \$ 1,711,000                | \$ 2,387,000                |

**NOTE 5 - INTANGIBLE ASSETS**

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

|                                                | <b>Estimated<br/>Useful Life</b> | <b>Gross Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> | <b>Net Carrying<br/>Amount</b> |
|------------------------------------------------|----------------------------------|----------------------------------|-------------------------------------|--------------------------------|
| Intangible assets being amortized:             |                                  |                                  |                                     |                                |
| Contractual customer relationships - VLI & SMC | 5-7 years                        | \$ 2,341,000                     | \$ 1,841,000                        | \$ 500,000                     |
| Customer relationships - GPS                   | 1-2 years                        | 6,678,000                        | 5,068,000                           | 1,610,000                      |
| Proprietary formulas - VLI                     | 3 years                          | 1,813,000                        | 1,813,000                           | —                              |
| Non-compete agreements-GPS & VLI               | 5 years                          | 2,007,000                        | 1,236,000                           | 771,000                        |
| Trade name - GPS                               | 15 years                         | 3,643,000                        | 217,000                             | 3,426,000                      |
| Intangible assets not being amortized:         |                                  |                                  |                                     |                                |
| Trade name - SMC                               | Indefinite                       | 224,000                          | —                                   | 224,000                        |
| Total other intangible assets                  |                                  | \$ 16,706,000                    | \$ 10,175,000                       | \$ 6,531,000                   |
| Goodwill                                       | Indefinite                       | \$ 20,155,000                    | —                                   | \$ 20,155,000                  |

Amortization expense totaling \$1,201,000 for the three months ended October 31, 2007, consisted of \$985,000, \$38,000, \$118,000 and \$60,000 for contractual customer relationships, proprietary formulas, non-compete agreements and the trade name, respectively. Amortization expense totaling \$331,000 for the three months ended October 31, 2006, consisted of \$126,000, \$115,000 and \$90,000 for contractual customer relationships, proprietary formulas and non-compete agreements, respectively.

Amortization expense totaling \$5,290,000 for the nine months ended October 31, 2007, consisted of \$4,490,000, \$268,000, \$350,000 and \$182,000 for contractual customer relationships, proprietary formulas, non-compete agreements and the trade name, respectively. Amortization expense totaling \$991,000 for the nine months ended October 31, 2006, consisted of \$377,000, \$344,000 and \$270,000 for contractual customer relationships, proprietary formulas and non-compete agreements, respectively.

Due to VLI's loss of key customer accounts, the continuing overall decline in the net sales of VLI, and the operating loss incurred by VLI for the quarter ended October 31, 2007, the Company conducted an analysis of the operations of VLI in order to identify any impairment in the carrying value of the goodwill related to this business. The unadjusted amount of goodwill related to VLI at October 31, 2007 was approximately \$6,565,000. In general, this business has reported operating results that are below expected results. Analyzing this business using both an income approach and a market approach suggested that the current fair value of this business was approximately \$7.0 million. Based on the analysis, the Company recorded a goodwill impairment loss of \$3,826,000 during the current quarter, thereby reducing the goodwill related VLI to an adjusted balance of approximately \$2,739,000 as of October 31, 2007.

The loss of business also suggested that the carrying value of VLI's long-lived intangible assets, non-contract customer relationships and non-compete agreements, may be impaired. The Company determined that the net unadjusted carrying values of these assets exceeded estimated amounts based on the undiscounted future cash flows attributable to these assets. Using fair values based on the estimated amounts of discounted cash flows, we recorded asset impairment losses in the amounts of \$513,000 and \$327,000, respectively, during the current quarter, thereby reducing the adjusted carrying values of these long-lived assets to approximately \$220,000 and \$333,000, respectively, as of October 31, 2007.

The total amount of the impairment of goodwill and other intangible assets, \$4,666,000, is included in the condensed consolidated statements of operations for the three and nine months ended October 31, 2007.

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

The Company leased administrative, manufacturing and warehouse facilities for VLI from an individual who was the former officer and shareholder of VLI. The lease costs through March 2007, the date of his employment termination, were considered related party expenses. SMC's administrative and maintenance facilities were rented from a former officer through July 2006. The total expense amounts under these arrangements were \$45,000 for the nine months ended October 31, 2007, and \$68,000 and \$208,000 for the three and nine months ended October 31, 2006, respectively.

The Company entered into a supply agreement with an entity owned by the former shareholder of VLI whereby the supplier committed to sell to the Company and the Company committed to purchase on an as-needed basis, certain organic products. VLI made \$47,000 in purchases under the supply agreement through March 2007, the date that the former officer and shareholder of VLI was terminated and \$23,000 and \$77,000 in purchases under the supply agreement for the three and nine months ended October 31, 2006, respectively.

The Company also sold its products in the normal course of business to an entity in which the former officer and owner of VLI had an ownership interest. VLI had approximately \$117,000 in sales to this entity through the aforementioned termination in March 2007, and \$118,000 and \$405,000 in sales to this entity for the three and nine months ended October 31, 2006, respectively. At October 31, 2007 and January 31, 2007, the previously affiliated entity owed \$182,000 and \$155,000 to VLI, respectively.

#### **NOTE 7 - DEBT**

On December 11, 2006, Argan amended its financing arrangements with its bank. The amended financing arrangements include an amended 3-year term loan for VLI in the amount of \$1.4 million with interest at LIBOR (4.75% at October 31, 2007) plus 3.25%; a new 4-year term loan that was used to acquire GPS in the amount of \$8.0 million with interest at LIBOR plus 3.25%; and a revolving loan with a maximum amount of \$4.25 million available until May 31, 2008, with interest at LIBOR plus 3.25%.

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

The amended financing arrangements contain an acceleration clause which allows the bank to declare amounts outstanding under the financing arrangements due and payable if it determines in good faith that a material adverse

change has occurred in the financial condition of the Company or any of its subsidiaries. The Company believes that it will continue to comply with its financial covenants under the financing arrangements. If the Company's performance does not result in compliance with any of its financial covenants, or if the bank seeks to exercise its rights under the acceleration clause referred to above, the Company would seek to modify its financing arrangements, but there can be no assurance that the bank would not exercise their rights and remedies under the financing arrangements including accelerating payments of all outstanding senior debt due and payable.

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

#### **NOTE 8 - INCOME TAXES**

Despite reporting a loss from operations before income taxes of \$1,387,000 for the nine months ended October 31, 2007, the Company recorded income tax expense of \$1,253,000 for the period. For the current year, the Company is being adversely impacted by its inability to utilize certain current operating losses for state income tax reporting purposes. In addition, the current year goodwill impairment loss of \$3,826,000 that is discussed in Note 5 is not deductible for income tax reporting purposes, and represents a permanent difference between financial and income tax reporting. For the nine months ended October 31, 2006, the effective income tax benefit rate was 32%.

The Company's income tax (expense) benefit for the nine months ended October 31, 2007 and 2006 differs from the expected income tax benefit computed by applying the U.S. Federal corporate income tax rate of 34% to the loss from operations before income taxes for the nine months ended October 31, 2007 and 2006 as shown in the table below.

|                                      | 2007           | 2006       |
|--------------------------------------|----------------|------------|
| Computed expected income tax benefit | \$ 471,000     | \$ 214,000 |
| Increase (decrease) resulting from:  |                |            |
| State income taxes, net              | (386,000)      | (107,000)  |
| Permanent differences                | (1,338,000)    | 95,000     |
|                                      | \$ (1,253,000) | \$ 202,000 |

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

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

#### NOTE 9 - STOCK BASED COMPENSATION

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

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

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

|                         | Nine Months Ended<br>October 31, |       |
|-------------------------|----------------------------------|-------|
|                         | 2007                             | 2006  |
| Dividend yield          | —                                | —     |
| Expected volatility     | 71%                              | 57%   |
| Risk-free interest rate | 4.89%                            | 5.11% |
| Expected life in years  | 5                                | 5     |

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

| Options                         | Shares   | Weighted-Average Exercise Price | Weighted-Average Remaining Contract Term (Years) | Aggregate Intrinsic Value |
|---------------------------------|----------|---------------------------------|--------------------------------------------------|---------------------------|
| Outstanding at January 31, 2007 | 244,000  | \$ 4.20                         |                                                  |                           |
| Granted                         | 142,000  | \$ 7.05                         |                                                  |                           |
| Exercised                       | (10,000) | 2.65                            |                                                  |                           |
| Forfeited or expired            | (3,000)  | \$ 6.32                         |                                                  |                           |
| Outstanding at October 31, 2007 | 373,000  | \$ 5.30                         | 6.5                                              | \$ 1,150,000              |
| Exercisable at October 31, 2007 | 215,000  | \$ 4.11                         | 7.4                                              | \$ 397,000                |

The per share weighted average grant date fair values of options awarded during the nine months ended October 31, 2007 and 2006 were \$4.90 and \$1.34, respectively. At October 31, 2007, there was approximately \$450,000 unrecognized compensation cost related to stock options granted under the Plan. The end of the period over which the compensation expense for these awards is expected to be recognized is October 2008.

A summary of the status of the Company's nonvested shares as of October 31, 2007, and changes during the nine months then ended, is presented below:

|                               | Shares  | Aggregate Intrinsic Value |
|-------------------------------|---------|---------------------------|
| Nonvested at January 31, 2007 | 16,000  |                           |
| Granted                       | 142,000 |                           |
| Vested                        | —       |                           |
| Forfeited                     | —       |                           |
| Nonvested at October 31, 2007 | 158,000 | \$ 753,000                |

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

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

At October 31, 2007, there were 864,000 shares of the Company's common stock available for issuance upon the exercise of stock options and warrants, including 261,000 shares of the Company's common stock available for award under the Plan.

#### NOTE 10 - LOSS PER SHARE

Basic and diluted net loss per share information is presented in accordance with SFAS No. 128, "Earnings Per Share." Basic loss per share is calculated by dividing the net loss by the weighted average number of common shares



outstanding for the applicable period. Common stock equivalents, including stock options and warrants, are not considered because the effect of their inclusion would be anti-dilutive.

**NOTE 11 - SEGMENT REPORTING**

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

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

The Company's operating segments are organized in separate business units with different management, customers, technology and services. The respective segments account for the respective businesses using the accounting policies in Note 2 to the Company's Annual Report on Form 10-KSB for the fiscal year ended January 31, 2007.

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

|                                                    | <b>Power<br/>Industry<br/>Services</b> |             | <b>Nutraceutical<br/>Products</b> |             | <b>Telecom<br/>Infrastructure<br/>Services</b> |           | <b>Other</b>   | <b>Consolidated</b> |
|----------------------------------------------------|----------------------------------------|-------------|-----------------------------------|-------------|------------------------------------------------|-----------|----------------|---------------------|
| Net sales                                          | \$                                     | 42,017,000  | \$                                | 4,617,000   | \$                                             | 2,629,000 | —              | \$ 49,263,000       |
| Cost of sales                                      |                                        | 35,548,000  |                                   | 4,193,000   |                                                | 2,076,000 | —              | 41,817,000          |
| Gross profit                                       |                                        | 6,469,000   |                                   | 424,000     |                                                | 553,000   | —              | 7,446,000           |
| Selling, general and administrative expenses       |                                        | 1,892,000   |                                   | 1,047,000   |                                                | 346,000   | 1,096,000      | 4,381,000           |
| Impairment of goodwill and other intangible assets |                                        | —           |                                   | 4,666,000   |                                                | —         | —              | 4,666,000           |
| Income (loss) from operations                      |                                        | 4,577,000   |                                   | (5,289,000) |                                                | 207,000   | (1,096,000)    | (1,601,000)         |
| Interest expense                                   |                                        | (145,000)   |                                   | (26,000)    |                                                | —         | —              | (171,000)           |
| Interest income                                    |                                        | 1,067,000   |                                   | —           |                                                | —         | 7,000          | 1,074,000           |
| Income (loss) before income taxes                  | \$                                     | 5,499,000   | \$                                | (5,315,000) | \$                                             | 207,000   | \$ (1,089,000) | (698,000)           |
| Income tax expense                                 |                                        |             |                                   |             |                                                |           |                | (1,259,000)         |
| Net loss                                           |                                        |             |                                   |             |                                                |           |                | \$ (1,957,000)      |
| Depreciation and amortization                      | \$                                     | 45,000      | \$                                | 140,000     | \$                                             | 135,000   | \$ 4,000       | \$ 324,000          |
| Amortization of intangibles                        | \$                                     | 947,000     | \$                                | 228,000     | \$                                             | 26,000    | \$ —           | \$ 1,201,000        |
| Goodwill                                           | \$                                     | 16,476,000  | \$                                | 2,739,000   | \$                                             | 940,000   | \$ —           | \$ 20,155,000       |
| Total assets                                       | \$                                     | 124,193,000 | \$                                | 9,909,000   | \$                                             | 4,896,000 | \$ 14,799,000  | \$ 153,797,000      |
| Fixed asset additions                              | \$                                     | 31,000      | \$                                | 88,000      | \$                                             | 164,000   | \$ —           | \$ 283,000          |

The following information is for the nine months ended October 31, 2007:

|                                              | <b>Power<br/>Industry<br/>Services</b> | <b>Nutraceutical<br/>Products</b> | <b>Telecom<br/>Infrastructure<br/>Services</b> | <b>Other</b>   | <b>Consolidated</b> |
|----------------------------------------------|----------------------------------------|-----------------------------------|------------------------------------------------|----------------|---------------------|
| Net sales                                    | \$ 130,970,000                         | \$ 14,602,000                     | \$ 7,260,000                                   | \$ —           | \$ 152,832,000      |
| Cost of sales                                | 119,383,000                            | 12,481,000                        | 5,776,000                                      | —              | 137,640,000         |
| Gross profit                                 | 11,587,000                             | 2,121,000                         | 1,484,000                                      | —              | 15,192,000          |
| Selling, general and administrative expenses | 6,998,000                              | 3,231,000                         | 1,044,000                                      | 2,442,000      | 13,715,000          |
| Impairment of goodwill and intangible assets | —                                      | 4,666,000                         | —                                              | —              | 4,666,000           |
| Income (loss) from operations                | 4,589,000                              | (5,776,000)                       | 440,000                                        | (2,442,000)    | (3,189,000)         |
| Interest expense                             | (461,000)                              | (88,000)                          | (1,000)                                        | —              | (550,000)           |
| Interest income                              | 2,343,000                              | —                                 | —                                              | 9,000          | 2,352,000           |
| Income (loss) before income taxes            | \$ 6,471,000                           | \$ (5,864,000)                    | \$ 439,000                                     | \$ (2,433,000) | (1,387,000)         |
| Income tax expense                           |                                        |                                   |                                                |                | (1,253,000)         |
| Net loss                                     |                                        |                                   |                                                |                | \$ (2,640,000)      |
| Depreciation and amortization                | \$ 139,000                             | \$ 434,000                        | \$ 383,000                                     | \$ 12,000      | \$ 968,000          |
| Amortization of intangibles                  | \$ 4,375,000                           | \$ 837,000                        | \$ 78,000                                      | \$ —           | \$ 5,290,000        |
| Fixed asset additions                        | \$ 35,000                              | \$ 212,000                        | \$ 260,000                                     | \$ —           | \$ 507,000          |

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

|                                                                       | <b>Nutraceutical<br/>Products</b> | <b>Telecom<br/>Infrastructure<br/>Services</b> | <b>Other</b> | <b>Consolidated</b> |
|-----------------------------------------------------------------------|-----------------------------------|------------------------------------------------|--------------|---------------------|
| Net sales                                                             | \$ 5,248,000                      | \$ 4,361,000                                   | \$ —         | \$ 9,609,000        |
| Cost of sales                                                         | 4,235,000                         | 3,506,000                                      | —            | 7,741,000           |
| Gross profit                                                          | 1,013,000                         | 855,000                                        | —            | 1,868,000           |
| Selling, general and administrative expenses                          | 1,178,000                         | 411,000                                        | 625,000      | 2,214,000           |
| Income (loss) from operations                                         | (165,000)                         | 444,000                                        | (625,000)    | (346,000)           |
| Interest expense and amortization of subordinated debt issuance costs | (79,000)                          | (12,000)                                       | 4,000        | (87,000)            |
| Other income, net                                                     | —                                 | 2,000                                          | —            | 2,000               |
| Income (loss) before income taxes                                     | \$ (244,000)                      | \$ 434,000                                     | \$ (621,000) | (431,000)           |
| Income tax benefit                                                    |                                   |                                                |              | 176,000             |
| Net loss                                                              |                                   |                                                |              | \$ (255,000)        |
| Depreciation and amortization                                         | \$ 146,000                        | \$ 121,000                                     | \$ 12,000    | \$ 279,000          |
| Amortization of intangibles                                           | \$ 305,000                        | \$ 26,000                                      | \$ —         | \$ 331,000          |
| Goodwill                                                              | \$ 6,565,000                      | \$ 940,000                                     | \$ —         | \$ 7,505,000        |
| Total assets                                                          | \$ 16,200,000                     | \$ 6,439,000                                   | \$ 468,000   | \$ 23,107,000       |
| Fixed asset additions                                                 | \$ 92,000                         | \$ 74,000                                      | \$ —         | \$ 166,000          |

The following information is for the nine months ended October 31, 2006:

|                                                                       | <b>Nutraceutical</b> |            | <b>Telecom</b>        |            |                     |
|-----------------------------------------------------------------------|----------------------|------------|-----------------------|------------|---------------------|
|                                                                       | <b>Products</b>      |            | <b>Infrastructure</b> |            |                     |
|                                                                       |                      |            |                       |            | <b>Consolidated</b> |
| Net sales                                                             | \$                   | 16,288,000 | \$                    | 10,843,000 | \$ 27,131,000       |
| Cost of sales                                                         |                      | 12,561,000 |                       | 8,507,000  | 21,068,000          |
| Gross profit                                                          |                      | 3,727,000  |                       | 2,336,000  | 6,063,000           |
| Selling, general and administrative expenses                          |                      | 3,335,000  |                       | 1,249,000  | 6,134,000           |
| Income (loss) from operations                                         |                      | 392,000    |                       | 1,087,000  | (71,000)            |
| Interest expense and amortization of subordinated debt issuance costs |                      | (287,000)  |                       | (41,000)   | (564,000)           |
| Other income, net                                                     |                      | —          |                       | 5,000      | 5,000               |
| Income (loss) before income taxes                                     | \$                   | 105,000    | \$                    | 1,051,000  | \$ (630,000)        |
| Income tax benefit                                                    |                      |            |                       |            | 202,000             |
| Net loss                                                              |                      |            |                       |            | \$ (428,000)        |
| Depreciation and amortization                                         | \$                   | 419,000    | \$                    | 351,000    | \$ 1,054,000        |
| Amortization of intangibles                                           | \$                   | 914,000    | \$                    | 77,000     | \$ 991,000          |
| Fixed asset additions                                                 | \$                   | 281,000    | \$                    | 489,000    | \$ 778,000          |

## NOTE 12 - CONTINGENCIES

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

On March 15, 2007, the District Court granted the Company and its executive officers' motion for summary judgment, thereby dismissing WFC's lawsuit against the Company and its executive officers in its entirety. WFC appealed the District Court's decision. The parties have filed their appellate briefs and are waiting for a date to be scheduled for oral argument. The Company intends to vigorously defend the appeal and this litigation.

Although the Company has reviewed WFC's claims and believes that they are without merit, the Company has recorded an accrual of approximately \$56,000 and \$286,000 at October 31, 2007 and January 31, 2007, respectfully, for subsequent legal services and estimated legal fees related to potential ongoing legal costs of the WFC litigation that it considers to be probable and that can be reasonably estimated. It is possible however, that the ultimate resolution of the WFC litigation could result in a material adverse effect on the results of operations of the Company for a particular future reporting period.

On August 27, 2007, Kevin Thomas filed a lawsuit against the Company, VLI and the Company's Chief Executive Officer (the "CEO") in the Circuit Court of Florida. Thomas was the former owner of VLI. The Company acquired VLI by way of merger on August 31, 2004. Thomas alleges the Company, VLI and the CEO breached various agreements regarding his compensation and employment package that arose from the acquisition of VLI. Thomas has alleged contractual and tort-based claims arising from his compensation and employment agreements and seeks rescission of

his covenant not to compete against VLI. The Company, VLI and the CEO deny that any breach of contract or tortious conduct occurred on their part. The Company has also asserted three counterclaims against Thomas for breach of contract, breach of fiduciary duty and tortious interference with contractual relations for the violation of his non-solicitation, confidentiality and non-compete obligations. The Company intends to vigorously defend this lawsuit and prosecute its counterclaims.

Although the Company has reviewed Thomas' claims and believes that they are without merit, the Company has recorded an accrual of approximately \$320,000 at October 31, 2007 for subsequent legal services and estimated legal fees related to potential ongoing legal costs of the Thomas litigation that it considers to be probable and that can be reasonably estimated. It is possible however, that the ultimate resolution of the Thomas litigation could result in a material adverse effect on the results of operations of the Company for a particular future reporting period.

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

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

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

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

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

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

agreements;

- compliance with certain debt covenants, which as a result, may interfere with our ability to successfully execute our business plan;
- our indebtedness, which could adversely affect our financial condition and impair our ability to fulfill our obligations under our financing arrangements;
- various legal, regulatory and litigation risk including but not limited to, class action lawsuits, regulatory activities and associated periodic reviews of the SEC and Public Company Accounting Oversight Board;
- the nature of our contracts, particularly fixed-price contracts;
- the failure to meet schedule or performance requirements of our contracts;

- our dependence on subcontractors;
- possible cost escalation associated with our fixed-price contracts;
- our ability to obtain new contracts for large-scale projects and the timing of the performance of these contracts;
- the effect of our reputation and financial exposure due to the failure of our partners to perform their contractual obligations;
- delays and/or defaults in customer payments;
- potential professional liability, product liability, warranty and other potential claims, which may not be covered by insurance;
- the presence of competitors with greater financial resources and the impact of competitive products, services and pricing;
- work stoppages and other labor problems;
- our liquidity position;
- a determination to write-off a significant amount of our intangible assets;
- our ability to successfully identify, integrate and complete acquisitions;
- our failure to attract and retain qualified personnel;
- our ability to retain key members of our management;
- our competitors' ability to develop or otherwise acquire equivalent or superior technology;
- general economic conditions;
- future changes in accounting standards or interpretations;
- inability to maintain an effective system of internal control, which could result in inaccurate reporting of our financial results or an inability to prevent fraud;
- provisions in our articles of incorporation and by-laws and rights agreement could make it more difficult to acquire us and may reduce the market price of our common stock;
- changes in the U.S. economy and global markets as a result of terrorists' actions;
- increases in employee-related costs and expenses including healthcare and other employee benefits such as unemployment insurance and workers' compensation; and
- our dependency on technology in our operations and the possible impact of system and information technology interruptions.



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

## **GENERAL**

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

## **CRITICAL ACCOUNTING POLICIES**

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

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

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

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

## **BACKLOG**

Backlog represents the total accumulation of new work awarded less the amount of revenue recognized to date on contracts at a specific point in time. We believe backlog is an indicator of future earnings potential. Although backlog reflects business that we consider to be firm, cancellations or reductions may occur and may reduce backlog and future revenue.

At October 31, 2007, the Company had entered into power industry service contracts for the construction of seven facilities, representing a total backlog of \$166 million compared to contracts of six facilities representing a total backlog of \$171 million at January 31, 2007. Management anticipates these facilities will be completed at various dates through fiscal year 2009.

Subsequent to October 31, 2007, the Company received an interim notice to proceed on a project that it estimates will provide approximately \$340 million in revenue over a two and one half (2 1/2) year period. The final notice to

proceed is subject to the parties signing a definitive engineering, procurement and construction contract.

**CONSOLIDATED RESULTS OF OPERATIONS****Comparison of the Results of Operations for the three months ended October 31, 2007 and 2006**

The following schedule compares the results of our operations for the three months ended October 31, 2007 and 2006. Except where noted, the percentage amounts represent the percentage of net sales for the corresponding period.

|                                                                       |                | <b>Three Months Ended October 31,</b> |                     |
|-----------------------------------------------------------------------|----------------|---------------------------------------|---------------------|
|                                                                       |                | <b>2007</b>                           | <b>2006</b>         |
| Net sales                                                             |                |                                       |                     |
| Power industry services                                               | \$ 42,017,000  | 85.3%                                 | \$ — —%             |
| Nutraceutical products                                                | 4,617,000      | 9.4%                                  | 5,248,000 54.6%     |
| Telecom infrastructure services                                       | 2,629,000      | 5.3%                                  | 4,361,000 45.4%     |
| Net sales                                                             | 49,263,000     | 100.0%                                | 9,609,000 100.0%    |
| Cost of sales **                                                      |                |                                       |                     |
| Power industry services                                               | 35,548,000     | 84.6%                                 | — —                 |
| Nutraceutical products                                                | 4,193,000      | 90.8%                                 | 4,235,000 80.7%     |
| Telecom infrastructure services                                       | 2,076,000      | 79.0%                                 | 3,506,000 80.4%     |
| Cost of sales                                                         | 41,817,000     | 84.9%                                 | 7,741,000 80.6%     |
| Gross profit                                                          | 7,446,000      | 15.1%                                 | 1,868,000 19.4%     |
| Selling, general and administrative expenses                          |                |                                       |                     |
|                                                                       | 4,381,000      | 8.9%                                  | 2,214,000 23.0%     |
| Impairment of goodwill and intangible assets                          |                |                                       |                     |
|                                                                       | 4,666,000      | 9.5%                                  | — —                 |
| Loss from operations                                                  | (1,601,000)    | (3.3)%                                | (346,000) (3.6)%    |
| Interest expense and amortization of subordinated debt issuance costs |                |                                       |                     |
|                                                                       | (171,000)      | *                                     | (87,000) (1.0)%     |
| Interest income                                                       | 1,074,000      | 2.2%                                  | 2,000 *             |
| Loss from operations before income taxes                              |                |                                       |                     |
|                                                                       | (698,000)      | (1.4)%                                | (431,000) (4.5)%    |
| Income tax (expense) benefit                                          | (1,259,000)    | (2.6)%                                | 176,000 1.8%        |
| Net loss                                                              | \$ (1,957,000) | \$ (4.0)%                             | \$ (255,000) (2.7)% |
| Earnings per share:                                                   |                |                                       |                     |
| Basic and diluted loss per share                                      | \$ (0.18)      |                                       | \$ (0.06)           |
| Weighted average number of shares:                                    |                |                                       |                     |
| Basic and diluted                                                     | 11,096,000     |                                       | 4,574,000           |

\* Less than 1%.

\*\* The cost of sales percentage amounts represent the percentage of net sales of the applicable segment.

The following analysis provides information as to the results of our operations for the three and nine month periods ended October 31, 2007 and 2006. In December 2006, we completed the acquisition of GPS, a transaction that is significant to our financial statements. As the results of operations for the current year periods include the operating results of GPS, and the operating results of the corresponding periods of the prior year do not, a comparison of our current year results to pro forma prior-year results follows this analysis below. The pro forma results are presented as if the acquisition of GPS and certain related transactions occurred on February 1, 2006. The acquisition of GPS

represented the establishment of our power industry services business segment.

### **Net Sales**

Net revenues of power industry services were \$42.0 million for the three months ended October 31, 2007, and represented 85.3% of consolidated net sales.

Net sales of nutraceutical products were \$4.6 million for the three months ended October 31, 2007, and represented 9.4% of consolidated net sales. Net sales of nutraceutical products were \$5.2 million for the three months ended October 31, 2006. This amount represented 54.6% of consolidated net sales for the prior-year period. The decrease in net sales of nutraceutical products of \$631,000, or 12%, primarily was due to the loss of one of VLI's largest customers, representing approximately 18% of this segment's net sales in the prior-year quarter, and a reduced level of net sales to VLI's largest customer. Despite an extremely competitive business environment, this business has added one significant customer this year, and expects to increase sales to existing customers in the upcoming fiscal year as it continues to expand its product offerings.

Net revenues of telecommunications infrastructure services were \$2.6 million for the three months ended October 31, 2007 compared to \$4.4 million for the three months ended October 31, 2006, representing a decrease in the net revenues of telecommunications infrastructure services of \$1.8 million, or 40%. The net revenues of telecommunications services for the three months ended October 31, 2007 and 2006 were 5.3% and 45.4% of consolidated net sales for the corresponding period, respectively. The substantial portion of the 92% decline in inside premises revenue between years relates to a reduced level of service provided to SMC's largest inside premises customer. A combination of increased competition and an overall reduction in the amount of work being conducted by the customer has adversely affected the level of our business between years. The net revenues related to services provided to SMC's outside premises customers declined by approximately 7% compared to the net revenues of the corresponding prior-year quarter. We expect that this business, which continues to generate net income on a quarterly basis, will achieve revenue growth in the upcoming fiscal year.

### **Cost of Sales**

For the three months ended October 31, 2007, the cost of revenues for power industry services was \$35.5 million, or approximately 85% of net revenues. During the current fiscal year, the Company has experienced an unexpected increase in costs related to one of its GPS contracts. An additional loss of approximately \$2.3 million was incurred on this project during the current quarter, increasing the total expected loss on this contract to approximately \$10.4 million. The total loss amount has been recorded in the accounts, and this project is now substantially complete. The profitable performance of services for the Company's other GPS construction projects underway during the current quarter more than offset the current quarter loss related to the loss project.

For the three months ended October 31, 2007, cost of sales for nutraceutical products were \$4.2 million, or 90.8% of corresponding net sales, compared to \$4.2 million, or 80.7% of corresponding net sales for the three months ended October 31, 2006. Expressed as a percentage of net sales, VLI's product packaging costs declined in the current quarter compared to the corresponding quarter of the prior year. However, substantially offsetting this favorable reduction was an increase in the cost of liquid product. In addition, the loss of the sales volume related to the VLI customers discussed above caused VLI to re-evaluate its inventory for additional obsolete quantities. As a result, the reserve for inventory obsolescence was increased by approximately \$257,000 during the quarter. The corresponding charge is included in the cost of sales of nutraceutical products for the three months ended October 31, 2007. The cost of sales of nutraceutical products for the current quarter also included a charge of approximately \$160,000 representing the loss incurred in connection with settling a dispute with a customer related to defective product.

For the three months ended, October 31, 2007, the cost of revenues for telecommunications infrastructure services was approximately \$2.1 million, or 79.0% of corresponding net revenues, compared to \$3.5 million for the three months ended October 31, 2006, or 80.4% of corresponding net revenues. SMC experienced a decrease in the percentage of cost of revenues due to higher gross margins on certain outside plant projects.

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

For the three months ended October 31, 2007, selling, general and administrative expenses were approximately \$4.4 million, or 8.9% of consolidated net sales, compared to approximately \$2.2 million for the three months ended October 31, 2006, or 23.0% of consolidated net sales. The increase of approximately \$2.2 million in expenses between the current and prior year quarters was due primarily to the addition of the selling, general and administrative costs of GPS. GPS was acquired in December 2006. Such costs for GPS in the current quarter were approximately \$1.9 million, but they represented only 4.5% of the net revenues of GPS for the quarter. In addition, the inclusion of the net revenues of GPS in consolidated net sales for the current quarter was a primary cause of the decline in corporate general and administrative expenses, expressed as a percentage of the corresponding consolidated net sales, from approximately 6.5% to approximately 2.2% between years. Corporate general and administrative expenses have increased substantially, from \$625,000 for the three months ended October 31, 2006 to \$1,096,000 for the three

months ended October 31, 2007, due to increased litigation costs, increased other professional fees including audit, tax and SOX internal control-related compliance fees, and increased stock option compensation expense.

### **Impairment Losses**

Due to VLI's loss of key customer accounts, the continuing overall decline in the net sales of VLI, and the operating loss incurred by VLI for the current quarter, we conducted an analysis of the operations of VLI in order to identify any impairment in the carrying value of the goodwill related to this business. The unadjusted amount of goodwill related to VLI at October 31, 2007 was approximately \$6,565,000. In general, this business has reported operating results that are below expected results. Analyzing this business using both an income approach and a market approach suggested that the current fair value of this business was approximately \$7.0 million. Based on this analysis, we recorded a goodwill impairment loss of \$3,826,000 during the current quarter, thereby reducing the goodwill related to VLI to an adjusted balance of approximately \$2,739,000 as of October 31, 2007.

The loss of business also suggested that the carrying value of VLI's long-lived intangible assets, non-contract customer relationships and non-compete agreements, may be impaired. In fact, we determined that the net unadjusted carrying values of these assets exceeded the estimated amounts of undiscounted future cash flows attributable to these assets. Using fair values based on the estimated amounts of discounted cash flows, we recorded asset impairment losses in the amounts of \$513,000 and \$327,000, respectively, during the current quarter, thereby reducing the adjusted carrying values of these long-lived assets to approximately \$220,000 and \$333,000, respectively, as of October 31, 2007.

### **Interest Income and Expense**

We reported interest income of \$1,074,000 for the three months ended October 31, 2007 compared to interest income of \$2,000 for the three months ended October 31, 2006. Interest income increased due to an increase in interest and investment income from cash and cash equivalents and investments held for sale. We have acquired a significant amount of cash and investments held for sale with the acquisition of GPS in December 2006 and the favorable cash flow from the operations of GPS during the current fiscal year. The acquisition of GPS was partially financed with the proceeds of a bank loan with an original principal amount of \$8.0 million. The consolidated condensed results of operations for the three months ended October 31, 2007 included the interest expense (based on LIBOR plus 3.25%) related to this loan of approximately \$144,000.

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

Despite reporting a loss from operations before income taxes of \$698,000 for the three months ended October 31, 2007, we incurred income tax expense of \$1,259,000 for the period. For the current year, the Company is being adversely impacted by our inability to utilize certain current operating losses for state income tax reporting purposes. In addition, the current year goodwill impairment loss of \$3,826,000 is not deductible for income tax reporting purposes, and represents a permanent difference between financial and income tax reporting. For the three months ended October 31, 2006, the effective income tax benefit rate was 32%.



**Comparison of the Results of Operations for the nine months ended October 31, 2007 and 2006**

The following schedule compares the results of our operations for the nine months ended October 31, 2007 and 2006. Except where noted, the percentage amounts represent the percentage of net sales for the corresponding period.

|                                                                       |                | <b>Nine Months Ended October 31,</b> |                        |
|-----------------------------------------------------------------------|----------------|--------------------------------------|------------------------|
|                                                                       |                | <b>2007</b>                          | <b>2006</b>            |
| Net sales                                                             |                |                                      |                        |
| Power industry services                                               | \$ 130,970,000 | 85.7%                                | \$ — —%                |
| Nutraceutical products                                                | 14,602,000     | 9.6%                                 | 16,288,000 60.0%       |
| Telecom infrastructure services                                       | 7,260,000      | 4.7%                                 | 10,843,000 40.0%       |
| Net sales                                                             | 152,832,000    | 100.0%                               | 27,131,000 100.0%      |
| Cost of sales **                                                      |                |                                      |                        |
| Power industry services                                               | 119,383,000    | 91.2%                                | — —                    |
| Nutraceutical products                                                | 12,481,000     | 85.5%                                | 12,561,000 77.1%       |
| Telecom infrastructure services                                       | 5,776,000      | 79.6%                                | 8,507,000 78.5%        |
| Cost of sales                                                         | 137,640,000    | 90.1%                                | 21,068,000 77.7%       |
| Gross profit                                                          | 15,192,000     | 9.9%                                 | 6,063,000 22.3%        |
| Selling, general and administrative expenses                          |                |                                      |                        |
|                                                                       | 13,715,000     | 9.0%                                 | 6,134,000 22.6%        |
| Impairment of goodwill and intangible assets                          |                |                                      |                        |
|                                                                       | 4,666,000      | 3.0%                                 | — —                    |
| Loss from operations                                                  | (3,189,000)    | (2.1)%                               | (71,000) *             |
| Interest expense and amortization of subordinated debt issuance costs |                |                                      |                        |
|                                                                       | (550,000)      | *                                    | (564,000) (2.1)%       |
| Interest income                                                       | 2,352,000      | 1.5%                                 | 5,000 *                |
| Income (loss) from operations before income taxes                     |                |                                      |                        |
|                                                                       | (1,387,000)    | (0.9)%                               | (630,000) (2.3)%       |
| Income tax (expense) benefit                                          | (1,253,000)    | (0.8)%                               | 202,000 0.7%           |
| Net loss                                                              | \$ (2,640,000) | (1.7)%                               | \$ (428,000) \$ (1.6)% |
| Earnings per share:                                                   |                |                                      |                        |
| Basic and diluted loss per share                                      | \$ (0.24)      |                                      | \$ (0.10)              |
| Weighted average number of shares:                                    |                |                                      |                        |
| Basic and diluted                                                     | 11,095,000     |                                      | 4,312,000              |

\* Less than 1%.

\*\* The cost of sales percentage amounts represent the percentage of the net sales of the applicable segment.

**Net Sales**

Net revenues of power industry services were approximately \$131 million for the nine months ended October 31, 2007, and represented 85.7% of consolidated net sales for the period.

Net sales of nutraceutical products were approximately \$14.6 million for the nine months ended October 31, 2007, representing 9.6% of consolidated net sales for the period, compared to net sales of nutraceutical products of approximately \$16.3 million for the nine months ended October 31, 2006, representing 60.0% of the prior-year period. The decrease in net sales of nutraceutical products of approximately \$1.7 million, or 10%, is due primarily to decreases in sales to two of VLI's largest customers which were offset in part by sales increases to two existing customers and one new customer.

The net revenues from telecommunications infrastructure services were approximately \$7.3 million for the nine months ended October 31, 2007 compared to net revenues of approximately \$10.8 million for the nine months ended October 31, 2006, representing a decrease between periods of approximately \$3.5 million, or 33%. The decrease is due primarily to decreased revenues for services provided to SMC's three largest customers. The net revenues of telecommunications services for the nine months ended October 31, 2007 and 2006 were 4.7% and 40.0% of consolidated net sales for the corresponding period, respectively.

### **Cost of Sales**

For the nine months ended October 31, 2007, the cost of revenues from power industry services was approximately \$119.4 million, or 91.2% of corresponding net revenues, including a loss of approximately \$11.6 million recorded in the current year related to a GPS project.

For the nine months ended October 31, 2007, the cost of sales for nutraceutical products was approximately \$12.5 million, or 85.5% of corresponding net sales, compared to approximately \$12.6 million for the nine months ended October 31, 2006, or 77.1% of corresponding net sales. The gross profit percentage erosion experienced by VLI in the current year is due primarily to higher liquid product raw material costs and the unfavorable adjustments recorded in the current quarter for excess and obsolete inventory that are discussed above.

For the nine months ended October 31, 2007, the cost of revenues for telecommunications infrastructure services was approximately \$5.8 million, or 79.6% of corresponding net revenues, compared to \$8.5 million for the nine months ended October 31, 2006, or 78.5% of corresponding net revenues. SMC experienced an increase in its cost of revenues percentage due to lower margin on certain outside plant projects.

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

For the nine months ended October 31, 2007, selling, general and administrative expenses were approximately \$13.7 million, or 9.0% of consolidated net sales, compared to approximately \$6.1 million for the nine months ended October 31, 2006, or 22.6% of consolidated net sales. These expenses increased by approximately \$7.6 million between years, including approximately \$7.0 million of such costs incurred by GPS in the current year. In addition, corporate general and administrative costs have increased substantially between years due to increased litigation costs, increased other professional fees, including audit, tax and SOX internal control-related compliance fees, and increased stock option compensation expense.

### **Impairment Losses**

As discussed above, we recorded impairment losses in the current quarter related to the goodwill and other intangible assets of VLI in the total amount of \$4,666,000. Accordingly, the asset impairment amounts are included in the condensed consolidated statement of operations for the nine months ended October 31, 2007.

### **Interest Income and Expense**

We reported interest income of approximately \$2.4 million for the nine months ended October 31, 2007 compared to interest income of \$5,000 for the nine months ended October 31, 2006. Interest income increased primarily due to an increase in interest and investment income from cash and cash equivalents and investments held for sale. We have acquired a significant amount of cash and investments held for sale with the acquisition of GPS in December 2006 and the favorable cash flow from the operations of GPS during the current fiscal year. The acquisition of GPS was partially financed with the proceeds of a bank loan with an original principal amount of \$8.0 million. The consolidated condensed results of operations for the nine months ended October 31, 2007 included the interest expense (based on LIBOR plus 3.25%) related to this loan of approximately \$460,000.

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

Despite reporting a loss from operations before income taxes of \$1,387,000 for the nine months ended October 31, 2007, we incurred income tax expense of \$1,253,000 for the period. For the current year, the Company is being adversely impacted by our inability to utilize certain current operating losses for state income tax reporting purposes. In addition, the current year goodwill impairment loss of \$3,826,000 is not deductible for income tax reporting

purposes, and represents a permanent difference between financial and income tax reporting. For the nine months ended October 31, 2006, the effective income tax benefit rate was 32%.

The Company's income tax (expense) benefit for the nine months ended October 31, 2007 and 2006 differs from the expected income tax benefit computed by applying the U.S. Federal corporate income tax rate of 34% to the loss from operations before income taxes for the nine months ended October 31, 2007 and 2006 as shown in the table below.

|                                           | Nine Months Ended<br>October 31, |            |
|-------------------------------------------|----------------------------------|------------|
|                                           | 2007                             | 2006       |
| Computed "expected" tax (expense) benefit | \$ 471,000                       | \$ 214,000 |
| Increase (decrease) resulting from:       |                                  |            |
| State income taxes, net                   | (386,000)                        | (107,000)  |
| Permanent differences                     | (1,338,000)                      | 95,000     |
|                                           | \$ (1,253,000)                   | \$ 202,000 |

## CONSOLIDATED RESULTS OF OPERATIONS COMPARED TO PRO FORMA RESULTS

The following analysis summarizes the results of our operations for three and nine months ended October 31, 2007 compared to unaudited pro forma results of operations for the corresponding periods of the prior year as if the acquisition of GPS and related transactions, including the new bank financing of \$8.0 million and the private offering of 2,853,335 shares, were completed on February 1, 2006.

The unaudited pro forma statement of operations does not purport to be indicative of the results that would have actually been obtained if the acquisition of GPS had occurred on February 1, 2006, or that may be obtained in the future. GPS previously reported its results of operations using a calendar year-end. No material events occurred subsequent to these reporting periods that would require adjustment to our unaudited pro forma statements of operations. The acquisition of GPS had no impact on the previously reported amounts for our nutraceutical products and telecom infrastructure services segments.

|                                                 | Three Months Ended<br>October 31, |               | Nine Months Ended<br>October 31, |               |
|-------------------------------------------------|-----------------------------------|---------------|----------------------------------|---------------|
|                                                 | 2007                              | 2006          | 2007                             | 2006          |
| Net sales                                       |                                   |               |                                  |               |
| Power industry services                         | \$ 42,017,000                     | \$ 37,158,000 | \$ 130,970,000                   | \$ 74,785,000 |
| Nutraceutical products                          | 4,617,000                         | 5,248,000     | 14,602,000                       | 16,288,000    |
| Telecom infrastructure services                 | 2,629,000                         | 4,361,000     | 7,260,000                        | 10,843,000    |
| Net sales                                       | 49,263,000                        | 46,767,000    | 152,832,000                      | 101,916,000   |
| Cost of sales                                   |                                   |               |                                  |               |
| Power industry services                         | 35,548,000                        | 34,313,000    | 119,383,000                      | 69,542,000    |
| Nutraceutical products                          | 4,193,000                         | 4,235,000     | 12,481,000                       | 12,561,000    |
| Telecom infrastructure services                 | 2,076,000                         | 3,506,000     | 5,776,000                        | 8,507,000     |
| Cost of sales                                   | 41,817,000                        | 42,054,000    | 137,640,000                      | 90,610,000    |
| Gross profit                                    | 7,446,000                         | 4,713,000     | 15,192,000                       | 11,306,000    |
| Selling and general and administrative expenses | 4,381,000                         | 4,102,000     | 13,715,000                       | 9,471,000     |
| Impairment of goodwill and intangible assets    | 4,666,000                         | —             | 4,666,000                        | —             |
| Income (loss) from operations                   | \$ (1,601,000)                    | \$ 611,000    | \$ (3,189,000)                   | \$ 1,835,000  |

## Comparison of the Unaudited Results of Operations for the three and nine months ended October 31, 2007 to the Unaudited Pro Forma Results of Operations for the three and nine months ended October 31, 2006

### Net Sales

The net revenues from power industry services were approximately \$42.0 million for the three months ended October 31, 2007 compared with approximately \$37.2 million of corresponding pro forma net revenues for the three months

ended October 31, 2006. For the nine months ended October 31, 2007, the net revenues from power industry services were approximately \$131.0 million compared with corresponding pro forma net revenues of approximately \$74.8 million for the nine months ended October 31, 2006. The net revenues from power industry services has increased between years primarily due to increased revenues from ongoing new projects started during the year ended January 31, 2007, including an ethanol facility, three bio-diesel projects and a peaking facility.

The reductions in the net sales of nutraceutical products and telecommunication infrastructure services between periods are discussed above.

### **Cost of Sales**

For the three months ended October 31, 2007, the cost of revenues for power industry services was approximately \$35.5 million, or 84.6% of corresponding net revenues, compared to pro forma cost of revenues of approximately \$34.3 million, or 92.3% of corresponding pro forma net revenues for the three months ended October 31, 2006. For the nine months ended October 31, 2007, the cost of revenues for power industry services was approximately \$119.4 million, or 91.2% of corresponding net revenues, compared to pro forma cost of revenues of approximately \$69.5 million, or 93.0% of corresponding pro forma net revenues for the nine months ended October 31, 2006. The increase in the level of construction activity by GPS is the reason for the increase in the cost of revenue amounts between years. The profitable performance of services on the Company's other GPS construction projects underway during the current fiscal year more than offset the losses of approximately \$2.3 million and \$11.6 million incurred on a GPS project in the three and nine months ended October 31, 2007, respectively..

The reductions in the cost of sales of nutraceutical products and telecommunication infrastructure services between periods are discussed above.

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

For the three months ended October 31, 2007, selling, general and administrative expenses were approximately \$4.4 million, or 8.9% of consolidated net sales, compared to the pro forma amount of approximately \$4.1 million for the three months ended October 31, 2006, or 8.8% of consolidated pro forma net sales.

For the nine months ended October 31, 2007, selling, general and administrative expenses were approximately \$13.7 million compared to a pro forma amount of approximately \$9.5 million for the nine months ended October 31, 2006. The increase of approximately \$4.2 million in expenses between years was due primarily to the increased level of business activity of GPS in the current year. In addition, corporate general and administrative costs have increased between years due to increased litigation costs, increased other professional fees, including audit, tax and SOX internal control-related compliance fees, and increased stock option compensation expense. Despite the increase, the amount of such costs expressed as a percentage of consolidated net sales for the corresponding period were 9.0% and 9.3%, respectively.

### **Impairment Losses**

As discussed above, we recorded impairment losses in the current quarter related to the goodwill and other intangible assets of VLI in the total amount of \$4,666,000. Accordingly, the asset impairment amounts are included in the condensed consolidated statement of operations for the nine months ended October 31, 2007.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Cash Position and Indebtedness**

Cash and cash equivalents were approximately \$75.3 million as of October 31, 2007 compared to \$25.4 million as of January 31, 2007. We also have an available balance of \$4.3 million under our revolving line of credit financing arrangement with our bank. The Company's consolidated working capital has increased during the current year from approximately \$12.5 million as of January 31, 2007 to approximately \$16.8 million as of October 31, 2007.

Net cash provided by operations for the nine months ended October 31, 2007, was approximately \$55.0 million compared with approximately \$1.4 million of cash provided by operations for the nine months ended October 31, 2006.

The Company's non-cash expenses increased during the nine months ended October 31, 2007 compared to the nine months ended October 31, 2006. Although depreciation and amortization decreased by \$86,000 to \$968,000 for the nine months ended October 31, 2007 from \$1,054,000 for the same period one year ago, the amortization of purchased intangibles increased by approximately \$4.3 million to \$5.3 million for the nine months ended October 31, 2007 from \$991,000 for the nine months ended October 31, 2006. Deferred income tax benefit increased to \$2,424,000 for the nine months ended October 31, 2007 from a benefit of \$491,000 for the corresponding period of the prior year. All of the aforementioned increases in non-cash expenses were primarily due to the acquisition of GPS. In addition, current year non-cash expenses include asset impairment losses of \$4,666,000 related to the goodwill and other intangible assets of VLI.

During the nine months ended October 31, 2007, billings in excess of estimated earnings provided approximately \$50.8 million in cash flow due primarily to an increase in cash collections as a result of a growth in operating activity. In addition, the Company reduced the amount of unbilled receivables during the current fiscal year by approximately \$11.4 million. Cash was used to reduce the level of accounts payable and accrued expenses by approximately \$12.4 million during the current year.



During the nine months ended October 31, 2007, net cash used in investing activities was approximately \$3.2 million compared to net cash used in investing activities of \$763,000 for the nine months ended October 31, 2006. Using cash provided by operations, the Company purchased investments during the current year, including approximately \$19.8 million in auction rate bonds. During the current quarter, auction rate bonds in the amount of \$14.8 million were sold.

For the nine months ended October 31, 2007, net cash used in financing activities was approximately \$1.9 million compared to \$363,000 used in financing activities for the nine months ended October 31, 2006. The increase is the result of principal payments on the bank debt drawn in December 2006 at the time of the GPS acquisition. During the nine months ended October 31, 2006, the Company received proceeds of \$1,862,000 from sale of its common stock that were used primarily to pay \$1.8 million in principal payments on a subordinated note due the former owner of VLI.

The financing arrangements provide for the measurement at the Company's fiscal year end and at each of the Company's fiscal quarter ends (using a rolling 12-month period) of certain financial covenants including requirements that the ratio of total funded debt to EBITDA not exceed 2 to 1, that the ratio of senior funded debt to EBITDA not exceed 1.50 to 1, and that the fixed charge coverage ratio not be less than 1.25 to 1. At the end of the fiscal year and at the end of the most recent fiscal quarter, the Company was in compliance with each of these financial covenants. The bank's consent is 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 an acceleration clause which allows the bank to declare amounts outstanding under the financing arrangements due and payable if it determines in good faith that a material adverse change has occurred in the financial condition of any of our companies. The Company believes that it will continue to comply with its financial covenants under the financing arrangement. If the Company's performance does not result in compliance with any of its financial covenants, or if the bank seeks to exercise its rights under the acceleration clause referred to above, the Company would seek to modify its financing arrangement, but there can be no assurance that the bank would not exercise their rights and remedies under the financing arrangement including accelerating payment of all outstanding senior debt due and payable.

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

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

We present Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) to provide investors with a supplemental measure of our operating performance. The following table shows the reconciliation of EBITDA for the three and nine months ended October 31, 2007 and 2006 to our reported net losses for the corresponding periods:

|                                                          | <b>Three Months Ended<br/>October 31,</b> |              |
|----------------------------------------------------------|-------------------------------------------|--------------|
|                                                          | <b>2007</b>                               | <b>2006</b>  |
| Net loss, as reported                                    | \$ (1,957,000)                            | \$ (255,000) |
| Interest expense and amortization of debt issuance costs | 171,000                                   | 87,000       |
| Income tax expense (benefit)                             | 1,259,000                                 | (176,000)    |
| Depreciation and amortization                            | 324,000                                   | 279,000      |
| Amortization of intangible assets                        | 1,201,000                                 | 331,000      |

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|                                                    |    |           |    |         |
|----------------------------------------------------|----|-----------|----|---------|
| Stock option compensation expense                  |    | 182,000   |    | 105,000 |
| Impairment of goodwill and other intangible assets |    | 4,666,000 |    | -       |
| EBITDA                                             | \$ | 5,846,000 | \$ | 371,000 |

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|                                                          | Nine Months Ended<br>October 31, |              |
|----------------------------------------------------------|----------------------------------|--------------|
|                                                          | 2007                             | 2006         |
| Net loss, as reported                                    | \$ (2,640,000)                   | \$ (428,000) |
| Interest expense and amortization of debt issuance costs | 550,000                          | 564,000      |
| Income tax expense (benefit)                             | 1,253,000                        | (202,000)    |
| Depreciation and amortization                            | 968,000                          | 797,000      |
| Amortization of intangible assets                        | 5,290,000                        | 991,000      |
| Stock option compensation expense                        | 282,000                          | 185,000      |
| Impairment of goodwill and other intangible assets       | 4,666,000                        | -            |
| EBITDA                                                   | \$ 10,369,000                    | \$ 1,907,000 |

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

## Customers

During the three and nine months ended October 31, 2007, the majority of our revenues were provided by a broad range of engineering, procurement and construction services to the power industry. Total revenues from power industry services accounted for 85% and 86% of consolidated net sales for the three and nine months ended October 31, 2007. Certain of our more significant current year customer relationships include four power industry service customers, Altra Biofuels Nebraska, LLC; Renewable Bio-Fuels Port Neches LLC; Green Earth Fuels of Houston LLC; and the Connecticut Municipal Electrical Energy Cooperative (CMEEC), which accounted for 31%, 24%, 16% and 14% of consolidated net sales for the three months ended October 31, 2007, respectively. These customers accounted for 23%, 16%, 23% and 17% of consolidated net sales for the nine months ended October 31, 2007, respectively. VLI, which provides nutritional and whole-food supplements as well as personal care products to customers in the global nutrition industry, accounted for 9% and 10% of consolidated net sales for the three and nine months ended October 31, 2007, respectively. No customer at VLI contributed more than 3% to our revenues during either current year period. SMC, which provides infrastructure services to telecommunications and utility customers as well as to the Federal Government, accounted for approximately 5% of net sales for both the three and nine months ended October 31, 2007.

During the nine months ended October 31, 2006, we did not have revenues from the power industry. Revenues consisted of sales from the nutritional and whole-food supplements as well as personal care products to customers in the global nutrition industry and services to telecommunications and utilities customers as well as to the Federal Government, through a contract with EDS. Certain of our more significant customers during the nine months ended October 31, 2006 were TriVita Corporation (TVC), Rob Reiss Companies (RRC), Verizon Communications, Inc. (VZ), Southern Maryland Electrical Cooperative (SMECO), EDS, CyberWize.com, Inc. (C) and Orange Peel Enterprises, Inc. (OPE). TVC, RRC, C and OPE are VLI customers. SMC's significant customers are VZ, SMECO, and EDS. TVC, RRC, C and OPE accounted for approximately 17%, 13%, 7% and 4 of consolidated net sales during the three months ended October 31, 2006. VZ, SMECO and EDS accounted for approximately 11%, 10% and 13% of consolidated net sales during the nine months ended October 31, 2006. Combined TVC, RRC, VZ, SMECO, EDS, C

and OPE accounted for approximately 80% of consolidated net sales during the nine months ended October 31, 2006.

### **Contractual Obligations**

A key ingredient for certain VLI products is imported. Due to the long lead-time associated with this raw material, VLI typically issues large purchase orders that schedule product deliveries 3 to 6 months from the order date. In addition, VLI is required to make purchase deposits with the supplier that cover 25% to 50% of the initial purchase order amount. At October 31, 2007 and January 31, 2007, VLI had open purchase orders of this type in the approximate amounts of \$2,274,000 and \$282,000, respectively, and corresponding deposits in the approximate amounts of \$1,179,000 and \$199,000, respectively. The deposit amounts are included in prepaid assets and other current assets in the accompanying condensed consolidated balance sheets.

## Seasonality

The Company's telecom infrastructure service operations may 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 may be due to the effect of winter weather on construction and outside plant activities as well as reduced daylight hours and customer budgetary constraints. Certain customers tend to complete budgeted capital expenditures before the end of the year, and postpone additional expenditures until the subsequent fiscal period.

## RECENT ACCOUNTING STANDARDS

In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("FAS") No. 141(R), "Business Combinations". FAS No. 141(R) replaces FAS No. 141 and provides greater consistency in the accounting and financial reporting of business combinations. FAS No. 141(R) requires the acquiring entity in a business combination to recognize all assets acquired and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, establishes principles and requirements for how an acquirer recognizes and measures any non-controlling interest in the acquiree and the goodwill acquired, and requires the acquirer to disclose the nature and financial effect of the business combination. Among other changes, this statement also required that "negative goodwill" be recognized in earnings as a gain attributable to the acquisition, that acquisition-related costs are to be recognized separately from the acquisition and expensed as incurred and that any deferred tax benefits resulted in a business combination are recognized in income from continuing operations in the period of the combination. FAS 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company will assess the impact that SFAS 141R may have on its financial position and results of operations.

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

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

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

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

## ITEM 4. CONTROLS AND PROCEDURES

**Evaluation of disclosure controls and procedures.** Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of October 31, 2007. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of

achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of October 31, 2007, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

**Changes in internal controls.** No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended October 31, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II**

### **OTHER INFORMATION**

#### **ITEM 1. LEGAL PROCEEDINGS**

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

On March 15, 2007, the District Court granted the Company and its executive officers' motion for summary judgment, thereby dismissing WFC's lawsuit against the Company and its executive officers in its entirety. WFC appealed the District Court's decision. The parties have filed their appellate briefs and are waiting for a date to be scheduled for oral argument. We intend to vigorously defend the appeal and this litigation.

Although we have reviewed WFC's claims and believe that they are without merit, we have recorded an accrual of approximately \$56,000 and \$286,000 at October 31, 2007 and January 31, 2007, respectfully, for subsequent legal services and estimated legal fees related to potential ongoing legal costs of the WFC litigation that we consider to be probable and that can be reasonably estimated. It is possible however, that the ultimate resolution of the WFC litigation could result in a material adverse effect on our results of operations for a particular future reporting period.

On August 27, 2007, Kevin Thomas filed a lawsuit against the Company, VLI and our Chief Executive Officer (the "CEO") in the Circuit Court of Florida. Thomas was the former owner of VLI. The Company acquired VLI by way of merger on August 31, 2004. Thomas alleges the Company, VLI and our CEO breached various agreements regarding his compensation and employment package that arose from the acquisition of VLI. Thomas has alleged contractual and tort-based claims arising from his compensation and employment agreements and seeks rescission of his covenant not to compete against VLI. The Company, VLI and our CEO deny that any breach of contract or tortious conduct occurred on their part. The Company has also asserted three counterclaims against Thomas for breach of contract, breach of fiduciary duty and tortious interference with contractual relations for the violation of his non-solicitation, confidentiality and non-compete obligations. We intend to vigorously defend this lawsuit and prosecute its counterclaims.

Although we have reviewed Thomas' claims and believe that they are without merit, we recorded an accrual of approximately \$320,000 at October 31, 2007 for subsequent legal services and estimated legal fees related to potential ongoing legal costs of the Thomas litigation that we consider to be probable and that can be reasonably estimated. It is possible however, that the ultimate resolution of the Thomas litigation could result in a material adverse effect on our results of operations for a particular future reporting period.

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

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

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

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

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

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

None

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**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

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

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**SIGNATURES**

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

**ARGAN, INC.**

December 17, 2007

By:

/s/ Rainer Bosselmann

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Rainer Bosselmann  
Chairman of the Board and  
Chief Executive Officer

December 17, 2007

By:

/s/ Arthur F. Trudel

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