ARGAN INC
Form 10QSB/A
December 02, 2005

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

FORM 10-QSB/A Amendment No. 1

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

For the quarterly period ended April 30, 2005

Commission File Number 001-31756

Argan, Inc.

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

| DELAWARE | 13-1947195 |
|---|---|
| (State or other jurisdiction of incorporation 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 |X| No |_|

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

| Common Stock | Shares outstanding |
|---|---|
| Common Stock, $.15 Par Value | 2,758,845 as of June 10, 2005 |

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

Amendment No. 1 Overview

We are filing Amendment No. 1 (Amendment) to the Argan, Inc. Quarterly Report on Form 10-QSB for the quarter ended April 30, 2005.

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 Vitarich Laboratories, Inc. (VLI), and for an agreement entered into with Kevin Thomas (Thomas) on January 28, 2005 with respect to a debt subordination and related concessions ("Concessions") given to Thomas in connection with consummating the agreement as described below. The Company is also restating inventory and cost of goods sold for the quarter ended April 30, 2005 related to an error in inventory valuation accounting.

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 "Agreement"). The Shares were issued at a purchase price of $7.75 per share, yielding aggregate proceeds of $999,998. The Investor is an entity controlled by Daniel Levinson, a director of the Company. Pursuant to the Agreement, we agreed to issue additional shares of our common stock to Investor in accordance with the Agreement based upon the earlier of (i) our 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 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 Agreement. The shares were issued pursuant to an exemption provided by Section 4(2) of the Securities Act. The resale of the shares was registered under the Securities Act on Form S-3 filed with the SEC on February 25, 2005.

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 through July 31, 2005. The Company recorded a fair value adjustment for a $1,000 gain and a $343,000 loss at April 30, 2005 and July 31, 2005, respectively, which is also reflected as a change in liability for the derivative financial instruments. The fair value adjustment was recorded as a change in the Company's other expenses or income and net loss. The liability for the derivative financial instruments related to the Investor was settled as a non-cash transaction by the issuance of additional shares of the Company's common stock on August 13, 2005.

On August 31, 2004, Argan acquired VLI for approximately $6.7 million in cash 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 $1.6 million in debt. The value of the shares issued in the acquisition of VLI has been revised to reflect the price per share of $6.00

of the Company's common stock at August 31, 2004 as opposed to $6.22, the quoted market price of the stock two days before and after the acquisition date. The impact of this change was to reduce the amount of goodwill and additional paid-in capital by $182,000. The purchase agreement also provides for contingent consideration based on EBITDA for the twelve months ended February 28, 2005. The additional contingent consideration would be paid in both cash and stock. 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.

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On January 28, 2005 the Company entered into a Letter Agreement with Thomas in consideration for his agreement to delay the timing of the payment of contingent cash consideration and for entering into a Debt Subordination Agreement (Subordination Agreement), reconstituting such additional cash consideration as subordinated debt. The Letter Agreement includes certain concessions to Thomas allowing him to receive additional consideration based on the market price of the Company's common stock. The concessions provide that in addition to providing Thomas additional shares if the Company issued additional shares at a price less than $7.75, if the Company did not raise additional shares at a price less than $7.75 per share then the Company would issue additional shares to Thomas based on the average closing price of the Company's common stock for the 30 days ended July 31, 2005, if the price was below $7.75 per share. These concessions allowing Thomas to receive additional shares under certain conditions represent a freestanding financial instrument and should be accounted for in accordance with EITF 00-19 "Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock." The Company has recorded the freestanding financial instrument as a liability for the fair value of $1,115,000 ascribed to the obligations of the Company to issue Thomas additional shares.

$501,000 of the charge related to the liability for derivative financial instrument is recorded as deferred issuance cost for subordinated debt which will be amortized over the life of the subordinated debt and $614,000 of the charge is recorded as compensation expense due to Thomas. The amortization of the deferred loan issuance cost will increase the Company's future interest expense through August 1, 2006, the maturity date of the note, and reduce net income. The charge for compensation to Thomas was classified as non-cash compensation expense and increased the net loss by $614,000 for the year January 31, 2005. The derivative financial instrument will be subject to adjustment for changes in fair value subsequent to issuance through July 31, 2005. The fair value adjustment will be recorded as a change in the liability for the derivative financial instrument and as a charge to the Company's other expenses and net loss. The liability for the derivative financial instrument was settled as a non-cash transaction by the issuance of additional shares of the Company's common stock on September 1, 2005. (See Note 2 for the impact of the restatement).

The Company is also restating its consolidated financial statements for the quarter ended April 30, 2005 related to an error in inventory valuation accounting. The error is the result of the Company incorrectly recording a write down of inventory in purchase accounting to the incorrect inventory items. The impact of correcting this error is to increase the cost of sales by $105,000, and reduce inventory by $105,000 and net income by $60,000 for the quarter ended April 30, 2005.

In August 2005, the Company re-evaluated the write down of the inventory in

purchase accounting. Based on the Company's updated analysis, management believes it is appropriate to reverse the reduction for the contingent asset impairment as it is within one year of the acquisition. The impact of reversing the inventory write-down will be recorded in the quarter ended July 31, 2005 and will result in an increase in inventory and a related reduction in goodwill of $264,000.

The consolidated financial statements and accompanying notes for the quarter ended April 30, 2005 have been restated to correct the aforementioned errors. These restatements are described in Note 2 to the consolidated financial statements. Details of the impact of the restatement on the accompanying balance sheet and statements of operations for the quarter ended April 30, 2005 are also described in Note 2 to the consolidated financial statements.



We have amended and restated in its entirety each item of the Original Form 10-QSB that has been affected by the restatement. This Amendment No. 1 to Form 10-QSB does not reflect events occurring after the filing of the Original Form 10-QSB or modify or update those disclosures (including disclosures relating to risks, uncertainties and other factors that may affect our future performance) in any way, except as to reflect the effects of the restatement.



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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ARGAN, INC.
Condensed Consolidated Balance Sheets
(Unaudited)

| | April 30, 2005 | January |
|---|---|---|
| ASSETS | Restated - See Note 2 | Rest |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 107,000 | $ |
| Accounts receivable, net of allowance for doubtful accounts of $68,000 at 4/30/2005 and $85,000 at 1/31/2005 | 3,751,000 | 2 |
| Receivable from affiliated entity, net of allowance for doubtful accounts of $75,000 at 4/30/2005 and $84,000 at 1/31/2005 | 134,000 | |
| Escrowed cash | 300,000 | |
| Estimated earnings in excess of billings | 365,000 | |
| Inventories, net | 3,153,000 | 3 |
| Prepaid expenses and other current assets | 680,000 | |
| TOTAL CURRENT ASSETS | 8,490,000 | 8 |
| Property and equipment, net of accumulated depreciation of $854,000 at 4/30/2005 and $679,000 at 1/31/2005 | 2,644,000 | 2 |
| Issuance cost for subordinated debt | 501,000 | |
| Other assets | 35,000 | |
| Contractual customer relationships, net | 539,000 | |
| Trade name | 224,000 | |
| Proprietary formulas, net | 1,944,000 | 2 |
| Non-contractual customer relationships, net | 1,733,000 | 1 |
| Non-compete agreement, net | 1,560,000 | 1 |
| Goodwill | 12,279,000 | 7 |
| TOTAL ASSETS | $ 29,949,000 | $ 25 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | $ 1,990,000 | $ 1 |

| | | |
|---|---|---|
| Billings in excess of cost and earnings | 6,000 | |
| Due to affiliates | -- | |
| Accrued expenses | 1,230,000 | 1 |
| Liability for derivative financial instruments | 1,231,000 | 1 |
| Deferred income tax liability | 119,000 | |
| Line of credit | 1,661,000 | 1 |
| Current portion of long-term debt | 557,000 | |
| TOTAL CURRENT LIABILITIES | 6,794,000 | 6 |
| Deferred income tax liability | 2,515,000 | 2 |
| Deferred rent | 12,000 | |
| Long-term debt | 362,000 | |
| Long-term subordinated debt due to former owner of Vitarich Laboratories, Inc. | 4,788,000 | |
| 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 - 2,762,078 shares issued at 4/30/2005 and 1/31/2005 and 2,758,845 shares outstanding at 4/30/2005 and 1/31/2005 | 414,000 | |
| Warrants outstanding | 849,000 | |
| Additional paid-in capital | 19,800,000 | 19 |
| Accumulated deficit | (5,552,000) | (5 |
| Treasury stock at cost: - 3,233 shares at 4/30/2005 and 1/31/2005 | (33,000) | |
| TOTAL STOCKHOLDERS' EQUITY | 15,478,000 | 15 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 29,949,000 | $ 25 |

See Accompanying Notes.



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

| | Three months ended April 30, | |
|---|---|---|
| | 2005 | 2004 |
| | Restated - See Note 2 | |
| Net sales | $ 7,156,000 | $ 1,807,000 |
| Cost of sales | 5,286,000 | 1,608,000 |
| Gross profit | 1,870,000 | 199,000 |
| Selling, general and administrative expenses | 1,891,000 | 791,000 |

| | | |
|---|---|---|
| Loss from operations | (21,000) | (592,000) |
| Interest expense | 56,000 | 7,000 |
| Other income, net | 27,000 | 29,000 |
| Loss from operations before income taxes | (50,000) | (570,000) |
| Income tax benefit | 28,000 | 218,000 |
| Net loss | ($ 22,000) | ($ 352,000) |
| Basic and diluted loss per share | ($ 0.01) | ($ 0.20) |
| Weighted average number of shares outstanding - basic and diluted | 2,992,000 | 1,803,000 |

See Accompanying Notes.



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

| | Three Months Ended April 30, | |
|---|---|---|
| | 2005 | 2004 |
| | Restated - See Note 2 | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | ($ 22,000) | ($ 352,000) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 195,000 | 95,000 |
| Amortization of purchase intangibles | 424,000 | 61,000 |
| Deferred income taxes | (30,000) | (222,000) |
| Unrealized gain on liability for derivative financial instruments | (23,000) | -- |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | (800,000) | 640,000 |
| Receivable from affiliated entity, net | (22,000) | -- |
| Escrowed cash | 304,000 | -- |
| Estimated earnings in excess of billings | (42,000) | 10,000 |
| Inventories, net | 312,000 | -- |
| Prepaid expenses and other current assets | (58,000) | (117,000) |
| Accounts payable and accrued expenses | 60,000 | (522,000) |
| Billings in excess of estimated earnings | 6,000 | 8,000 |
| Due to affiliates | (47,000) | -- |
| Other | 23,000 | 5,000 |
| Net cash provided by (used in) operating activities | 280,000 | (394,000) |

CASH FLOWS FROM INVESTING ACTIVITIES:

| | | |
|---|---|---|
| Purchase of investments | -- | (19,500,000) |
| Redemptions of investments | -- | 17,000,000 |
| Purchases of property and equipment | (118,000) | (22,000) |
| Net cash used in investing activities | (118,000) | (2,522,000) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from line of credit | 600,000 | -- |
| Proceeds from long-term debt | 8,000 | -- |
| Payments on line of credit | (598,000) | -- |
| Principal payments on term debt | (232,000) | (123,000) |
| Net cash used in financing activities | (222,000) | (123,000) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 167,000 | 5,212,000 |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (60,000) | (3,039,000) |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $ 107,000 | $ 2,173,000 |

See Accompanying Notes.



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

NOTE 1- ORGANIZATION

NATURE OF OPERATIONS

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

AI was organized as a Delaware corporation in May 1961.

The Company operates in two reportable segments. (See Note 8)

MANAGEMENT'S PLANS, LIQUIDITY AND BUSINESS RISKS

As of April 30, 2005, the Company had an accumulated deficit of $5.6 million. Further, as a result of recurring losses, the Company has historically experienced negative cash flows from operations. At April 30, 2005, the Company had $2.0 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 integrate 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 and 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 has 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. The additional shares of common stock to be issued would equal the price paid by Investor divided by the lower of (i) the weighted average of all stock sold by the Company prior to July 31, 2005, or (ii) ninety percent of the average bid price of the Company's common stock for the thirty days ended July 31, 2005, if the price was less than $7.75, less the 129,032 shares previously issued. (See Notes 2, 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 $1 million provided that such payment would not put the Company in default of its current financing arrangement with the Bank. (See Notes 2 and 4)

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On April 8, 2005, the Company renewed its line of credit with the Bank, extending the maturity date to May 31, 2006. The 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)

During the three months ended April 30, 2005, the Company had positive cash flows from operations of $280,000. 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 do not reflect any adjustments should the Company be unable to meet its future operating cash needs in the ordinary course of business. The Company continues to take various actions to align its cost structure to appropriately match its expected revenues, including limiting its operating expenditures and controlling its capital expenditures. Any future acquisitions, other significant unplanned costs or cash requirements may require the Company to raise additional funds through the issuance of debt and equity securities. There can be no assurance that such financing will be available on terms acceptable to the Company, or at all. If additional funds are raised by issuing equity securities, significant dilution to the existing stockholders may result.

NOTE 2 - 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 as described below. The Company is also restating inventory and cost of goods sold for the quarter ended April 30, 2005 related to an error in inventory valuation accounting.

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 "Agreement"). The Shares were issued at a purchase price of $7.75 per share, yielding aggregate proceeds of $999,998. The Investor is an entity controlled by Daniel Levinson, a director of the Company. Pursuant to the Agreement, we agreed to issue additional shares of our common stock to Investor in accordance with the Agreement based upon the earlier of (i) our 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 per share. Any additional shares issued would effectively reduce the Investor's purchase price per common share as set forth in the Agreement. The shares were issued pursuant to an exemption provided by Section 4(2) of the Securities Act. The resale of the shares was registered under the Securities Act on Form S-3 filed with the SEC on February 25, 2005.

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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 at issuance was accounted for as a liability for a derivative financial instrument. This liability relates to the obligation to issue Investor additional shares under certain conditions. The derivative financial instrument is subject to adjustment for changes in fair value subsequent to issuance. The Company recorded a fair value adjustment for a $1,000 gain and a $343,000 loss at April 30, 2005 and July 31, 2005 respectively, which is also reflected as a change in the liability for the derivative financial instruments. The fair value adjustment was recorded as a change in the Company's other expense or income and net loss. The liability for derivative financial instruments related to the Investor was settled as a non-cash transaction by the issuance of additional shares of the Company's common stock on August 13, 2005.

On August 31, 2004, Argan acquired VLI for approximately $6.7 million in cash 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 $1.6 million in debt. The value of the shares issued in the acquisition of VLI has been revised to reflect the price per share of $6.00 of the Company's common stock at August 31, 2004 as opposed to $6.22, the quoted market price of the stock two days before and after the acquisition date. The

impact of this change was to reduce the amount of goodwill and additional paid-in capital by $182,000. The purchase agreement also provides for contingent consideration based on EBITDA for the twelve months ended February 28, 2005. 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. The additional contingent consideration would be paid in both cash and stock. (See Note 4)

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 (Subordination Agreement), reconstituting such additional cash consideration as subordinated debt. The Letter Agreement includes certain concessions to Thomas allowing him to receive additional consideration based on the market price of the Company's common stock. The concessions provide that in addition to providing Thomas additional shares if the Company issued additional shares at a price less than $7.75, if the Company did not issue additional shares at a price less than $7.75 per share then the Company would issue additional shares to Thomas based on the average closing price of the Company's common stock for the 30 days ended July 31, 2005, if the price were below $7.75 per share. These concessions allowing Thomas to receive additional shares under certain conditions represent a freestanding financial instrument and should be accounted for in accordance with EITF 00-19. The Company has recorded the freestanding financial instrument as a liability for the fair value of $1,115,000 ascribed to the obligations of the Company to issue Thomas additional shares.

$501,000 of the charge related to the liability for derivative financial instrument is recorded as deferred issuance cost for subordinated debt which will be amortized over the life of the subordinated debt and $614,000 of the charge was recorded as compensation expense due to Thomas. The amortization of the deferred loan issuance cost will increase the Company's future interest expense through August 1, 2006, the maturity date of the note, and reduce net income. The charge for compensation to Kevin Thomas was classified as non-cash compensation expense and increased the net loss by $614,000 for the year January 31, 2005. The derivative financial instrument will be subject to adjustment for changes in fair value subsequent to issuance through July 31, 2005. The fair value adjustment will be recorded as a change in liability for the derivative financial instrument and as a charge to the Company's other expenses or income and net loss. The liability for the derivative financial instrument was settled as a non-cash transaction by the issuance of additional shares of the Company's common stock on September 1, 2005.



The Company is also restating its consolidated financial statements for the quarter ended April 30, 2005 related to an error in inventory valuation accounting. The error is the result of the Company incorrectly recording a write down of inventory in purchase accounting to the incorrect inventory items. The impact of correcting this error is to increase the cost of sales by $105,000, and reduce inventory by $105,000 and net income by $60,000 for the quarter ended April 30, 2005.

In August 2005, the Company re-evaluated the write down of inventory in purchase accounting. Based on the Company's updated analysis, management believes it is appropriate to reverse the reduction for the contingent asset impairment as it is within one year of the acquisition. The impact of reversing the inventory write-down will be recorded in the quarter ended July 31, 2005 and will result

in an increase to inventory and a related reduction in goodwill of $264,000.

As a result of the revised accounting for Investment and Concessions and the correction of the error in accounting for inventory, the Company restated its financial statements which resulted in a change from net income of $20,000 to a net loss of $22,000 and a change in earnings per share from $0.01 per share to a loss per share of ($0.01) for the three months ended April 30, 2005.

The following tables set forth the effects of the restatement on certain line items within the Company's consolidated balance sheet as of April 30, 2005 and consolidated statement of operations for the three months ended April 30, 2005.

| Balance Sheet | As Reported April 30, 2005 | As Restated April 30, 2005 |
|---|---|---|
| Inventories, net | $3,259,000 | $3,153,000 |
| Issuance cost for subordinated debt | -- | $501,000 |
| Goodwill | $12,461,000 | $12,279,000 |
| Total assets | $29,736,000 | $29,949,000 |
| Liability for derivative financial instruments | -- | $1,231,000 |
| Total current liabilities | $ 5,563,000 | $6,794,000 |
| Deferred income tax liability | $ 2,556,000 | $2,515,000 |
| Additional paid-in capital | $20,121,000 | $19,800,000 |
| Accumulated deficit | ($4,896,000) | ($5,552,000) |
| Total stockholders' equity | $16,455,000 | $15,478,000 |
| Total liabilities and stockholders' equity | $29,736,000 | $29,949,000 |



| Statement of Operations | As Reported Three Months Ended April 30, 2005 | As Restated Three Months Ended April 30, 2005 |
|---|---|---|
| Cost of sales | $5,181,000 | $5,286,000 |
| Gross profit | $1,975,000 | $1,870,000 |
| Income (loss) from operations | $84,000 | ($21,000) |
| Other income, net | $4,000 | $27,000 |
| Income (loss) from operations before income taxes | $32,000 | ($50,000) |
| Income tax provision (benefit) | $12,000 | ($28,000) |
| Net income (loss) | $20,000 | ($22,000) |
| Income (loss) per share: | | |
| - Basic | $0.01 | ($0.01) |
| - Diluted | $0.01 | antidilutive |

| Statement of Cash Flows | As Reported Three Months April 30, 2005 | As Restated Three Months April 30, 2005 |
|---|---|---|
| Net income (loss) | $20,000 | ($22,000) |

| | | |
|---|---|---|
| Deferred income taxes | $11,000 | ($30,000) |
| Unrealized gain on liability for derivative financial instruments | -- | ($23,000) |
| Inventories, net | $206,000 | $312,000 |

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation - The condensed consolidated balance sheet as of April 30, 2005 and the condensed consolidated statements of operations and cash flows for the three months ended April 30, 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 April 30, 2005 and 2004 and the results of its operations and its cash flows for the periods presented. The Company prepares its interim financial information using the same accounting principles as it does for its annual financial statements.

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

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 (Restated - See Note 2) at April 30, 2005 consist of the following:

| | |
|---|---|
| Raw materials | $ 2,629,000 |
| Work-in process | 154,000 |
| Finished goods | 370,000 |
| | $ 3,153,000 |

Income 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, warrants and contingently issuable shares were antidilutive during the three months ended April 30, 2005 and 2004.



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

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 expense or income, 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 $30,000 for the three months ended April 30, 2005. Costs associated with shipping goods to customers which aggregate $51,000 are accounted for as part of selling expenses for the three months ended April 30, 2005.

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

Pro Forma Disclosures
For the three months ended April 30,

| | 2005 | 2004 |
|---|---|---|
| | Restated - See Note 2 | |
| Net loss, as reported | ($ 22,000) | ($ 352,000) |
| Add: Stock based compensation recorded in the financial statements | -- | -- |
| Deduct: Total stock-based employee compensation expense determined under fair value based | 20,000 | 18,000 |
| Pro forma net loss | ($ 42,000) | ($ 370,000) |
| Basic and diluted per share: | | |
| Basic and diluted - as reported | ($ 0.01) | ($ 0.20) |
| Basic and diluted - pro forma | ($ 0.01) | ($ 0.21) |

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 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 standards 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 SFAS No. 151 on February 1, 2006. The Company has not determined the impact of adopting the new standards and is continuing its analysis of the impact.

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 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 contains provisions for 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 are met. To meet the EBITDA thresholds, VLI must have adjusted EBITDA in excess of $2.3 million. Results in excess of the adjusted EBITDA threshold serve as the basis to determine the amount of additional payment.

The Company's preliminary estimate of the Additional Consideration is approximately $2.7 million in cash and approximately 350,000 shares of AI common stock with an estimated value of $2.1 million. The Company is in the process of reviewing and finalizing the calculation of the amount of Additional Consideration.

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.

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 in 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. 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 Thomas of $614,000 at January 31, 2005. The liability for derivative financial instrument is subject to adjustment for changes in fair value at April 30, 2005 for which the Company recorded a $22,000 gain in other income.

The Company's preliminary accounting for the acquisition of VLI and the preliminary 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 $11,339,000, $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 $556,000, $267,000 and $240,000 at April 30, 2005 for PF, NCR and NCA, respectively.

The following unaudited pro forma statement of operations of the Company for the three months ended April 30, 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.

| | Three Months Ended April 30, 2004 |
|---|---|
| Pro Forma Statement of Operations | |
| Net sales | $ 5,386,000 |
| Cost of sales | 4,264,000 |
| Gross profit | 1,122,000 |
| Selling, general and | |

| | |
|---|---|
| administrative expenses | 1,689,000 |
| Loss from operations | (567,000) |
| Other income, net | 10,000 |
| Loss before income tax benefit | (557,000) |
| Income tax benefit | 213,000 |
| Net loss | ($ 344,000) |
| Loss per share | ($ 0.13) |
| Weighted average shares outstanding | 2,628,000 |

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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 ("Share Price"), yielding aggregate proceeds of $999,998 (See Note 2). 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 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 at issuance was accounted for as a liability for a derivative financial instrument. This liability relates to the obligation to issue Investor additional shares under certain conditions. The derivative financial instrument is subject to adjustment for changes in fair value subsequent to issuance. During the three months ended April 30, 2005, the Company recorded a fair value adjustment of a $1,000 gain which is recorded in other income, net.

The Company leases administrative, manufacturing and warehouse facilities from individuals who are officers of SMC and VLI. The total expense under these arrangements was $69,000 and $18,000 for the three months ended April 30, 2005 and 2004, respectively.

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 $24,000 in purchases under the supply agreement during the three months ended April 30, 2005.

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 $149,000 in sales with this entity for three months ended April 30, 2005. At April 30, 2005, the affiliated entity owed $134,000 to VLI, net of an allowance for doubtful accounts of $75,000.

NOTE 6 - DEBT

In August 2003, the Company entered into a financing arrangement with the Bank aggregating $2,950,000 in available financing in two facilities - a revolving line of credit with $1,750,000 in availability, having an initial expiration of July 31, 2004 and bearing interest at LIBOR plus 2.75%, and a three year term note with an original outstanding balance of $1,200,000, expiring July 31, 2006 and bearing interest at LIBOR plus 2.95%.

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In August 2004 and April 2005, the Company agreed to amend the existing financing arrangements with the Bank whereby the revolving line of credit was initially increased to $3.5 million and ultimately to $4.25 million in maximum availability. 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 April 30, 2005, the Company had $500,000 outstanding under the term note and $1,661,000 outstanding under the revolving line of credit.

The financing arrangements amended on April 8, 2005, waives the April 30, 2005 measurement of certain financial covenants including requiring that the ratio of debt to pro forma earnings before interest, taxes, depreciation and amortization (EBITDA) not exceed 2.5 to 1 (with the next test date being July 31, 2005) and requiring pro forma fixed charge coverage ratio not less than 1.25 to 1 (with the next test date being July 31, 2005). 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 also 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. 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 issuance 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 ("Share Price"), 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. (See Note 5) 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 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, at January 31, 2005, $139,000 of the proceeds 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 through July 31, 2005. During the three months ended April 30, 2005, the Company recorded a fair value adjustment of a $1,000 gain which is recorded in other income, net.

NOTE 8 - 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 assessing performance.

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

The Company's operating segments are organized in separate business units with different management, customers, technology and services. The respective segments account for the respective businesses using the accounting policies in Note 3 to the Company's Form 10-KSB and Note 3 in this filing. Summarized financial information concerning the Company's operating segments is shown in the following tables:

| For the Three Months Ended April 30, 2005 | | | | |
|---|---|---|---|---|
| | Nutraceutical Products | Telecom Infrastructure Services | Other | Consolidated |

| | | | Restated | Restated |
|---|---|---|---|---|
| Net sales | $ 4,728,000 | $ 2,428,000 | $ -- | $ 7,156,000 |
| Cost of sales | 3,379,000 | 1,907,000 | -- | 5,286,000 |
| Gross profit | 1,349,000 | 521,000 | -- | 1,870,000 |
| Selling, general and administrative expenses | 1,137,000 | 354,000 | 400,000 | 1,891,000 |
| Income (Loss) from operations | 212,000 | 167,000 | (400,000) | (21,000) |
| Interest expense (income) | 58,000 | 11,000 | (13,000) | 56,000 |
| Other income, net | -- | 2,000 | 25,000 | 27,000 |
| Income (loss) before income taxes | $ 154,000 | $ 158,000 | ($ 362,000) | (50,000) |
| Income tax benefit | | | | 28,000 |
| Net loss | | | | ($ 22,000) |
| Depreciation and amortization | $ 77,000 | $ 98,000 | $ 20,000 | $ 195,000 |
| Amortization of intangibles | $ 399,000 | $ 25,000 | -- | $ 424,000 |
| Goodwill | $ 11,339,000 | $ 940,000 | -- | $ 12,279,000 |
| Total Assets | $ 23,817,000 | $ 5,204,000 | $ 928,000 | $ 29,949,000 |



NOTE 9 - Contingencies

During the twelve months ended January 31, 2005, WFC asserted in writing 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 in connection with the Stock Purchase Agreement.

On March 22, 2005, WFC filed a complaint in Los Angeles Superior Court alleging the Company and its executive officers, individually, committed breach of contract, intentional misrepresentation, concealment and non-disclosure, negligent misrepresentation and false promise. WFC seeks declaratory relief and compensatory and punitive damages in an amount to be proven at trial as well as the recovery of attorney's fees. The Company has reviewed WFC's claim and believes that substantially all of the claims are without merit. The Company will vigorously contest WFC's claim.

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 at April 30, 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.

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 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.

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 the shares issued in the acquisition of VLI, and for an agreement entered into with Kevin Thomas (Thomas) on January 28, 2005 with respect to a debt subordination and related concessions ("Concessions") given to Thomas in connection with consummating the agreement as described below. The Company is also restating inventory and cost of goods sold for the quarter ended April 30, 2005 related to an error in inventory valuation accounting.



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 "Agreement"). The Shares were issued at a purchase price of $7.75 per share, yielding aggregate proceeds of $999,998. The Investor is an entity controlled by Daniel Levinson, a director of the Company. Pursuant to the Agreement, we agreed to issue additional shares of our common stock to Investor in accordance with the Agreement based upon the earlier of (i) our 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 shares previously issued. Any additional shares issued would effectively reduce the Investor's purchase price per common share as set forth in the Agreement. The shares were issued pursuant to an exemption provided by Section 4(2) of the Securities Act. The resale of the shares was registered under the Securities Act on Form S-3 filed with the SEC on February 25, 2005.

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 at issuance was accounted for as a liability for a derivative financial instrument. This liability relates to the obligation to issue Investor additional shares under certain conditions. The derivative financial instrument is subject to adjustment for changes in fair value subsequent to issuance through July 31, 2005. The Company recorded a fair value adjustment for a $1,000 gain and a $343,000 loss at April 30, 2005 and July 31, 2005 respectively, which is also reflected as a change in the liability for the derivative financial instruments. The fair value adjustment was recorded as a change in the Company's other expenses or income and net loss. The liability for derivative financial instruments related to the Investor was settled as a non-cash transaction by the issuance of additional shares of the Company's common stock on August 13, 2005.

On August 31, 2004, Argan acquired VLI for approximately $6.7 million in cash and 825,000 shares of the Company's common stock or $4,950,000 in fair value. The Company also assumed $1.6 million in debt. The value of the shares issued in the acquisition of VLI has been revised to reflect the price per share of $6.00 of the Company's common stock at August 31, 2004 as opposed to $6.22, the quoted market price of the stock two days before and after the acquisition date. The impact of this change was to reduce the amount of goodwill and additional paid-in capital by $182,000. The purchase agreement also provides for contingent consideration based on EBITDA for the twelve months ended February 28, 2005. The additional contingent consideration would be paid in both cash and stock. 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 January 28, 2005 the Company entered into a Letter Agreement with Thomas in consideration for his agreement to delay the timing of the payment of contingent cash consideration and for entering into a Debt Subordination Agreement (Subordination Agreement), reconstituting such additional cash consideration as subordinated debt. The Letter Agreement includes certain concessions to Thomas allowing him to receive additional consideration based on the market price of the Company's common stock. The concessions provide that in addition to providing Thomas additional shares if the Company raised additional shares at a price less than $7.75, if the Company did not issue additional shares at a price less than $7.75 per share then the Company would issue additional shares to Thomas based on the average closing price of the Company's common stock for the 30 days ended July 31, 2005, if the price were below $7.75 per share. These concessions allowing Thomas to receive additional shares under certain conditions represent a freestanding financial instrument and should be accounted for in accordance with EITF 00-19. The Company has recorded the freestanding financial instrument as a liability for the fair value of $1,115,000 ascribed to the obligations of the Company to issue Thomas additional shares.

$501,000 of the charge related to the liability for derivative financial instrument is recorded as deferred issuance cost for subordinated debt which will be amortized over the life of the subordinated debt and $614,000 of the charge is recorded as compensation expense due to Thomas. The amortization of the deferred loan issuance cost will increase the Company's future interest expense through August 1, 2006, the maturity date of the note, and reduce net income. The charge for compensation to Thomas was classified as non-cash compensation expense and increased net loss by $614,000 for the year January 31, 2005. The derivative financial instrument is subject to adjustment for changes in fair value subsequent to issuance through the July 31, 2005. The fair value adjustment will be recorded as a change in liability for the derivative financial instrument and as a charge to the Company's other expenses and net income. The liability for the derivative financial instrument was settled as a non-cash transaction by the issuance of additional shares of the Company's common stock on September 1, 2005.

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.

RECENT EVENTS

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 ("Share Price"), 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 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.

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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

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

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.

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.

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 in a debt subordination agreement, reconstituting such additional cash consideration as subordinated debt. Pursuant to the Letter Agreement, the Company has agreed to issue additional shares of our common stock to Thomas under certain conditions upon the earlier of (i) the 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 at a price less than $7.75 per share then the Company would issue additional shares to Thomas based on the average closing price of the Company's common stock for the thirty days ended July 31, 2005, if the price were below $7.75 per share.

The Concessions given to Thomas pursuant to the Letter Agreement are being accounted for as liability for derivative financial instrument under EITF 00-19. 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 of $614,000 at January 31, 2005. The liability for derivative financial instrument is subject to adjustment for changes in fair value at April 30, 2005 for which the Company recorded a $22,000 gain in other income and $1,609,000 in other expense at settlement on July 31, 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 waives the January 31, 2005 and April 30, 2005 measurement of certain financial covenants including requiring the ratio of debt to pro forma earnings before interest, taxes, depreciation and amortization (EBITDA) not to exceed 2.5 to 1 (with the next test date being July 31, 2005) and requiring pro forma fixed charge coverage ratio not less than 1.25 to 1 (with the next test date being July 31, 2005). Bank consent continues to be required for acquisitions and divestitures. The Company continues to pledge the majority of the Company's assets to secure the financing arrangements. The 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. 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 issuance amortization.

Western Filter Corporation Litigation

On October 31, 2003, we 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 resulting from a breach of the representations and warranties made by us in connection with that sale. 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.

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

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We are a holding company with no operations other than our investments in VLI and SMC. At April 30, 2005, there were no restrictions with respect to dividends or other payments from VLI and SMC to the Company.

NUTRITIONAL PRODUCTS

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

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

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

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

TELECOM INFRASTRUCTURE SERVICES

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

We continue to participate in the expansion of the telecommunications industry by working with various telecommunications providers. We 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 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. 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.

The timing of billing to customers varies based on individual contracts and often differs from the period of revenue recognition. Estimated earnings in excess of billings and billings in excess of estimated earnings totaled $365,000 and $6,000, respectively, at April 30, 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.

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.

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 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 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 $30,000 for the three months ended April 30, 2005. Costs associated with shipping goods to customers which aggregate $51,000 is accounted for as part of selling expenses for the three months ended April 30, 2005.

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 April 30, 2005, we have cumulatively recorded a net operating loss carry forward aggregating $266,000 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.

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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 contains provisions for 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 are met. To meet the EBITDA thresholds, VLI must have adjusted EBITDA in excess of $2.3 million. Results in excess of the adjusted EBITDA threshold serve as the basis to determine the amount of additional payment.

The Company's preliminary estimate of the Additional Consideration is approximately $2.7 million in cash and approximately 350,000 shares of AI common stock with an estimated value of $2.1 million. The Company is in the process of reviewing and finalizing the calculation of the amount of Additional Consideration.

On January 31, 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.

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 in a debt subordination agreement, reconstituting such additional cash consideration as subordinated debt. Pursuant to the Letter Agreement dated January 28, 2005, the Company has agreed to issue additional shares of our common stock to Thomas based upon the earlier of (i) the 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) 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. 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 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. The liability for derivative financial instrument is subject to adjustment for changes in fair value at April 30, 2005 for which the Company recorded a $22,000 gain as other income, net.

The Company's preliminary accounting for the acquisition of VLI and the preliminary 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 $11,339,000, $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 $556,000, $267,000 and $240,000 at April 30, 2005 for PF, NCR and NCA, respectively.

Results of Operations for the Three Months Ended April 30, 2005 Compared to the Pro Forma Results of Operations for the Three Months ended April 30, 2004



The following summarizes the results of our operations for the three months ended April 30, 2005 compared to the pro forma results for the three months ended April 30, 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 results in the statements of operations.

| | Three Months Ended April 30, | |
|---|---|---|
| Statements of Operations | 2005 Restated | 2004 (Pro Forma) |
| Net sales | $ 7,156,000 | $ 5,386,000 |
| Cost of sales | 5,286,000 | 4,264,000 |
| Gross profit | 1,870,000 | 1,122,000 |
| Selling general and administrative expenses | 1,891,000 | 1,689,000 |
| Loss from operations | (21,000) | (567,000) |
| Other (expense) income, net | (29,000) | 10,000 |
| Loss from operations before income taxes | (50,000) | (557,000) |
| Income tax benefit | (28,000) | (213,000) |

| | | |
|---|---|---|
| Net loss | ($ 22,000) | ($ 344,000) |

Net sales

Net sales were $7,156,000 for the three months ended April 30, 2005 compared to pro forma net sales of $5,386,000 for the three months ended April 30, 2004. The increase of $1,770,000 or 33% is due primarily to an increase of $1,149,000 in sales volume at VLI. Sales increased to VLI's largest customer as well as substantial sales to a new customer provided most of the sales increase. In addition, SMC experienced an increase of $504,000 in sales volume from infrastructure services provided to SMC's customers under fixed-priced contracts.

Cost of sales

For the three months ended April 30, 2005, cost of sales was $5,286,000 or 74% of net sales compared to $4,264,000 or 79% of pro forma net sales for the three months ended April 30, 2004. Decreased costs as a percent of net sales is due to efficiencies experienced as SMC's volume and number of fixed-priced contracts increased during the three months ended April 30, 2005. In addition, VLI had a decrease in cost of sales as a percentage of net sales due to increased pricing which it passed onto its customer base.

Selling general and administrative expenses

Selling, general and administrative expenses were $1,891,000 or 26% of net sales for the three months ended April 30, 2005 compared to $1,689,000 or 31% of pro forma net sales for the three months ended April 30, 2004, an increase of $202,000. SMC reduced its selling, general and administrative expenses by $76,000 due to the streamlining its support staff. In addition, corporate expenses as a percentage of net sales decreased from 20% to 6% due to corporate costs increasing at a slower rate than the overall growth of net sales.

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Other expense, net

We had other expense, net of $29,000 for the three months ended April 30, 2005 compared to pro forma other income, net of $10,000 for the three months ended April 30, 2004. The Company experienced interest expense due to the funding of VLI's increased inventory to support increased net sales which was offset, in part, by the fair value adjustment gain of $23,000 for the liability for financial instruments.

Income tax (benefit) provision

The Company's effective income tax benefit rate was 56% for the three months ended April 30, 2005 compared to a 38% pro forma income tax benefit rate for the three months ended April 30, 2004.

The Company's effective income tax benefit rate was increased by the impact of the fair value adjustment for liability for derivative financial instruments which is a permanent difference for income tax reporting purposes.

LIQUIDITY AND CAPITAL RESOURCES

Cash Position and Indebtedness

We had $1.7 million in working capital at April 30, 2005, including $107,000 of cash and cash equivalents. In addition we had $2.0 million available under credit facilities.

Working capital increased by $200,000 to $1.7 million at April 30, 2005 from $1.5 million at January 31, 2005. This increase was primarily due to the strong operating performances of VLI and SMC. The Company had loss before taxes of $50,000. The Company's non-cash expenses included in the determination of income before income taxes included $424,000 for amortization of purchase intangibles and $195,000 for depreciation and other amortization.

Cash Flows

Net cash provided by operations for the three months ended April 30, 2005 was $280,000 compared with $394,000 of cash used in operations for the three months ended April 30, 2004.

During the three months ended April 30, 2005, the Bank released $304,000 in escrows to us (see discussion below). Net cash used for investing activities was $118,000 and $2,522,000 for the three months ended April 30, 2005 and 2004, respectively. During the three months ended April 30, 2005, we had cash of $118,000 used in the purchase of property and equipment. During the three months ended April 30, 2004, we had cash of $2,500,000 used in the net purchase of investments and cash used in purchase of property and equipment of $22,000.

Net cash used by financing activities was $222,000 and $123,000 for the three months ended April 30, 2005 and 2004, respectively. During the three months ended April 30, 2005, we used cash of $232,000 to pay down term-debt.

In August 2003, we entered into a financing arrangement with the Bank aggregating $2,950,000 in available financing in two facilities - a revolving line of credit with $1,750,000 in availability, expiring July 31, 2004 and bearing interest at LIBOR plus 2.75%, and a three year term note with an original outstanding balance of $1,200,000, expiring July 31, 2006 and bearing interest at LIBOR plus 2.95%.

In August 2004 and April 2005, we agreed to amend the existing financing arrangements with the Bank whereby the revolving line of credit was initially increased to $3.5 million and ultimately to $4.25 million in maximum availability. 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 April 30, 2005, the Company had $1,661,000 outstanding under the revolving line of credit and additional availability of $2.0 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.

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The amended financing arrangements waives the April 30, 2005 measurement of certain financial covenants including requiring the ratio of debt to pro forma earnings before interest, taxes, depreciation and amortization (EBITDA) not to exceed 2.5 to 1 (with the next test date being July 31, 2005) and requiring pro forma fixed charge coverage ratio not less than 1.25 to 1 (with the next test date being July 31, 2005). Bank consent continues to be required for acquisitions and divestitures. The Company continues to pledge the majority of

the Company's assets to secure the financing arrangements. The 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. 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 issuance amortization.

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

Customers

During the three months ended April 30, 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 23%, 14% and 6% of consolidated net sales during the three months ended April 30, 2005. SMECO and GD accounted for approximately 12% and 9% of consolidated net sales during the three months ended April 30, 2005. Combined TVC, RRC, SMECO, GD, and C accounted for approximately 64% of consolidated net sales during the three months ended April 30, 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.

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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 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 standards and is continuing its analysis of the impact.

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 related to inventory valuation 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, the Company will begin to receive sub certifications from their division level executives. 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 process of the Company's subsidiaries financial information. As part of this comprehensive review, the Company has enhanced their review of cost and gross margin to detect errors associated with inventory valuation.



PART ll

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

During the twelve months ended January 31, 2005, Western Filter Corporation

(WFC) notified the Company in writing that WFC believes that the Company breached certain representations and warranties under the Stock Purchase Agreement in connection with the sale of Puroflow Incorporated to WFC. WFC asserts damages in excess of the $300,000 escrow which is being held by a third party in connection with the Stock Purchase Agreement.

The Company has reviewed WFC's claim and believes that substantially all of the claims are without merit. The Company will vigorously contest WFC's claim.

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

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 April 30, 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.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

a) Exhibits:

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

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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 2, 2005 By: /s/ Rainer Bosselmann
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Rainer Bosselmann
Chairman of the Board and
Chief Executive Officer

December 2, 2005 By: /s/ Arthur F. Trudel
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Arthur F. Trudel
Chief Financial Officer

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