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

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**FORM 10-Q**

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Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended October 31, 2019

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from      to  
Commission File number 1-8777

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**VIRCO MFG. CORPORATION**

(Exact Name of Registrant as Specified in its Charter)

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Delaware

(State or Other Jurisdiction of  
Incorporation or Organization)

95-1613718

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

2027 Harpers Way, Torrance, CA

(Address of Principal Executive Offices)

90501

(Zip Code)

Registrant's Telephone Number, Including Area Code: (310) 533-0474

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

<u>Title of each class</u>	<u>Trading Symbol</u>	<u>Name of each exchange on which registered</u>
<u>Common Stock, \$0.01 par value per share</u>	<u>VIRC</u>	<u>The Nasdaq Stock Market LLC</u>

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.:

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares outstanding for each of the registrant's classes of common stock, as of the latest practicable date:  
Common Stock, \$.01 par value — 15,713,549 shares as of December 12, 2019.

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**PART I. Financial Information**

**Item 1. Financial Statements**

**Virco Mfg. Corporation**

**Unaudited Condensed Consolidated Balance Sheets**

	<b>10/31/2019</b>	<b>1/31/2019</b>	<b>10/31/2018</b>
	<b>(In thousands)</b>		
<b>Assets</b>			
<b>Current assets</b>			
Cash	\$ 697	\$ 738	\$ 2,481
Trade accounts receivables, net	17,697	13,253	24,281
Other receivables	54	40	340
Income tax receivable	314	175	157
Inventories	42,907	47,289	42,670
Prepaid expenses and other current assets	1,601	1,616	1,547
<b>Total current assets</b>	<b>63,270</b>	<b>63,111</b>	<b>71,476</b>
<b>Non-current assets</b>			
<b>Property, plant and equipment</b>			
Land	3,731	3,731	3,731
Land improvements	694	688	688
Buildings and building improvements	51,200	51,176	51,176
Machinery and equipment	110,104	108,253	106,896
Leasehold improvements	978	830	828
<b>Total property, plant and equipment</b>	<b>166,707</b>	<b>164,678</b>	<b>163,319</b>
Less accumulated depreciation and amortization	126,684	122,758	121,254
<b>Net property, plant and equipment</b>	<b>40,023</b>	<b>41,920</b>	<b>42,065</b>
Operating lease right-of-use assets	22,251	—	—
Deferred tax assets, net	6,087	9,598	8,422
Other assets, net	8,234	8,484	8,563
<b>Total assets</b>	<b>\$ 139,865</b>	<b>\$ 123,113</b>	<b>\$ 130,526</b>

*See accompanying notes to unaudited condensed consolidated financial statements.*

**Virco Mfg. Corporation**  
**Unaudited Condensed Consolidated Balance Sheets**

	<u>10/31/2019</u>	<u>1/31/2019</u>	<u>10/31/2018</u>
	(In thousands, except share and par value data)		
<b>Liabilities</b>			
<b>Current liabilities</b>			
Accounts payable	\$ 10,914	\$ 17,760	\$ 18,052
Accrued compensation and employee benefits	6,124	4,568	5,432
Current portion of long-term debt	872	5,504	6,232
Current portion operating lease liability	3,506	—	—
Other accrued liabilities	3,976	4,293	4,645
Total current liabilities	<u>25,392</u>	<u>32,125</u>	<u>34,361</u>
<b>Non-current liabilities</b>			
Accrued self-insurance retention	1,617	1,190	1,952
Accrued pension expenses	13,426	14,487	14,530
Income tax payable	59	45	42
Long-term debt, less current portion	13,485	15,910	13,980
Operating lease liability, less current portion	20,778	—	—
Other long-term liabilities	559	2,329	2,377
Total non-current liabilities	<u>49,924</u>	<u>33,961</u>	<u>32,881</u>
<b>Commitments and contingencies (Notes 6, 7 and 14)</b>			
<b>Stockholders' equity</b>			
<b>Preferred stock:</b>			
Authorized 3,000,000 shares, \$0.01 par value; none issued or outstanding	—	—	—
<b>Common stock:</b>			
Authorized 25,000,000 shares, \$0.01 par value; issued and outstanding 15,713,549 shares at 10/31/2019 and 15,541,956 at 1/31/2019 and 10/31/2018	157	155	155
Additional paid-in capital	118,544	118,106	117,871
Accumulated deficit	(45,500)	(52,192)	(45,510)
Accumulated other comprehensive loss	(8,652)	(9,042)	(9,232)
Total stockholders' equity	<u>64,549</u>	<u>57,027</u>	<u>63,284</u>
Total liabilities and stockholders' equity	<u>\$ 139,865</u>	<u>\$ 123,113</u>	<u>\$ 130,526</u>

See accompanying notes to unaudited condensed consolidated financial statements.

**Virco Mfg. Corporation**

**Unaudited Condensed Consolidated Statements of Income**

	<b>Three months ended</b>	
	<b>10/31/2019</b>	<b>10/31/2018</b>
	(In thousands, except per share data)	
Net sales	\$ 66,998	\$ 76,809
Costs of goods sold	40,153	50,379
Gross profit	26,845	26,430
Selling, general and administrative expenses	20,476	21,469
Loss (gain) on sale of property, plant & equipment	—	—
Operating Income	6,369	4,961
Pension expense	188	296
Interest expense	603	630
Income before income taxes	5,578	4,035
Income tax expense	1,686	1,103
Net income	\$ 3,892	\$ 2,932
Net income per common share:		
Basic	\$ 0.25	\$ 0.19
Diluted	0.25	0.19
Weighted average shares of common stock outstanding:		
Basic	15,654	15,486
Diluted	15,710	15,582

*See accompanying notes to unaudited condensed consolidated financial statements.*

**Virco Mfg. Corporation**

**Unaudited Condensed Consolidated Statements of Income**

	<b>Nine months ended</b>	
	<b>10/31/2019</b>	<b>10/31/2018</b>
	(In thousands, except per share data)	
Net sales	\$ 164,250	\$ 174,180
Costs of goods sold	99,582	112,933
Gross profit	64,668	61,247
Selling, general and administrative expenses	51,714	51,900
Loss (gain) on sale of property, plant & equipment	3	(1)
Operating income	12,951	9,348
Pension expense	564	856
Interest expense, net	2,210	1,898
Income before income taxes	10,177	6,594
Income tax expense	3,485	1,759
Net Income	\$ 6,692	\$ 4,835
Net income per common share:		
Basic	\$ 0.43	\$ 0.31
Diluted	0.43	0.31
Weighted average shares outstanding:		
Basic	15,568	15,399
Diluted	15,621	15,491

*See accompanying notes to unaudited condensed consolidated financial statements.*

**Virco Mfg. Corporation**  
**Unaudited Condensed Consolidated Statements of Comprehensive Income**

	<b>Three months ended</b>	
	<b>10/31/2019</b>	<b>10/31/2018</b>
	(In thousands)	
Net income	\$ 3,892	\$ 2,932
Other comprehensive income:		
Pension adjustments (net of tax of \$45 and \$487 at October 31, 2019 and 2018, respectively)	130	1,376
Net comprehensive income	\$ 4,022	\$ 4,308

*See accompanying notes to unaudited condensed consolidated financial statements.*



**Virco Mfg. Corporation**  
**Unaudited Condensed Consolidated Statements of Comprehensive Income**

	<b>Nine months ended</b>	
	<b>10/31/2019</b>	<b>10/31/2018</b>
	(In thousands)	
Net income	\$ 6,692	\$ 4,835
Other comprehensive income :		
Pension adjustments (net of tax of \$137 and \$10 at October 31, 2019 and 2018, respectively)	390	27
Net comprehensive income	\$ 7,082	\$ 4,862

*See accompanying notes to unaudited condensed consolidated financial statements.*

**Virco Mfg. Corporation**

**Unaudited Condensed Consolidated Statements of Cash Flows**

	Nine months ended	
	10/31/2019	10/31/2018
	(In thousands)	
<b>Operating activities</b>		
Net income	\$ 6,692	\$ 4,835
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation and amortization	4,350	4,288
Non-cash lease expense	258	—
Provision for doubtful accounts	60	60
Loss (gain) on sale of property, plant and equipment	3	(1)
Deferred income taxes	3,511	1,671
Stock-based compensation	686	673
Defined pension plan settlement	—	341
Amortization of net actuarial loss for pension plans	528	600
<b>Changes in operating assets and liabilities:</b>		
Trade accounts receivable	(4,504)	(12,956)
Other receivables	(15)	(311)
Inventories	4,382	(613)
Income taxes	(124)	13
Prepaid expenses and other current assets	265	(199)
Accounts payable and accrued liabilities	(5,869)	4,418
Net cash provided by operating activities	10,223	2,819
<b>Investing activities:</b>		
Capital expenditures	(2,963)	(3,319)
Proceeds from sale of property, plant and equipment	—	3
Net cash used in investing activities	(2,963)	(3,316)
<b>Financing activities:</b>		
Borrowing from long-term debt	30,923	51,033
Repayment of long-term debt	(37,980)	(47,503)
Payment on deferred financing costs	—	(124)
Tax withholding payments on share-based compensation	(244)	(265)
Cash dividends paid	—	(697)
Net cash (used in) provided by financing activities	(7,301)	2,444
Net (decrease) increase in cash	(41)	1,947
Cash at beginning of period	738	534
Cash at end of period	\$ 697	\$ 2,481

*See accompanying notes to unaudited condensed consolidated financial statements.*

Virco Mfg. Corporation

Unaudited Consolidated Statements of Changes in Equity and Accumulated Other Comprehensive Income (Loss)

Three-Month Period Ended October 31, 2019

In thousands, except share data	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive income	Total Stockholder's Equity
	Shares	Amount				
Balance at August 1, 2019	15,713,549	\$ 157	\$ 118,282	\$ (49,392)	\$ (8,782)	\$ 60,265
Net income	—	—	—	3,892	—	3,892
Cash dividends	—	—	—	—	—	—
Pension adjustments, net of tax effect of \$45	—	—	—	—	130	130
Shares vested and others	—	—	—	—	—	—
Stock compensation expense	—	—	262	—	—	262
<b>Balance at October 31, 2019</b>	<b>15,713,549</b>	<b>\$ 157</b>	<b>\$ 118,544</b>	<b>\$ (45,500)</b>	<b>\$ (8,652)</b>	<b>\$ 64,549</b>

Three-Month Period Ended October 31, 2018

In thousands, except share data	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive income	Total Stockholder's Equity
	Shares	Amount				
Balance at August 1, 2018	15,541,956	\$ 155	\$ 117,636	\$ (48,208)	\$ (10,608)	\$ 58,975
Net income	—	—	—	2,932	—	2,932
Cash dividends	—	—	—	(234)	—	(234)
Pension adjustments, net of tax effect of \$487	—	—	—	—	1,376	1,376
Shares vested and others	—	—	—	—	—	—
Stock compensation expense	—	—	235	—	—	235
<b>Balance at October 31, 2018</b>	<b>15,541,956</b>	<b>\$ 155</b>	<b>\$ 117,871</b>	<b>\$ (45,510)</b>	<b>\$ (9,232)</b>	<b>\$ 63,284</b>

Nine-Month Period Ended October 31, 2019

In thousands, except share data	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive income	Total Stockholder's Equity
	Shares	Amount				
Balance at February 1, 2019	15,541,956	\$ 155	\$ 118,106	\$ (52,192)	\$ (9,042)	\$ 57,027
Net income	—	—	—	6,692	—	6,692
Cash dividends	—	—	—	—	—	—
Pension adjustments, net of tax effect of \$137	—	—	—	—	390	390
Shares vested and others	171,593	2	(248)	—	—	(246)
Stock compensation expense	—	—	686	—	—	686
<b>Balance at October 31, 2019</b>	<b>15,713,549</b>	<b>\$ 157</b>	<b>\$ 118,544</b>	<b>\$ (45,500)</b>	<b>\$ (8,652)</b>	<b>\$ 64,549</b>

Nine-Month Period Ended October 31, 2018

In thousands, except share data	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive income	Total Stockholder's Equity
	Shares	Amount				
<b>Balance at February 1, 2018</b>	15,357,457	\$ 154	\$ 117,465	\$ (49,648)	\$ (9,259)	\$ 58,712
Net income	—	—	—	4,835	—	4,835
Cash dividends	—	—	—	(697)	—	(697)
Pension adjustments, net of tax effect of \$10	—	—	—	—	27	27
Shares vested and others	184,499	1	(267)	—	—	(266)
Stock compensation expense	—	—	673	—	—	673
<b>Balance at October 31, 2018</b>	<b>15,541,956</b>	<b>\$ 155</b>	<b>\$ 117,871</b>	<b>\$ (45,510)</b>	<b>\$ (9,232)</b>	<b>\$ 63,284</b>

*See accompanying notes to unaudited condensed consolidated financial statements.*

## VIRCO MFG. CORPORATION

### Notes to unaudited Condensed Consolidated Financial Statements

October 31, 2019

#### Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements and are presented in accordance with the requirements of Form 10-Q and Rule 10-01 of Regulation S-X. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2019 ("Form 10-K"). In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the three and nine months ended October 31, 2019, are not necessarily indicative of the results that may be expected for the fiscal year ending January 31, 2020. The balance sheet at January 31, 2019, has been derived from the audited consolidated financial statements at that date, but does not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. All references to the "Company" refer to Virco Mfg. Corporation and its subsidiaries.

#### Note 2. Seasonality

The market for educational furniture is marked by extreme seasonality, with approximately 50% of the Company's total sales typically occurring from June to August each year, the Company's peak season. Hence, the Company typically builds and carries significant amounts of inventory during and in anticipation of this peak summer season to facilitate the rapid delivery requirements of customers in the educational market. This requires a large up-front investment in inventory, labor, storage and related costs as inventory is built in anticipation of peak sales during the summer months. As the capital required for this build-up generally exceeds cash available from operations, the Company has generally relied on third-party bank financing to meet cash flow requirements during the build-up period immediately preceding the peak season. In addition, the Company typically is faced with a large balance of accounts receivable during the peak season. This occurs for two primary reasons. First, accounts receivable balances typically increase during the peak season as shipments of products increase. Second, many customers during this period are educational institutions and government entities, which tend to pay accounts receivable slower than commercial customers.

The Company's working capital requirements during and in anticipation of the peak summer season require management to make estimates and judgments that affect assets, liabilities, revenues and expenses, and related contingent assets and liabilities. On an ongoing basis, management evaluates its estimates, including those related to market demand, labor costs and stocking inventory.

#### Note 3. New Accounting Pronouncements

##### *Recently Adopted Accounting Updates*

The Company adopted Accounting Standards Codification ("ASC") 842 - *Leases*, as of February 1, 2019, using transition relief to the modified retrospective approach. The transition relief to the modified retrospective approach allows the recording of existing leases at adoption and recognizing a cumulative-effect adjustment to the opening balance of retained earnings on the adoption date. As a result, the Company did not restate comparative periods in transition to ASC 842 and instead reported comparative periods under ASC 840 - *Leases*. In addition, the Company elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed the Company to carry forward the historical lease classification. Further, the Company did not elect the practical expedient to use hindsight in determining the lease term and in assessing impairment of right-of-use ("ROU") assets. The Company has elected to account for leases with an original term of 12 months or less that do not contain a purchase option as short-term leases.

Adoption of the new standard resulted in the recording of ROU assets and lease liabilities of approximately \$23.9 million and \$25.6 million respectively, as of February 1, 2019. The difference between the ROU assets and lease liabilities was due to previous deferred rent balances that were removed and offset against the ROU asset under ASC 842. The adoption of this standard did not materially impact our interim unaudited consolidated statement of operations, shareholders' equity or cash flows. See **Note 6** for additional disclosures.

## Leases

The Company determines if an arrangement is a lease at inception. Operating leases in which the Company is the lessee are included in operating lease ROU assets and operating lease liabilities in the interim unaudited condensed consolidated balance sheet. The Company does not have any finance leases, as a lessee, and no long-term leases for which it is the lessor.

ROU assets represent the right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the reasonably certain lease term. As most of the Company's leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. The Company uses the implicit rate when readily determinable. The operating lease ROU asset also includes any lease payments made and reduced by lease incentives, such as tenant improvement allowances. The Company's lease terms include options to extend or terminate the lease only when it is reasonably certain that we will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

The Company has elected the practical expedient to account for non-lease components and the lease components to which they relate, as a single lease component for the following asset classes: (i) Buildings, (ii) Equipment, and (iii) Automobiles.

In June 2018, the FASB issued ASU 2018-07, *Compensation - Stock compensation (Topic 718)* which simplifies several aspects of the accounting for nonemployee share-based payment transactions resulting from expanding the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. Some of the areas for simplification apply only to nonpublic entities. The amendments specify that Topic 718 applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in a grantor's own operations by issuing share-based payment awards. The amendments also clarify that Topic 718 does not apply to share-based payments used to effectively provide (1) financing to the issuer or (2) awards granted in conjunction with selling goods or services to customers as part of a contract accounted for under Topic 606, *Revenue from Contracts with Customers*. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. Early adoption is permitted. The Company adopted this ASU effective February 1, 2019. The adoption of the standard did not materially impact the Condensed Consolidated Statements of Operations, Comprehensive Income or Cash Flows and Statement of Stockholders' Equity and Comprehensive Income (Loss).

### *Recently Issued Accounting Updates*

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. ASU 2016-13 replaces the incurred loss impairment methodology for measuring and recognizing credit losses with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The adoption date, as modified by the recently issued ASU 2019-10 discussed below, will be for the fiscal year ending after December 15, 2022 and interim periods therein. The Company does not believe there will be a material impact to the financial statements as a result of adopting this ASU.

In November 2019, the FASB issued ASU 2019-10, *Financial Instruments-Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*. ASU 2019-10 moves the effective date for certain previously issued amendments to later dates, depending on the filing status of the respective entity. Specifically, due to the amendment and the Company's status as a smaller reporting company, the new effective dates for relevant previously issued amendments not yet adopted by the Company relate to ASU 2016-13 as described above.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820)* which modifies the disclosure requirements of fair value measurements in Topic 820, *Fair Value Measurement*. For public companies the ASU removes disclosure requirements for transfers between Level 1 and Level 2 of the fair value hierarchy, the policy for timing of transfers between levels and the valuation process for Level 3 fair value measurements. The ASU modifies the disclosure requirements for investments in certain entities that calculate net asset value and clarifies that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date. The ASU adds the disclosure requirement for changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. The amendments in this update are effective for all entities for fiscal years beginning after December 15, 2019 including interim periods within that fiscal year. Early adoption is permitted. The Company does not believe there will be a material impact to the financial statements as a result of adopting this ASU.

Other recently issued accounting updates are not expected to have a material impact on the Company's consolidated financial statements.

#### **Note 4. Revenue Recognition**

##### *Adoption of ASC Topic 606, "Revenues from Contracts with Customers"*

On February 1, 2018, the Company adopted ASC Topic 606 with no significant impact to its financial position or results of operations, using the modified retrospective method. Results for reporting periods beginning after February 1, 2018 are presented under ASC Topic 606. The Company had no adjustment to opening retained earnings as of February 1, 2018 as a result of adopting ASC Topic 606. The adoption of the standard did not materially impact the Condensed Consolidated Statements of Operations and Comprehensive Income or Cash Flows.

##### *Revenue Recognition*

The Company manufactures, markets and distributes a wide variety of school and office furniture to wholesalers, distributors, educational institutions and governmental entities. Revenue is recorded for promised goods or services when control is transferred to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services.

The Company's sales generally involve a single performance obligation to deliver goods pursuant to customer purchase orders. Prices for our products are based on published price lists and customer agreements. The Company has determined that the performance obligations are satisfied at a point in time when the Company completes delivery per the customer contract. The majority of sales are free on board ("FOB") destination where the destination is specified per the customer contract and may include delivering the furniture into the classroom, school site or warehouse. Sales of furniture that are sold FOB factory are typically made to resellers of our product who in turn provide logistics to the ultimate customer. Once a product has been delivered per the shipping terms, the customer is able to direct the use of, and obtain substantially all of the remaining benefits from, the asset. The Company considers control to have transferred upon shipment or delivery in accordance with shipping terms because the Company has a present right to payment at that time, the customer has legal title to the asset, the Company has transferred physical possession of the asset, and the customer has significant risks and rewards of ownership of the asset.

Sales are recorded net of discounts, sales incentives and rebates, sales taxes and estimated returns and allowances. The Company offers sales incentives and discounts through various regional and national programs to our customers. These programs include product rebates, product returns allowances and trade promotions. Variable consideration for these programs is estimated in the transaction price at contract inception based on current sales levels and historical experience using the expected value method, subject to constraint.

The Company generates revenue primarily by manufacturing and distributing products through resellers and direct-to-customers. Control transfers to both resellers and direct customers at a point in time when the delivery process is complete as determined by the corresponding shipping terms. Therefore, we do not consider them to be meaningfully different revenue streams given similarities in the nature of the products, performance obligation and distribution processes. Sales are predominately in the United States and to a similar class of customer. We do not manage or evaluate the business based on product line or any other discernable category.

For product produced by and sourced from third parties, management has determined that it is the principal in all cases, since it (i) bears primary responsibility for fulfilling the promise to the customer; (ii) bears inventory risk before and/or after the good or service is transferred to the customer; and (iii) has discretion in establishing the price for the sale of good or service to the customer.

#### **Note 5. Inventories**

Inventories are valued at the lower of cost (determined on a first-in, first-out basis) or net realizable value and includes material, labor and factory overhead. The Company maintains valuation allowances for estimated slow-moving and obsolete inventory to reflect the difference between the cost of inventory and the estimated net realizable value. Valuation allowances for slow-moving and obsolete inventory are determined through a physical inspection of the product in connection with a physical inventory, a review of slow-moving product and consideration of active marketing programs. The market for education furniture is traditionally driven by value, not style, and the Company has not typically incurred significant obsolescence expenses. If market conditions are less favorable than those anticipated by management, additional valuation allowances may

be required. Due to reductions in sales volume in the past years, the Company's manufacturing facilities are operating at reduced levels of capacity. The Company records the cost of excess capacity as a period expense, not as a component of capitalized inventory valuation.

The following table presents breakdown of the Company's inventories as of October 31, 2019, January 31, 2019 and October 31, 2018:

	<u>10/31/2019</u>	<u>1/31/2019</u>	<u>10/31/2018</u>
	(in thousands)		
Finished goods	\$ 15,380	\$ 15,908	\$ 14,552
WIP	15,567	18,820	16,633
Raw materials	11,960	12,561	11,485
Inventories	<u>\$ 42,907</u>	<u>\$ 47,289</u>	<u>\$ 42,670</u>

Management continually monitors production costs, material costs and inventory levels to determine that inventories are fairly stated.

#### **Note 6. Leases**

The Company has operating leases on real property, equipment, and automobiles that expire at various dates. The Company determines if an arrangement is a lease at inception and assesses classification of the lease at commencement. All of the Company's leases are classified as operating leases, as a lessee. The Company uses the implicit rate when readily determinable, or the incremental borrowing rate. Our incremental borrowing rate is estimated to approximate the interest rate on a collateralized basis with similar terms and payments using company specific credit spreads. The Company's lease terms include options to extend or terminate the lease only when it is reasonably certain that we will exercise that option. Lease expense for our operating leases is recognized on a straight-line basis over the lease term.

The Company has an operating lease for its corporate office, manufacturing and distribution facility located in Torrance, CA, currently with a remaining lease term through April 30, 2025. The Company leases equipment under a 5-year operating lease arrangement. The Company has the option of buying the assets at the end of the lease period at a price that does not result in the Company being reasonably certain of exercising the option. In addition, the Company leases trucks, automobiles, and forklifts under operating leases that include certain fleet management and maintenance services. Certain of the leases contain renewal or purchase options and require payment for property taxes and insurance. The Company records lease expense on a straight-line basis based on the contractual lease payments. Tenant improvements are capitalized and depreciated over the remaining life of the applicable lease, and related tenant allowances are recorded as a reduction to the ROU asset.

In accordance with ASC 842, quantitative information regarding our leases is as follows:



	<b>Three-Months Ended</b> <b>10/31/2019</b>	<b>Nine-Months Ended</b> <b>10/31/2019</b>
	(in thousands)	
Operating lease cost	\$ 1,365	\$ 4,065
Short-term lease cost	115	251
Short-term sublease income	(30)	(60)
Total lease cost	<u>\$ 1,450</u>	<u>\$ 4,256</u>

**Other operating leases information:**

Cash paid for amounts included in the measurement of lease liabilities	\$ 1,365,000
Right-of-use assets obtained in exchange for new lease liabilities	\$ 384,000
Weighted-average remaining lease term (years)	5.2
Weighted-average discount rate	6.37%

Minimum future lease payments (in thousands) for operating leases in effect as of October 31, 2019, are as follows:

	<b>Operating Lease</b>
Remaining of 2020	\$ 1,370
2021	4,973
2022	5,582
2023	5,149
2024	5,192
Thereafter	6,687
<b>Remaining balance of lease payments</b>	<u><b>\$ 28,953</b></u>
Short-term lease liabilities	\$ 3,506
Long-term lease liabilities	20,778
<b>Total lease liabilities</b>	<u><b>\$ 24,284</b></u>
<b>Difference between undiscounted cash flows and discounted cash flows</b>	<u><b>\$ 4,669</b></u>

In accordance with ASC 840, future minimum lease payments under non-cancelable leases as of January 31, 2019 were as follows (in thousands):

<b>Year ending January 31,</b>	
2020	\$ 5,045
2021	4,405
2022	5,041
2023	5,040
2024	5,192
Thereafter	6,687
<b>Total minimum lease payments</b>	<u><b>\$ 31,410</b></u>

In accordance with ASC 840, rent expense for operating leases for the three and nine months ended October 31, 2018 was \$1,543,000 and \$4,512,000, respectively.

## Note 7. Debt

Outstanding balances for the Company's long-term debt were as follows (in thousands):

	10/31/2019	1/31/2019	10/31/2018
Revolving credit line	\$ 7,412	\$ 14,858	\$ 13,245
Other	6,945	6,556	6,967
Total debt	\$ 14,357	\$ 21,414	\$ 20,212
Less current portion	872	5,504	6,232
Non-current portion	\$ 13,485	\$ 15,910	\$ 13,980

The Company has a Revolving Credit and Security Agreement (the "Credit Agreement") with PNC Bank, National Association, as administrative agent and lender ("PNC"). The credit agreement has been amended twenty times since its origination in 2011 through fiscal 2019, which, among other things, extended the maturity date of the Credit Agreement for three years until March 19, 2023.

The Revolving Credit Facility is an asset-based line of credit that is subject to a borrowing base limitation and generally provides for advances of up to 85% of eligible accounts receivable, plus a percentage equal to the lesser of 60% of the value of eligible inventory or 85% of the liquidation value of eligible inventory, plus \$15,000,000 from January 1 through June 30 of each year, minus undrawn amounts of letters of credit and reserves. The Revolving Credit Facility is secured by substantially all of the Borrowers', as defined, personal property and certain of the Borrowers' real property. The principal amount outstanding under the Credit Agreement and any accrued and unpaid interest is due no later than March 19, 2023, and the Revolving Credit Facility is subject to certain prepayment penalties upon earlier termination of the Revolving Credit Facility. Prior to the maturity date, principal amounts outstanding under the Credit Agreement may be repaid and reborrowed at the option of the Borrowers without premium or penalty, subject to borrowing base limitations, seasonal adjustments and certain other conditions.

The Revolving Credit Facility bears interest, at the Borrowers' option, at either the Alternate Base Rate (as defined in the Credit Agreement) or the Eurodollar Currency Rate (as defined in the Credit Agreement), in each case plus an applicable margin. The applicable margin for Alternate Base Rate loans is a percentage within a range of 0.75% to 1.25%, and the applicable margin for Eurodollar Currency Rate loans is a percentage within a range of 1.75% to 2.25%, in each case based on the EBITDA of the Borrowers at the end of each fiscal quarter and may be increased at PNC's option by 2.0% during the continuance of an event of default. Accrued interest with respect to principal amounts outstanding under the Credit Agreement is payable in arrears on a monthly basis for Alternative Base Rate loans, and at the end of the applicable interest period but at most every three months for Eurodollar Currency Rate loans. The interest rate at October 31, 2019 was 5.75%.

On March 19, 2018, the Company entered into Amendment No. 17, which amended the Credit Agreement by (i) extending the maturity date of the Credit Agreement for three years until March 19, 2023. In connection with the Seventeenth Amendment, the Borrowers also agreed to pay to PNC Bank a non-refundable extension fee of \$250,000.

In March 2019, the Company entered into Amendment No. 19 which, among other things, (i) increased the Maximum Revolving Advance Amount to \$65,000,000 with seasonal adjustments to the credit limit and subject to borrowing base limitations, (ii) increased seasonal advance to \$15,000,000 from January to July of each year, (iii) increased equipment loan to \$2,000,000, (iv) to reduce borrowings under the line to less than or equal to \$10,000,000 for a period of 30 consecutive days during the fourth quarter of each fiscal year. In connection with Amendment No. 19, the Borrowers also agreed to pay to PNC Bank a non-refundable fee of \$24,000. The clean-down provision allows the Company to maintain a minimum outstanding balance to be carried on an uninterrupted period extending beyond one year and ultimately due at the scheduled maturity date in March 2023. As a result of Amendment No. 19, the clean-down limit was increased to \$10,000,000, thereby allowing the Company to refinance an additional \$2,000,000 of its short-term borrowings under the line of credit on a long-term basis at January 31, 2019.

Events of default (subject to certain cure periods and other limitations) under the Credit Agreement include, but are not limited to, (i) non-payment of principal, interest or other amounts due under the Credit Agreement, (ii) the violation of terms, covenants, representations or warranties in the Credit Agreement or related loan documents, (iii) any event of default under

agreements governing certain indebtedness of the Borrowers and certain defaults by the Borrowers under other agreements that would materially adversely affect the Borrowers, (iv) certain events of bankruptcy, insolvency or liquidation involving the Borrowers, (v) judgments or judicial actions against the Borrowers in excess of \$250,000, subject to certain conditions, (vi) the failure of the Company to comply with Pension Benefit Plans (as defined in the Credit Agreement), (vii) the invalidity of loan documents pertaining to the Credit Agreement, (viii) a change of control of the Borrowers and (ix) the interruption of operations of any of the Borrowers' manufacturing facilities for five consecutive days during the peak season or 15 consecutive days during any other time, subject to certain conditions. For the year ended January 31, 2019, the Company was in violation of the minimum fixed charge coverage ratio resulting in an Event of Default.

In April 2019, the Company entered into Amendment No. 20 which, among other things, waived the covenant violation for the fourth quarter of fiscal 2019, amended the minimum EBITDA covenant and the fixed charge coverage ratio for fiscal 2020, and eliminated the Company's ability to pay dividends or repurchase stock commencing on February 1, 2019 and ending on January 31, 2020. The fixed charge coverage ratio is as follows: (i) for the consecutive two fiscal quarter period ending July 31, 2019, 2.25 to 1.00, and (ii) for each consecutive four fiscal quarter period of Borrowers ending thereafter, 1.10 to 1.00. Minimum EBITDA for the three consecutive fiscal month period ending on April 30, 2019, may not be less than (negative) \$5,000,000. In addition, certain restrictions were placed upon the Company's capital expenditures limiting the amount: (a) in the first fiscal quarter ending April 30, 2019 in an aggregate amount in excess of \$900,000, (b) in the consecutive two fiscal quarter periods ending July 31, 2019 in an aggregate amount in excess of \$1,900,000, (c) in the consecutive three fiscal quarter period ended October 31, 2019 in an aggregate amount in excess of (i) \$3,900,000, if an only if, the Borrowers' EBITDA for the consecutive two fiscal quarter period ending July 31, 2019 exceeds \$8,500,000 or (ii) \$2,900,000 if Borrowers' EBITDA for such period is less than or equal to \$8,500,000 and (d) in the consecutive four fiscal quarter period ending January 31, 2020 or any fiscal year thereafter, in an aggregate amount for all Borrowers in excess of \$8,000,000. In connection with Amendment No. 20 the Borrowers also agreed to pay to PNC Bank a non-refundable fee of \$125,000. The Company believes that normal operating cash flow will allow it to meet the clean down requirement with no adverse impact on the Company's liquidity. The Company was in compliance with its financial covenants as of October 31, 2019.

Pursuant to the Credit Agreement, substantially all of the Borrowers' accounts receivable are automatically and promptly swept to repay amounts outstanding under the Revolving Credit Facility upon receipt by the Borrowers. Due to this automatic liquidating nature of the Revolving Credit Facility, if the Borrowers breach any covenant, violate any representation or warranty or suffer a deterioration in their ability to borrow pursuant to the borrowing base calculation, the Borrowers may not have access to cash liquidity unless provided by PNC at its discretion. In addition, certain of the covenants and representations and warranties set forth in the Credit Agreement contain limited or no materiality thresholds, and many of the representations and warranties must be true and correct in all material respects upon each borrowing, which the Borrowers expect to occur on an ongoing basis. There can be no assurance that the Borrowers will be able to comply with all such covenants and be able to continue to make such representations and warranties on an ongoing basis.

The Company's line of credit with PNC is structured to provide seasonal credit availability during the Company's peak summer season. Approximately \$10,700,000 was available for borrowing as of October 31, 2019.

Management believes that the carrying value of debt approximated fair value at October 31, 2019 and 2018, as all of the long-term debt bears interest at variable rates based on prevailing market conditions.

## **Note 8. Income Taxes**

The Company recognizes deferred income taxes under the asset and liability method of accounting for income taxes in accordance with the provisions of ASC No. 740, *Accounting for Income Taxes*. Deferred income taxes are recognized for differences between the financial statement and tax basis of assets and liabilities at enacted statutory tax rates in effect for the years in which the differences are expected to reverse. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. In assessing the realizability of deferred tax assets, the Company considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income or reversal of deferred tax liabilities during the periods in which those temporary differences become deductible. The Company maintains a partial valuation allowance against certain state deferred tax assets that the Company does not believe it is more-likely-than-not to realize.

The January 31, 2016 and subsequent years remain open for examination by the IRS and state tax authorities. The Company is not currently under any state examination. The Company is currently under IRS examination for its fiscal year ended January 31, 2016 Federal tax return.

## Note 9. Net income per Share

	Three Months Ended		Nine Months Ended	
	10/31/2019	10/31/2018	10/31/2019	10/31/2018
	(In thousands, except per share data)			
Net income	\$ 3,892	\$ 2,932	\$ 6,692	\$ 4,835
Weighted average shares of common stock outstanding	15,654	15,486	15,568	15,399
Net effect of dilutive shares - based on the treasury stock method using average market price	56	96	53	92
Totals	<u>15,710</u>	<u>15,582</u>	<u>15,621</u>	<u>15,491</u>
Net income per share - basic	\$ 0.25	\$ 0.19	\$ 0.43	\$ 0.31
Net income per share - diluted	\$ 0.25	\$ 0.19	\$ 0.43	\$ 0.31

## Note 10. Stock-Based Compensation

### Stock Incentive Plan

The Company's two stock plans are the 2019 Employee Stock Incentive Plan (the "2019 Plan") and the 2011 Employee Incentive Stock Plan (the "2011 Plan").

Under the 2019 Plan, the Company may grant an aggregate of 1,000,000 shares to its employees in the form of restricted stock units and non-employee directors in the form of restricted stock awards. Restricted stock units and awards granted under the 2019 Plan are expensed ratably over the vesting period of the awards. The Company determines the fair value of its restricted stock units or awards and related compensation expense as the difference between the market value of the units or awards on the date of grant less the exercise price of the units or awards granted. During the nine-month periods ended October 31, 2019, the Company granted 228,000 units, vested 0 shares according to their terms and forfeited 0 shares under the 2019 Plan. As of October 31, 2019, there were approximately 772,000 shares available for future issuance under the 2019 Plan.

Under the 2011 Plan, the Company may grant an aggregate of 2,000,000 shares to its employees in the form of restricted stock units and non-employee directors in the form of restricted stock awards. Restricted stock units and awards granted under the 2011 Plan are expensed ratably over the vesting period of the awards. The Company determines the fair value of its restricted stock units or awards and related compensation expense as the difference between the market value of the units or awards on the date of grant less the exercise price of the units or awards granted. During the nine-month periods ended October 31, 2019, the Company granted 59,385 restricted awards to non-employee directors and 260,000 units to its employees; vested 55,555 stock awards and 168,000 units according to their terms and forfeited 24,000 stock units under the 2011 Plan. As of October 31, 2019, there were approximately 892 shares available for future issuance under the 2011 Plan.

During the three months ended October 31, 2019, stock-based compensation expense related to restricted stock awards recognized in cost of goods sold and selling, general and administrative expenses was \$74,000 and \$189,000, respectively. During the three months ended October 31, 2018, stock-based compensation expense related to restricted stock awards recognized in cost of goods sold and selling, general and administrative expenses was \$60,000 and \$175,000, respectively.

During the nine months ended October 31, 2019, stock-based compensation expense related to restricted stock awards recognized in cost of goods sold and selling, general and administrative expenses was \$190,000 and \$496,000, respectively. During the nine months ended October 31, 2018, stock-based compensation expense related to restricted stock awards recognized in cost of goods sold and selling, general and administrative expenses was \$178,000 and \$495,000, respectively.

As of October 31, 2019, there was \$3,073,000 of unrecognized compensation expense related to unvested restricted stock units, which is expected to be recognized over a weighted average period of approximately 3 years.

**Note 11. Statement of Changes in Equity and Accumulated Other Comprehensive Income (Loss)**

The Company’s Credit Agreement with PNC currently restricts the Company from issuing dividends or making payments with respect to the Company’s capital stock through January 31, 2020. The Company did not declare a cash dividend during quarter ended October 31, 2019. The Company declared a quarterly cash dividend of \$0.015 per share, payable January 10, 2019 to shareholders of record as of December 27, 2018, during the same period last year.

**Note 12. Retirement Plans**

The Company and its subsidiaries cover certain employees under a noncontributory defined benefit retirement plan, entitled the Virco Employees’ Retirement Plan (the “Pension Plan”). Benefits under the Employees Retirement Plan are based on years of service and career average earnings. As more fully described in the Form 10-K, benefit accruals under the Employees Retirement Plan were frozen effective December 31, 2003. There is no service cost incurred under this plan.

The Company also provides a supplementary retirement plan for certain key employees, the VIP Retirement Plan (the “VIP Plan”). The VIP Plan provides a benefit of up to 50% of average compensation for the last 5 years in the VIP Plan, offset by benefits earned under the Pension Plan. As more fully described in the Annual Report on Form 10-K for the year ended January 31, 2019, benefit accruals under this plan were frozen since December 31, 2003. There is no service cost incurred under this plan.

The net periodic pension cost for the Pension Plan and the VIP Plan for the three and nine months ended October 31, 2019 and 2018 were as follows (in thousands):

	<b>Combined Employee Retirement Plans</b>			
	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>10/31/2019</b>	<b>10/31/2018</b>	<b>10/31/2019</b>	<b>10/31/2018</b>
Service cost	\$ —	\$ —	\$ —	\$ —
Interest cost	355	370	1,065	1,080
Expected return on plan assets	(343)	(348)	(1,029)	(1,162)
Plan settlement	—	22	—	341
Amortization of prior service cost	—	—	—	—
Recognized net actuarial loss	176	252	528	597
Benefit cost	<u>\$ 188</u>	<u>\$ 296</u>	<u>\$ 564</u>	<u>\$ 856</u>

**401(k) Retirement Plan**

The Company’s retirement plan, which covers all U.S. employees, allows participants to defer from 1% to 75% of their eligible compensation through a 401(k)-retirement program. The plan includes Virco stock as one of the investment options. At October 31, 2019 and 2018, the plan held 710,319 shares and 646,984 shares of Virco stock, respectively. For the three months ended October 31, 2019 and 2018, the compensation costs incurred for employer match was 204,000 and 190,000, respectively. For the nine months ended October 31, 2019 and 2018, the compensation costs incurred for employer match was \$578,000 and \$553,000, respectively.

**Note 13. Warranty Accrual**

The Company provides an assurance type warranty against all substantial defects in material and workmanship. The standard warranty offered on products sold through January 31, 2013 is 10 years. Effective February 1, 2014, the Company modified its warranty to a limited lifetime warranty. The warranty effective February 1, 2014 is not anticipated to have a significant effect on warranty expense. Effective January 1, 2017, the Company modified the warranty offered to provide specific warranty periods by product component, with no warranty period longer than ten years. The Company’s warranty is not a guarantee of service life, which depends upon events outside the Company’s control and may be different from the warranty period. The Company accrues an estimate of its exposure to warranty claims based upon both product sales data and an analysis of actual warranty claims incurred.

The following is a summary of the Company's warranty-claim activity for the three and nine months ended October 31, 2019 and 2018 (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>10/31/2019</b>	<b>10/31/2018</b>	<b>10/31/2019</b>	<b>10/31/2018</b>
Beginning balance	\$ 800	\$ 925	\$ 700	\$ 925
Provision	71	77	387	219
Costs incurred	(71)	(77)	(287)	(219)
Ending balance	<u>\$ 800</u>	<u>\$ 925</u>	<u>\$ 800</u>	<u>\$ 925</u>

#### **Note 14. Contingencies**

The Company has a self-insured retention for product and general liability losses up to \$250,000 per occurrence, workers' compensation liability losses up to \$250,000 per occurrence and for automobile liability losses up to \$50,000 per occurrence. The Company has purchased insurance to cover losses in excess of the retention up to a limit of \$30,000,000. The Company has obtained an actuarial estimate of its total expected future losses for liability claims and recorded a liability equal to the net present value.

The Company and its subsidiaries are defendants in various legal proceedings resulting from operations in the normal course of business. It is the opinion of management, in consultation with legal counsel, that the ultimate outcome of all such matters will not materially affect the Company's financial position, results of operations or cash flows.

#### **Note 15. Reclassification of Prior Year Presentation**

Certain prior year amounts have been reclassified for consistency with the current year presentation. We have reclassified the pension costs from selling, general and administrative expense to non-operating pension expense in the Company's Condensed Consolidated Statement of Income for the three and nine months ended October 31, 2018. This reclassification had no impact upon the reported net income. This change in classification does not affect previously reported cash flows from operating activities in the Condensed Consolidated Statements of Cash Flows.

#### **Note 16. Delivery Costs**

For the quarter ended October 31, 2019 and 2018, shipping and classroom delivery costs of approximately \$7,897,000, \$9,295,000, respectively, were included in selling, general and administrative expenses in the accompanying consolidated statements of operations.

For the nine months ended October 31, 2019 and 2018, shipping and classroom delivery costs of approximately \$17,154,000, \$18,406,000, respectively, were included in selling, general and administrative expenses in the accompanying consolidated statements of operations.

#### **Note 17. Subsequent Events**

In accordance with ASC 855 "Subsequent Events" Management evaluated subsequent events through the date the condensed consolidated financial statements were issued. Management concluded that no subsequent events have occurred that would require recognition or disclosure in the condensed consolidated financial statements.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Results of Operations

#### *Three Months Ended October 31, 2019*

For the three months ended October 31, 2019, the Company earned a pre-tax profit of \$5,578,000 on sales of \$66,998,000 compared to a pre-tax profit of \$4,035,000 on sales of \$76,809,000 in the prior year.

Net sales for the three months ended October 31, 2019 decreased by \$9,811,000 or 12.8%, compared to the same period last year. The Company began the quarter with an order backlog that was more than \$18 million lower than the prior year due to slow order rates for the first and second quarters. Order rates for the first six months declined by approximately 14% compared to the same period last year. Order rates for the third quarter reflected a significant improvement, increasing by over 27% compared to the same period last year. The decrease in revenue for the quarter was attributable to the reduced beginning backlog, partially offset by the increased order rate for the third quarter. Order backlog at October 31, 2019 is approximately \$19.0 million and is \$3 million greater than the prior year.

The third quarter results reflect continued seasonality of the Company's business. School districts in many parts of the Country have accelerated the beginning of back to school to mid-August, impacting the summer delivery window. At the beginning of the fiscal year, the Company substantially revised its production stocking program in order to facilitate the timeliness and completeness of order fulfillment during the summer. This new production stocking program was very successful with an improvement in the timeliness of deliveries and a greater portion of orders filled in the second quarter.

In the prior year the Company was adversely affected by increased cost of commodities, particularly steel and components imported from China. In addition, the Company was adversely impacted by increased costs for labor, employee benefits, and freight. The Company anticipated continued pressure on these costs during the fiscal year ending January 31, 2020, including additional tariff related costs incurred in the second quarter of the fiscal year ending January 31, 2020. To compensate for these increased costs, the Company raised selling prices at the beginning of the year. The amount of price increase varied based upon the type of product and competitive considerations, but no product increased by less than 10%. Gross margin for the third quarter was 40.1% compared to 34.4% in the prior year. The gross margin was favorably affected by the price increase described above, partially offset by unfavorable manufacturing overhead variances incurred when production rates declined in response to the decrease in unit volume.

Selling, general and administrative expenses for the three months ended October 31, 2019 decreased by \$993,000 compared to the same period last year and increased as a percentage of sales to 30.6% from 28.0%. The decrease in selling, general and administrative expenses was primarily attributable to decreased freight expense.

Interest expense decreased by \$27,000 for the three months ended October 31, 2019 compared to the same period last year. The Company has borrowed less money to finance seasonal working capital in the third quarter.

#### *Nine Months Ended October 31, 2019*

For the nine months ended October 31, 2019, the Company earned a pre-tax profit of \$10,177,000 on net sales of \$164,250,000 compared to a pre-tax profit of \$6,594,000 on net sales of \$174,180,000 in the same period last year. Net sales for the nine months ended October 31, 2019 decreased by approximately \$9,930,000 or 5.7% compared to the same period last year. This net decrease was primarily the result of a reduction in unit volume offset by an increase in selling prices. The Company began the year with a backlog of orders that was approximately \$4.2 million greater than the prior year. Order rates for the first six months decreased by approximately 14% compared to the prior year. Order rates for the third quarter reflected a significant improvement, increasing by over 27% compared to the same period last year. Because the third quarter is traditionally a slow period for orders, strong third quarter order rates mitigated the reduction for the first two quarters, but as of October 31, 2019 orders trailed the prior year by approximately \$13 million, a 7.3% reduction compared to the same period last year.

As described above the Company increased selling prices at the beginning of the year to recover increased commodity and other costs incurred during 2018. The impact of the price increase was not fully effective until the second quarter as the beginning backlog at January 31, 2019 reflected selling prices in effect prior to the price increase.

Gross margin as a percentage of sales improved to 39.4% for the nine months ended October 31, 2019 compared to 35.2% in the same period last year. The gross margin was favorably affected by the price increase described above, partially offset by unfavorable manufacturing overhead variances incurred when production rates declined in response to the decrease in unit volume.

Selling, general and administrative expenses for the nine months ended October 31, 2019 decreased by approximately \$186,000 compared to the same period last year and increased as a percentage of sales by 1.7%.

Interest expense increased by \$312,000 for the nine months ended October 31, 2019 compared to the same period last year. The Company has borrowed slightly more money to finance seasonal working capital in the first six months of the year and increased as a result of higher interest rates.

#### *Income Taxes for the three- and nine-months ended October 31, 2019*

Income tax expense for the third quarter and nine months ended October 31, 2019 is greater than the prior year, primarily due to the increase in pre-tax income.

### **Liquidity and Capital Resources**

Approximately 50% of the Company's annual sales volume is shipped in the months of June through August of each year. The Company traditionally manufactures large quantities of inventory during the first and second quarters of each fiscal year in anticipation of seasonally high summer shipments. In addition, the Company finances a large balance of accounts receivable during the peak season. During the last two months of the third quarter, the Company typically repays significant portions of the seasonal working capital borrowed to finance the summer activity. Accounts receivable increased by \$4,504,000 from January 31, 2019 to October 31, 2019. This compares to prior year when accounts receivable grew by \$12,896,000 during the same period. The accounts receivable balance was approximately \$6.6 million lower at October 31, 2019 than at October 31, 2018 due to lower third quarter sales. The decrease in accounts receivable at October 31, 2019 compared to the January 31, 2019, was offset in part by a reduction in account payable.

For the first nine months, the Company decreased inventory by approximately \$4,382,000 at October 31, 2019 compared to January 31, 2019. This compares to an increase of \$613,000 during the same period last year. Inventory at October 31, 2019 was \$238,000 greater than the prior year. The increase in inventory compared to the prior year is primarily due an increase in valuation due to increased commodity and tariffs costs.

Interest expense for the nine months ended October 31, 2019 is slightly higher the same period last year. Borrowings under the Company's revolving line of credit with PNC Bank were higher in the first six months of the year.

Capital spending for the nine months ended October 31, 2019 was \$2,963,000 compared to \$3,319,000 for the same period last year. Capital expenditures are being financed through the Company's credit facility with PNC Bank and operating cash flow.

The Company believes that cash flows from operations, together with the Company's unused borrowing capacity with PNC Bank will be sufficient to fund the Company's debt service requirements, capital expenditures and working capital needs for the next twelve months.

### **Off Balance Sheet Arrangements**

None.

### **Critical Accounting Policies and Estimates**

The Company's critical accounting policies are outlined in its Annual Report on Form 10-K for the fiscal year ended January 31, 2019.

#### *Operating Lease Liabilities*

On February 1, 2019, the Company adopted ASU No. 2016-02-*Leases (Topic 842)*, using the modified retrospective approach and applying the transitional relief allowing entities to initially apply the requirements at the adoption date by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption.

In accordance with ASC 842, the Company determines if an arrangement is a lease at inception. Operating leases in which the Company is the lessee are included in operating lease right-of-use ("ROU") assets, other current liabilities, and operating lease liabilities in the consolidated balance sheets. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. The Company's lease terms include options to extend or terminate the lease only when it is reasonably certain that we will exercise that option. As most of the Company's leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. Our incremental borrowing rate is estimated to approximate the interest rate



on a collateralized basis with similar terms and payments using company specific credit spreads. The Company uses the implicit rate when readily determinable. The incremental borrowing rate used is 6.39%.

Adoption of the new standard resulted in the recording of ROU assets and lease liabilities of approximately \$23.9 million and \$25.6 million respectively, as of February 1, 2019.

### **Forward-Looking Statements**

From time to time, including in this Quarterly Report on Form 10-Q for the quarterly period ended October 31, 2019, the Company or its representatives have made and may make forward-looking statements, orally or in writing. Such forward-looking statements may be included in, without limitation, reports to stockholders, press releases, oral statements made with the approval of an authorized executive officer of the Company and filings with the Securities and Exchange Commission ("SEC"). The words or phrases "anticipates," "expects," "will continue," "believes," "estimates," "projects," or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. The results contemplated by the Company's forward-looking statements are subject to certain risks and uncertainties that could cause actual results to vary materially from anticipated results, including without limitation, availability of funding for educational institutions, availability and cost of materials, especially steel, availability and cost of labor, demand for the Company's products, competitive conditions affecting selling prices and margins, capital costs and general economic conditions. Such risks and uncertainties are discussed in more detail in the Company's Form 10-K for the fiscal year ended January 31, 2019 under the caption "Risk Factors".

The Company's forward-looking statements represent its judgment only on the dates such statements were made. By making any forward-looking statements, the Company assumes no duty to update them to reflect new, changed or unanticipated events or circumstances.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

The Company is subject to interest rate risk related to its seasonal borrowings used to finance additional inventory and receivables. Rising interest rates may adversely affect the Company's results of operations and cash flows related to its variable-rate bank borrowings under its credit line with PNC. Accordingly, a 100-basis point upward fluctuation in PNC's base rate would have caused the Company to incur additional interest charges of approximately \$77,000 and \$272,000 for the three and nine months ended October 31, 2019, respectively. The Company would have benefited from a similar interest savings if the base rate were to have fluctuated downward by a like amount.

### **Item 4. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including its Principal Executive Officer along with its Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934 ("Exchange Act") as of October 31, 2019. Based upon the foregoing, the Company's Principal Executive Officer along with the Company's Principal Financial Officer concluded that the Company's disclosure controls and procedures as of such date were effective to ensure that the information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to Company management, including its Principal Executive Officer and Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, Company management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

#### **Changes in Internal Control Over Financial Reporting**

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including its Principal Executive Officer along with its Principal Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures. Based upon the foregoing, the Company's Principal Executive Officer along with the Company's Principal Financial Officer concluded that the Company's disclosure controls and procedures (as such term

is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective as of the end of the period covered by this Quarterly Report on Form 10-Q.

There have been no changes in the Company's internal control over financial reporting during the fiscal quarter covered by this quarterly report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

## PART II — Other Information

### Virco Mfg. Corporation

#### Item 1. Legal Proceedings

The Company is a party to various legal actions arising in the ordinary course of business which, in the opinion of the Company, are not material in that management either expects that the Company will be successful on the merits of the pending cases or that any liabilities resulting from such cases will be substantially covered by insurance. While it is impossible to estimate with certainty the ultimate legal and financial liability with respect to these actions, management believes that the aggregate amount of such liabilities will not be material to the results of operations, financial position, or cash flows of the Company.

#### Item 1A. Risk Factors

You should carefully consider and evaluate the information in this Quarterly Report and the risk factors set forth under the caption “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended January 31, 2019 (the “Form 10-K”), which was filed with the SEC on May 1, 2019. The risk factors associated with our business have not materially changed compared to the risk factors disclosed in the Form 10-K.

#### Item 2. Unregistered Sales of Equity Securities, Use of Proceeds and Issuer Purchases of Equity Securities

None.

#### Item 3. Defaults Upon Senior Securities

None.

#### Item 4. Mine Safety Disclosures

Not applicable.

#### Item 5. Other Information

None.

#### Item 6. Exhibits

<b>Exhibit Number</b>	<b>Document</b>
<u>31.1</u>	<u>Certification of Robert A. Virtue, Chief Executive Officer, pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.</u>
<u>31.2</u>	<u>Certification of Robert E. Dose, Vice President, Finance, pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.</u>
<u>32.1</u>	<u>Certifications of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>

Exhibit 101.INS — XBRL Instance Document.

Exhibit 101.SCH — XBRL Taxonomy Extension Schema Document.

Exhibit 101.CAL — XBRL Taxonomy Extension Calculation Linkbase Document.

Exhibit 101.LAB — XBRL Taxonomy Extension Label Linkbase Document.

Exhibit 101.PRE — XBRL Taxonomy Extension Presentation Linkbase Document.

## SIGNATURES

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

Date: December 13, 2019

VIRCO MFG. CORPORATION

By: /s/ Robert E. Dose

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*Robert E. Dose*

*Vice President — Finance*

*(Principal Financial Officer)*

## CERTIFICATIONS

I, Robert A. Virtue, certify that:

1. I have reviewed this Form 10-Q of Virco Mfg. Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Robert A. Virtue

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Robert A. Virtue

*Chief Executive Officer and Chairman of the Board  
(Principal Executive Officer)*

Date: December 13, 2019

## CERTIFICATIONS

I, Robert E. Dose, certify that:

1. I have reviewed this Form 10-Q of Virco Mfg. Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Robert E. Dose

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Robert E. Dose

*Vice President — Finance, Secretary and Treasurer  
(Principal Financial Officer)*

Date: December 13, 2019

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Each of the undersigned hereby certifies, in his capacity as an officer of Virco Mfg. Corporation (the “Company”), for purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his own knowledge:

- The Quarterly Report of the Company on Form 10-Q for the period ended October 31, 2019, fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and
- The information contained in such report fairly presents, in all material respects, the financial condition and results of operation of the Company.

Date: December 13, 2019

/s/ Robert A. Virtue

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Robert A. Virtue

Chief Executive Officer and Chairman of the Board  
(Principal Executive Officer)

/s/ Robert E. Dose

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Robert E. Dose

Vice President — Finance, Secretary and Treasurer  
(Principal Financial Officer)

A signed original of this written statement required by Section 906 has been provided to Virco Mfg. Corporation and will be retained by Virco Mfg. Corporation and furnished to the Securities and Exchange Commission or its staff upon request.