Siena Market Line
3rd week of March 2016

Argan, Inc. (AGX)

AGX

Analyst: Kyle Ritchie

BUY on AGX

Price Target: $47.13

Key Statistics as of 3/9/16

Market Price:	$31.96
Industry:	Industrials
Market Cap:	$474 M
52-Week Range:	$28.03 - $42.50
5 Year Beta:	1.01
Dividend Yield:	2.19%

Thesis Points:

- Historical and Current ROIC/WACC ratio Demonstrates Value Creation
- Proven Ability to Efficiently Manage Operating Costs
- Stable Capital Structure

Company Description

Argan, Inc., through its subsidiaries, provides a range of development, consulting, engineering, procurement, construction, commissioning, operations, and maintenance services to the power generation and renewable energy markets. The company operates through Power Industry Services and Telecommunications Infrastructure Services segment. The Power Industry Services segment serves public utilities, independent power project owners, municipalities, public institutions, and private industry. The Telecommunications Infrastructure Services segment serves the federal government, local governments, telecommunications, and broadband service providers, as well as electric utilities primarily in the mid-Atlantic region. Argan, Inc. was founded in 1961 and is headquartered in Rockville, Maryland.

Thesis

Argan, Inc. conducts its operations through its wholly-owned subsidiaries, Gemma Power Systems (GPS), LLC and affiliates, and Southern Maryland Cable (SMC), Inc. Through a construction joint-venture formed during 2014, the company is currently manufacturing two natural gas-fired power plants in the Marcellus Shale region (northeast Pennsylvania). Over the past three years, the company successfully completed the construction of six significant energy projects located near Desert Hot Springs, California. The company also completed a biomass-fired project, prior to its planned completion date, for East Texas Electric Cooperative, Inc. for a power plant fueled by chipped-timber located near Woodville, Texas. This company has proven its ability to efficiently, timely and properly manufacture energy plants that are essential to the regions they serve. The company continues to receive business increasing its backlog as it operates solely in the U.S while. Historically, the company has been able to manage operating costs significantly below its competitors. Furthermore, the company has managed to do so without incurring any debt over the past five years. It is evident through a DCF valuation with a focus on ROIC that Argan has flown under the radar in the market and is currently undervalued.

Industry Outlook

The second half of 2015 was a difficult year for companies on almost every front. The uncertainty in the price of crude oil played a major role in this volatile market which has carried over into the beginning of 2016. The price chart on the previous page reflects AGX stock price over the past year. In comparison with the green line which represents the S&P 500, it is clear that like most other stocks, AGX has reacted to market volatility almost identically.

The Industrial Production Index (IPI) is an economic indicator published by the Federal Reserve Board of the United States. From 1920 until 2016, Industrial Production in the US averaged 3.83% beating the average GDP from 1947-2016 which stands at 3.24%.

The preceding chart represents the percent change in the IPI on a monthly basis in comparison to the respective month of the previous year. It is the third consecutive fall. Economists forecast this negative trend to continue in the short-term as follows:

Calendar	GMT	Reference	Actual	Previous	Consensus	Forecast
12/16/2015	2:15 PM	Nov	-1.20%	0.30%		0.30%
1/15/2016	2:15 PM	Dec	-1.80%	-1.20%		-1.40%
2/17/2016	2:15 PM	Jan	-0.70%	-1.80%		-0.60%
3/16/2016	1:15 PM	Feb		-0.70%		-0.70%
4/15/2016	1:15 PM	Mar				-0.58%
5/17/2016	1:15 PM	Apr				-0.36%

In regards to Argan specifically, industry and revenue growth drivers include the reduction in heavy carbon emitting power plants. Standards under the Clean Power Plan will shift the construction of power plants from coal-fired generators to natural gas, renewable energy, and power-generation facilities.

Business Model/Management

Argan has a simple business model. The company generates its revenue through its wholly-owned subsidiaries: Gemma Power Systems (GPS), Southern Maryland Cable, Inc. (SMC), Atlantic Projects Company, Ltd. (APC) and its most recently acquired, The Roberts Company (Roberts). GPS provides engineering, procurement and construction services to power generation and renewable energy markets. SMC provides telecommunications data infrastructure services. APC was acquired last year in May and provides turbine, boiler, large rotating equipment installation, and commissioning along with outage services to the global power industry. Roberts was acquired in December of 2015 and is principally an industrial fabricator and constructor serving both light and heavy industrial organizations. The company manages its subsidiaries and utilizes their collective resources to complete industrial projects.

Argan's management team is that of an experienced one. Chief Executive Officer and chairman Rainer H Bosselmann has been with Argan since 2003. An analysis of his total return (TRA) since inception is 14.33% compared to a relative 6.38% in the sector. Prior to joining Argan the stock was valued at $7.75, and since he has been appointed to CEO the stock has increased to $31.63. The Vice Chairman and CEO of GPS is William F. Griffin Jr. Lastly, the Chief Financial Officer is David Watson.

An interesting feature of the upper management team for Argan is how they are compensated. As stated in the Proxy Statement, document 14A filed on May 8, 2015; "It has been our practice to not set specific individual goals for any of the executives at the start of each year. Instead, the CEO and Compensation Committee review the overall performance of the company." This is a very appealing feature for investors. What this translates to is management does not have to aim for specific margins or sheer revenue growth out of self-interest. The management team works together to create shareholder value and has no particular target when valuing the company itself. Internal and organic growth is just as important as inorganic growth for this company.

The elements of compensation for management include the following: a base salary, an annual cash bonus awards, and stock options. Year over year salaries have increased and bonuses have been distributed demonstrating an effective management team.

Cross-Sectional Analysis

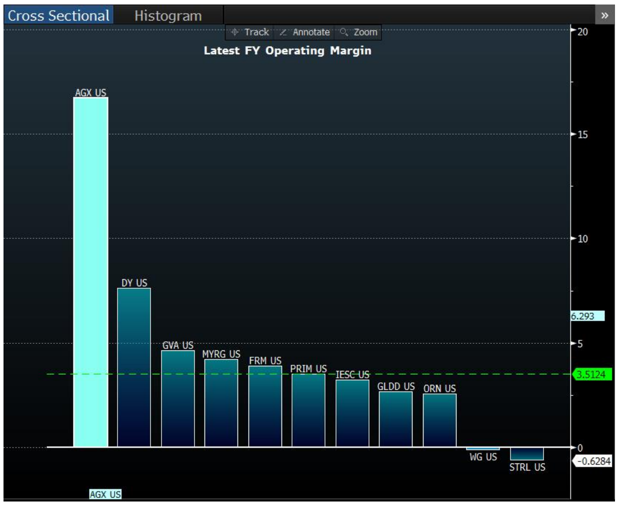
This section includes a cross-sectional analysis of Argan. Management has suggested the following publicly traded companies as most comparable in regards to the industry and market capitalization: Dycom Industries, Furmanite Corp, Granite Construction, Great Lakes Dredge & Dock Corp, Integrated Electrical Services Corp, MYR Group Inc., Primoris Services Corp., Orion Marine Group, Inc., Sterling Construction Company, Inc., and Willbros Group, Inc.

Figures in the analysis have been taken from the latest year, will show a median green line and AGX will appear as the lighter blue bar graph.

First off, the gross profit margin, which can be seen in the next column above.

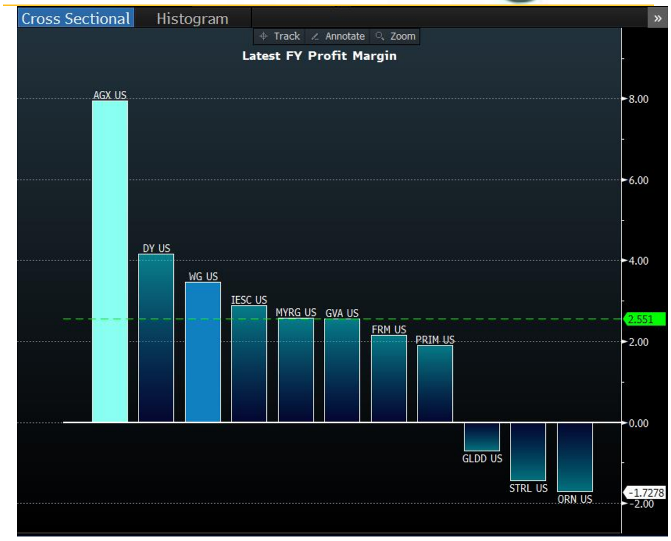
As you can see from the preceding graph, Argan has a gross profit margin of 21.8% while the median among its peers falls at 11.5%.

The next margin to be analyzed is the operating margin.



Argan's percentage of earnings before interest and taxes is over 16% while the median of its peers is 3.5%.

The graph on the following page compares the profit margin of Argan in comparison to the aforementioned peers. Argan's profit margin in the latest year was 7.95% while the median of its peers was 2.55%.



ROIC/WACC – Value Creation

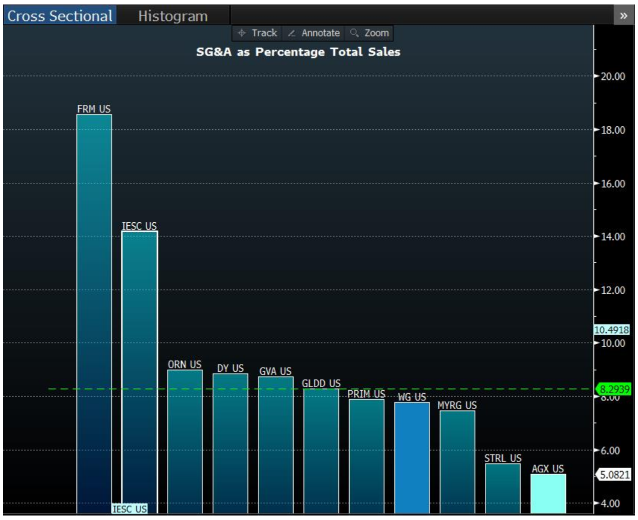
An important indicator of how effective a company's capital expenditures truly are is the ROIC/WACC ratio. This ratio demonstrates value creation. When a company is returning a higher yield on newly invested capital in comparison to its weighted average cost of capital – the company is creating shareholder value. As you can see from the chart below, Argan has strategically chosen projects that are profitable.

ROIC	13.2%	13.2%	23.4%	58.4%	32.9%
WACC	5.6%	5.6%	6.5%	7.3%	8.6%
ROIC/WACC	2.35	2.35	3.62	8.04	3.81

The company invests in the necessary components, and through its subsidiaries, delivers quality and efficient renewable-energy power plants to its customers. Adjusting for variable accounting factors such as goodwill impairment, the five-year average ROIC/WACC ratio is 4.03. This figure may appear relatively high but the amount of revenue Argan generates through construction contracts justifies this rate of return.

Efficiently Managed Op. Costs

The graph demonstrates why Argan has managed to earn these higher margins. The chart below compares the company's SG&A expense as a percentage of sales. Argan's SG&A expense as a percentage of net sales is 5.08% while the median of its peers is above 8%. Given the fact that the cost of goods in the industrial sector is the highest operating expense, Argan has managed to significantly decrease all other operating expenses to improve profitability to shareholders.



Furthermore, through diversified acquisitions of essential business components, Argan has established favorable relationships with its suppliers. Coupled with their diversified subsidiaries, Argan's ability to decrease other operating expenses proves the value being created for the company.

Stable Capital Structure

A key component to the long-term success of this company is its stable capital structure. Over the past five years, Argan has not needed to incur any debt, short or long-term, to finance its business operations. This is very appealing to investors who understand the importance of a strong balance sheet. Operating in an industry that is so capital intensive makes it crucial to not incur debt that a company cannot manage.
In regards to the previously named peers, the median D/E of these companies is .48 while Argan's is 0.
Furthermore, Argan has had a growing cash balance since 2011 suggesting and proving its capability to acquire more companies. The table below shows Argan's cash balance for the last five years in millions.

Cash/Near Cash/Short-Term Investments	2010	2011	2012	2013	2014	2015
	66.2	83.3	156.5	175.1	272.2	333.7

Valuation

The valuation of AGX is based on a discounted cash flow model with a focus on return on invested capital. Attached below are the inputs and assumptions that have been used in the forecast along with a Monte Carlo simulator to demonstrate which inputs are most sensitive in the valuation.

When valuing AGX a conservative approach has been applied. Since AGX operates solely in the US, a 40% tax rate as well as 6% risk premium has been applied. However, since AGX is a small-cap company, an additional premium has been added amounting to 8.36%.

A 3% risk-free rate as well as a 3% long-term growth rate has been used. A ten-year period of convergence has been used to forecast the time until the continuing period.

Using the aforementioned assumptions, the model has computed an intrinsic value of $41.49 with a 1-year target of $47.13.

The two analysts covering AGX have a median target of $47.50.

Conclusion

In conclusion, it is clear that AGX is certainly undervalued. Given the current market volatility, AGX is a safe investment as its five-year unlevered beta is .56 while its current unlevered beta is 1.01. The company has no debt, a large cash balance, and analysts are forecasting 2016 revenue growth to be 56%. While this figure has not been used in the valuation, it is clear that expectations for this company are high. The macro-economic analysis as well as the internal financial analysis of AGX points to only direction, BUY.

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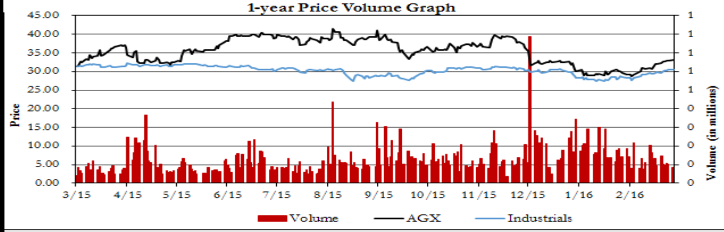
CENTER FOR GLOBAL FINANCIAL STUDIES

Argan, Inc. (AGX) | **BULLISH**

Analysis by Kyle Ritchie	Current Price:	$31.63	Intrinsic Value	$41.49	Target 1 year Return: 49.02%
3/10/2016	Divident Yield:	0.0%	Target Price	$47.13	Probability of Price Increase: 98.59%



Description

Argan, Inc., through its subsidiaries, provides a range of development, consulting, engineering, procurement, construction, commissioning, operations, and maintenance services to the power generation and renewable energy markets.

General Information

Sector	Industrials
Industry	Construction and Engineering
Last Guidance	November 3, 2015
Next earnings date	April 7, 2016
Estimated Country Risk Premium	8.48%
Effective Tax rate	40%
Effective Operating Tax rate	39%

Market Data

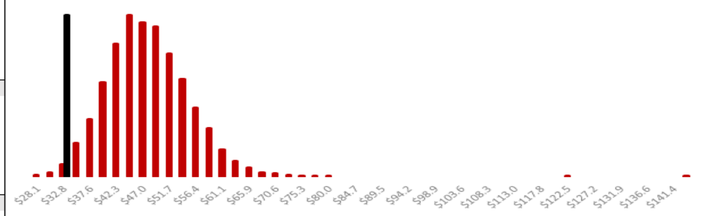
Market Capitalization	$468.96
Daily volume (mil)	0.06
Shares outstanding (mil)	14.83
Diluted shares outstanding (mil)	15.01
% shares held by institutions	80%
% shares held by investments Managers	67%
% shares held by hedge funds	11%
% shares held by insiders	8.27%
Short interest	3.00%
Days to cover short interest	2.63
52 week high	$42.50
52-week low	$28.03
Levered Beta	1.06
Volatility	38.05%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
10/31/2014	20.42%	64.77%
1/31/2015	5.34%	20.08%
4/30/2015	-3.41%	48.79%
7/31/2015	-2.58%	85.05%
10/31/2015	8.66%	11.72%
Mean	5.69%	46.08%
Standard error	4.3%	13.7%

Peers

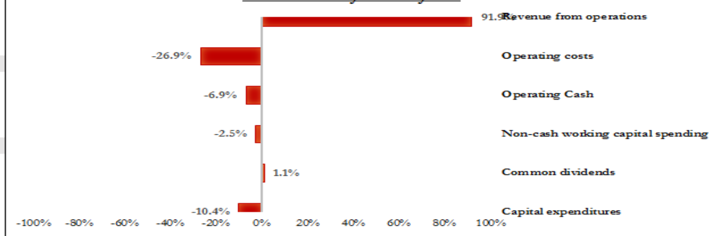
Target Price Distribution--Prob(Price Increase)= 99%



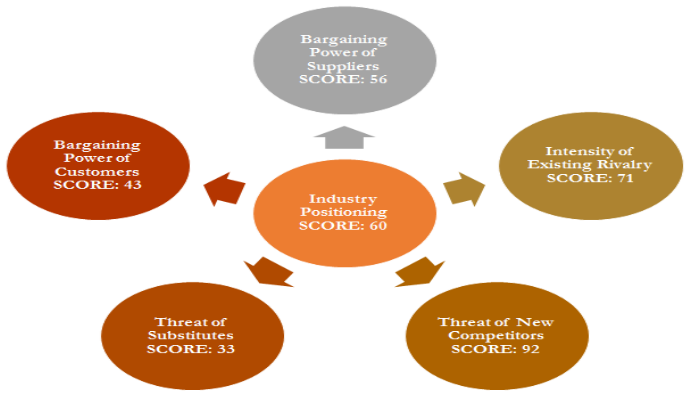
Management	Position	Total compensations growth	Total return to shareholders
Bosselmann, Rainer	Chairman, Chief Executive Of	6.58% per annum over 6y	-5.08% per annum over 6y
Griffin, William	Director, Vice Chairman of G	13.65% per annum over 6y	-5.08% per annum over 6y
Martin, Daniel	President of Gemma Power Sys	0.19% per annum over 5y	12.06% per annum over 5y
Trudel, Arthur	Senior Advisor to Chairman &	4.65% per annum over 6y	-5.08% per annum over 6y
Watson, David	Chief Financial Officer and	N/M	N/M
Deily, Richard	Vice President	N/M	N/M

Profitability	AGX (LTM)	AGX (5 years historical average)	Industry (LTM)
ROIC	26.5%	28.24%	8.24%
NOPAT Margin	15%	11.51%	2.7%
Revenue/Invested Capital	1.83	2.45	3.06
ROE	26.0%	19.38%	9.09%
Adjusted net margin	14%	11.35%	2.6%
Revenue/Adjusted Book Value	1.80	1.71	3.53
Invested Funds	**AGX (LTM)**	**AGX (5 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	74.3%	104.3%	22%
Estimated Operating Cash/Total Capital	25.2%	69.8%	N/A
Non-cash working Capital/Total Capital	-25.2%	-50.0%	16%
Invested Capital/Total Capital	51.5%	64.8%	74%
Capital Structure	**AGX (LTM)**	**AGX (5 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.24	0.17	0.14
Cost of Existing Debt	1.96%	1.42%	3.29%
Estimated Cost of new Borrowing	1.38%	1.38%	3.29%
CGFS Risk Rating	1.96%	AAA	BBB
Unlevered Beta (LTM)	0.00%	0.56	1.17
WACC	1.96%	6.73%	12.33%

Sensitivity Analysis



Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	17.3%	14.5%	2.36
10/31/2016	27.5%	13.9%	3.38
10/31/2017	25.1%	14.0%	3.72
10/31/2018	22.6%	14.0%	3.53
10/31/2019	20.2%	14.0%	3.37
10/31/2020	17.7%	14.0%	3.24
10/31/2021	15.3%	14.0%	3.11
10/31/2022	12.8%	14.0%	2.99
10/31/2023	10.4%	13.9%	1.11
10/31/2024	7.9%	13.9%	1.05
10/31/2025	5.5%	13.9%	1.00
Continuing Period	3.0%	13.9%	0.94

Period	Invested Capital	Net Claims	Price per share
Base Year	$79.55	-$41.50	$39.73
10/31/2016	$117.70	-$109.53	$45.27
10/31/2017	$74.28	-$159.30	$50.97
10/31/2018	$151.12	-$221.16	$56.93
10/31/2019	$218.63	-$297.36	$63.06
10/31/2020	$194.76	-$390.12	$69.27
10/31/2021	$221.04	-$501.41	$75.43
10/31/2022	$284.08	$451.71	$81.36
10/31/2023	$354.70	$429.56	$96.09
10/31/2024	$432.29	$379.15	$111.90
10/31/2025	$515.60	$286.58	$129.12
Continuing Period			