

Edgar Filing: ARGAN INC - Form 10QSB

ARGAN INC  
Form 10QSB  
December 14, 2005

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

FORM 10-QSB

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

For the quarterly period ended October 31, 2005 Commission File Number 001-31756  
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Argan, Inc.  
-----

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

DELAWARE  
-----

13-1947195  
-----

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

One Church Street, Suite 302, Rockville MD  
-----

20850  
-----

(Address of principal executive offices)

(ZIP Code)

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

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

Yes  No

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

Common Stock  
Common Stock, \$.15 Par Value  
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3,814,008 Shares outstanding  
as of December 12, 2005  
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Transitional Small Business Disclosure Format (Check One): Yes  No

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ARGAN, INC.  
Condensed Consolidated Balance Sheets

October 31, 2005      January 31, 2005  
=====                      =====

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ASSETS	(Unaudited)	Re
CURRENT ASSETS:		
Cash and cash equivalents	\$ 27,000	\$
Accounts receivable, net of allowance for doubtful accounts of \$88,000 at 10/31/2005 and \$85,000 at 1/31/2005	3,529,000	
Receivable from affiliated entity, net of allowance for doubtful accounts of \$0 at 10/31/2005 and \$84,000 at 1/31/2005	175,000	
Escrowed cash	300,000	
Estimated earnings in excess of billings	348,000	
Inventories, net of reserves of \$84,000 at 10/31/2005 and \$62,000 at 1/31/2005	2,639,000	
Prepaid expenses and other current assets	485,000	
	-----	-----
TOTAL CURRENT ASSETS	7,503,000	
	-----	-----
Property and equipment, net of accumulated depreciation of \$1,186,000 at 10/31/2005 and \$679,000 at 1/31/2005	3,341,000	
Issuance cost for subordinated debt	375,000	
Other assets	36,000	
Contractual customer relationships, net	487,000	
Trade name	224,000	
Proprietary formulas, net	1,528,000	
Non-contractual customer relationships, net	1,533,000	
Non-compete agreement, net	1,380,000	
Goodwill	13,315,000	
	-----	-----
TOTAL ASSETS	\$ 29,722,000	\$
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 2,446,000	\$
Due to affiliates	112,000	
Accrued expenses	1,132,000	
Liability for derivative financial instruments	--	
Deferred income tax liability	74,000	
Line of credit	1,378,000	
Current portion of long-term debt	418,000	
Subordinated debt due to former owner of Vitarich Laboratories, Inc.	3,292,000	
	-----	-----
TOTAL CURRENT LIABILITIES	8,852,000	
	-----	-----
Deferred income tax liability	2,159,000	
Deferred rent	10,000	
Long-term debt	202,000	
Long-term debt due to former owner of Vitarich Laboratories, Inc.	422,000	
STOCKHOLDERS' EQUITY		
Preferred stock, par value \$.10 per share - 500,000 shares authorized- issued - none	--	
Common stock, par value \$.15 per share - 12,000,000 shares authorized -3,740,596 and 2,762,078 shares issued at 10/31/2005 and 1/31/2005 and 3,737,363 and 2,758,845 shares outstanding at 10/31/2005 and 1/31/2005	560,000	
Warrants outstanding	849,000	
Additional paid-in capital	24,926,000	
Accumulated deficit	(8,225,000)	
Treasury stock at cost: 3,233 shares at 10/31/2005 and 1/31/2005	(33,000)	
	-----	-----
TOTAL STOCKHOLDERS' EQUITY	18,077,000	
	-----	-----

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TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY \$ 29,722,000 \$  
===== =====

See Accompanying Notes

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

	Three months ended October 31 2005	2004	Nine months 2005
	=====	=====	=====
Net sales	\$ 7,133,000	\$ 4,850,000	\$ 21,141,000
Cost of sales	5,431,000	3,483,000	16,211,000
	-----	-----	-----
Gross profit	1,702,000	1,367,000	4,930,000
Selling, general and administrative expenses	1,847,000	1,513,000	5,721,000
Impairment loss	--	--	--
	-----	-----	-----
Loss from operations	(145,000)	(146,000)	(791,000)
Interest expense	205,000	34,000	364,000
Other expense (income), net	1,000	(8,000)	1,926,000
	-----	-----	-----
Loss before income taxes	(351,000)	(172,000)	(3,081,000)
Income tax benefit	64,000	29,000	386,000
	-----	-----	-----
Net loss	\$ (287,000)	\$ (143,000)	\$ (2,695,000)
	=====	=====	=====
Basic and diluted loss per share:	\$ (0.08)	\$ (0.06)	\$ (0.06)
	=====	=====	=====
Weighted average number of shares outstanding - basic and diluted	3,814,000	2,354,000	3,314,000
	=====	=====	=====

See Accompanying Notes

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

Nine Months End  
October 31,

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	2005	=====
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (2,695,000)	\$ (2)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	721,000	
Amortization of purchase intangibles	1,272,000	
Impairment loss on goodwill and intangibles	--	1
Deferred income taxes	(430,000)	
Non-cash loss on liability for derivative financial instruments	1,930,000	
Gain on sale of property and equipment	(33,000)	
Changes in operating assets and liabilities:		
Accounts receivable, net	(578,000)	
Receivable from affiliated entity, net	(63,000)	
Escrowed cash	304,000	
Estimated earnings in excess of billings	(25,000)	
Inventories, net	1,090,000	
Prepaid expenses and other current assets	110,000	
Accounts payable and accrued expenses	298,000	(1)
Billings in excess of estimated earnings	--	
Due to affiliates	65,000	
Other	9,000	
Net cash provided by (used in) operating activities	1,975,000	(2)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of Vitarich Laboratories, Inc.	(426,000)	(6)
Purchase of investments	--	(9)
Redemptions of investments	--	12
Purchases of property and equipment	(955,000)	
Proceeds on sale of property and equipment	70,000	
Net cash used in investing activities	(1,311,000)	(3)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercised stock options	--	
Proceeds from line of credit	2,500,000	2
Proceeds from long-term debt	8,000	
Principal payments on long-term debt	(531,000)	(1)
Principal payments on line of credit	(2,781,000)	
Payment to former stockholder on loan to Vitarich Laboratories, Inc.	--	
Net cash (used in) provided by financing activities	(804,000)	
NET DECREASE IN CASH AND CASH EQUIVALENTS	(140,000)	(5)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	167,000	5
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 27,000	\$

See Accompanying Notes

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

### NOTE 1- ORGANIZATION AND BASIS OF PRESENTATION

#### NATURE OF OPERATIONS

Argan, Inc. (AI or the Company) conducts its operations through its wholly owned subsidiaries Vitarich Laboratories, Inc. (VLI) which it acquired in August 2004 and Southern Maryland Cable, Inc. (SMC) which it acquired in July 2003. Through VLI, the Company develops, manufactures and distributes premium nutritional supplements, whole-food dietary supplements and personal care products. Through SMC, the Company provides telecommunications infrastructure services including project management, construction and maintenance to the Federal Government, telecommunications and broadband service providers, as well as electric utilities primarily in the Mid-Atlantic region.

AI was organized as a Delaware corporation in May 1961.

The Company operates in two reportable segments. (See Note 9)

#### MANAGEMENT'S PLANS, LIQUIDITY AND BUSINESS RISKS

As of October 31, 2005, the Company had an accumulated deficit of \$8.2 million. At October 31, 2005, the Company had \$2.5 million available under its revolving line of credit with the Bank of America, N.A. (the Bank). The Company operates in two distinct markets. The market for nutritional products is highly competitive and the telecom and infrastructure services industry is fragmented and also very competitive. The successful execution of the Company's business plan is dependent upon the Company's ability to continue integrating acquired businesses and acquired assets into its operations, its ability to increase and retain its customers, the ability to maintain compliance with significant government regulation, the ability to attract and retain key employees as well as the Company's ability to manage its growth and expansion, among other factors.

On January 28, 2005, the Company raised approximately \$1 million through the issuance of 129,032 shares of common stock to an Investor. Such proceeds were used by the Company to pay down certain of its existing obligations. Pursuant to the Agreement, the Company agreed to issue additional shares of common stock to the Investor upon the earlier of (i) the Company's issuance of additional shares of common stock having an aggregate purchase price of at least \$2.5 million at a price per share less than \$7.75, or (ii) July 31, 2005. (See Notes 5 and 7).

The Company also entered into an agreement with the former owner of VLI, Kevin J. Thomas (Thomas) to delay the timing of the payment of contingent cash consideration to the earlier of August 1, 2006 or the Company's issuance of additional equity having an aggregate purchase price of more than \$1 million. Thomas would be paid the remaining contingent consideration up to the excess over the \$1 million provided that such payment would not put the Company in default of its current financing arrangement with the Bank. (See Note 6)

On April 8, 2005, the Company renewed its line of credit with the Bank, extending the maturity date to May 31, 2006. The maximum availability under the line of credit was increased to \$4.25 million and the Bank released \$304,000 in cash to the Company which it was holding in escrow as collateral. (See Note 6)

At July 31, 2005, the Company failed to comply with certain financial covenants under its borrowing arrangements with the Bank. The Bank waived the failure for the measurement period ended July 31, 2005. (See Note 6) The Company was in compliance with the aforementioned financial covenants at October 31, 2005.

During the nine months ended October 31, 2005, the Company had positive cash flows from operations of \$1,975,000. Management believes that capital resources available under its renewed line of credit combined with cash generated from the Company's operations is adequate to meet the Company's future operating cash needs. Accordingly, the carrying value of the assets and liabilities in the accompanying balance sheet does not reflect any adjustments should the Company be unable to meet its future operating cash needs in the ordinary course of business. The Company continues to take various actions to align its cost structure to appropriately match its expected revenues, including limiting its operating expenditures and controlling its capital expenditures. Any future acquisitions, other significant unplanned costs or cash requirements may require the Company to raise additional funds through the issuance of debt and equity securities. There can be no assurance that such financing will be available on terms acceptable to the Company, or at all. If additional funds are raised by issuing equity securities, significant dilution to the existing stockholders may result.

#### BASIS OF PRESENTATION

The condensed consolidated balance sheet as of October 31, 2005 and the condensed consolidated statements of operations for the three and nine months ended October 31, 2005 and 2004 and cash flows for the nine months ended October 31, 2005 and 2004, respectively, are unaudited. In the opinion of management, the accompanying financial statements contain all adjustments, which are of a normal and recurring nature, considered necessary to present fairly the financial position of the Company as of October 31, 2005 and the results of its operations and its cash flows for the periods presented. The Company prepares its interim financial information using the same accounting principles as it does for its annual financial statements.

These financial statements do not include all disclosures associated with annual financial statements and, accordingly, should be read in conjunction with the footnotes contained in the Company's consolidated financial statements for the year ended January 31, 2005, together with the independent registered public accounting firm's report, included in the Company's Annual Report on Form 10-KSB/A, as filed with the Securities and Exchange Commission. The results of operations for any interim period are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year.

#### NOTE 2 - RESTATEMENT

On September 19, 2005, senior management and the Audit Committee of the Board of Directors of the Company concluded that the Company's financial statements for the fiscal year ended January 31, 2005 and for the quarter ended April 30, 2005 should be restated.

The restatements relate to the Company's amendment of its accounting for an investment made by MSR I SBIC, L.P. ("MSR") on January 28, 2005 ("Investment"), for the value of shares issued in the acquisition of VLI, and for an agreement entered into with Thomas on January 28, 2005 with respect to a debt subordination and related concessions ("Concessions") given to Thomas in connection with consummating the agreement. The Company also restated inventory and cost of goods sold for the quarter ended April 30, 2005 related to an error in inventory valuation accounting.

The impact of the restatements are detailed in the Company's Form 10-KSB/A in Note 2 and in Form 10-QSB/A in Note 2 both filed with the Securities and

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Exchange Commission on December 2, 2005. Refer to accompanying Notes 4 and 5 for a description of the aforementioned transactions with MSR and Thomas which resulted in the restatements.

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### NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES

Property and Equipment - The Company recorded net gains of \$33,000 and \$55,000 on disposal of equipment which resulted in a decrease in selling, general and administrative expenses during the nine months and three months ended October 31, 2005.

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 at October 31, 2005 consist of the following:

Raw materials	\$ 2,245,000
Work-in process	131,000
Finished goods	263,000
	-----
	\$ 2,639,000
	=====

Earnings Per Share - (Loss) income per share is computed by dividing net (loss) income by the weighted average number of common shares outstanding for the period. Outstanding stock options and warrants were not included in the weighted average number of shares outstanding during the three and nine months ended October 31, 2005 and 2004 due to the Company's net loss and because the market price of the Company's stock was significantly below the respective exercise prices for the stock options and warrants.

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

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

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



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raising additional capital.

Shipping Fees and Costs - The Company accounts for shipping fees and costs in accordance with Emerging Issues Task Force Issue No. 00-10 "Accounting for Shipping and Handling Fees and Costs." Amounts billed to customers in sales transactions related to shipping recorded associated in net sales were \$116,000 and \$47,000 for the nine and three months ended October 31, 2005 and \$25,000 for the nine and three months ended October 31, 2004. Costs associated with shipping goods to customers which aggregate \$116,000 and \$39,000 are accounted for as part of selling expenses for the nine and three months ended October 31, 2005 and \$24,000 for nine and three months ended October 31, 2004.

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

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

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### Pro Forma Disclosures For the three months ended October 31,

	2005 =====	2004 =====
Net loss, as reported	\$ (287,000)	\$ (143,000)
Add: Stock based compensation recorded in the financial statements	--	--
Deduct: Total stock-based employee compensation expense determined under fair value based methods	12,000	5,000
	-----	-----
Pro forma net loss	\$ (299,000)	\$ (148,000)
	=====	=====
Basic and diluted per share:		
Basic and diluted - as reported	\$ (0.08)	\$ (0.06)
	=====	=====
Basic and diluted - pro forma	\$ (0.08)	\$ (0.06)
	=====	=====

### Pro Forma Disclosures For the nine months ended October 31,

	2005 =====	2004 =====
Net loss, as reported	\$ (2,695,000)	\$ (2,254,000)
Add: Stock based compensation recorded in the financial statements	--	--
Deduct: Total stock-based employee compensation expense determined under fair value based methods	38,000	25,000
	-----	-----
Pro forma net loss	\$ (2,733,000)	\$ (2,279,000)
	=====	=====

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Basic and diluted per share:		
Basic and diluted - as reported	\$ (0.81)	\$ (1.13)
	=====	=====
Basic and diluted - pro forma	\$ (0.82)	\$ (1.15)
	=====	=====

### IMPACT OF CHANGES IN ACCOUNTING STANDARDS

In December 2004, the Financial Accounting Standards Board issued FASB Statement No. 123 (revised 2004), Share-Based Payment ("SFAS 123(R)"). SFAS 123(R) supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and amends FASB No. 95, Statement of Cash Flows. SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. The Company will adopt SFAS 123(R) on February 1, 2006. The Company has not determined the impact of adopting the new standard and is continuing its analysis of the impact.

In November 2005, the Financial Accounting Standards Board issued FASB Statement No. 151 "Inventory Costs - an amendment of ARB No. 43, Chapter 4 (SFAS 151)." This Statement amends the guidance in ARB No. 43, Chapter 4 "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Paragraph 5 of ARB 43, Chapter 4, previously stated that "...under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges..." This Statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The Company will adopt SFAS No. 151 on February 1, 2006. The Company has not determined the impact of adopting the new standard and is continuing its analysis of the impact.

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### NOTE 4- ACQUISITION OF VITARICH LABORATORIES, INC.

On August 31, 2004, the Company acquired, by merger, all of the common stock of VLI, a developer, manufacturer and distributor of premium nutritional supplements, whole-food dietary supplements and personal care products. The Company's purchase of VLI was focused on acquiring VLI's long-standing customer and exclusive vendor relationships and its well established position in the fast growing global nutrition industry, each of which supports the premium paid over the fair value of the tangible assets acquired.

The results of operations of the acquired company are included in the consolidated results of the Company from August 31, 2004, the date of acquisition.

The purchase price was approximately \$6.7 million in cash, including expenses, and 825,000 shares of the Company's common stock with fair value of \$4,950,000 or \$6.00 per share utilizing the quoted market price on the acquisition date. The Company also assumed approximately \$1.6 million in debt. The merger agreement contained provisions for the payment of additional consideration ("Additional Consideration") by the Company to the former VLI shareholder to be satisfied in the Company's common stock and cash if certain Earnings Before Interest Taxes Depreciation and Amortization (EBITDA) thresholds for the twelve

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months ended February 28, 2005 were met.

The Company's Additional Consideration was approximately \$275,000 in cash, \$2.7 million in a subordinated note and approximately 348,000 shares of AI common stock with a fair value of \$2.1 million or \$6.00 per share utilizing the quoted market price on February 28, 2005.

On July 5, 2005, the Company and Thomas entered into an agreement (Earn Back Agreement) concerning the calculation of Additional Consideration due Thomas. In the Earn Back Agreement, the Company agreed to pay Thomas \$594,000 in a subordinated note and 77,000 shares of common stock with a fair value of \$5.50 per share utilizing the quoted market price on July 5, 2005. The \$1,015,000 of Additional Consideration has been recorded by the Company as additional purchase consideration and an increase in goodwill. The amount of Additional Consideration due in shares of the Company's common stock aggregating 77,000 shares with a fair value of approximately \$422,000 is reflected as long-term debt due to former owner of Vitarich Laboratories, Inc. In addition, if certain inventory considered to be an overstock for purchase accounting at the time of the acquisition was reduced to normal levels of usage by November 30, 2005, Thomas would be paid an additional \$264,000, one-half in a subordinated note and one-half in common stock. The Company has not accrued any additional amount due Thomas at October 31, 2005.

On January 31, 2005, the Company entered into a debt subordination agreement with Thomas, the former owner of VLI, SMC and the Bank, to reconstitute the cash portion of the Additional Consideration as subordinated debt payable on August 1, 2006 unless such payment would put the Company in default of its financing arrangements with the Bank. The subordinated note carries an interest rate of 10% with interest paid in arrears on October 1, 2005, January 1, 2006, April 1, 2006, July 1, 2006 and at maturity on August 1, 2006. During the nine and three months ended October 31, 2005, the Company incurred \$92,000 and \$68,000 in interest expense for the subordinated debt.

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On January 28, 2005, the Company entered into a letter agreement ("Letter Agreement") with Thomas in consideration for his agreement to delay the timing of the payment of contingent cash consideration and for entering into a debt subordination agreement reconstituting such additional cash consideration as subordinated debt. Pursuant to the Letter Agreement, the Company agreed to issue additional shares of common stock to Thomas upon the earlier of (i) Company's issuance of additional shares of our common stock at a price per share less than \$7.75, or (ii) July 31, 2005. The additional shares of common stock to be issued would equal the price paid by Thomas divided by the lower of (i) the weighted average of all stock sold by the Company prior to July 31, 2005, or (ii) if the Company did not issue additional shares, the Company would issue additional shares to Thomas at the average closing price of Argan's common stock for the thirty days ended July 31, 2005 if the price was less than \$7.75 per share less any shares already issued. The concessions given to Thomas pursuant to the Letter Agreement whereby the Company agreed that should it not issue additional shares for consideration, it would issue additional shares to Thomas at a price determined by reference to the Company's prevailing thirty-day average stock price were accounted for as a derivative financial instrument. The Company recorded a liability for derivative financial instrument of \$1,115,000, deferred loan issuance cost for subordinated debt of \$501,000 and compensation expense to Kevin Thomas of \$614,000 at January 31, 2005. The liability for derivative financial instrument was subject to adjustment for changes in fair value subsequent to its issuance. The Company recorded a loss of \$1,587,000 in other expense, net and net loss for the subsequent changes in fair value. The liability for derivative financial instruments aggregating \$2,702,000 was

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settled in a non-cash transaction by the issuance of 535,052 shares of the Company's common stock on September 1, 2005.

The Company's accounting for the acquisition of VLI and the estimate of the Additional Consideration uses the purchase method of accounting whereby the excess of cost over the net amounts assigned to assets acquired and liabilities assumed is allocated to goodwill and intangible assets based on their estimated fair values. Such intangible assets identified by the Company include \$12,375,000, \$2,500,000, \$2,000,000 and \$1,800,000, respectfully, allocated to goodwill, Proprietary Formulas (PF), Non-Contractual Customer Relationships (NCR) and a Non-Compete Agreement (NCA). The Company is amortizing PF over three years and NCR and NCA over five years. Accumulated amortization is \$972,000, \$467,000 and \$420,000 at October 31, 2005 for PF, NCR and NCA, respectively.

At the date of acquisition, the Company identified a preacquisition contingency with respect to approximately \$264,000 for certain inventory items and reduced VLI's valuation by that amount. The Company has been monitoring the sales level of the specific inventory items during the allocation period (since the date of acquisition). Based on the additional sales performance information regarding this inventory, the Company reversed the preacquisition contingency and recorded a decrease to Goodwill and an increase in Inventory of \$264,000 during the three months ended July 31, 2005.

The following unaudited pro forma statement of operations of the Company for the three and nine months ended October 31, 2004 does not purport to be indicative of the results that would have actually been obtained if the aforementioned acquisition had occurred on February 1, 2004, or that may be obtained in the future. VLI previously reported its results of operations using a calendar year-end. No material events occurred subsequent to this reporting period that would require adjustment to our unaudited pro forma statement of operations. The number of shares outstanding used in calculating pro forma earnings per share assume that the shares issued in connection with the acquisition of VLI were outstanding since February 1, 2004.

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	Three Months Ended October 31, 2004 -----	Nine Months Ended October 31, 2004 -----
Pro Forma Statement of Operations		
Net sales	\$ 6,202,000	\$ 18,098,000
Cost of sales	4,450,000	13,678,000
	-----	-----
Gross profit	1,752,000	4,420,000
Selling, general and administrative expenses	1,716,000	4,938,000
Impairment loss	--	1,942,000
	-----	-----
Income (Loss) from operations	36,000	(2,460,000)
Other expense, net	(48,000)	(50,000)
	-----	-----
Loss before income tax benefit	(12,000)	(2,510,000)
Income tax benefit	5,000	714,000
	-----	-----
Net loss	\$ (7,000)	\$ (1,796,000)
	=====	=====
Loss per share	--	\$ (0.50)

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	=====	=====
Weighted average shares outstanding	3,588,000	3,588,000
	=====	=====

### NOTE 5 - RELATED PARTY TRANSACTIONS

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

Pursuant to the Subscription Agreement, the Company agreed to issue additional shares of Common Stock to Investor in accordance with the Subscription Agreement based upon the earlier of (i) the Company's issuance of additional shares of Common Stock having an aggregate purchase price of at least \$2,500,000 at a price per share less than \$7.75, or (ii) July 31, 2005. The additional shares of common stock to be issued would equal the price paid by Investor divided by the lower of (i) the weighted average of all stock sold by the Company prior to July 31, 2005 or (ii) ninety percent of the average bid price of the Company's common stock for the thirty days ended July 31, 2005, if the price was less than \$7.75 per share, less the 129,032 shares previously issued. Any additional shares issued would effectively reduce the Investor's purchase price per common share as set forth in the Subscription Agreement.

The provision in the agreement which allows the Investor to receive additional shares under certain conditions represents a derivative under Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities." Accordingly, \$139,000 of the proceeds received upon issuance was accounted for as a liability for derivative financial instrument. This liability relates to the obligation to issue Investor additional shares under certain conditions. The derivative financial instrument is subject to adjustment for changes in fair value subsequent to issuance. The fair value adjustment loss of \$343,000 was recorded during the nine months ended October 31, 2005 and included in other expense net and net loss. The liability aggregating \$482,000 was settled in a non-cash transaction by the issuance of 95,321 shares of the Company's common stock on August 13, 2005.

The Company retained Investor under a consulting arrangement to assist in identifying and meeting potential equity investors. Under this consulting arrangement, the Company paid the Investor \$100,000 during the nine months ended October 31, 2005.

The Company leases administrative, manufacturing and warehouse facilities from individuals who are officers of SMC and VLI. The total expense under these arrangements were \$75,000 and \$222,000 for the three and nine months ended October 31, 2005 and \$40,000 and \$79,000 for the three and nine months ended October 31, 2004.

The Company also entered into a supply agreement with an entity owned by the former shareholder of VLI whereby the supplier committed to sell to the Company and the Company committed to purchase on an as-needed basis, certain organic products. VLI made \$68,000 and \$146,000, respectively, in purchases under the supply agreement during the three and nine months ended October 31, 2005. No purchases were made by the Company during the three and nine months ended October 31, 2004.

At October 31, 2005, the Company has accrued \$112,000 for reimbursement to Thomas for certain leasehold improvements which he constructed in the building that the Company leases from Thomas.

The Company also sells its products in the normal course of business to an entity in which the former owner of VLI has an ownership interest. The pricing on such transactions is consistent with VLI's general customer pricing for nonaffiliated entities. VLI had approximately \$129,000 and \$430,000 and \$130,000 and \$130,000, respectively, in sales with this entity for the three and nine months ended October 31, 2005 and 2004. At October 31, 2005, the affiliated entity owed \$175,000 to VLI, net of an allowance for doubtful accounts of zero which the Company had reduced from \$120,000 during the three months ended October 31, 2005 due to collections of aged receivables.

NOTE 6 - DEBT

In April 2005, the Company agreed to amend the existing financing arrangements with the Bank. Under this arrangement, the Company has a revolving line of credit of \$4.25 million and a term loan with an original balance of \$1.2 million. The April 2005 amendment extended the expiration of the revolving line of credit to May 31, 2006. Under the amended financing arrangements, amounts outstanding under the revolving line of credit and the three year term note bear interest at LIBOR plus 3.25% and 3.45%, respectively. Availability on a monthly basis under the revolving line is determined by reference to accounts receivable and inventory on hand which meet certain Bank criteria. The aforementioned three year term note remains in effect and the final monthly scheduled payment of \$33,000 is due on July 31, 2006. As of October 31, 2005, the Company had \$300,000 outstanding under the term note and \$1,378,000 outstanding under the revolving line of credit with \$2.5 million of additional availability.

The financing arrangements amended on April 8, 2005 provide for the measurement at Argan's fiscal year end and at each of Argan's fiscal quarter ends of certain financial covenants including requiring that the ratio of debt to pro forma earnings before interest, taxes, depreciation and amortization (EBITDA) not exceed 2.5 to 1 and requiring a pro forma fixed charge coverage ratio of not less than 1.25 to 1. Bank consent continues to be required for acquisitions and divestitures. The Company continues to pledge the majority of the Company's assets to secure the financing arrangements. In conjunction with the amendment, the Bank released to the Company \$304,000, which it was holding in escrow as collateral.

At July 31, 2005, the Company failed to comply with the aforementioned financial covenants. The Bank waived the failure for the measurement period ended July 31, 2005. The Company was in compliance with the aforementioned financial covenants at October 31, 2005. For future measurement periods, the Bank revised the definitions of certain components of the financial covenants to specifically exclude the impact of items associated with derivative financial instruments such as, valuation gains and losses, compensation expense and non-cash deferred loan issuance cost amortization.

NOTE 7 - PRIVATE OFFERING OF COMMON STOCK

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

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Company. (See Note 4) Pursuant to the Subscription Agreement, the Company has agreed to issue additional shares of Common Stock to Investor in accordance with the Subscription Agreement based upon the earlier of (i) the Company's issuance of additional shares of Common Stock having an aggregate purchase price of at least \$2,500,000 at a price per share less than \$7.75, or (ii) July 31, 2005. The additional shares of common stock to be issued would equal the price paid by Investor divided by the lower of (i) the weighted average of all stock sold by the Company prior to July 31, 2005 or (ii) ninety percent of the average bid price of Argan's common stock for the thirty days ended July 31, 2005, if the price was less than \$7.75, less the 129,032 previously issued. Any additional shares issued would effectively reduce the Investor's purchase price per common share as set forth in the Subscription Agreement.

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The provision in the agreement which allows the Investor to receive additional shares under certain conditions represents a derivative under Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities." Accordingly, \$139,000 of the proceeds received upon issuance was accounted for as a liability for a derivative financial instrument. This liability relates to the obligation to issue Investor additional shares under certain conditions. The derivative financial instrument is subject to adjustment for changes in fair value subsequent to issuance. During the nine months ended October 31, 2005, the Company recorded a fair value adjustment loss of \$343,000 which is recorded in other expense and net loss. The liability aggregating \$482,000 was settled in a non-cash transaction by the issuance of 95,321 shares of the Company's common stock on August 13, 2005.

### NOTE 8 - INCOME TAXES

The Company had an effective income tax benefit rate of 18% and 13% for the three and nine months ended October 31, 2005. The effective income tax benefit rate changed during the three months ended October 31, 2005 resulting in an increase in income tax benefit of \$25,000. During the nine months ended October 31, 2005, the Company recorded the \$1,930,000 valuation loss for the liability for derivative financial instruments as other expense which is treated as a permanent difference for income tax reporting purposes. This permanent difference reduced our income tax benefit rate from 38% to 13% for the nine months ended October 31, 2005. The Company had an effective tax benefit rate of 17% and 28%, respectively, for the three and nine months ended October 31, 2004. During the nine months ended October 31, 2004, the Company recorded a \$740,000 impairment of goodwill which is treated as a permanent difference for tax reporting purposes. This permanent difference reduced our effective income tax benefit rate from 38% to 28% for the nine months ended October 31, 2004.

### NOTE 9 - SEGMENT REPORTING

Effective with the acquisition of VLI on August 31, 2004, the Company has two reportable operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and assess performance.

The Company's two operating segments are nutraceutical products and telecom infrastructure services. The Company conducts its operations through its wholly owned subsidiaries - VLI and SMC. The "Other" column includes the Company's corporate and unallocated expenses.

The Company's operating segments are organized in separate business units with different management, customers, technology and services. The respective

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segments account for the respective businesses using the accounting policies in Note 3 to the Company's Form 10-KSB/A and Note 3 in this filing. Summarized financial information concerning the Company's operating segments is shown in the following tables:

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For the Nine Months  
Ended October 31, 2005

	Nutraceutical Products	Telecom Infrastructure Services	Other	Consolidated
Net sales	\$ 13,337,000	\$ 7,804,000	\$ --	\$ 21,141,000
Cost of sales	10,111,000	6,100,000	--	16,211,000
Gross profit	3,226,000	1,704,000	--	4,930,000
Selling, general and administrative expenses	3,341,000	1,128,000	1,252,000	5,721,000
(Loss) income from operations	(115,000)	576,000	(1,252,000)	(791,000)
Interest expense	238,000	43,000	83,000	364,000
Other (income) expense, net	--	(2,000)	1,928,000	1,926,000
(Loss) income before income taxes	(\$ 353,000)	\$ 535,000	\$ (3,263,000)	(\$ 3,081,000)
Income tax benefit				
Net loss				\$ (3,081,000)
Depreciation and amortization	\$ 267,000	\$ 300,000	\$ 154,000	\$ 721,000
Amortization of intangibles	\$ 1,194,000	\$ 78,000	--	\$ 1,272,000
Goodwill	\$ 12,375,000	\$ 940,000	--	\$ 13,315,000
Total Assets	\$ 21,314,000	\$ 5,281,000	\$ 3,127,000	\$ 29,722,000

For the Nine Months  
Ended October 31, 2004

	Nutraceutical (1) Products	Telecom Infrastructure Services	Other	Consolidated
Net sales	\$ 2,767,000	\$ 5,718,000	\$ --	\$ 8,485,000
Cost of sales	1,825,000	4,873,000	--	6,698,000



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Gross profit	942,000	845,000	--	1,787,000
Selling, general and administrative expenses	580,000	1,279,000	1,132,000	2,991,000
Impairment loss	--	1,942,000	--	1,942,000
Income (loss) from operations	362,000	(2,376,000)	(1,132,000)	(3,146,000)
Interest expense	25,000	36,000	3,000	64,000
Other income	--	5,000	58,000	63,000
Income (loss) before income taxes	\$ 337,000	\$ (2,407,000)	\$ (1,077,000)	(3,147,000)
Income tax benefit				893,000
Net loss				\$ (2,254,000)
Depreciation and amortization	\$ 40,000	\$ 287,000	\$ 22,000	\$ 349,000
Amortization of intangibles	\$ 266,000	\$ 140,000	--	\$ 406,000
Goodwill	\$ 6,441,000	\$ 940,000	--	\$ 7,381,000
Total Assets	\$ 19,174,000	\$ 5,361,000	\$ 799,000	\$ 25,334,000

(1) Operating results of VLI are included since date of acquisition, August 31, 2004.

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For the Three Months  
Ended October 31, 2005

	Nutraceutical Products	Telecom Infrastructure Services	Other	Consolidated
Net sales	\$ 4,085,000	\$ 3,048,000	\$ --	\$ 7,133,000
Cost of sales	3,146,000	2,285,000	--	5,431,000
Gross profit	939,000	763,000	--	1,702,000
Selling, general and administrative expenses	1,062,000	382,000	403,000	1,847,000
(Loss) income from operations	(123,000)	381,000	(403,000)	(145,000)
Interest expense	106,000	19,000	80,000	205,000
Other expense, net	1,000	--	--	1,000

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(Loss) income before income taxes	\$ (230,000)	\$ 362,000	\$ (483,000)	(351,000)
Income tax benefit				64,000
Net loss				\$ (287,000)
Depreciation and amortization	\$ 101,000	\$ 102,000	\$ 96,000	\$ 299,000
Amortization of intangibles	\$ 398,000	\$ 26,000	--	\$ 424,000
Goodwill	\$ 12,375,000	\$ 940,000	--	\$ 13,315,000
Total Assets	\$ 21,314,000	\$ 5,281,000	\$ 3,127,000	\$ 29,722,000

For the Three Months  
Ended October 31, 2004

	Nutraceutical(1) Products	Telecom Infrastructure Services	Other	Consolidate
Net sales	\$ 2,767,000	\$ 2,083,000	\$ --	\$ 4,850,000
Cost of sales	1,825,000	1,658,000	--	3,483,000
Gross profit	942,000	425,000	--	1,367,000
Selling, general and administrative expenses	580,000	452,000	481,000	1,513,000
Impairment loss	--	--	--	--
Income (loss) from operations	362,000	(27,000)	(481,000)	(146,000)
Interest expense	25,000	9,000	--	34,000
Other income	--	--	8,000	8,000
Income (loss) before income taxes	\$ 337,000	\$ (36,000)	\$ (473,000)	(172,000)
Income tax benefit				29,000
Net loss				\$ (143,000)
Depreciation and amortization	\$ 40,000	\$ 96,000	\$ 13,000	\$ 149,000
Amortization of intangibles	\$ 266,000	\$ 26,000	--	\$ 292,000
Goodwill	\$ 6,441,000	\$ 940,000	--	\$ 7,381,000
Total Assets	\$ 19,174,000	\$ 5,361,000	\$ 799,000	\$ 25,334,000

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- (1) Operating results of VLI are included since date of acquisition, August 31, 2004.

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### NOTE 10 - CONTINGENCIES

On October 31, 2003, the Company completed the sale of Puroflow Incorporated (a wholly-owned subsidiary) to Western Filter Corporation (WFC) for approximately \$3.5 million in cash, of which \$300,000 is held in escrow to indemnify WFC from losses if a breach of the representations and warranties made by the Company in connection with that sale should occur. During the twelve months ended January 31, 2005, WFC notified the Company in writing, asserting that WFC believes that the Company breached certain representations and warranties under the Stock Purchase Agreement. WFC asserts damages in excess of the \$300,000 escrow which is being held by a third party.

WFC filed a civil action against Argan, Inc. on March 22, 2005. The suit was initially filed in the Superior Court of the State of California for the County of Los Angeles. The complaint asserts seven claims against the Company: (1) breach of contract; (2) intentional misrepresentation; (3) concealment and non-disclosure; (4) negligent misrepresentation; (5) false promise; (6) negligence; and (7) declaratory disclosure as well as negligent misrepresentations against the Company's executive officers.

WFC alleges substantial damages. This action was removed to the United States District Court for the Central District of California. On June 30, 2005, WFC filed its Second Amended Complaint. The Company filed its Motion to Dismiss the Complaint on July 27, 2005. The District Court denied the Company's Motion to Dismiss on November 18, 2005. The Company will file its Answer and Special Defenses. The Company has reviewed WFC's complaint and believes that most claims are substantially without merit. The Company will vigorously contest WFC's claims.

During the twelve months ended January 31, 2005, the Company recorded an accrual related to this matter of \$260,000 for estimated payments and legal fees related to WFC's claim that it considers to be probable and that can be reasonably estimated. Although the ultimate amount of liability that may result from this matter for which the Company has recorded an accrual at October 31, 2005 is not ascertainable, the Company believes that any amounts exceeding the aforementioned accrual should not materially affect the Company's financial condition. It is possible, however, that the ultimate resolution of WFC's claim could result in a material adverse effect on the Company's results of operations for a particular reporting period.

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

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

This Form 10-QSB contains certain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, which are intended to be covered by the safe harbor created thereby. These statements relate to future events or our future financial performance, including statements relating to our products, customers, suppliers, business prospects, financings, investments and effects of acquisitions. In some cases, forward

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looking statements can be identified by terminology such as "may," "will," "should," "expect," "anticipate," "intend," "plan," "believe," "estimate," "potential," or "continue," the negative of these terms or other comparable terminology. These statements involve a number of risks and uncertainties, including preliminary information; the effects of future acquisitions and/or investments; competitive factors; business and economic conditions generally; changes in government regulations and policies, our dependence upon third-party suppliers; continued acceptance of our products in the marketplace; technological changes; and other risks and uncertainties that could cause actual events or results to differ materially from any forward-looking statement.

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### GENERAL

We conduct our operations through our wholly owned subsidiaries, Vitarich Laboratories, Inc. (VLI) that we acquired in August 2004 and Southern Maryland Cable, Inc. (SMC) that we acquired in July 2003. Through VLI, we develop, manufacture and distribute premium nutritional products. Through SMC, we provide telecommunications infrastructure services including project management, construction and maintenance to the Federal Government, telecommunications and broadband service providers as well as electric utilities.

We were organized as a Delaware corporation in May 1961.

### RESTATEMENT

On September 19, 2005, senior management and the Audit Committee of the Board of Directors of the Company concluded that the Company's financial statements for the fiscal year ended January 31, 2005 and for the quarter ended April 30, 2005 should be restated.

The restatements relate to the Company's amendment of its accounting for an investment made by MSR I SBIC, L.P. ("MSR") on January 28, 2005 ("Investment"), for the value of shares issued in the acquisition of VLI, and for an agreement entered into with Thomas on January 28, 2005 with respect to a debt subordination and related concessions ("Concessions") given to Thomas in connection with consummating the agreement. The Company also restated inventory and cost of goods sold for the quarter ended April 30, 2005 related to an error in inventory valuation accounting.

The impact of the restatements are detailed in the Company's Form 10-KSB/A in Note 2 and in Form 10-QSB/A in Note 2 both filed with the Securities and Exchange Commission on December 2, 2005. Refer to accompanying Notes 4 and 5 for a description of the aforementioned transactions with MSR and Thomas which resulted in the restatements.

### RECENT EVENTS

#### Earn Back Agreement

On July 5, 2005, the Company and Thomas entered into an agreement (Earn Back Agreement) concerning the calculation of Additional Consideration due Thomas. In the Earn Back Agreement, the Company agreed to pay Thomas \$594,000 in a subordinated note and 77,000 shares of common stock with a fair value of \$5.50 per share utilizing the quoted market price on July 5, 2005. The \$1,015,000 payment has been recorded by the Company as additional purchase consideration and an increase in goodwill. The amount of Additional Consideration due in shares of the Company's common stock aggregating 77,000 shares with a fair value of approximately \$422,000 is reflected as long-term debt due to former owner of

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Vitarich Laboratories, Inc. In addition, if certain inventory considered to be an overstock for purchase accounting at the time of the acquisition was reduced to normal levels of usage, Thomas would be paid an additional \$264,000 one-half in a subordinated note and one-half in common stock. The Company has not accrued any additional amount due Thomas at October 31, 2005.

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### Private Sale of Stock

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

Pursuant to the Subscription Agreement, the Company has agreed to issue additional shares of our common stock to Investor in accordance with the Subscription Agreement based upon the earlier of (i) the Company's issuance of additional shares of our common stock generating aggregate proceeds of at least \$2,500,000 at a price per share less than \$7.75, or (ii) July 31, 2005. The additional shares of common stock to be issued would equal the price paid by Investor divided by the lower of (i) the weighted average of all stock sold by the Company prior to July 31, 2005 or (ii) ninety percent of the average bid price of the Company's common stock for the thirty days ended July 31, 2005, if the price was less than \$7.75 per share, less the 129,032 shares previously issued. Any additional shares issued would effectively reduce the Investor's purchase price per share of our common stock as set forth in the Subscription Agreement.

The provision in the agreement which allows the Investor to receive additional shares under certain conditions represents a derivative under Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities." Accordingly, \$139,000 of the proceeds received upon issuance have been accounted for as liability for derivative financial instrument. This liability relates to the obligation to issue Investor additional shares under certain conditions. The derivative financial instrument is subject to adjustment for changes in fair value subsequent to issuance. The fair value adjustment loss of \$343,000 was recorded during the nine months ended October 31, 2005 and included in other expense, net and net loss. The liability aggregating \$482,000 was settled in a non-cash transaction by the issuance of 95,321 shares of the Company's common stock on August 13, 2005.

### Subordination of Certain Debt

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

Debtor entered into a certain Financing and Security Agreement dated as of August 19, 2003, as amended, with Lender whereby Lender extended to Debtor certain loans. On August 31, 2004, with the consent of Lender, the Debtor entered into an Agreement and Plan of Merger (the "Merger Agreement"), whereby

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the Company acquired all of the common stock of Vitarich Laboratories, Inc. ("Vitarich") by way of merger of Vitarich with and into a wholly-owned subsidiary of the Company, with Vitarich (now VLI) as the surviving company. Pursuant to the Merger Agreement, Thomas (who was a shareholder of Vitarich) is entitled to receive from Debtor, subject to certain conditions, Additional Cash Consideration as provided in the Merger Agreement.

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

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On January 28, 2005, the Company entered into a letter agreement ("Letter Agreement") with Thomas in consideration for his agreement to delay the timing of the payment of contingent cash consideration and for entering into a debt subordination agreement reconstituting such additional cash consideration as subordinated debt. Pursuant to the Letter Agreement, the Company agreed to issue additional shares to Thomas upon the earlier of (i) Company's issuance of additional shares of common stock at a price per share less than \$7.75; or (ii) if the Company did not issue additional shares at a price less than \$7.75 per share then the Company would issue additional shares to Thomas based on the average closing price of the Company's closing stock for the thirty days ended July 31, 2005, if the price were below \$7.75 per share. The concessions given to Kevin Thomas pursuant to the Letter Agreement are being accounted for as a derivative financial instrument under EITF 00-19. The Company recorded a liability for a derivative financial instrument of \$1,115,000, deferred loan commitment charge of \$501,000 and compensation expense of \$614,000 at January 31, 2005. The derivative financial instrument is subject to adjustment for changes in fair value subsequent to issuance. A fair value adjustment of \$1,587,000 was recorded during the nine months ended October 31, 2005, and included in other expense and net loss. The liability aggregating \$2,702,000 was settled in a non-cash transaction by issuance of 535,052 shares of the Company's common stock on September 1, 2005.

### Amendment of Financing Arrangements

On April 8, 2005, the Company agreed to amend the existing financing arrangements with the Bank of America, N.A. ("the Bank") whereby the revolving line of credit was increased to \$4.25 million in maximum availability, expiring May 31, 2006. The amended financing arrangements provides for the measurement of certain financial covenants at the end of Argan's fiscal quarters and year-end including requiring the ratio of debt to pro forma earnings before interest, taxes, depreciation and amortization (EBITDA) not to exceed 2.5 to 1 and requiring a pro forma fixed charge coverage ratio of not less than 1.25 to 1. Bank consent continues to be required for acquisitions and divestitures. The

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Company continues to pledge the majority of the Company's assets to secure the financing arrangements. The Bank has released to the Company \$304,000 which it was holding in escrow as collateral.

At July 31, 2005, the Company failed to comply with the aforementioned financial covenants. The Bank waived the failure for the measurement period ended July 31, 2005. The Company was in compliance with the aforementioned financial covenants at October 31, 2005. For future measurement periods, the Bank revised the definitions of certain components of the financial covenants to specifically exclude the impact of items associated with derivative financial instruments such as, valuation gains and losses, compensation expense which are settled with the non-cash issuance of the Company's common stock and non-cash deferred loan issuance cost amortization.

### Western Filter Corporation Litigation

On October 31, 2003, the Company completed the sale of Puroflow Incorporated (a wholly-owned subsidiary) to Western Filter Corporation (WFC) for approximately \$3.5 million in cash, of which \$300,000 is held in escrow to indemnify WFC from losses if a breach of the representations and warranties made by the Company in connection with that sale should occur. During the twelve months ended January 31, 2005, WFC notified the Company in writing, asserting that WFC believes that the Company breached certain representations and warranties under the Stock Purchase Agreement. WFC asserts damages in excess of the \$300,000 escrow which is being held by a third party.

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WFC filed a civil action against Argan, Inc. on March 22, 2005. The suit was initially filed in the Superior Court of the State of California for the County of Los Angeles. The complaint asserts seven claims against the Company: (1) breach of contract; (2) intentional misrepresentation; (3) concealment and non-disclosure; (4) negligent misrepresentation; (5) false promise; (6) negligence; and (7) declaratory disclosure as well as negligent misrepresentations against the Company's executive officers.

WFC alleges substantial damages. This action was removed to the United States District Court for the Central District of California. On June 30, 2005, WFC filed its Second Amended Complaint. The Company filed its Motion to Dismiss the Complaint on July 27, 2005. The District Court denied the Company's Motion to Dismiss on November 18, 2005. The Company will file its Answer and Special Defenses. The Company has reviewed WFC's complaint and believes that most claims are substantially without merit. The Company will vigorously contest WFC's claims.

During the twelve months ended January 31, 2005, the Company recorded an accrual for estimated payments and legal expenses related to this matter of \$260,000 with respect to this claim.

### HOLDING COMPANY STRUCTURE

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

We are a holding company with no operations other than our investments in VLI and SMC. At October 31, 2005, there were no restrictions with respect to

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dividends or other payments from VLI and SMC to the Company.

### NUTRITIONAL PRODUCTS

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

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

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

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

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### TELECOM INFRASTRUCTURE SERVICES

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

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

We intend to emphasize our high quality reputation, outstanding customer base and highly motivated work force in competing for larger and more diverse contracts. We believe that our high quality and well maintained fleet of vehicles and construction machinery and equipment is essential to meet customers' needs for high quality and on-time service. We are committed to invest in our repair and maintenance capabilities to maintain the quality and life of our equipment. Additionally, we invest annually in new vehicles and equipment.

### Critical Accounting Policies

Management is required to make judgments, assumptions and estimates that affect the amounts reported when we prepare financial statements and related disclosures in conformity with generally accepted accounting principles. Note 3 contained in the Company's consolidated financial statements for the year ended January 31, 2005 included in the Company's Annual Report contained in Form 10-KSB/A, as filed with the Securities and Exchange Commission describes the significant accounting policies and methods used in the preparation of our consolidated financial statements. Estimates are used for, but not limited to our accounting for revenue recognition, allowance for doubtful accounts, inventory valuation, long-lived assets and deferred income taxes. Actual results



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could differ from these estimates. The following critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of our consolidated financial statements.

### Revenue Recognition

#### Vitarich Laboratories, Inc.

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

#### Southern Maryland Cable, Inc.

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

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The timing of billing to customers varies based on individual contracts and often differs from the period of revenue recognition. Estimated earnings in excess of billings totaled \$348,000 at October 31, 2005.

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

### Inventories

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

### Impairment of Long-Lived Assets

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

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### Impairment of Goodwill

In accordance with SFAS No. 142, we will conduct annually on November 1, a review of our goodwill and intangible assets with an indefinite useful life to determine whether their carrying value exceeds their fair market value. Should this be the case, a detailed analysis will be performed to determine if the goodwill and other intangible assets are impaired. We will also review the finite intangible assets when events or changes in circumstances indicate that the carrying amount may not be recovered.

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

### Contractual Customer Relationships ("CCR's")

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

### Trade Name

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

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We are using the relief-from-royalty method described above to test the Trade Name for impairment annually on November 1 and on an interim basis if events or changes in circumstances between annual tests indicate the Trade Name might be impaired. Based on the annual impairment test, no impairment was recorded.

### Proprietary Formulas

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

### Non-Contractual Customer Relationships

The fair value of the Non-Contractual Customer Relationships (NCR's) was

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determined at the time of acquisition of VLI by discounting the net cash flows expected from existing customer revenues. Although VLI does not operate using long-term contracts, historical experience indicates that customer repeat orders due to the costs associated with changing suppliers. VLI has had a relationship of five years or more with most of its currently significant customers. The expected cash flows were discounted based on a rate that reflects the perceived risk of the NCR's, the estimated weighted average cost of capital and VLI's asset mix. We are amortizing the NCR's over a five year life based on the length of VLI's significant customer relationships.

### Non-Compete Agreement

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

### Derivative Financial Instruments

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

### Shipping Fees and Costs

The Company accounts for shipping fees and costs in accordance with Emerging Issues Task Force Issue No. 00-10 "Accounting for Shipping and Handling Fees and Costs." Amounts billed to customers in sales transactions related to shipping recorded in net sales were \$116,000 and \$47,000 for the nine and three months ended October 31, 2005 and \$25,000 for the nine and three months ended October 31, 2004. Costs associated with shipping goods to customers which aggregate \$116,000 and \$39,000 are accounted for as part of selling expenses for the nine and three months ended October 31, 2005 and \$24,000 for the nine and three months ended October 31, 2004.

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### Deferred Tax Assets and Liabilities

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

At October 31, 2005, we have cumulatively recorded a net operating loss carry

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forward aggregating \$254,000 which expires in 2024 and 2025.

### ACQUISITION OF VITARICH LABORATORIES, INC.

On August 31, 2004, the Company acquired, by merger, all of the common stock of VLI, a developer, manufacturer and distributor of premium nutritional supplements, whole-food dietary supplements and personal care products. The Company's purchase of VLI was focused on acquiring VLI's long-standing customer and exclusive vendor relationships and its well established position in the fast growing global nutrition industry, each of which supports the premium paid over the fair value of the tangible assets acquired.

The results of operations of the acquired company are included in the consolidated results of the Company from August 31, 2004, the date of acquisition.

The estimated purchase price was approximately \$6.7 million in cash, including expenses, and 825,000 shares of the Company's common stock with fair value of \$4,950,000 or \$6.00 per share utilizing the quoted market price on the acquisition date. The Company also assumed approximately \$1.6 million in debt. The merger agreement contained provisions for the payment of additional consideration ("Additional Consideration") by the Company to the former VLI shareholder to be satisfied in the Company's common stock and cash if certain Earnings Before Interest Taxes Depreciation and Amortization (EBITDA) thresholds for the twelve months ended February 28, 2005 were met.

The Company's Additional Consideration was approximately \$275,000 in cash, \$2.7 million in a subordinated note and approximately 348,000 shares of AI common stock with a fair estimated value of \$2.1 million or \$6.00 per share utilizing the quoted market price on February 28, 2005.

On July 5, 2005, the Company and Thomas entered into an agreement (Earn Back Agreement) concerning the calculation of Additional Consideration due Thomas. In the Earn Back Agreement, the Company agreed to pay Thomas \$594,000 in a subordinated note and 77,000 shares of common stock with a fair value of \$5.50 per share utilizing the quoted market price on July 5, 2005. The \$1,015,000 of Additional Consideration has been recorded by the Company as additional purchase consideration and an increase in goodwill. The amount of Additional Consideration due in shares of the Company's common stock aggregating 77,000 shares with a fair value of approximately \$422,000 is reflected as long-term debt due to former owner of Vitarich Laboratories, Inc. In addition, if certain inventory considered to be an overstock for purchase accounting at the time of the acquisition was reduced to normal levels of usage, Thomas would be paid an additional \$264,000, one-half in a subordinated note and one-half in common stock. The Company has not accrued any additional amount due Thomas at October 31, 2005.

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On January 31, 2005, the Company entered into a debt subordination agreement with Thomas, the former owner of VLI, SMC and the Bank, to reconstitute the cash portion of the Additional Consideration as subordinated debt payable on August 1, 2006 unless such payment would put the Company in default of its financing arrangements with the Bank. The subordinated note carries an interest rate of 10% with interest paid in arrears on October 1, 2005, January 1, 2006, April 1, 2006, July 1, 2006 and at maturity on August 1, 2006. During the nine and three months ended October 31, 2005, the Company incurred \$92,000 and \$68,000 in interest expense for the subordinated debt.

On January 28, 2005, the Company entered into a letter agreement ("Letter

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Agreement") with Thomas in consideration for his agreement to delay the timing of the payment of contingent cash consideration and for entering into a debt subordination agreement reconstituting such additional cash consideration as subordinated debt. Pursuant to the Letter Agreement, the Company agreed to issue additional shares of common stock to Thomas upon the earlier of (i) Company's issuance of additional shares of common stock at a price per share less than \$7.75, or (ii) July 31, 2005. The additional shares of common stock to be issued would equal the price paid by Investor divided by the lower of (i) the weighted average of all stock sold by the Company prior to July 31, 2005 or (ii) if the Company did not issue additional shares the Company would issue additional shares to Thomas at the average closing price of Argan's common stock for the thirty days ended July 31, 2005 if the price was less than \$7.75 per share less any shares previously issued. The concessions given to Kevin Thomas pursuant to the Letter Agreement whereby the Company agreed that should it not issue additional shares for consideration, it would issue additional shares to Thomas at a price determined by reference to the Company's prevailing thirty-day average stock price were accounted for as a derivative financial instrument. The Company recorded a liability for derivative financial instrument of \$1,115,000, deferred loan issuance cost for subordinated debt of \$501,000 and compensation expense to Kevin Thomas of \$614,000 at January 31, 2005. The liability for derivative financial instrument was subject to adjustment for changes in fair value subsequent to its issuance. The Company recorded losses of \$1,587,000 in other expense, net and net loss for the subsequent changes in fair value. The liability for derivative financial instruments aggregating \$2,702,000 was settled in a non-cash transaction by the issuance of 535,052 shares of the Company's common stock on September 1, 2005.

The Company's accounting for the acquisition of VLI and the estimate of the Additional Consideration uses the purchase method of accounting whereby the excess of cost over the net amounts assigned to assets acquired and liabilities assumed is allocated to goodwill and intangible assets based on their estimated fair values. Such intangible assets identified by the Company include \$12,375,000, \$2,500,000, \$2,000,000 and \$1,800,000, respectfully, allocated to goodwill, Proprietary Formulas (PF), Non-Contractual Customer Relationships (NCR) and a Non-Compete Agreement (NCA). The Company is amortizing PF over three years and NCR and NCA over five years. Accumulated amortization is \$972,000, \$467,000 and \$420,000 at October 31, 2005 for PF, NCR and NCA, respectively.

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At the date of acquisition, the Company identified a preacquisition contingency with respect to approximately \$264,000 in a specific inventory category and reduced VLI's valuation by that amount. The Company has been monitoring the sales level of the specific inventory category during the allocation period (since the date of acquisition). Based on the additional sales performance information regarding this inventory, the Company has reversed the preacquisition contingency and recorded a decrease to Goodwill and an increase in Inventory of \$264,000 during the three months ended July 31, 2005.

### Results of Operations

The following summarizes the results of our operations for the three and nine months ended October 31, 2005 compared to the pro forma results for the three and nine months ended October 31, 2004, as if the acquisition of VLI was completed on February 1, 2004. The unaudited statements of operations do not purport to be indicative of the results that would have actually been obtained if the aforementioned acquisition had occurred on February 1, 2004, or that may be obtained in the future. VLI previously reported its results of operations using a calendar year-end. No material events occurred subsequent to the reporting period that would require adjustment to our unaudited pro forma

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results in the statements of operations.

Statements of Operations	Three Months Ended October 31,		Nine Months Ended October 31,	
	2005	2004 (Pro forma)	2005	2004 (Pro forma)
Net sales	\$ 7,133,000	\$ 6,202,000	\$ 21,141,000	\$ 18,098,000
Cost of sales	5,431,000	4,450,000	16,211,000	13,678,000
Gross profit	1,702,000	1,752,000	4,930,000	4,420,000
Selling general and administrative expenses	1,847,000	1,716,000	5,721,000	4,938,000
Impairment loss	--	--	--	1,942,000
(Loss) income from operations	(145,000)	36,000	(791,000)	(2,460,000)
Other expense, net	(206,000)	(48,000)	(2,290,000)	(50,000)
Loss from operations before income taxes	(351,000)	(12,000)	(3,081,000)	(2,510,000)
Income tax benefit	64,000	5,000	386,000	714,000
Net loss	\$ (287,000)	\$ (7,000)	\$ (2,695,000)	\$ (1,796,000)

Results of Operations for the Three Months Ended October 31, 2005 Compared to the Pro Forma Results of Operations for the Three Months ended October 31, 2004

### Net sales

Net sales were \$7,133,000 for the three months ended October 31, 2005 compared to pro forma net sales of \$6,202,000 for the three months ended October 31, 2004. The increase of \$931,000 or 15% is due primarily to an increase of \$965,000 at SMC in sales volume. SMC experienced a \$475,000 increase in activity with one customer under time and materials arrangements. Sales volume for infrastructure services provided to SMC's customers under fixed-price contracts was also a significant source of the sales increase. VLI experienced relatively flat sales volume as compared to the same period one year ago due primarily to the impact of hurricane Wilma. VLI lost more than one week's production due to lack of electric power and water.

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### Cost of sales

For the three months ended October 31, 2005, cost of sales was \$5,431,000 or 76% of net sales compared to \$4,450,000 or 72% of pro forma net sales for the three months ended October 31, 2004. SMC had above average margins for the aforementioned customer under time and materials arrangements. SMC experienced decreased costs as a percent of net sales as the volume and number of fixed-priced contracts increased during the three months ended October 31, 2005. SMC's improved margin performance was offset by VLI which had increased cost of sales as a percentage of net sales due to increased pricing of raw materials and the impact of hurricane Wilma. VLI is in the process of examining its vendor

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costs and will be repricing its product offerings with the expectation to return to historical levels of margins.

### Selling general and administrative expenses

Selling, general and administrative expenses were \$1,847,000 or 26% of net sales for the three months ended October 31, 2005 compared to \$1,716,000 or 28% of pro forma net sales for the three months ended October 31, 2004, an increase of \$131,000. VLI has been aggressively seeking to diversify its customer base which resulted in a \$94,000 increase in selling costs for the three months ended October 31, 2005 related to increased staffing and related costs to support the marketing program. During the three months ended October 31, 2005, the Company reduced its allowances for doubtful accounts by \$107,000 to reflect improved collections of aged receivables. In addition, Argan incurred costs associated with the restatement of its financial statements for the Company's Form 10-KSB/A for January 31, 2005 and Form 10-QSB/A for April 30, 2005. In addition, the Company recorded net gains of \$55,000 on disposal of equipment which resulted in a decrease in selling, general and administrative expenses for the three months ended October 31, 2005.

### Other expense, net

We had other expense, net of \$206,000 for the three months ended October 31, 2005 compared to pro forma other expense, net of \$48,000 for the three months ended October 31, 2004. The Company incurred \$207,000 in interest expense during the three months ended October 31, 2005 due, in large part, to the amortization of bond issuance cost for subordinated debt and interest due Thomas on the subordinated debt that the Company owes Thomas.

### Income tax benefit

We had an effective income tax benefit rate of 18% for the three months ended October 31, 2005 compared to a 42% pro forma income tax benefit rate for the three months ended October 31, 2004. During the nine months ended October 31, 2005, the Company recorded the \$1,930,000 valuation loss for the liability for derivative financial instruments as other expense which is treated as a permanent difference for income tax reporting purposes. This permanent difference reduced our annual income tax benefit rate from 38% to 13%. The Company recorded an 18% effective income tax benefit rate for the three months ended October 31, 2005 to "true-up" to the annual effective income tax benefit rate of 13%.

### Results of Operations for the Nine Months Ended October 31, 2005 Compared to the Pro Forma Results of Operations for the Nine Months ended October 31, 2004

#### Net Sales

Net sales were \$21,141,000 for the nine months ended October 31, 2005 compared to pro forma net sales of \$18,098,000 for the nine months ended October 31, 2004. The increase of \$3,043,000 or 17% is due primarily to increases of \$2,086,000 and \$957,000 in sales volume at SMC and VLI, respectively. SMC experienced \$760,000 of its increased sales volume from infrastructure services provided to customers under fixed-price contracts. In addition, one customer under time and materials arrangements increased sales activity with SMC by \$554,000. VLI's sales increase would have been greater had the impact of hurricane Wilma not closed VLI for more than one week because of lack of electric power and water.

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### Cost of sales

For the nine months ended October 31, 2005, cost of sales was \$16,211,000 or 77% of net sales compared to \$13,678,000 or 76% of pro forma net sales for the nine months ended October 31, 2004. SMC experienced decreased costs as a percent of net sales as the sales volume and number of fixed-priced contracts increased during the nine months ended October 31, 2005 allowing SMC to more effectively utilize its technical and project management teams. In addition, the aforementioned SMC customer under time and materials arrangements experienced above average margins. VLI's margins were slightly below historical levels due to increased raw material costs. VLI is in the process of examining its vendor costs and is repricing its product offerings with the expectation to return to historical margin levels.

### Selling general and administrative expenses

Selling, general and administrative expenses were \$5,721,000 or 27% of net sales for the nine months ended October 31, 2005 compared to \$4,938,000 or 27% of pro forma net sales for the nine months ended October 31, 2004, an increase of \$783,000. Argan retained MSR for a fee of \$100,000 to assist in identifying sources of additional equity investors. VLI has been aggressively seeking to diversify its customer base which resulted in approximately an \$160,000 increase in selling costs for staff salaries and other costs to support the marketing program. During the nine months ended October 31, 2005, the Company reduced its allowance for doubtful accounts by \$81,000 to reflect improved collections of aged receivables. In addition, VLI has upgraded its senior management team which resulted in increased salaries as well as placement, relocation and severance costs of \$125,000. Argan incurred substantial costs in the restatements of its financial statements for the Company's Form 10-KSB/A for January 31, 2005 and Form 10-QSB/A for April 30, 2005. In addition, the Company recorded net gains of \$33,000 on disposal of equipment which resulted in a decrease in selling, general and administrative expenses for the nine months ended October 31, 2005.

### Impairment of Goodwill and Intangibles

During the nine months ended October 31, 2004, the Company determined that both events and changes in circumstances with respect to its business climate would have significant effect on its future estimated cash flows. During the nine months ended October 31, 2004, SMC had a customer contract terminated which had historically provided positive margins and cash flows. In addition, SMC experienced revenue levels well below expectations for its largest fixed priced contract customer. As a consequence, SMC has reduced its future expectations of cash flows. As a result of these events, the Company believed that there was an indication that its intangible assets not subject to amortization might be impaired. The Company determined the fair value of its Goodwill and Trade Name and compared it to its respective carrying amounts. The carrying amounts exceeded the Goodwill and Trade Name's respective fair values by \$740,000 and \$456,000, respectively, which the Company recorded as an impairment loss for the nine months ended October 31, 2004.

During the nine months ended October 31, 2004, the Company terminated a customer contract. The impact of the termination indicated that its Contractual Customer Relationships carrying amount was not fully recoverable. Accordingly, the Company determined the fair value of the CCR's and compared it to its carrying amount. The Company recorded an impairment loss of \$746,000 by which the CCR's carrying amount exceeded its fair value.

### Other expense, net

We had other expense, net of \$2,290,000 for the nine months ended October 31, 2005 compared to pro forma other expense, net of \$50,000 for the nine months ended October 31, 2004. The fair value loss for the liability for derivative



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financial instruments of \$1,930,000 was realized during the nine months ended October 31, 2005. The Company's interest expense increased to \$364,000 due to interest on subordinated debt of \$92,000 and \$126,000 in amortization of issuance cost for subordinated debt.

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### Income tax benefit

We had an effective income tax benefit rate of 13% for the nine months ended October 31, 2005 compared to a 28% pro forma income tax benefit rate for the nine months ended October 31, 2004. During the nine months ended October 31, 2005, the Company recorded the \$1,930,000 loss for the liability for derivative financial instruments as other expense which is treated as a permanent difference for income tax reporting purposes. This permanent difference reduced our effective income tax benefit rate from 38% to 13% for the nine months ended October 31, 2005. We recorded a \$740,000 impairment of goodwill for the nine months ended October 31, 2004 which is treated as a permanent difference for income tax reporting purposes. This permanent difference reduced our effective income tax benefit rate from 38% to 28% for the nine months ended October 31, 2004.

### RELATED PARTY TRANSACTIONS

We retained MSR under a consulting arrangement to assist in identifying and meeting potential equity investors. Under this consulting arrangement we paid the MSR \$100,000 during the nine months ended October 31, 2005.

We lease administrative, manufacturing and warehouse facilities from individuals who are officers of SMC and VLI. The total expense under these arrangements were \$75,000 and \$222,000 for the three and nine months ended October 31, 2005 and \$40,000 and \$79,000 for the three and nine months ended October 31, 2004.

We also entered into a supply agreement with an entity owned by the former shareholder of VLI whereby the supplier committed to sell to us and we committed to purchase on an as-needed basis, certain organic products. VLI made \$68,000 and \$146,000 in purchases under the supply agreement during the three and nine months ended October 31, 2005. No purchases were made by the Company during the three and nine months ended October 31, 2004.

At October 31, 2005, we accrued \$112,000 for reimbursement to Thomas for certain leasehold improvements which he constructed in the building that we lease from Thomas.

We also sell our products in the normal course of business to an entity in which the former owner of VLI has an ownership interest. The pricing on such transactions is consistent with VLI's general customer pricing for nonaffiliated entities. VLI had approximately \$129,000 and \$430,000 in sales to this entity for three and nine months ended October 31, 2005. At October 31, 2005, the affiliated entity owed \$176,000 to VLI, net of an allowance for doubtful accounts of zero which the Company reduced from \$120,000 during the three months ended October 31, 2005 due to collections of aged receivables.

### LIQUIDITY AND CAPITAL RESOURCES

#### Cash Position and Indebtedness

We had negative working capital of approximately \$1.3 million at October 31, 2005. We had cash and cash equivalents of \$27,000 and \$2.5 million available under credit facilities.

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Working capital decreased by \$2.8 million to negative working capital of \$1.3 million at October 31, 2005 from \$1.5 million in working capital at January 31, 2005. This decrease was primarily due to \$3,292,000 in subordinated debt due to former owner of Vitarich Laboratories, Inc. which is due August 1, 2006, an increase in accounts receivable of \$578,000 and decrease in liability for derivative financial instruments of \$1,254,000. The Company had a loss before taxes of \$3,081,000 for the nine months ended October 31, 2005. The Company's non-cash expenses included in the determination of loss before income taxes included the non-cash loss on liability for derivative financial instruments of \$1,930,000, \$1,272,000 for amortization of purchase intangibles and \$721,000 for depreciation and other amortization.

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### Cash Flows

Net cash provided by operations for the nine months ended October 31, 2005 was \$1,975,000 compared with \$2,247,000 of cash used in operations for the nine months ended October 31, 2004 due to improved performance of SMC operations.

During the nine months ended October 31, 2005, the Bank released \$304,000 in escrows to us (see discussion below). During the nine months ended October 31, 2005, net cash used for investing activities was \$1,311,000 compared to net cash used in investing activities of \$3,762,000 for the nine months ended October 31, 2004. During the nine months ended October 31, 2005, we had cash of \$955,000 used in the purchase of property and equipment and \$426,000 used to pay \$275,000 in additional consideration in the purchase of VLI as well as other acquisition costs of \$151,000. During the nine months ended October 31, 2004, the Company used cash of \$6,650,000 in the acquisition of VLI. During the nine months ended October 31, 2004, we had cash of \$3,000,000 provided by the sale of investments net of purchases. During the nine months ended October 31, 2004 we used cash to purchase property and equipment of \$123,000.

For the nine months ended October 31, 2005, net cash used by financing activities was \$804,000. We had \$982,000 in cash provided by financing activities for the nine months ended October 31, 2004. During the nine months ended October 31, 2005 and 2004, we used cash of \$531,000 and \$1,091,000 to pay down term-debt. During the nine months ended October 31, 2004, we increased our net draw in excess of payments on our line of credit by \$2,569,000 primarily to assume debt on the acquisition of VLI.

In April 2005, we agreed to amend the existing financing arrangements with the Bank. Under this arrangement, the Company has a revolving line of credit of \$4.25 million and a term loan with an original balance of \$1.2 million. Under the April 2005 amendment the line of credit is extended to May 31, 2006. Availability on a monthly basis under the revolving line is determined by reference to accounts receivable and inventory on hand which meet certain Bank criteria. The aforementioned three-year term note remains in effect with its last monthly payment of \$33,000 due July 31, 2006. As of October 31, 2005, the Company had \$1,378,000 outstanding under the revolving line of credit and additional availability of \$2.5 million. Under the amended financing arrangements, amounts outstanding under the revolving line of credit and the three-year term note bear interest at LIBOR plus 3.25% and 3.45%, respectively.

The amended financing arrangements provide for the measurement of certain financial covenants at each of Argan's fiscal quarter and year end including requiring the ratio of debt to pro forma earnings before interest, taxes, depreciation and amortization (EBITDA) not to exceed 2.5 to 1 and requiring pro forma fixed charge coverage ratio not less than 1.25 to 1. Bank consent

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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 Bank has released \$304,000 to the Company which it was holding in escrow as collateral.

At July 31, 2005, the Company failed to comply with the aforementioned financial covenants. The Bank waived the failure for the measurement period ended July 31, 2005. The Company was in compliance with the aforementioned financial covenants at October 31, 2005. For future measurement periods, the Bank revised the definitions of certain components of the financial covenants to specifically exclude the impact of items associated with derivative financial instruments such as, valuation gains and losses, compensation expense which are settled with the non-cash issuance of the Company's common stock and non-cash deferred loan issuance cost amortization.

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

### Customers

During the nine months ended October 31, 2005, we provided nutritional and whole-food supplements as well as personal care products to customers in the global nutrition industry and services to telecommunications and utilities customers as well as to the Federal Government, through a contract with General Dynamics Corp. (GD). Certain of our more significant customer relationships are with TriVita Corporation (TVC), Rob Reiss Companies (RRC), Southern Maryland Electrical Cooperative (SMECO), GD, and CyberWize.com, Inc. (C). TVC, RRC and C are VLI customers. SMC's significant customers are SMECO and GD. TVC, RRC and C accounted for approximately 22%, 12% and 6% of consolidated net sales during the nine months ended October 31, 2005. SMECO and GD accounted for approximately 12% and 10% of consolidated net sales during the nine months ended October 31, 2005. Combined TVC, RRC, SMECO, GD, and C accounted for approximately 62% of consolidated net sales during the nine months ended October 31, 2005.

### Seasonality

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

### IMPACT OF CHANGES IN ACCOUNTING STANDARDS

In December 2004, the Financial Accounting Standards Board issued FASB Statement No. 123 (revised 2004), Share-Based Payment ("SFAS 123(R)"). SFAS 123(R) supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and amends FASB Statement No. 95, Statement of Cash Flows. SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their

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fair values. Pro forma disclosure is no longer an alternative. We will adopt SFAS 123(R) on February 1, 2006. We have not determined the impact of adopting the new standard and are still evaluating the impact.

In November 2005, the Financial Accounting Standards Board issued FASB Statement No. 151 "Inventory Costs - an amendment of ARB No. 43, Chapter 4 (SFAS 151)." This Statement amends the guidance in ARB No. 43, Chapter 4 "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Paragraph 5 of ARB 43, Chapter 4, previously stated that "...under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges..." This Statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The Company will SFAS No. 151 on February 1, 2006. The Company has not determined the impact of adopting the new standard and is continuing its analysis of the impact.

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### ITEM 3. CONTROLS AND PROCEDURES

In the Company's 2005 Form 10-KSB, management concluded that its internal control over financial reporting was effective as of January 31, 2005. Recently, management determined that a material agreement was not disclosed or accounted for properly in the Company's consolidated financial statements for the year ended January 31, 2005 and that an error occurred in the application of first-in, first-out (FIFO) inventory accounting in the quarter ended April 30, 2005. As a result, Management concluded that the Company's financial statements for the fiscal year ended January 31, 2005 and for the first quarter ended April 30, 2005 were required to be restated to account for the agreement and to adjust inventory and cost of goods sold. Further, management concluded that both of these errors resulted from material weaknesses in the Company's internal controls over financial reporting. Specifically, management has identified deficiencies in the design of the Company's process surrounding disclosure controls and in the operating effectiveness of inventory accounting controls.

To address these material weaknesses and to mitigate these issues, management has instituted more formalized processes for all members of senior management and outside counsel to review all material agreements and filings with the SEC prior to their release. Material agreements will be accumulated at their corporate offices for review and evaluation. In addition, Management has also enhanced the quality of their accounting expertise at the VLI subsidiary and have begun to incorporate a more thorough and comprehensive review and monitoring.

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## PART 11

### OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

On October 31, 2003, the Company completed the sale of Puroflow Incorporated (a

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wholly-owned subsidiary) to Western Filter Corporation (WFC) for approximately \$3.5 million in cash, of which \$300,000 is held in escrow to indemnify WFC from losses if a breach of the representations and warranties made by the Company in connection with that sale should occur. During the twelve months ended January 31, 2005, WFC notified the Company in writing, asserting that WFC believes that the Company breached certain representations and warranties under the Stock Purchase Agreement. WFC asserts damages in excess of the \$300,000 escrow which is being held by a third party.

WFC filed a civil action against Argan, Inc. on March 22, 2005. The suit was initially filed in the Superior Court of the State of California for the County of Los Angeles. The complaint asserts seven claims against the Company: (1) breach of contract; (2) intentional misrepresentation; (3) concealment and non-disclosure; (4) negligent misrepresentation; (5) false promise; (6) negligence; and (7) declaratory disclosure as well as negligent misrepresentations against the Company's executive officers.

WFC alleges substantial damages. This action was removed to the United States District Court for the Central District of California. On June 30, 2005, WFC filed its Second Amended Complaint. The Company filed its Motion to Dismiss the Complaint on July 27, 2005. The District Court denied the Company's Motion to Dismiss on November 18, 2005. The Company will file its Answer and Special Defenses. The Company has reviewed WFC's complaint and believes that the claims are substantially without merit. The Company will vigorously contest WFC's claims.

During the twelve months ended January 31, 2005, the Company recorded an accrual for a loss related to this matter of \$260,000 for estimated payments and legal expenses related to WFC's claim that it considers to be probable and that can be reasonably estimated. Although the ultimate amount of liability at October 31, 2005 that may result from this matter for which the Company has recorded an accrual is not ascertainable, the Company believes that any amounts exceeding the aforementioned accrual should not materially affect the Company's financial condition. It is possible, however, that the ultimate resolution of WFC's claim could result in a material adverse effect on the Company's results of operations for a particular reporting period.

### 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

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a) Exhibits:

Exhibit No.	Title
Exhibit 10.25	Subordinated Term Note (Earnback Obligations) as of November 30, 2005 between Argan, Inc. and Kevin J. Thomas
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

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

ARGAN, INC.

December 14, 2005

By: /s/ Rainer Bosselmann

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Rainer Bosselmann  
Chairman of the Board and Chief Executive Officer

December 14, 2005

By: /s/ Arthur F. Trudel

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Arthur F. Trudel  
Chief Financial Officer

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