

VIRCO MFG CORPORATION

Form 10-K

April 22, 2013

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

Annual Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934  
For the fiscal year ended January 31, 2013.

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

VIRCO MFG. CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of incorporation or  
organization)

95-1613718

(IRS Employer Identification No.)

2027 Harpers Way, Torrance, California

(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:

Title of each class

Name of each exchange on which registered:

Common Stock, \$0.01 Par Value

NASDAQ

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the issuer is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes  No

No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

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 (§232.405 of this chapter) 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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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. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

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

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant on July 31, 2012, was \$24 million (based upon the closing price of the registrant’s common stock on such day, as reported by the NASDAQ).

As of April 1, 2013, there were 14,550,371 shares of the registrant’s common stock (\$0.01 par value) outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant’s definitive proxy statement for its 2013 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission are incorporated by reference into Part III of this annual report on Form 10-K as set forth herein.

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PART I

Cautionary Statement Regarding Forward-Looking Statements

This report on Form 10-K contains a number of “forward-looking statements” that reflect the Company's current views with respect to future events and financial performance, including, but not limited to, availability of funding for educational institutions, statements regarding plans and objectives of management for future operations, including plans and objectives relating to products, pricing, marketing, expansion, manufacturing processes, and business strategies; the Company's ability to continue to control costs and inventory levels; availability and cost of raw materials, especially steel and petroleum-based products; the availability and cost of labor; the potential impact of the Company's “Assemble-To-Ship” program on earnings; market demand; the Company's ability to position itself in the market; references to current and future investments in and utilization of infrastructure; statements relating to management's beliefs that cash flow from current operations, existing cash reserves, and available lines of credit will be sufficient to support the Company's working capital requirements to fund existing operations; references to expectations of future revenues; pricing; and seasonality.

Such statements involve known and unknown risks, uncertainties, assumptions and other factors, many of which are out of the Company's control and difficult to forecast, that may cause actual results to differ materially from those which are anticipated. Such factors include, but are not limited to, changes in, or the Company's ability to predict, general economic conditions, the availability and cost of raw materials, the markets for school and office furniture generally and specifically in areas and with customers with which the Company conducts its principal business activities, the rate of approval of school bonds for the construction of new schools, the extent to which existing schools order replacement furniture, customer confidence, competition and other factors included in the “Risk Factors” section of this report.

In this report, words such as “anticipates,” “believes,” “expects,” “will continue,” “future,” “intends,” “plans,” “estimates,” “potential,” “budgets,” “may,” “could” and similar expressions identify forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof.

Throughout this report, our fiscal years ended January 31, 2009, January 31, 2010, January 31, 2011, January 31, 2012 and January 31, 2013 are referred to as years 2008, 2009, 2010, 2011 and 2012, respectively.

Please note that this report includes trademarks of Virco, including, but not limited to, the following: ZUMA<sup>®</sup>, ZUMAFrd<sup>™</sup>, Ph.D. I.Q.<sup>®</sup>, Virtuoso<sup>®</sup>, Classic Series<sup>™</sup>, Martest Lunada<sup>®</sup>, Plateau<sup>®</sup>, Core-a-Gator<sup>®</sup>, Future Access<sup>®</sup>, Sigma<sup>®</sup>, Metaphor<sup>®</sup>, Telos<sup>®</sup>, TEXT<sup>®</sup> and Parameter<sup>®</sup>. Solely for convenience, from time to time, we refer to our trademarks in this report without the <sup>®</sup> and <sup>™</sup> symbols, but such references are not intended to indicate that we will not assert, to the fullest extent under applicable law, our rights to our trademarks. In addition, other names and brands included in this report may be claimed by us as well or by third parties.

Item 1. Business

Introduction

Designing, producing and distributing high-value furniture for a diverse family of customers is a 63-year tradition at Virco Mfg. Corporation (“Virco” or the “Company”, or in the first person, “we”, “us” and “our”). Virco was incorporated in California in February 1950, and reincorporated in Delaware in April 1984. Though Virco started as a local manufacturer of chairs and desks for Los Angeles-area schools, over the years, Virco has become the largest manufacturer and supplier of moveable educational furniture and equipment for the preschool through 12th grade market in the United States. The Company now manufactures a wide assortment of products, including mobile tables, mobile storage equipment, desks, computer furniture, chairs, activity tables, folding chairs and folding tables. Additionally, Virco has worked with accomplished designers - such as Peter Glass, Richard Holbrook, and Bob Mills - to develop additional products for contemporary applications. These include the best-selling ZUMA Series; the recently introduced TEXT<sup>®</sup> and Parameter furniture collections; Metaphor and I.Q. Series items for educational settings; the Ph.D. Executive seating line; and the wide-ranging Plateau Series.

Along with serving customers in the education market - which in addition to preschool through 12th grade public and private schools includes: junior and community colleges; four-year colleges and universities; trade, technical and vocational schools - Virco is a leading furniture and equipment supplier for convention centers and arenas; the hospitality industry with respect to banquet and meeting facilities; government facilities at the federal, state, county

and municipal levels; and places of worship. We also sell to wholesalers, distributors, traditional retailers and catalog retailers that serve these same markets.

To meet the furniture and equipment needs of our customers, Virco operates a 560,000 sq. ft. office, manufacturing and warehousing facility located on 23.5 acres of land in Torrance, California; this facility includes our corporate headquarters, West Coast showroom, and all West Coast distribution operations. To complement our California-based operations, Virco

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owns 100 acres of land in Conway, Arkansas, containing 1,200,000 sq. ft. of manufacturing, warehousing, and office space. With high-density storage systems, 70 dock doors dedicated to outbound freight, and substantial yard capacity to store and stage trailers, this facility supports Virco's ability to handle increased sales during our peak summer delivery season and enhances the efficiency with which orders are filled. Virco also operates two other facilities in Conway. The first is a 375,000 sq. ft. factory - acquired in 1954, and expanded and modernized in subsequent years - where a variety of operations take place, including the manufacture of fabricated steel components, chrome plating, and plastic injection-molding; components generated here are transferred to other facilities for assembly into finished goods. The second is a 175,000 sq. ft. manufacturing facility where compression-molded hard plastic components are fabricated and stored.

Because the product needs and preferences of our customers continue to evolve - and in response to competitive furniture and equipment offerings from domestic and offshore suppliers - Virco maintains an ongoing new product development program. We've worked with accomplished designers - such as Peter Glass, Richard Holbrook, and Bob Mills - to introduce exciting furniture and equipment solutions for contemporary applications. Over the past five years, Virco has launched a substantial number of new products, including the following.

In 2008, Virco introduced the TEXT® table collection for learning environments. Designed by the award-winning team of Peter Glass and Bob Mills, TEXT tables feature heavy-gauge tubular steel and proven Virco construction for extended product life, and elliptical legs, swooping yokes and arched feet for exceptional elegance. Selected TEXT models can be equipped with a variety of technology-support and storage accessories. Lunada® tables made their debut at the end of 2008. Combining Virco's popular Lunada bi-point bases with a selection of 20 top sizes, Lunada tables make great choices for seminar, conference and related settings.

In 2009, Virco introduced Flip-Top Technology tables for computer classrooms and related environments. Flip-Top Technology tables feature a 6" deep locking flip-top compartment that secures cables, surge protectors and wires beneath the work surface. Also in 2009, utilizing our new flat metal forming capabilities, Virco introduced an array of desks, returns and bookcases.

In 2010, Virco introduced Parameter®, an invigorating collection of desks, returns and credenzas for use by teachers, principals and district administrators in their classrooms or offices. Parameter affordably combines all the functionality - and more - of traditional mid-priced desks with high-end design elements. Virco's flat metal forming capabilities are used to manufacture Parameter items. Several new products were released in the second half of 2010, including: Parameter and TEXT help desks for educators, which have a rounded work surface edge at one end where students can comfortably pull up a chair for assistance with their work; Parameter mobile pedestals; Parameter high-capacity wire management panels; Plateau adjustable-height tables; several 2000 Series "EL" (extra large) classroom furniture models with an expanded seating surface; and a new collection of Virco vertical files.

In 2011, Virco introduced the Sage™ Contract and Civitas™ seating lines. Combining Virco's super-comfortable Sage shell with a sleek, new-look frame, Sage Contract chairs are great for offices and reception areas, colleges, hospitality venues and other adult environments. Civitas chair and stool models - available in 18", 25" and 30" seat-heights with either a Sage, shell, an ergonomically contoured ZUMA® Series shell, or highly sustainable ZUMAFrd™ seat and back components made of Fortified Recycled Wood™ hard plastic - provide exceptional seating solutions for foodservice, libraries, media centers, circulation areas and related venues. Other 2011 product releases included: 53 Series steel storage cabinets; an expanded range of 53 Series lateral files; special versions of Virco's 543 and 546 Series desks with wire management capabilities; HWT (hinged wire trough) technology tables for computer labs and related applications; an array of 36" wide Plateau® and 2BC Series bookcases; adjustable-height versions of Virco's 120, 121 and 122 Series stools; and three ZUMA rocking chairs with "bump" glides designed for environments where limited motion may be desired, such as areas for children with severe sensory integration problems or Autism.

In 2012, to complement the recently released Civitas chair and stool collection, Virco introduced an assortment of Civitas café table tops and tulip-shaped table bases. Tops are available in a variety of round, square and "squirrel" shaped sizes and can be ordered with three different eye-catching edge profiles, while bases come in three heights to coordinate with the Civitas line's 18", 25" and 30" seat-height chair and stools. Other 2012 product releases included: a new collection of Sage rocking chairs; 53 Series wardrobe tower cabinets; new Parameter file credenzas and additional Parameter mobile pedestals; a selection of 24" wide TEXT seminar tables; Metaphor® sled-based chair/desk

combo units; a wheelchair-accessible version of the ZUMA cantilevered single-student desk; CT Series tables with a hand crank mechanism for top height adjustment; new oval mobile tables with attached benches or stools; and several mobile cabinet models with a magnetic marker back. Products targeted for release in 2013 include an array of additions to the ZUMA and Sage seating lines with integral tubular steel arms, an expanded range of Parameter desks and workstations; and wheelchair-accessible versions of the ZUMA line's ZBOOM single-student desks for collaborative learning environments.

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Virco's impressive flat metal forming capabilities are further enhanced when combined with our Assemble-to-Ship ("ATS") strategy, which allows for the manufacture and storage of common components during the portion of the year when demand for our product is low followed by assembly to customer-specific combinations prior to shipment. The combination of flat metal forming and ATS enables Virco to offer an array of desks at three price points that provide a variety of furniture solutions for customer applications in a wide range of environments.

As of January 31, 2013, the Company's employment force was approximately 760 strong, manufacturing its products in 1.1 million square feet of fabrication facilities and 1.2 million square feet of assembly and warehousing facilities in Torrance, California and Conway, Arkansas. Additionally, the Company's PlanSCAPE® project management software allows its sales representatives to provide CAD layouts of classrooms, as well as classroom-by-classroom planning documents for the budgeting, acquisition and installation of furniture, fixtures and equipment ("FF&E"). In recent years, due to budgetary pressures, many schools have reduced or eliminated central warehouses, janitorial services, and professional purchasing functions. As a result, fewer school districts administer their own bids, and are more likely to use regional, state, or national contracts. A shift to site-based management combined with reductions in professional purchasing personnel has increased the reliance of schools on suppliers that provide for a variety of needs from one source rather than administering different vendor relationships for each item. In response to these changes, the Company has expanded both the products and the services it provides to its educational customers. Now, in addition to buying furniture FOB Factory, customers can purchase furniture for delivery to warehouses and school sites, and can also purchase full-service furniture delivery that includes the installation of the furniture in classrooms. Because the Company has been aggressively developing new furniture lines to enhance the range of products it manufactures - and by purchasing furniture and equipment from other companies for re-sale with Virco products - the Company is now able to provide "one-stop shopping" for all FF&E needs in the K-12 market.

The expansion of the Company's product line combined with the expansion of its services over the years has provided Virco with the ability to serve various markets including the education market (the Company's primary market), which is made up of public and private schools (preschool through 12th grade), junior and community colleges; four-year colleges and universities; and trade, technical and vocational schools. Virco also serves convention centers and arenas; the hospitality industry with respect to banquet and meeting facilities; government facilities at the federal, state, county and municipal levels; and places of worship. In addition, the Company also sells to wholesalers, distributors, traditional retailers and catalog retailers that serve these same markets.

Virco serves its customers through a well-trained, nationwide sales and support team. Virco's educational product line is marketed through an extensive direct sales force, as well as through a growing dealer network. In addition, Virco has a Corporate Sales Group to pursue wholesalers, mail order accounts and national chains where management believes that it would be more efficient to have a single sales representative or group service such customers, as they tend to have needs that transcend the geographic boundaries established for Virco's local accounts. The Company also has an array of support services, including complete package solutions for the FF&E line item on school budgets; computer-assisted layout planning; transportation planning; and product delivery, installation, and repair.

Another important element of Virco's business model is the Company's emphasis on developing and maintaining key manufacturing, assembly, distribution, and service capabilities. For example, Virco has developed competencies in several manufacturing processes that are important to the markets the Company serves, such as finishing systems, plastic molding, metal fabrication and woodworking. Virco's physical facilities are designed to support its ATS strategy. Warehouses have substantial staging areas combined with a large number of dock doors to support the seasonal peak in shipments during summer months.

During the last decade, many furniture manufacturers closed their domestic manufacturing facilities and began importing increasing quantities of furniture from international sources. During this same period, Virco elected to significantly reduce its work force, but retain its domestic factory locations. In recent years, the Company believes that its domestic manufacturing capabilities have evolved into a significant strength. The Company has effectively used product selection, color selection, and dependable execution of delivery and installation to customers to enhance its market position. With increasing costs from international sources and increasing freight costs, our factories are cost-competitive for bulky educational furniture and equipment items. The Company's ATS strategy allows for low-cube component parts to be sourced globally, with fabrication of bulky welded steel frames, wood tops, and



larger molded-plastic components to be performed locally. Domestic production of laminated wood tops and molded plastic enables the Company to market a color palette that cannot be matched in a short delivery window by imported finished goods. Domestic assembly allows the Company to use standard ATS components to assemble customer-specific product and color combinations shortly prior to delivery and installation.

Finally, management continues to hone Virco's ability to finance, manufacture and warehouse furniture within the relatively narrow delivery window associated with the highly seasonal demand for education sales. In 2011 and 2012, approximately 50%

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of the Company's total sales were delivered in June, July, and August with an even higher portion of educational sales delivered in that period. Shipments of furniture in July and August can be six times greater than in the seasonally slow winter months. Virco's substantial warehouse space allows the Company to build adequate inventories to service this narrow delivery window for the education market.

### Principal Products

Virco produces the broadest line of furniture for the K-12 market of any manufacturer in the United States. By supplementing products manufactured by Virco with products from other manufacturers, Virco provides a comprehensive product assortment that covers substantially all products and price points that are traditionally included on the FF&E line item on a new school project or school budget. Virco also provides a variety of products for preschool markets and has recently developed products that are targeted for college, university, and corporate learning center environments. The Company has an ambitious and on-going product development program featuring products developed in-house as well as products developed with accomplished designers. The Company's primary furniture lines are constructed of tubular metal legs and frames, combined with wood and plastic tops, plastic seats and backs, upholstered seats and backs, and upholstered rigid polyethylene and polypropylene shells. Virco also has flat metal forming capabilities to enable the production of desks, returns, bookcases, filing cabinets, mobile pedestals and related items.

Virco's principal manufactured products include:

**SEATING** - Launched in 2004, the ergonomically supportive ZUMA® line designed by Peter Glass and Bob Mills posted the highest initial-year new product sales total in the Company's history. Recent additions to the ZUMA line include two cantilever chairs with 13" and 15" seat heights; a tablet arm chair with a compact footprint; two rockers with 13" and 15" seat heights; and a chair with an articulating tablet arm which was introduced in Virco's 2009 Equipment for Educators™ catalog. The ZUMAFrd™ collection, introduced in 2005, features Fortified Recycled Wood™ hard plastic seats, backrests and work surfaces. ZUMAFrd products have up to 70% recycled content and are 98% recyclable. The Sage™ line, designed to serve students in college, university and other adult education settings, and on high school campuses, was introduced in late 2006. Along with its original adult-height models, Sage now offers a 13" and a 15" 4-leg chair and a corresponding pair of cantilever chairs; there's also a selection of Sage rockers introduced in 2012. In addition to these chairs, for younger, smaller students, Virco has introduced an articulating Sage tablet arm model for high school and adult learning venues. Selected adult-height Sage models can also now be ordered with a padded, upholstered seat. In 2007, the Company introduced the Metaphor® Series - an updated sequel to Virco's best-selling Classic Series™ furniture with improvements in comfort, ergonomics, stackability, and manufacturing efficiencies - and the Telos® Series, a wide-ranging product line with ergonomically contoured Fortified Recycled Wood components. In 2011, Virco launched the Sage Contract line for offices and reception areas, colleges, hospitality venues and other adult environments; Civitas™ chairs and stools for foodservice, libraries, media centers, circulation areas and related venues; and adjustable-height versions of 120, 121 and 122 Series stools. Other Virco seating alternatives include easily-adjustable Ph.D.® task chairs; I.Q.® Series classroom chairs; and comfortable, attractive Virtuoso® chairs by Charles Perry. Classic Series™ stack chairs and Martest 21® hard plastic seating models are popular choices in schools across America. Along with this range of seating, Virco offers folding chairs and upholstered stack chairs, as well as additional plastic stack chairs and upholstered ergonomic chairs.

**TABLES** - In April 2008, Virco introduced the TEXT® table collection for learning environments. Designed by the award-winning team of Peter Glass and Bob Mills, TEXT tables feature heavy-gauge tubular steel and proven Virco construction for extended product life, and elliptical legs, swooping yokes and arched feet for exceptional elegance. Selected TEXT models can be equipped with a variety of technology-support and storage accessories. Lunada® tables made their debut at the end of 2008. Combining Virco's popular Lunada bi-point bases with a selection of 20 top sizes, Lunada tables make great choices for seminar, conference and related settings. Designed for Virco by Peter Glass, Plateau® tables bring exceptional versatility, sturdy construction and great styling to working and learning environments. For durable, easy-to-use lightweight folding tables, Virco's Core-a-Gator® models are unsurpassed. When paired with attractive, durable Virco café tops, Lunada bases by Peter Glass provide eye-catching table solutions for hospitality settings; Civitas tops and bases were introduced in 2012. Virco also carries traditional folding tables, CT Series tables with a hand crank mechanism for top height adjustment, activity tables and office tables, as

well as the computer tables and mobile tables described below.

COMPUTER FURNITURE - The TEXT table collection described in the preceding paragraph provides educators an array of computer furniture choices for learning environments; Virco's Flip-Top Technology table line and the recently released HWT Technology table collection also deliver popular computer furniture solutions. Future Access® computer tables come with an integral wire management panel and all rectangular models have a smooth post-formed front and rear edge. Like our Future Access models, 8700 Series computer tables can be equipped with Virco's functional computing accessories, such as keyboard mouse trays, CPU holders and support columns for optional elevated shelves. The Plateau Office Solutions collection offers

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desks and workstations with technology-support capabilities, while the Plateau Library/Technology Solutions line has specialty tables and other products for computing applications.

**DESKS/CHAIR DESKS** - From the ergonomic and collaborative-learning strengths of our best-selling ZUMA® student desks to the continuing popularity of our traditional Classic Series™ chair desks and combo units, Virco's wide-ranging furniture models can be found in thousands of America's schools. Related products include teacher desks and tablet arm units. Selected models are available with durable, colorfast Martest 21® or Fortified Recycled Wood™ hard plastic components. For teachers, principals and district administrators, Virco has introduced the distinctive, stylish and modern Parameter® collection of desks, returns and credenzas; designed in collaboration with Peter Glass and Bob Mills, Parameter is also great for business environments.

**ADMINISTRATIVE OFFICE FURNITURE** - In addition to the Plateau® Office Solutions and Parameter desks and related products described above, Virco now manufactures a selection of desks, returns, bookcases and other items that employ the Company's flat metal forming capabilities. These products include 53 Series steel storage cabinets, an expanded range of 53 Series lateral files, and special versions of 543 and 546 Series desks with wire management capabilities released in 2011; moreover, Virco introduced 53 Series wardrobe tower cabinets, Parameter file credenzas and additional Parameter mobile pedestals in 2012. Plateau bookcases in popular 36" wide and 48" wide models are available for classroom settings and related educational environments as well as administrative offices.

**LABORATORY FURNITURE** - For biology and chemistry classes, and other school- and college-based lab settings, Virco offers a variety of steel-based science tables. Virco manufactures the table bases of these items and equips them with specialty tops purchased from vendor partners. Virco's ZUMA, Sage™, Telos®, Metaphor®, I.Q.®, Classic Series, and 3000 Series collections also include pneumatically adjustable lab stools with high-range seat-height adjustment and a steel foot-ring.

**MOBILE FURNITURE** - School cafeterias are perfect venues for the ever-popular Virco mobile tables - including a selection of new oval mobile tables with attached benches or stools introduced in 2012 - while classrooms benefit from the spacious storage capacity of Virco mobile cabinets; additional models with a magnetic marker back were launched in 2012. An array of Virco product lines includes mobile chairs for school settings and offices.

**STORAGE EQUIPMENT** - For moving selected Virco chairs and folding tables, the Company carries a wide range of handling and storage equipment. As a service to our convention center, arena, and auditorium customers, Virco also manufactures stackable storage trucks that work with Virco upholstered stack chairs, folding chairs and folding tables. Virco's wide-ranging product selection includes hundreds of furniture models that are certified according to the Greenguard® Children & Schools Program for indoor air quality. In 2005 Virco's ZUMA and ZUMAFrd™ products earned the distinction of being the first classroom furniture models to be certified through the Greenguard Children & Schools Program. All of the models in the Company's most recently introduced product lines - including CT Series tables with a hand crank mechanism and Civitas seating, café tops and bases - are Greenguard-certified. Along with Virco's leadership relative to Greenguard-certified furniture, the Company also introduced the classroom furniture industry's first Take-Back program in 2006, enabling qualifying schools, colleges, universities, and other organizations and customers to return selected out-of-service furniture components for recycling rather than sending these items to a landfill.

In order to provide a comprehensive product offering for the education market, the Company supplements Virco-manufactured products with items purchased for re-sale, including wood and steel office furniture, early learning products for pre-school and kindergarten classrooms, science laboratory furniture, and library tables, chairs and equipment. In 2009, Virco began carrying a complete line of specialty furniture and equipment from Wenger® Corporation for music rooms, performance areas and related spaces; Virco also now offers customized, space-efficient workstations by Interior Concepts™ for technology and language labs, media centers, computer classrooms, reception areas and offices. Wenger and Interior Concepts are two of the many vendors with which the Company partners in order to effectively position Virco as the preferred one-stop furniture and equipment source for K-12 schools. None of the products from vendor partners accounted for more than 10% of consolidated revenues in 2012.

To complement Virco's extensive selection of furniture and equipment, we offer customers a variety of valuable services in connection with the purchase of Virco products; revenues from these service levels are included in the purchase price of the furniture items. In addition to giving customers the option of purchasing Virco products and

making their own delivery arrangements, Virco provides three levels of delivery service. When customers choose Standard Delivery - also known as tailgate delivery - the delivery driver is responsible for moving the customer's goods to the tailgate of the truck only; therefore, the customer must have personnel on hand to unload the truck. For additional charges Virco also offers Inside Delivery (no installation), or Full-Service Delivery (delivered and installed). To assist customers involved with FF&E purchases for new

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school construction projects or school renovations, Virco's PlanSCAPE® service provides room-by-room computerized layout planning and full FF&E project management.

### Customers

Virco's major customers include educational institutions, convention centers and arenas, hospitality providers, government facilities, and places of worship. No customer accounted for more than 10% of Virco's consolidated revenues during 2012.

### Raw Materials

Virco purchases steel, aluminum, plastic, polyurethane, polyethylene, polypropylene, plywood, particleboard, cartons and other raw materials from many different sources for the manufacture of its principal products. Management believes the Company is not more vulnerable with respect to the sources and availability of these raw materials than other manufacturers of similar products. The Company's largest raw material cost is for steel, followed by plastics and wood.

The price of these commodities, particularly steel and plastic, has been volatile in recent years. Steel and plastic prices increased significantly in 2004 and 2005, in part due to worldwide demand of these materials, especially in China. By comparison, in 2006 and 2007 the price of these commodities was relatively stable. In 2008, steel prices increased by more than 80% during a four month period from April to July, followed by a period of modest decline in the latter part of 2008 and relative stability in 2009 and 2010. During 2011, the Company incurred significant increases in the cost of steel during the second quarter and plastic during the second and third quarters which adversely impacted the profitability of orders received at the beginning of the year (such orders were shipped during the summer). During 2012 the cost of steel, plastic, and wood were stable.

In addition to the raw materials described above, the Company purchases components used in the fabrication and assembly of furniture from a variety of overseas locations, but primarily from China. These components are classified as raw materials in the financial statements until such time that the components are consumed in a fabrication or assembly processes. These components are sourced from a variety of factories, none of which are owned or operated by the Company. Costs for these imported components increased moderately during the last three years, and are expected to increase further in 2013.

With respect to the Company's annual contracts (or those contracts that have longer terms), the Company may have limited ability to increase prices during the term of the contract. The Company has, however, negotiated increased flexibility under many of these contracts, allowing the Company to increase prices on future orders. Nevertheless, even with respect to these more flexible contracts, the Company does not have the ability to increase prices on orders received prior to any announced price increases. Due to the intensely seasonal nature of our business, the Company may receive significant orders during the first and second quarters for delivery in the second and third quarters. With respect to any of the contracts described above, if the costs of raw materials increase suddenly or unexpectedly, the Company cannot be certain that it will be able to implement corresponding increases in its sales prices in order to offset such increased costs. Significant cost increases in providing products during a given contract period can adversely impact operating results and have done so during prior years, especially in 2004, 2005, 2008, and 2011. The Company typically benefits from any decreases in raw material costs under the contracts described above.

### Marketing and Distribution

Virco serves its customers through a well-trained, nationwide sales and support team, as well as a growing dealer network. In addition, Virco has a Corporate Sales Group to pursue wholesalers, mail order accounts and national chains where management believes it would be more efficient to have a single sales representative or group approach such persons, as they tend to have needs that transcend the geographic boundaries established for Virco's local accounts.

Virco's educational product line is marketed through what management believes to be the largest direct sales force of any education furniture manufacturer. The Company's approach to servicing its customer base is very flexible, and is tailored to best meet the needs of individual customers and regions. When considered to be most efficient, the sales force will call directly upon school business officials, who may include purchasing agents or individual school principals where site-based management is practiced. Where it is considered advantageous, the Company will use large exclusive distributors and full-service dealer partners. The Company's direct sales force is considered to be an

important competitive advantage over competitors who rely primarily upon dealer networks for distribution of their products.

Virco's sales force is assisted by the Company's proprietary PlanSCAPE® software and experienced PlanSCAPE managers when preparing complete package solutions for the FF&E segment of bond-funded public school construction projects. PlanSCAPE software also enables the entire Virco sales force to prepare quotations for less complicated projects.

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A significant portion of Virco's business is awarded through annual bids with school districts or other buying groups used by school districts. These bids are typically valid for one year. Many contracts contain penalty, performance, and debarment provisions that can result in debarment for a number of years, a financial penalty, or calling of performance bonds.

Sales of commercial and contract furniture are made throughout the United States by distributorships and by Company sales representatives who service the distributorship network. Virco representatives call directly upon state and local governments, convention centers, individual hospitality venues, and mass merchants. This market includes colleges and universities, preschools, private schools, and office training facilities, which typically purchase furniture through commercial channels.

The Company sells to thousands of customers, and, as such no single customer represented more than 10 percent of the Company's consolidated revenues in 2012. Significant purchases of furniture using public funds often require annual bids or some form of "authorization" to purchase goods or services from a vendor. This authorization can include state contracts, local and national buying groups, or local school districts that "piggyback" on the bid of a larger district. In virtually all cases, purchase orders and payments are processed by the individual school districts, even though the contract pricing may be determined by a state contract, national or local buying group, or consortium of school districts. Schools usually can purchase from more than one contract or purchasing vehicle, if they are participants in buying groups as well as being eligible for a state or national contract.

Virco is the exclusive supplier of movable classroom furniture for one nationwide purchasing organization under which many of our customers price their furniture. See "Risk Factors : Approximately 50% of our sales are priced through one contract, under which we are the exclusive supplier of classroom furniture." Sales priced under this contract represented approximately 49% of Virco's sales in 2012, 50% of Virco's sales in 2011, and 43% of Virco's sales in 2010. In the third quarter of 2008, the Company was awarded a three-year contract with this purchasing organization extending through 2011. In 2008 the Company was awarded three one-year extensions extending through 2014. If Virco were unable to sell under this contract, we would be able to sell to the vast majority of our customers under alternative contracts.

### Seasonality

The educational sales market is extremely seasonal. Approximately 50% of the Company's total sales in 2012 were delivered in June, July, and August with an even higher portion of educational sales delivered in that period.

Shipments during peak weeks in July and August can be as great as six times the level of shipments in the winter months.

### Working Capital Requirements During the "Peak" Summer Season

As discussed above, the market for educational furniture and equipment is marked by extreme seasonality, with the majority of shipments occurring from June to August each year, which is the Company's peak season. As a result of this seasonality, Virco builds and carries significant amounts of inventory during the 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, Virco has historically relied on bank financing to meet cash flow requirements during the build-up period immediately preceding the high season. Currently, the Company has a line of credit with PNC Bank to assist in meeting cash flow requirements as inventory is built for, and business is transacted during, the peak summer season.

In addition, Virco typically is faced with a large balance of accounts receivable during the peak season. This occurs for three primary reasons. First, accounts receivable balances naturally increase during the peak season as product shipments increase. Second, many customers during this period are government institutions, which tend to pay accounts receivable more slowly than commercial customers. Third, many summer deliveries may be "projects" where the Company provides furniture for a new school or significant refurbishment of an existing school. Projects may require architect sign off, school board approval prior to payment, or punch list completion, all of which can delay payment. Virco has historically enjoyed high levels of collectability on these accounts receivable due to the low-credit risk associated with such customers. Nevertheless, due to the time differential between inventory build-up in anticipation of the peak season and the collection on accounts receivable throughout the peak season, the Company



must rely on external sources of financing.

As a result of the seasonality of our business, our manufacturing capacity is dictated by the capacity requirement during the months of June, July, and August. Because of this seasonality, factory utilization is lower during the slow season. The Company utilizes a variety of tactics to address this seasonal business. During the summer months, which comprise our second and third fiscal quarters, our personnel utilization generally is at or close to full capacity. The Company utilizes temporary labor and significant overtime to meet the seasonal requirements. During the slow portions of the year, temporary labor and overtime are eliminated to moderate the off-season costs. Our manufacturing facility capacity utilization generally remains less than 100% during these summer months; because physical structure capacity cannot be adjusted as readily as personnel

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capacity, we have secured sufficient physical structure capacity to accommodate our current needs as well as for anticipated future growth. Our physical structure utilization is significantly lower during the first and fourth quarters of each year than it is during the second and third quarters.

The Company utilizes a comparable strategy to address warehousing and distribution requirements. During summer months, temporary labor is hired to supplement experienced warehouse and distribution personnel. More than 90% of the Company's freight is provided by third-party carriers. The Company has secured sufficient warehouse capacity to accommodate our current needs as well as anticipated future growth.

Virco'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. For example, management expends a significant amount of time in the first quarter of each year developing a stocking plan and estimating the number of temporary summer employees, the amount of raw materials, and the types of components and products that will be required during the peak season. If management underestimates any of these requirements, Virco's ability to meet customer orders in a timely manner or to provide adequate customer service may be diminished. If management overestimates any of these requirements, the Company may have to absorb higher storage, labor and related costs, each of which may negatively affect the Company's results of operations. On an on-going basis, management evaluates its estimates, including those related to market demand, labor costs, and stocking inventory. Moreover, management continually strives to improve its ability to correctly forecast the requirements of the Company's business during the peak season each year based in part on annual contracts which are in place and management's experience with respect to the market.

As part of Virco's efforts to balance seasonality, financial performance and quality without sacrificing service or market share, management has been refining the Company's ATS operating model. ATS is Virco's version of mass-customization, which assembles standard, stocked components into customized configurations before shipment. The ATS program reduces the total amount of inventory and working capital needed to support a given level of sales. It does this by increasing the inventory's versatility, delaying assembly until the last moment, and reducing the amount of warehouse space needed to store finished goods. As part of the ATS stocking program, Virco has endeavored to create a more flexible work force. The Company has developed compensation programs to reward employees who are willing to move from fabrication to assembly to the warehouse as seasonal demands evolve.

### Other Matters

#### Competition

Virco has numerous competitors in each of its markets. In the educational furniture market, Virco manufactures furniture and sells direct to educational customers. Competitors typically fall into two categories (1) furniture manufacturers that sell to dealers which re-sell furniture to the end user, and (2) dealers that purchase product from these manufacturers and re-sell to educational customers. The manufacturers that Virco competes with include HON (HNI) which recently acquired Sagus International LLC (which markets product under Artco-Bell, American Desk, and Midwest Folding Products), KI Inc., Bretford, Smith System, Columbia, Scholarcraft and VS America. Our largest competitor historically that purchases and re-sells furniture has been School Specialty (SCHS). In January 2013, School Specialty filed for bankruptcy under Chapter 11 of the Bankruptcy Code. In addition to School Specialty, there are numerous smaller local education furniture dealers that sell into local markets. Competitors in contract furniture vary depending upon the specific product line or sales market and include Falcon Products, Inc., MTS and Mity Enterprises, Inc.

The educational furniture market is characterized by price competition, as many sales occur on a bid basis.

Management compensates for this market characteristic through a combination of methods that include emphasizing the value of Virco's products and product assortment, the convenience of one-stop shopping for "Equipment for Educators™", the value of Virco's project management capabilities, the value of Virco's distribution and delivery capabilities, and the value of Virco's customer support capabilities and other intangibles. In addition, management believes that the streamlining of costs assists the Company in compensating for this market characteristic by allowing Virco to offer a higher value product at a lower price. For example, as discussed above, Virco has decreased distribution costs by avoiding re-sellers, and management believes that the Company's large direct sales force and the Company's sizeable manufacturing and warehousing capabilities facilitate these efforts. Although management prefers

to compete on the value of Virco products and services, when market conditions warrant, the Company will compete based on direct prices and may reduce its prices to build or maintain its market share.

**Backlog**

Sales order backlog at January 31, 2013, totaled \$17.3 million and approximated eight weeks of sales, compared to \$14.4 million at January 31, 2012, and \$17.6 million at January 31, 2011. Substantially all of the backlog will ship during 2013.

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### Patents and Trademarks

In the last 10 years, the United States Patent and Trademark Office (the “USPTO”) has issued to Virco more than 50 patents on its various new product lines. These patents cover various design and utility features in Ph.D.® chairs, I.Q.® Series furniture, the ZUMAFrd™ family of products, and the ZUMA® family of products, among others. Virco has a number of other design and utility patents in the United States and other countries that provide protection for Virco's intellectual property as well. These patents expire over the next one to 17 years. Virco maintains an active program to protect its investment in technology and patents by monitoring and enforcing its intellectual property rights. While Virco's patents are an important element of its success, Virco's business as a whole is not believed to be materially dependent on any one patent. See “Risk Factors : An inability to protect our intellectual property could have a significant impact on our business.”

In order to distinguish genuine Virco products from competitors' products, Virco has obtained the rights to certain trademarks and trade names for its products and engages in advertising and sales campaigns to promote its brands and to identify genuine Virco products. While Virco's trademarks and trade names play an important role in its success, Virco's business as a whole is not believed to be materially dependent on any one trademark or trade name, except perhaps “Virco,” which the Company has protected and enhanced as an emblem of quality educational furniture for over 60 years.

Virco has no franchises or concessions that are considered to be of material importance to the conduct of its business and has not appraised or established a value for its patents or trademarks.

### Employees

As of January 31, 2013, Virco and its subsidiaries employed approximately 760 full-time employees at various locations. Of this number, approximately 590 are involved in manufacturing and distribution, approximately 105 in sales and marketing and approximately 65 in administration. The Company also utilizes temporary workers as necessary to meet any seasonal production, warehousing or distribution requirements that cannot be filled by its full time workforce. During 2012, the Company employed approximately 200 temporary workers during the months of June and July.

### Environmental Compliance

Virco is subject to numerous federal, state, and local environmental laws and regulations in the various jurisdictions in which it operates that (a) govern operations that may have adverse environmental effects, such as the discharge of materials into the environment, as well as handling, storage, transportation and disposal practices for solid and hazardous wastes, and (b) impose liability for response costs and certain damages resulting from past and current spills, disposals or other releases of hazardous materials. In this context, Virco works diligently to remain in compliance with all such environmental laws and regulations as these affect the Company's operations. Moreover, Virco has enacted policies for recycling and resource recovery that have earned repeated commendations, including: recognition by the California Department of Resources Recycling and Recovery (CalRecycle) in 2011 and 2010 as a Waste Reduction Awards Program (WRAP) honoree; recognition by the United States Environmental Protection Agency in 2003 as a WasteWise Hall of Fame Charter Member, in 2002 as a WasteWise Partner of the Year and in 2001 as a WasteWise Program Champion for Large Businesses; and recognition by the Sanitation Districts of Los Angeles County for compliance with industrial waste water discharge guidelines in 2007 through 2010. This is only a partial list of Virco's environmental awards and commendations; for a more complete list, go to [www.virco.com](http://www.virco.com) and click on the Corporate Stewardship header. In addition to these awards and commendations, Virco's ZUMA and ZUMAFrd product lines were the first classroom furniture collections to earn indoor air quality certification through the stringent GREENGUARD® Children & Schools Program. As a follow-up to the certification of ZUMA and ZUMAFrd models in 2005, hundreds of other Virco furniture items - including all models in the Company's recently introduced CT Series table line and Civitas™ seating, café top and base collection - have earned GREENGUARD certification. Moreover, all Virco products covered by the Consumer Product Safety Improvement Act of 2008 are in compliance with this legislation. All affected Virco models are also in compliance with the California Air Resources Board rule implemented on January 1, 2009, concerning formaldehyde emissions from composite wood products. Environmental laws have changed rapidly in recent years, and Virco may be subject to more stringent environmental laws in the future. The Company has expended, and may be expected to continue to expend, significant amounts in the

future for compliance with environmental rules and regulations, for the investigation of environmental conditions, for the installation of environmental control equipment, or remediation of environmental contamination. Normal recurring expenses relating to operating our factories in a manner that meets or exceeds environmental laws are matched to the cost of producing inventory. It is possible that the Company's operations may result in noncompliance with, or liability for remediation pursuant to, environmental laws. Should such eventualities occur, the Company records liabilities for remediation costs when remediation costs are probable and can be reasonably estimated. See

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“Risk Factors : We could be required to incur substantial costs to comply with environmental requirements.” Violations of, and liabilities under, environmental laws and regulations may increase our costs or require us to change our business practices.

## Financial Information About Industry Segment and Geographic Areas

Virco operates in a single industry segment. For information regarding the Company's revenues, gross profit and total assets for each of the last three fiscal years, see the Company's consolidated financial statements.

During 2012, Virco derived nearly 10% of its revenues from customers located outside of the United States (primarily Canada and Puerto Rico). During 2011, Virco derived approximately 7% of its revenues from customers located outside of the United States (primarily in Canada and Panama). During 2010, Virco derived approximately 6% of its revenues from customers located outside of the United States (primarily in Canada). The Company determines sales to these markets based upon the customers' principal place of business. During 2012, 2011 and 2010, the Company did not have any long-lived assets outside of the United States.

## Executive Officers of the Registrant

As of April 1, 2013, the executive officers of the Company, who are elected by and serve at the discretion of the Company's Board of Directors, were as follows:

Name	Office	Age at January 31, 2013	Has Held Office Since
Robert A. Virtue (1)	President, Chairman of the Board and Chief Executive Officer	80	1990
Douglas A. Virtue (2)	Executive Vice President	54	1992
J. Scott Bell (3)	Vice President — General Manager, Conway Division	56	2004
Robert E. Dose (4)	Vice President — Finance, Secretary and Treasurer	56	1995
Patricia Quinones (5)	Vice President — Logistics, Marketing Services and Information Technology	49	2004
D. Randal Smith (6)	Vice President — Marketing and Corporate Stewardship	64	1995
Bassey Yau (7)	Vice President — Corporate Controller, Assistant Secretary and Assistant Treasurer.	54	2004

(1) Appointed Chairman in 1990; has been employed by the Company for 56 years and has served as the President since 1982 and Chief Executive Officer since 1988.

(2) Appointed in 1992; has been employed by the Company for 27 years and has served in Production Control, as Contract Administrator, as Manager of Marketing Services, as General Manager of the Torrance Division, and currently as Corporate Executive Vice President.

(3) Appointed in 2004; has been employed by the Company for 24 years and has served in a variety of manufacturing, safety, and environmental positions, and currently Vice President — General Manager, Conway Division.

(4) Appointed in 1995; has been employed by the Company for 22 years and has served as the Corporate Controller, and currently as Vice President of Finance, Secretary and Treasurer.

(5) Appointed in 2004; has been employed by the Company for 21 years in a variety customer and marketing service positions, and currently as Vice President of Logistics, Marketing Services and Information Technology.

(6) Appointed in 1995; has been employed by the Company for 28 years in a variety of sales and marketing positions, and currently as Vice President of Marketing & Corporate Stewardship.

(7) Appointed in 2004; has been employed by the Company for 16 years and has served as Corporate Controller, and currently as Vice President Accounting, Corporate Controller, Assistant Secretary and Assistant Treasurer.

None of the Company's officers have employment contracts.

## Available Information

Virco files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (“SEC”). Stockholders may read and copy this information at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the



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SEC at 1-800-SEC-0330. Stockholders may also obtain copies of this information by mail from the Public Reference Room at the address set forth above, at prescribed rates.

The SEC also maintains an Internet website that contains reports, proxy statements and other information about issuers like Virco who file electronically with the SEC. The address of that site is [www.sec.gov](http://www.sec.gov).

In addition, Virco makes available to its stockholders, free of charge through its Internet website, its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed, or furnished pursuant to, Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"), as soon as reasonably practicable after Virco electronically files such material with, or furnishes it to, the SEC. The address of that site is [www.virco.com](http://www.virco.com).

Item 1A. Risk Factors

The following risk factors and other information included in this Annual Report on Form 10-K should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we presently deem less significant may also adversely affect our business, operating results, cash flows, and financial condition. If any of the following risks actually occur, our business, operating results, cash flows and financial condition could be materially adversely affected.

Our product sales are significantly affected by education funding, which is a function of general economic conditions. If the economy continues to remain weak or further weakens, funding for education may fail to improve or decrease further, which would adversely affect our business and results of operations.

Our sales are significantly impacted by the level of education funding primarily in North America, which, in turn, is a function of the general economic environment. In a weak economy, like the one currently being experienced in the United States, state and local revenues decline, restricting funding for K-12 education spending which typically leads to a decrease in demand for school furniture. Sustained depressions in the per-student funding levels provided for in-state and local budgets could have a materially adverse impact on our business, financial condition and results of operations.

As part of the American Recovery and Reinvestment Act (ARRA), the Federal Government provided \$44 billion to be distributed through the Department of Education by April 30, 2009. Significant portions of this money were used to avoid reductions-in-force at educational institutions. It is anticipated that the amount of Federal assistance will decrease in 2013. This decrease and any continued depressions in state and local revenues and gaps in state budgets may require substantial additional reductions in school budgets, which in turn could lead to further declines in demand for school furniture, fixtures and equipment, which would materially adversely affect our revenue and results of operations.

In addition, geopolitical uncertainties, terrorist attacks, acts of war, natural disasters, increases in energy and other costs or combinations of such factors and other factors that are outside of our control could at any time have a significant effect on the economy, which in turn would affect government revenues and allocations of government spending. The occurrence of any of these or similar events in the future could cause demand for our products to decline or competitive pricing pressures to increase, either or both of which would adversely affect our business, operating results, cash flows and financial condition.

Gaps in state budgets may adversely affect our revenue and results of operations.

Virtually all states are required to balance their operating budgets either on an annual or bi-annual basis. Unlike the federal government, states cannot maintain services during an economic downturn by running a deficit. Without federal economic assistance, states that have not recovered from the recent recession will need to address remaining shortfalls with a combination of spending cuts and/or tax increases. If states cut spending for education to address such budgetary shortfalls, our revenue and results of operations will be adversely affected.

Reduced levels of spending on education may significantly impact spending on furniture and increase price competition in the furniture market. If price competition increases, we may need to reduce our prices to build or maintain our market share, which in turn could lower our profit margins.

The educational furniture market is characterized by price competition, as many sales occur on a bid basis. When state and local funding for education declines, schools typically reduce spending on all budget line items prior to reducing teacher and administrator salaries and benefits. This in turn can result in reduced demand for school furniture, which



in turn can intensify price competition in our industry. This price competition could impact our ability to implement price increases or, in some cases, such as during an industry downturn, maintain prices. In addition, when market conditions warrant, we may need to reduce prices to build or maintain our market share. If we are unable to increase or maintain prices for our products, our profit

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margins could decline. Such decline will be compounded to the extent we are unable to maintain or reduce the cost of our products, which may be especially difficult in the current environment given the volatility of the commodities markets.

Our efforts to introduce new products that meet customer requirements may not be successful, which could limit our sales growth or cause our sales to decline.

To keep pace with industry trends, such as changes in education curriculum and increases in the use of technology, and with evolving regulatory and industry requirements, including environmental, health, safety and similar standards for the education environment and for product performance, we must periodically introduce new products. The introduction of new products requires the coordination of the design, manufacturing and marketing of such products, which may be affected by factors beyond our control. The design and engineering of certain of our new products can take up to a year or more, and further time may be required to achieve customer acceptance. Accordingly, the launch of any particular product may be later or less successful than we originally anticipated. Additionally, our competitors may develop new product designs that achieve a high level of customer acceptance, which could give them a competitive advantage over us in making future sales. Difficulties or delays in introducing new products or lack of customer acceptance of new products could limit our sales growth or cause our sales to decline.

The majority of our sales are generated under annual contracts, which combined with the seasonal nature of our business, may limit our ability to raise prices on a timely basis during a given year in response to increases in costs. We commit to annual contracts that determine selling prices for goods and services for periods of one year, and occasionally longer. Though the Company has negotiated increased flexibility under many of these contracts that may allow the Company to increase prices on future orders, the Company does not have the ability to raise prices on orders received prior to any announced price increase. Due to the intensely seasonal nature of our business, the Company may receive significant orders during the first and second quarters for delivery in the second and third quarters. With respect to any of the contracts described above, if the costs of providing our products or services increase between the date the orders are received and the shipping date, we may not be able to implement corresponding increases in our sales prices for such products or services in order to offset the related increased costs. Significant cost increases in providing either the services or products during a given contract period could therefore lower our profit margins. By way of example, in 2008, we incurred a severe increase in the price of steel. Steel prices increased by more than 80% during a four month period from April to July. During the period from April through the third quarter of 2008, the price of petroleum increased substantially, affecting the cost of plastic, inbound freight, freight to customers, and other energy costs. During the third quarter of 2008, we successfully raised the sales prices under a significant number of our annual contracts in an effort to recover margin lost to increased costs. Due to the seasonal nature of our business, however, approximately 2/3 of orders received and approximately 75% of shipments for the year were priced prior to the third quarter increase. During 2011, the Company incurred an increase of approximately 30% in the cost of steel during the second quarter, and nearly a 30% increase in the cost of certain plastics over the second and third quarters. The Company increased prices for the 2012 year in an effort to recover these commodity cost increases and intends to increase prices again for 2013.

We depend on outside suppliers who may be unable to meet our volume and quality requirements, and we may be unable to obtain alternative sources.

We require substantial amounts of raw materials and components to manufacture our products, which we purchase from outside sources. Raw materials comprised our single largest total cost for 2012, 2011, and 2010. Contracts with most of our suppliers are short-term. These suppliers may not continue to provide raw materials and components to us at attractive prices, or at all, and we may not be able to obtain the raw materials we need in the future from these or other providers on the scale and within the time frames we require. In the current economic environment, many of the Company's suppliers may experience difficulty obtaining financing and may go out of business. The Company may have difficulty replacing these suppliers, especially if the supplier fails as the Company is entering the seasonal summer shipping season. Moreover, we do not carry significant inventories of raw materials, components or finished goods that could mitigate an interruption or delay in the availability of raw materials and components. In addition, because we purchase components from international sources, primarily China, we are subject to fluctuations in currency exchange rates as well as the impact of natural disasters, war and other factors that may disrupt the

transportation systems or shipping lines used by our suppliers, and other uncontrollable factors such as changes in foreign regulation or economic conditions. Any failure to obtain raw materials and components on a timely basis, or any significant delays or interruptions in the supply of raw materials, could prevent us from being able to manufacture products ordered by our customers in a timely fashion, which could have a negative impact on our reputation and could cause our sales to decline.

Increases in basic commodity, raw material and component costs could adversely affect our profitability.

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Fluctuations in the price, availability and quality of the commodities, raw materials and components used in manufacturing our products could have an adverse effect on our costs of sales, profitability and our ability to meet customers' demand. The price of commodities, raw materials and components, including steel and plastics, our largest raw material categories, have been volatile in recent years, and the cost, quality and availability of such commodities have been significantly affected in recent years by, among other things, changes in global supply and demand, changes in laws and regulations (including tariffs and duties), changes in exchange rates and worldwide price levels, natural disasters, labor disputes, terrorism and political unrest or instability. These factors could lead to further price increases or supply interruptions in the future. As discussed above, in the short term, rapid changes in raw material costs can be very difficult for us to offset with price increases because, in the case of many of our contracts, we have committed to selling prices for goods and services for periods of one year, and occasionally longer. Our profit margins could be adversely affected if commodity, raw material and component costs remain high or escalate further, and, we are unable to pass along a portion of the higher costs to our customers.

We are affected by the cost of energy, and increases in energy prices could reduce our margins and profits.

The profitability of our operations is sensitive to the cost of energy relative to our transportation costs, the costs of petroleum-based materials (like plastics), and the costs of operating our manufacturing facilities. Petroleum prices have fluctuated significantly in recent years. Prices and availability of petroleum products are subject to political, economic and market factors that are generally outside our control. Political events in petroleum-producing regions as well as hurricanes and other weather-related events may cause petroleum prices to increase. If such prices increase, our transportation costs may be adversely affected in the form of increased operation costs for our fleet and surcharges on freight paid to third-party carriers. If our transportation costs continue to increase, and/or the price of petroleum-based products and cost of operating our manufacturing facilities increase, these increases could have a negative impact on our gross margins and profitability.

Approximately 50% of our sales are priced through one contract, under which we are the exclusive supplier of classroom furniture.

A nationwide contract/price list, which allows schools and school districts to purchase furniture without bidding, accounts for the pricing of a significant portion of our sales. This contract/price list is sponsored by a nationwide purchasing organization that does not purchase products from the Company. By providing a public bid specification and authorization service to publicly-funded agencies, the organization's contract/price list enables such agencies to make authorized expenditures of taxpayer funds. For all sales under this contract/price list, Virco has a direct selling relationship with the purchaser, whether it is a school, a district, or another publicly-funded agency. In addition, Virco can ship directly to the purchaser; perform installation services at the purchaser's location; and finally bill directly to, and collect from, the purchaser. Although Virco sells direct to hundreds of individual schools and school districts, and these schools and school districts can purchase our products and services under several bids and contracts available to them, approximately 49% of Virco's sales in 2012 and 50% of Virco's sales in 2011 were priced under this nationwide contract/price list. In the 3rd quarter of 2008, the Company was awarded a three-year contract with this purchasing organization extending through 2011. In addition, in 2008 the Company was awarded three one-year extensions extending through 2014. If Virco were to lose its exclusive supplier status under this contract/price list, and other manufacturers were allowed to sell under this contract/price list, it could cause Virco's sales, or growth in sales, to decline.

We operate in a seasonal business, and require significant amounts of working capital through our existing credit facility to fund acquisitions of inventory, fund expenses for freight and installation, and finance receivables during the summer delivery season. Restrictions imposed by the terms of our existing credit facility may limit our operating and financial flexibility. In addition, there can be no assurance that the Company will meet the requirements of its financial covenants on an ongoing basis or that should it fail to meet such covenants in the future, the agent and lender under the Credit Agreement will agree to waivers or amendments with respect thereto.

Our credit facility, among other things, largely prevents us from incurring any additional indebtedness, limits capital expenditures, restricts dividends and stock repurchases, and provides for seasonal variations in the maximum borrowing amount, including a reduced maximum level of borrowing during the fourth fiscal quarter. Our credit facility also provides for periodic financial covenants, which currently include a minimum EBITDA, a minimum

tangible net worth and a minimum fixed charge coverage ratio requirement. As a result of the foregoing, our operational and financial flexibility may be limited, which may prevent us from engaging in transactions that might further our growth strategy or otherwise be considered beneficial to us.

Under our credit facility, substantially all of our accounts receivable are automatically and promptly swept to repay amounts outstanding under the credit facility upon our receipt. Due to this automatic liquidating nature, if we breach any covenant, violate any representation or warranty or suffer a deterioration in our ability to borrow pursuant to the borrowing base calculation contained in the credit facility, we may not have access to cash liquidity unless provided by the lender in its

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discretion. If the indebtedness under our credit facility were to be accelerated, we cannot be certain that we will have sufficient funds available to pay such indebtedness or that we will have the ability to refinance the accelerated indebtedness on terms favorable to us or at all. Any such acceleration could also result in a foreclosure on all or substantially all of our assets, which would have a negative impact on the value of our common stock and jeopardize our ability to continue as a going concern. In addition, certain of the covenants and representations and warranties set forth in our credit facility 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 we expect to occur on an ongoing basis. There can be no assurance that we will be able to comply with all such covenants and be able to continue to make such representations and warranties on an ongoing basis. Due to continued weak demand for education furniture, the Company has been unable to satisfy its minimum tangible net worth and minimum EBITDA covenants for numerous periods and most recently its minimum EBITDA covenant for the relevant period ending December 31, 2012. On each occasion, the lender under the Company's Credit Agreement has agreed to amend the Company's credit facility and/or waive the violation. Accordingly, on March 1, 2013, the Company entered into Amendment No. 5 to the Credit Agreement, which waived the violation of the minimum EBITDA covenant at December 31, 2012 and amended the minimum tangible net worth covenant and minimum EBITDA covenant at January 31, 2013. There can be no assurance that the Company will meet the requirements of its financial covenants on an ongoing basis or that, should it again fail to meet such covenants, the Agent and Lender under its Credit Agreement will agree to waivers or amendments with respect thereto.

We may not be able to renew our credit facility on favorable terms, or at all, which would adversely affect our results of operations.

We have historically relied on third-party bank financing to meet our seasonal cash flow requirements. On an annual basis, we prepare a forecast of seasonal working capital requirements and use borrowings under our credit facility with PNC Bank to help meet these seasonal cash flow and working capital requirements. Disruptions in the U.S. credit markets have caused the interest rate on prospective debt financing to widen considerably and have made financing terms for borrowers less attractive, and in certain cases have resulted in the unavailability of certain types of debt financing. Continued uncertainty in the credit markets may negatively impact our ability to renew our credit facility upon its maturity in 2014 on favorable terms or at all. If we are unable to renew our credit facility on favorable terms (including available borrowing line and the rate of interest charged thereunder), or at all, our ability to fund our operations would be impaired, which would have a material adverse effect on our results of operations.

If management does not accurately forecast the Company's requirements for the peak summer season, the Company's results of operations could be adversely affected.

The Company's business is highly seasonal and requires significant working capital in anticipation of and during the peak summer season. This requires management to make estimates and judgments with respect to the Company's working capital requirements during, and in anticipation of, the peak summer season. Management expends a significant amount of time in the first quarter of each year developing a stocking plan and estimating the number of temporary summer employees, the amount of raw materials, and the types of components and products that will be required during the peak season. If management does not accurately forecast the Company's requirements, the Company's results of operations could be adversely affected. For example, if management underestimates any of these requirements, Virco's ability to meet customer orders in a timely manner or to provide adequate customer service may be diminished. If management overestimates any of these requirements, the Company may be required to absorb higher storage, labor and related costs, each of which may negatively affect the Company's results of operations.

We may require additional capital in the future, which may not be available or may be available only on unfavorable terms.

Our capital requirements depend on many factors, including capital improvements, tooling and new product development. To the extent that our existing capital is insufficient to meet these requirements and cover any losses, we may need to raise additional funds through financings or curtail our growth and reduce our assets. Any equity or debt financing, if available at all, may be on terms that are not favorable to us. Equity financings could result in dilution to our stockholders, and the securities may have rights, preferences and privileges that are senior to those of our common stock. If our need for capital arises because of significant losses, the occurrence of these losses may make it more

difficult for us to raise the necessary capital.

An inability to protect our intellectual property could have a significant impact on our business.

We attempt to protect our intellectual property rights through a combination of patent, trademark, copyright and trade secret laws. Our ability to compete effectively with our competitors depends, to a significant extent, on our ability to maintain the proprietary nature of our intellectual property. The degree of protection offered by the claims of the various patents, trademarks and service marks may not be broad enough to provide significant proprietary protection or competitive advantages to us, and

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patents, trademarks or service marks may not be issued on our pending or contemplated applications. In addition, not all of our products are covered by patents. It is also possible that our patents, trademarks and service marks may be challenged, invalidated, cancelled, narrowed or circumvented. If we are unable to maintain the proprietary nature of our intellectual property with respect to our significant current or proposed products, our competitors may be able to sell copies of our products, which could adversely affect our ability to sell our original products and could also result in competitive pricing pressures.

If third parties claim that we infringe upon their intellectual property rights, we may incur liability and costs and may have to redesign or discontinue an infringing product.

We face the risk of claims that we have infringed third parties' intellectual property rights. Companies operating in the furniture industry routinely seek protection of the intellectual property for their product designs, and our principal competitors may have large intellectual property portfolios. Our efforts to identify and avoid infringing third parties' intellectual property rights may not be successful. Any claims of intellectual property infringement, even those without merit, could (i) be expensive and time-consuming to defend; (ii) cause us to cease making, licensing or using products that incorporate the challenged intellectual property; (iii) require us to redesign, reengineer, or rebrand our products or packaging, if feasible; or (iv) require us to enter into royalty or licensing agreements in order to obtain the right to use a third party's intellectual property. Such claims could have a negative impact on our sales and results of operations.

We could be required to incur substantial costs to comply with environmental requirements. Violations of, and liabilities under, environmental laws and regulations may increase our costs or require us to change our business practices.

Our past and present ownership and operation of manufacturing plants are subject to extensive and changing federal, state, and local environmental laws and regulations, including those relating to discharges to air, water and land, the handling and disposal of solid and hazardous waste and the cleanup of properties affected by hazardous substances. As a result, we are involved from time to time in administrative and judicial proceedings and inquiries relating to environmental matters and could become subject to fines or penalties related thereto. We cannot predict what environmental legislation or regulations will be enacted in the future, how existing or future laws or regulations will be administered or interpreted or what environmental conditions may be found to exist. Compliance with more stringent laws or regulations, or stricter interpretation of existing laws, may require additional expenditures by us, some of which may be material. If new environmental laws and regulations are introduced and enforced domestically, but not implemented or enforced internationally, we will operate at a competitive disadvantage compared to competitors who source product primarily from international sources. In addition, in the past we have been identified as a potentially responsible party pursuant to the Comprehensive Environmental Response Compensation and Liability Act ("CERCLA") for remediation costs associated with waste disposal sites previously used by us. In general, CERCLA can impose liability for costs to investigate and remediate contamination without regard to fault or the legality of disposal and, under certain circumstances, liability may be joint and several, resulting in one party being held responsible for the entire obligation. Liability may also include damages for harm to natural resources. We may also be subject to claims for personal injury or contribution relating to CERCLA sites. We reserve amounts for such matters when expenditures are probable and reasonably estimable.

In addition to environmental laws and regulations affecting our manufacturing activities, the Company is subject to laws and regulations related to consumer product regulation. The Company sells products that are subject to the Consumer Product Safety Improvement Act of 2008 and the California Air Resources Board rule implemented on January 1, 2009, concerning formaldehyde emissions from composite wood products. The Company has controls in place to insure that its products meet all consumer product regulations, and a significant number of Virco products have been certified according to the GREENGUARD® Environmental Institute's stringent Children & Schools Program.

The Patient Protection and Affordable Care Act may increase the cost of providing medical benefits to employees, which could have a significant adverse impact on our results of operations.

We currently provide medical, dental, vision, and life insurance benefits to substantially all full-time employees.

Recent legislation regarding health care reform may cause the cost of providing medical insurance to our employees to



increase. We may not be able to pass the cost of increased medical costs to our customers, which could cause our costs of sales to increase and our gross profit to decline.

We may not be able to manage our business effectively if we are unable to retain our experienced management team or recruit other key personnel.

The success of our operations is highly dependent upon our ability to attract and retain qualified employees and upon the ability of our senior management and other key employees to implement our business strategy. We believe there are only a limited

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number of qualified executives in the industry in which we compete. The loss of the services of key members of our management team could seriously harm our efforts to successfully implement our business strategy.

We are subject to potential labor disruptions, which could have a significant impact on our business.

None of our work force is represented by unions, and while we believe that we have good relations with our work force, we may experience work stoppages or other labor problems in the future. Any prolonged work stoppage could have an adverse effect on our reputation, our vendor relations and our customers.

Our insurance coverage may not adequately insulate us from expenses for product defects.

We maintain product liability and other insurance coverage that we believe to be generally in accordance with industry practices. Our insurance coverage may not be adequate to protect us fully against substantial claims and costs that may arise from product defects, particularly if we have a large number of defective products that we must repair, retrofit, replace or recall.

Volatility in the equity markets or interest rates could substantially increase our pension costs and have a negative impact on our operating results.

We sponsor one qualified defined benefit pension plan, the Virco Employee Retirement Plan (the "Employee Plan"), and two nonqualified pension plans. The difference between plan obligations and assets, or the funded status of the Employee Plan, significantly affects net periodic benefit costs of our Employee Plan and our ongoing funding requirements with respect to the Employee Plan. The Employee Plan is funded with trust assets invested in a diversified portfolio of debt and equity securities and other investments. Among other factors, changes in interest rates, investment returns and the market value of plan assets can (i) affect the level of plan funding; (ii) cause volatility in the net periodic pension cost; and (iii) increase our future contribution requirements. Because the current economic environment is characterized by declining investment returns and interest rates, we may be required to make additional cash contributions to the Employee Plan and recognize further increases in our net pension cost to satisfy our funding requirements. A significant decrease in investment returns or the market value of plan assets or a significant decrease in interest rates could increase our net periodic pension costs and adversely affect our results of operations.

Holders of approximately 40% of the shares of our stock have entered into an agreement restricting the sale of the stock.

Certain shares of the Company's common stock received by the holders thereof as gifts from Julian A. Virtue, including shares received in subsequent stock dividends, are subject to an agreement that restricts the sale or transfer of those shares. As a result of the share ownership and representation on the board and in management, the parties to the agreement have significant influence on affairs and actions of the Company, including matters requiring stockholder approval such as the election of directors and approval of significant corporate transactions. In addition, these transfer restrictions and concentration of ownership could have the effect of impeding an acquisition of the Company.

Our corporate documents and Delaware law contain provisions that could discourage, delay or prevent a change in control of our company.

Provisions in our certificate of incorporation and our amended and restated bylaws may discourage, delay or prevent a merger or acquisition involving us that our stockholders may consider favorable. In addition, our certificate of incorporation provides for a staggered board of directors, whereby directors serve for three-year terms, with approximately one-third of the directors coming up for reelection each year. Having a staggered board will make it more difficult for a third party to obtain control of our board of directors through a proxy contest, which may be a necessary step in an acquisition of us that is not favored by our board of directors. We are also subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law. Under these provisions, if anyone becomes an "interested stockholder," we may not enter into a "business combination" with that person for three years without special approval, which could discourage a third party from making a takeover offer and could delay or prevent a change of control. For purposes of Section 203, "interested stockholder" means, generally, someone owning 15% or more of our outstanding voting stock or an affiliate of ours that owned 15% or more of our outstanding voting stock during the past three years, subject to certain exceptions as described in Section 203. Additionally, the board of directors entered into a Rights Agreements pursuant to which certain preferred stock purchase rights would become

exercisable when a person acquires or commences to acquire a beneficial interest of at least 20% of our outstanding common stock.

Our stock price has historically been volatile, and investors in our common stock could suffer a decline in value.

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There has been significant volatility in the market price and trading volume of equity securities, which may be unrelated to the financial performance of the companies issuing the securities. The limited “float” of shares available for purchase or sale of Virco stock can magnify this volatility. These broad market fluctuations may negatively affect the market price of our common stock. Some specific factors that may have a significant effect on our common stock market price include:

- actual or anticipated fluctuations in our operating results or future prospects;
- our announcements or our competitors’ announcements of new products;
- the public’s reaction to our press releases, our other public announcements and our filings with the SEC;
- strategic actions by us or our competitors, such as acquisitions or restructurings;
- new laws or regulations or new interpretations of existing laws or regulations applicable to our business;
- changes in accounting standards, policies, guidance, interpretations or principles;
- changes in our growth rates or our competitors’ growth rates;
- our inability to raise additional capital;
- conditions of the school furniture industry as a result of changes in funding or general economic conditions, including those resulting from war, incidents of terrorism and responses to such events; and
- changes in stock market analyst recommendations or earnings estimates regarding our common stock, other comparable companies or the education furniture industry generally.

### Item 1B. Unresolved Staff Comments

None.

### Item 2. Properties

#### Torrance, California

Virco leases a 560,000 sq. ft. office, manufacturing and warehousing facility located on 23.5 acres of land in Torrance, California. This facility is occupied under a five year lease expiring on February 28, 2015. This facility also includes the corporate headquarters, the West Coast showroom, and all West Coast distribution operations.

#### Conway, Arkansas

The Company owns 100 acres of land in Conway, Arkansas, containing 1,200,000 sq. ft. of manufacturing, warehousing, and office space. This facility - which is equipped with high-density storage systems, features 70 dock doors dedicated to outbound freight, and has substantial yard capacity to store and stage trailers - has enabled the Company to consolidate the warehousing function and implement the Assemble-to-Ship inventory stocking program. Management believes that this facility supports Virco's ability to handle increased sales during the peak delivery season and enhances the efficiency with which orders are filled.

In addition to the complex described above, the Company operates two other facilities in Conway, Arkansas. The first is a 375,000 sq. ft. fabrication facility that was acquired in 1954, and expanded and modernized over subsequent years. The Company manufactures fabricated steel components, chrome plates, and fabricates injection-molded plastic components at this facility. These components are transferred to other facilities for assembly into finished goods. The second is a 175,000 sq. ft. manufacturing facility that is used to fabricate and store compression-molded components. This building is leased under a 10-year lease expiring in March 2018.

### Item 3. Legal Proceedings

Virco has various legal actions pending against it 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 suits and claims, 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.

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Item 4. Mine Safety Disclosures

Not applicable.

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## PART II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The NASDAQ exchange is the principal market on which Virco Mfg. Corporation (VIRC) stock is traded. As of March 27, 2013, there were approximately 226 registered stockholders according to the Company's transfer agent records. There were approximately 999 beneficial stockholders.

## Dividend Policy

Historically it has been the board of directors' policy to periodically review the payment of cash and stock dividends in light of the Company's earnings and liquidity. During the fourth quarter of 2007, the Company initiated a quarterly dividend of \$0.025 per share. Due to the timing of regularly scheduled board of directors meetings, declaration dates often times fell in the quarter prior to the payment date, as was the case in the 2nd and 4th quarters of 2009 and 2010. Effective as of the third quarter of 2011, the board of directors suspended the quarterly cash dividend program. In addition, pursuant to the terms of the Company's current line of credit with PNC Bank, which was entered into on December 22, 2011, the Company is prohibited from paying dividends. Consequently, for at least as long as this covenant is included in its credit agreement with PNC Bank, no dividends will be paid by the Company to its stockholders.

## Quarterly Dividend and Stock Market Information

	Cash Dividends Declared		Common Stock Range			
	2012	2011	2012 High	Low	2011 High	Low
1st Quarter	\$—	\$0.05	\$2.25	\$1.56	\$3.51	\$2.83
2nd Quarter	—	—	1.96	1.45	3.43	2.35
3rd Quarter	—	—	3.84	1.48	2.73	1.35
4th Quarter	—	—	2.89	1.31	1.87	1.31

## Stock Repurchases

The Company did not repurchase any shares of its stock during 2012. Pursuant to the Company's credit agreement with PNC Bank, the Company is prohibited from repurchasing any shares of its stock except in cases where a repurchase is financed by a substantially concurrent issuance of new shares of the Company's common stock.

## Stock Performance Graph

The graph set forth below compares the five-year cumulative total stockholder return of the Company's common stock with the cumulative total stockholder return of (i) an industry peer group index, and (ii) the NASDAQ Market Index. The graph assumes \$100 was invested on February 1, 2008, in the Company's common stock, the NASDAQ Market Index and the companies in the peer group and assumes the reinvestment of dividends, if any.

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AMONG VIRCO MFG. CORPORATION, NASDAQ MARKET INDEX  
AND MORNINGSTAR INDEX

Company/Market/Peer Group	Period Ending					
	1/31/2008	1/31/2009	1/31/2010	1/31/2011	1/31/2012	1/31/2013
Virco Mfg. Corporation	\$100.00	\$34.00	\$58.77	\$52.43	\$31.08	\$46.61
NASDAQ Market Index	\$100.00	\$62.39	\$91.63	\$116.43	\$122.60	\$139.03
Morningstar Business Equipment	\$100.00	\$58.68	\$83.12	\$107.70	\$94.66	\$83.50

The current composition of Morningstar Business Equipment Index is as follows: ACCO Brands Corp, Avery Dennison Corp, Canon Inc., Ennis, Inc., HNI Corporation, Herman Miller, Inc., Kewaunee Scientific Corp, Knoll, Inc., Pitney Bowes Inc., Standard Register Company, Steelcase, Inc., VeriFone Systems, Inc., and Virco Mfg. Corporation.

## Item 6. Selected Financial Data

The following tables set forth selected historical consolidated financial data for the periods indicated. The following data should be read in conjunction with Item 8, Financial Statements and Supplementary Data, and with Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

## Five Year Summary of Selected Financial Data

In thousands, except per share data	2012	2011	2010	As Adjusted 2009 (1)	As Adjusted 2008 (1)
Summary of Operations					
Net sales	\$158,856	\$166,441	\$180,995	\$190,513	\$212,003
Net (loss) income (1)	\$(3,830)	\$(13,803)	\$(17,594)	\$(725)	\$2,479
Net (loss) income per share data (a) (1)					
Basic	\$(0.27)	\$(0.97)	\$(1.25)	\$(0.05)	\$0.17
Assuming dilution	(0.27)	(0.97)	(1.25)	(0.05)	0.17
Cash dividends declared per share	\$—	\$0.05	\$0.10	\$0.10	\$0.10

a) Net loss per share was calculated based on basic shares outstanding due to the anti-dilutive effect on the inclusion of common stock equivalent shares.

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## Other Financial Data

In thousands, except per share data	2012	2011	2010	As Adjusted 2009 (1)	As Adjusted 2008 (1)
Total assets (1)	\$82,163	\$94,225	\$100,588	\$122,432	\$123,432
Working capital (1)	\$12,526	\$18,598	\$29,498	\$38,386	\$36,525
Current ratio (1)	1.5/1	1.7/1	2.5/1	2.7/1	2.4/1
Total long-term obligations	\$30,707	\$36,119	\$30,169	\$30,236	\$25,104
Stockholders' equity (1)	\$27,020	\$30,896	\$50,402	\$69,270	\$71,520
Shares outstanding at year-end	14,550	14,354	14,205	14,163	14,239
Stockholders' equity per share (1)	\$1.86	\$2.15	\$3.55	\$4.89	\$5.02

(1) The historical financial data has been modified for the results of operations and ending balance sheets for 2008 and 2009 to reflect our 2010 change in accounting principle for our method of accounting for certain of our inventory.

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

## Cautionary Statement Regarding Forward-Looking Statements

This Management's Discussion and Analysis of Financial Condition and Results of Operations includes a number of forward-looking statements that reflect the Company's current views with respect to future events and financial performance, including, but not limited to, availability of funding for educational institutions, economic conditions, statements regarding plans and objectives of management for future operations, including plans and objectives relating to products, pricing, marketing, expansion, and manufacturing processes; new business strategies; the Company's ability to continue to control costs and inventory levels; availability and cost of raw materials, especially steel and petroleum-based products; the availability and cost of labor; the potential impact of the Company's "Assemble-To-Ship" program on earnings; market demand; the Company's ability to position itself in the market; references to current and future investments in and utilization of infrastructure; statements relating to management's beliefs that cash flow from current operations, existing cash reserves, and available lines of credit will be sufficient to support the Company's working capital requirements to fund existing operations; references to expectations of future revenues; pricing; and seasonality.

Such statements involve known and unknown risks, uncertainties, assumptions and other factors, many of which are outside of the Company's control and difficult to forecast, that may cause actual results to differ materially from those which are anticipated. Such factors include, but are not limited to, changes in, or the Company's ability to predict, general economic conditions, the markets for school and office furniture generally and specifically in areas and with customers with which the Company conducts its principal business activities, the rate of approval of school bonds for the construction of new schools, the extent to which existing schools order replacement furniture, customer confidence, competition and other factors included in the "Risk Factors" section of this report.

In this report, words such as "anticipates," "believes," "expects," "will continue," "future," "intends," "plans," "estimates," "potential," "budgets," "may," "could" and similar expressions identify forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof.

## Executive Overview

Management's strategy is to position Virco as the overall value supplier of educational furniture and equipment. The markets that Virco serves include the education market (the Company's primary market), which is made up of public and private schools (preschool through 12th grade), junior and community colleges, four-year colleges and universities; and trade, technical and vocational schools. Virco also serves convention centers and arenas; the hospitality industry, with respect to their banquet and meeting facilities; government facilities at the federal, state, county and municipal levels; and places of worship. In addition, the Company sells to wholesalers, distributors, retailers and catalog retailers that serve these same markets. These institutions are frequently characterized by extreme seasonality and/or a bid-based purchasing function. The Company's business model, which is designed to support this strategy, includes the development of several competencies to enable superior service to the markets in which Virco competes. An important element of Virco's business model is the Company's emphasis on developing and maintaining



key manufacturing, warehousing, distribution, installation, project management, and service capabilities. The Company has developed a comprehensive product offering for the furniture, fixtures and equipment needs of the K-12 education market, enabling a school to procure all of its furniture, fixtures and equipment (“FF&E”) requirements from one source.

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Virco's product offering consists primarily of items manufactured by Virco, complemented with products sourced from other furniture manufacturers. Our product offerings are continually enhanced with an ongoing new product development program that incorporates internally developed products as well as product lines developed with accomplished designers. Finally, management continues to hone Virco's ability to forecast, finance, manufacture, warehouse, deliver, and install furniture within the relatively narrow delivery window associated with the highly seasonal demand for education sales. In 2012 and 2011, approximately 50% of the Company's total sales were delivered in June, July, and August with an even higher portion of educational sales delivered in that period. Shipments during July and August can be as great as six times the level of shipments in the winter months. Virco's substantial warehouse space allows the Company to build and ship adequate inventories to service this narrow delivery window for the education market.

The market and operating environment for school furniture, fixtures, and equipment has been challenging during the last decade and is likely to continue to be so for at least the near future. Schools suffered significant budgetary pressures from 2001 to 2005 following the "dot com" bust, and more recently in 2008 through 2012 as a result of the recession and severe budget deficits incurred by state and local governments.

In addition, the furniture industry in general, including the market for school furniture, has been significantly impacted by low cost competition from China. In 2004, 2005, and 2008 commodity prices for some of the Company's primary raw materials, particularly steel and plastic, were extremely volatile. During 2011, the Company incurred a cost increase of approximately 30% in the cost of steel during the second quarter, and nearly a 30% increase in the cost of certain plastics over the second and third quarters. Due to recent volatility in the commodities' markets, similar volatility for the Company's raw materials is likely to continue for the near term. Because a majority of the Company's sales are generated under annual contracts in which the Company has limited ability to raise the price of its products during the term of the contract, if the costs of the Company's raw materials increase suddenly or unexpectedly, the Company cannot be certain that it will be able to implement corresponding increases in its sales prices in order to offset such increased costs. Significant cost increases in providing products during a given contract period can adversely impact operating results and have done so during prior years. The Company typically benefits from any decreases in raw material costs under the contracts described above.

The years 2008 through 2012 were particularly challenging for the Company and the educational furniture industry in general and conditions are likely to remain challenging for the near term. The budgetary pressures placed on school budgets in these years as a result of the recession were more severe than any period in recent history. These budgetary pressures directly impacted the demand for the Company's products, as the demand for educational furniture largely depends upon: (1) available funding in a school's general operating fund and (2) the completion of bond-funded projects, which is directly impacted by the amount of bond financing issued to fund new school construction, to renovate older schools, and to fully equip new and renovated schools. In response to the 2008 recession, passage of new bond issuances declined, and bond funded project completions have trended down each year. Despite an increase in the numbers of students attending school, completions of projects from bond financing declined in each of the last five years and school operating budgets experienced significant strain during the same period. In response to these budgetary pressures, as is traditionally the case, schools opted to retain teachers and spend less on repairs, maintenance and replacement furniture, which in turn reduced the demand for, and sales of, the Company's products. Completions of new schools, additions and renovations are not anticipated to improve in 2013.

Although recent years have reflected continual declines in the overall market for school furniture, there are some indicators that the industry is at the bottom of a trough and may turn up beginning in 2014. Industry forecasts indicate that new school construction will increase beginning in 2014. The architecture billing index for February 2013 was the highest since November 2007.

During a period of robust education spending during the 1990's, the Company expanded and modernized its manufacturing and distribution facilities at the Torrance, CA and Conway, AR locations. During the last decade, the Company has worked continuously to significantly reduce its cost structure while concurrently expanding its product offering, expanding manufacturing process capabilities and more fully automating its facilities. For example, headcount of permanent employees as of January 31, 2013, was approximately 760 compared to a peak of nearly 2,950 in August 2000. Factory overhead in 2012 declined by more than 55% compared to 2000. The Company

accomplished this without closing a factory and while continuing to add new production processes, including flat metal forming, and other capabilities to support an ambitious product development program.

In 2010, 2011, and 2012 Virco continued to invest in new products, which positively impacted sales. In 2010, the Company introduced, Parameter®, an invigorating collection of desks, returns and credenzas, and initiated a program to further expand the use of our flat metal forming capabilities to produce lateral files, vertical files and mobile pedestals. In 2011, Virco launched the Sage™ Contract line for offices and reception areas, colleges, hospitality venues and other adult environments; Civitas™ chairs and stools for foodservice, libraries, media centers, circulation areas and related venues; and adjustable-height versions of 120, 121 and 122 Series stools. In 2012, to complement the recently released Civitas chair and stool collection,

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Virco introduced an assortment of Civitas café table tops and tulip-shaped table bases; other 2012 introductions included a new collection of Sage rocking chairs; 53 Series wardrobe tower cabinets; new Parameter® file credenzas and additional Parameter mobile pedestals. Additional product releases scheduled for 2013 will provide the Company with attractive new products that we believe will enable the Company to take market share in specific targeted price points.

Virco also benefits from its proprietary PlanSCAPE® software, and experienced PlanSCAPE managers, which allow Virco to prepare complete package solutions for the FF&E segment of bond-funded public school construction projects. PlanSCAPE software also enables the entire Virco sales force to prepare quotations for less complicated projects. PlanSCAPE project management software allows Virco's sales representatives to provide classroom-by-classroom planning documents for the budgeting, acquisition and installation of FF&E.

The Company anticipates that demand for furniture in the education markets may be flat or continue to decline in 2013. Although general economic conditions have improved, significant state and local budget deficits may adversely affect funding for education. The Company expects that completion of bond-funded school and college construction projects will be lower in 2013 than in each of 2008, 2009, 2010, 2011 and 2012. Management also anticipates a continued lower level of demand for replacement furniture due to the significant financial pressures being placed on school operating budgets. During 2011, in an effort to bring the Company's cost structure in line with decreased revenues, the Company offered early retirement and voluntary separation packages to its employees in Arkansas and California. Combined with normal attrition, the Company reduced its workforce by approximately 205 persons (20%). During 2012 the workforce declined by an additional 65 full time positions. These savings will be offset somewhat by the cost of temporary direct labor employees hired to meet production requirements during 2013. The Company plans to maintain stringent limits on full time staffing, supplemented with temporary labor as necessary in order to produce, warehouse, deliver, and install furniture during the coming summer. Because the Company has not closed any manufacturing or distribution facilities that are utilized in operations, any increase in demand for our products can be met without any required investment in physical infrastructure.

While the Company anticipates challenging economic conditions to continue to impact its core customer base in the near term, there are certain underlying demographics, customer responses, and changes in the competitive landscape that provide opportunities. First, the underlying demographics of the student population are stable compared to the volatility of school budgets, and the related level of furniture and equipment purchases. This volatility is attributable to the financial health of the school systems. Virco management believes that there is a pent-up demand for quality school furniture (though it is unclear when and to what extent that pent-up demand will be converted into a meaningful increase in purchases). Second, management believes that parents and voters will demand that we educate our children and make this an ongoing priority for future government spending. Third, many schools have responded to the budget strains by reducing their support infrastructure. School districts historically have operated central warehouses and professional purchasing departments in a central business office. In order to retain teaching staff, many school districts have shut down the warehouses and reduced their purchasing departments and janitorial staffs. This change provides opportunities to sell services to schools, such as project management for new or renovated schools, delivery to individual school sites rather than truckload deliveries to central warehouses, and installation of furniture in classrooms. Moreover, this change offers opportunities for Virco to promote its complete product assortment which allows one-stop shopping as opposed to sourcing furniture needs from a variety of suppliers. Fourth, many suppliers have shut down or dramatically curtailed their domestic manufacturing capabilities, making it difficult for competitors to provide custom colors or finishes during a tight seasonal summer delivery window when they are reliant upon a supply chain extending to China. Unlike its primary competitors, Virco has maintained and invested in automation at its domestic manufacturing facilities, recently adding flat metal forming processes to its manufacturing capabilities and bringing production into its factories of items formerly sourced from other suppliers. Virco's domestic factories are a strategic resource for providing its customers with timely delivery of a broad selection of colors, finishes, laminates, and product styles.

During 2013 the Company anticipates continued uncertainty and volatility in commodity costs, particularly with respect to certain raw materials, transportation, and energy. The Company does not anticipate that this volatility will be as dramatic as experienced in 2011, but it has no assurances that commodity prices will remain stable. The

Company may benefit from industry disruption in 2013. In 2012, a smaller domestic manufacturing competitor liquidated, and in the beginning of 2013 a significant reseller of school furniture entered Chapter 11 reorganization. While such events are illustrative of the challenging conditions in the Company's industry, the Company is hopeful that this disruption presents an opportunity for Virco to expand its customer base.

Critical Accounting Policies and Estimates

This discussion and analysis of Virco's financial condition and results of operations is based upon the Company's financial statements which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires Virco management to make estimates and judgments that affect the Company's reported assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis,

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management evaluates such estimates, including those related to revenue recognition, allowance for doubtful accounts, valuation of inventory and related obsolescence reserves, self-insured retention for products and general liability insurance, self-insured retention for workers' compensation insurance, provision for warranty, liabilities under defined benefit and other compensation programs, and estimates related to deferred tax assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. This forms the basis of judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Factors that could cause or contribute to these differences include the factors discussed above under Item 1, Business, and elsewhere in this annual report on Form 10-K. Virco's critical accounting policies are as follows:

**Revenue Recognition:** The Company recognizes revenue in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 605, "Revenue Recognition." Revenue is recognized when title passes under its various shipping terms, when installation services are complete, and when collectability is reasonably assured. The Company reports sales net of sales returns and allowances and sales taxes imposed by various government authorities, where applicable. In most instances, the Company sells furniture on bids and contracts, which may include multiple elements. For sales that include freight to the customer, many sales are delivered on the same day shipped, with an average delivery being in route for 1 to 2 days. Installation, which involves carrying the furniture to the classroom and setting the desks and chairs in place, typically occurs the day the furniture is delivered. In accordance with ASC 605-25 ("ASC 605-25"), "Revenue Recognition - Multiple-Element Arrangements," revenue arrangements with multiple deliverables are generally accounted for by the Company on a combined unit of accounting as our customers control our ability to deliver and install the furniture, and as a result the furniture delivery and installation are generally provided at the same time. We recognize the consideration for the combined unit of accounting once the final item has been delivered and installed.

**Allowances for Doubtful Accounts:** Considerable judgment is required when assessing the ultimate realization of receivables, including assessing the probability of collection, current economic trends, historical bad debts and the current creditworthiness of each customer. The Company maintains allowances for doubtful accounts that may result from the inability of our customers to make required payments. Over the past five years, the Company's allowance for doubtful accounts has ranged from approximately 0.7% to 3.0% of accounts receivable at year-end. The allowance is evaluated using historic experience combined with a detailed review of past-due accounts. The Company does not typically obtain collateral to secure credit risk. The primary reason that Virco's allowance for doubtful accounts represents such a small percentage of accounts receivable is that a large portion of the accounts receivable is attributable to low-credit-risk governmental entities, giving Virco's receivables a historically high degree of collectability. Although many states are experiencing budgetary difficulties, it is not anticipated that Virco's credit risk will be significantly impacted by these events. Over the next year, no significant change is expected in the Company's sales to government entities as a percentage of total revenues.

**Inventory Valuation:** Inventory is valued at the lower of cost or market (determined on a first-in, first-out basis) and includes material, labor, and factory overhead. The Company maintains allowances for estimated slow moving and obsolete inventory to reflect the difference between the cost of inventory and the estimated market value. 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 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.

**Self-Insured Retention:** For 2010, 2011, and 2012 the Company was self-insured for product liability losses ranging up to \$250,000 per occurrence, for workers' compensation losses up to \$250,000 per occurrence, and for auto liability up to \$50,000 per occurrence. The Company obtains annual actuarial valuations for the self-insured retentions.

Product liability, workers' compensation, and auto reserves for known and unknown incurred but not reported ("IBNR")

losses are recorded at the net present value of the estimated losses using a risk-free discount rate ranging from 0.5%-5.5% for 2012, 2011, and 2010. Given the relatively short term over which the IBNR losses are discounted, the sensitivity to the discount rate is not significant. Estimated workers' compensation losses are funded during the insurance year and subject to retroactive loss adjustments. The Company's exposure to self-insured retentions varies depending upon the market conditions in the insurance industry and the availability of cost-effective insurance coverage. Self-insured retentions for 2013 will be comparable to the retention levels for 2012.

Warranty Reserve: The Company provides a warranty against all substantial defects in material and workmanship. The Company's warranty is not a guarantee of service life, which depends upon events outside the Company's control and may be

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different from the warranty period. The standard warranty offered on products sold through January 31, 2005, is five years. Effective February 1, 2005, the standard warranty was increased to 10 years on products sold after February 1, 2005. The Company's warranties generally provide that customers can return a defective product during the specified warranty period following purchase in exchange for a replacement product or that the Company can repair the product at no charge to the customer. The Company determines whether replacement or repair is appropriate in each circumstance. The Company uses historic data to estimate appropriate levels of warranty reserves. Because product mix, production methods, and raw material sources change over time, historic data may not always provide precise estimates for future warranty expense.

**Defined Benefit Obligations:** The Company has three defined benefit plans, the Virco Employees Retirement Plan (the "Employee Plan"), the Virco Important Performers Plan (the "VIP Plan") and the Non-Employee Directors Retirement Plan (the "Directors Plan"), which provide retirement benefits to employees and outside directors. Virco discounted the pension obligations for the various plans using the following rates:

	2012	2011	2010	
Employee Plan	4.00	% 4.50	% 5.50	%
VIP Plan	4.25	% 4.50	% 6.00	%
Directors Plan	4.00	% 4.50	% 5.50	%

Because the Company froze new benefit accruals for all three plans effective December 31, 2003, the assumed rate of increase in compensation has no effect on the accounting for the plans. The Company estimated a 6.5% return on plan assets for the Employee Plan for all three years. The VIP Plan and Directors Plan are unfunded and have no plan assets. These rate assumptions can vary due to changes in interest rates, the employment market, and expected returns in the stock market. In prior years, the discount rate and the anticipated rate of return on plan assets have decreased by several percentage points, causing pension expense and pension obligations to increase. In 2008, the Company incurred significant losses on investments held in trust to fund the Employee Plan. These investment losses will cause future pension costs to increase, and will require future cash contributions to adequately fund the Employee Plan.

In the third quarter of 2011 the Company offered an early retirement program to employees who voluntarily terminated their employment with the Company. The incentive offered was a cash incentive and did not include additional retirement benefits, but was heavily directed toward employees with significant years of service.

Approximately 150 employees accepted this offer. Due to the volume of lump sum payments processed during the third and fourth quarters of 2011, the Company incurred a pension settlement cost for the Employee Plan. In the fourth quarter of 2012, as a result of cumulative retirement benefits paid during the year, the Company incurred and additional pension settlement cost.

Although the Company does not anticipate any change in these rates in the coming year, any moderate change should not have a significant effect on the Company's financial position, results of operations or cash flows. The Company obtains annual actuarial valuations for all three plans.

**Deferred Tax Assets and Liabilities:** The Company recognizes deferred income taxes under the asset and liability method of accounting for income taxes in accordance with the provisions of FASB ASC Topic 740 "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 whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. 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 considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The Company incurred a substantial operating loss for the years ended January 31, 2012 and 2011. During the fourth quarter of the year ended January 31, 2011, based on this consideration, the Company determined the realization of a majority of the net deferred tax assets no longer met the more likely than not criteria and a valuation allowance was recorded against the majority of the net deferred tax assets. Valuation allowances totaled \$24,601,000 and \$22,859,000 at January 31,



2013 and 2012, respectively. At January 31, 2013, the Company has net operating loss carryforwards for federal and state income tax purposes, expiring at various dates through 2033. Federal net operating losses that can potentially be carried forward totaled approximately \$23,563,000 at January 31, 2013. State net operating losses that can potentially be carried forward totaled approximately \$49,635,000 at January 31, 2013.

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Results of Operations (2012 vs. 2011)

Financial Results and Cash Flow

The Company incurred a pre-tax loss of \$4,039,000 on net sales of \$158,856,000 for the fiscal year ended January 31, 2013, compared to pre-tax loss of \$13,748,000 on net sales of \$166,441,000 in the fiscal year ended January 31, 2012. Net loss per share was \$0.27 for the fiscal year ended January 31, 2013, compared to net loss per share of \$0.97 in the prior year. Cash flow provided by operations was \$7,163,000 for the fiscal year ended January 31, 2013, compared to cash flow used by operations of \$910,000 in the prior year. As more fully discussed below, during 2011 the Company offered a voluntary retirement program to all employees. It was estimated that the annual expense reduction from this program could be approximately \$9 to \$10 million, offset by the cost of temporary employees hired during the summer months. The Company's spending on salaries, wages and other employee benefit costs for full time employees for 2012 was nearly \$8 million less than 2011. In addition a variety of other employee related expenses such as travel declined, allowing the Company to reduce its operating loss by \$9.7 million on a reduction in sales volume.

Sales

Virco's sales decreased by 4.5% in 2012 to \$158,856,000 compared to \$166,441,000 in 2011. The decrease in sales was caused by continued unfavorable economic conditions that had an adverse impact on budgets for school spending and by a reduction in completions of bond-funded projects.

Volume declined by approximately \$16 million, offset by increases in price. Sales of Virco's new products, including Parameter®, Civitas™ and Text® increased by nearly \$1.5 million in 2012 compared to 2011, but were offset by reductions in older product lines. Sales for project orders declined by more than \$6 million in fiscal 2012 compared to project orders in fiscal 2011 as a result of reduced construction completions. The reduction in order rates occurred primarily in the third quarter, with the reduction in shipments occurring in the fourth quarter of 2012. Order rates for the fourth quarter increased slightly compared to the comparable period in 2011, resulting in a \$2.9 million increase in backlog at January 31, 2013 compared to January 31, 2012.

For 2013 the Company anticipates that the persistent budgetary challenges for state and local governments combined with an anticipated reduction in completions of bond-funded projects may cause the amount of school furniture sold to be comparable to or perhaps less than 2012. As we have throughout this recession, the Company continues to focus on strategies to develop and strengthen its brand with an aggressive product development campaign. The Company is accelerating efforts to increase sales to customers who purchase furniture and equipment through the General Services Administration (GSA) and to pursue international projects. We will continue to use our domestic factories to provide greater flexibility for custom specifications such as laminates, colors, and on-time delivery. As discussed below, the Company significantly reduced its workforce through an early retirement program in 2011. The Company reduced its workforce by an additional 65 full time staff in 2012, primarily through attrition. This significant reduction in force largely spared our direct sales force. The Company will continue to emphasize the value, design and color selections of its products, the value of its distribution, delivery, installation, and project management capabilities, and the value of timely deliveries during the peak seasonal delivery period. In order to increase or maintain market share during 2013, when market conditions warrant, the Company will compete based on direct prices and may reduce its prices to build or maintain its market share.

The Company is beginning 2013 with approximately \$2.4 million less inventory than in 2012, \$10.0 million less than in 2011, and \$18.2 million less than 2010. Due to the reduced quantity of inventory at January 31, 2013, production levels and related factory overhead absorption, which vary depending upon selling volumes, are anticipated to be higher in 2013 than in 2012. As discussed above, the Company significantly reduced its workforce during 2011 and reduced it again in 2012. The Company intends to hire temporary workers as necessary during 2013 to meet any seasonal production, warehousing or distribution requirements that cannot be filled by the remaining full-time workforce.

During 2013 the Company anticipates continued uncertainty and volatility in commodity costs, particularly with respect to certain raw materials, transportation, and energy. The Company does not anticipate that this volatility will be as dramatic in 2013 as experienced in 2011, but that it could be more volatile than in 2012. For more information, please see the section below entitled "Inflation and Future Change in Prices."

Cost of Sales

Cost of sales was 67.6% of sales in 2012 and 71.1% of sales in 2011. This decrease was due to an increase in selling prices and reduced factory spending partially offset by a reduction in factory utilization. The Company benefited from stable material costs during 2012.

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As a percentage of sales, raw material costs were 1.2% lower than in 2011. The Company increased selling prices at the beginning of the year in effort to improve gross margins. The cost of raw materials was stable during the year, resulting in raw material costs declining as a percentage of sales. Direct labor costs as a percentage of sales were unchanged in 2012 compared to 2011. The impact of increasing selling prices was offset by a slight deterioration in efficiency due to the increased utilization of temporary labor in 2012 compared to 2011. Manufacturing overhead as a percentage of sales decreased by 2.3% in 2012 from 2011. This decrease was primarily attributable to a decrease in factory spending offset in part by a reduction production hours and the related impact on factory utilization. Production hours, which decreased by nearly 8% compared to the prior year, were reduced in response to a reduction in sales combined with an effort to reduce inventory at year end.

**Selling, General and Administrative and Other Expenses**

Selling, general and administrative expenses for the fiscal year ended January 31, 2013, decreased by approximately \$6.7 million compared to the prior year, and were 34.1% of sales as compared to 36.4% in the prior year. The primary reason for this decrease was the \$4.6 million reduction of severance costs in 2012 compared to 2011. In 2011, the Company offered an early retirement program to all employees. Approximately 150 employees, or 15% of the Company's workforce, accepted the offer. When combined with normal attrition of employees that were not replaced, at January 31, 2012, the Company reduced the number of full-time employees by approximately 205, or 20% of the workforce at January 31, 2011. In 2012 attrition and normal retirements allowed the Company to reduce headcount by an additional 65 persons. The early retirement program was a cash payment to employees that was based upon years of service. Virco disbursed nearly \$2.6 million to severed employees under this program in 2011. Because the majority of the employees accepting the offer were long-term employees with vested pension benefits, the Company incurred nearly \$2.0 million of pension settlement costs during the third and fourth quarters on 2011 and an additional \$760,000 of pension settlement costs in the fourth quarter of 2012. The reduction in employees was evenly distributed between direct labor and other overhead, sales support, and G&A positions.

Warehousing, freight and installation costs decreased in dollars and by 0.5% as a percentage of sales. Selling costs declined due to a reduction in volume but increased by less than 0.1% as a percentage of sales. G&A spending decreased slightly, but increased slightly as a percentage of sales due to an increase in retirement plan expense.

Interest expense was \$434,000 more in 2012 compared to 2011 as a result of increased levels of borrowing, increased costs related to an asset based loan, and increased accretion expense for certain liabilities.

**Provision for 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 Topic 740, "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 whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. 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 considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment.

During 2012, 2011 and 2010 the Company incurred significant operating losses. The Company has incurred a cumulative operating loss for the last three years. While the Company has taken significant measures to return to profitability, the short-term outlook for the school furniture market is challenging. Based on these considerations, at January 31, 2013 and January 31, 2012, the Company determined the realization of a majority of the net deferred tax assets no longer met the more likely than not criteria, and a valuation allowance was recorded against the majority of the net deferred tax assets. The Company has determined that it is more likely than not that some portion of the state net operating loss and credit carryforwards will be realized and has not provided a valuation allowance on a portion of the state net operating loss and credit carryforwards. At January 31, 2013, the Company had net operating losses carried forward for federal and state income tax purposes, expiring at various dates through 2033 if not utilized. Federal net operating losses that can potentially be carried forward totaled approximately \$23,563,000 at January 31,

2013. State net operating losses that can potentially be carried forward totaled approximately \$49,635,000 at January 31, 2013.

Because the Company has recorded a valuation allowance for the majority of deferred tax assets, the effective tax rate for 2013 may be low, with income tax being primarily income and franchise taxes as required by various states.

Results of Operations (2011 vs. 2010)

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## Financial Results and Cash Flow

On January 31, 2011, the Company elected to change its costing method for the material component of raw materials. The effect of this accounting change for the fiscal year ended January 31, 2011 was to decrease cost of sales by, and increase gross margin by, \$640,000. Net loss decreased by \$354,000. There was no effect on net cash flow from operations. In addition, during the fourth quarter ended January 31, 2011, the Company determined the realization of a majority of the net deferred tax assets no longer met the more likely than not criteria, and an additional valuation allowance of \$14.0 million was recorded against the net deferred tax assets. After adjusting the results for the change in accounting, for the fiscal year ended January 31, 2012, the Company incurred a pre-tax loss of \$13,748,000 on net sales of \$166,441,000 compared to pre-tax loss of \$8,587,000 on net sales of \$180,995,000 in the same period last year. Net loss per share was \$0.97 for the fiscal year ended January 31, 2012, compared to net loss per share of \$1.25 in the prior year. Cash flow used in operations was \$910,000 for the fiscal year ended January 31, 2012, compared to cash flow provided by operations of \$5,452,000 in the prior year.

## Sales

Virco's sales decreased by 8.0% in 2011 to \$166,441,000 compared to \$180,995,000 in 2010. The decrease in sales was caused by continued unfavorable economic conditions that had an adverse impact on budgets for school spending and by a reduction in completions of bond-funded projects. Volume declined by approximately \$23 million, offset by increases in price. In 2010, the Company bid aggressively in certain markets in an effort to grow volume in a difficult market. This adversely impacted the gross margin in 2010. In 2011, the Company increased prices in an effort to restore margins to more profitable levels and to compensate for increases in raw material costs experienced during 2011. Sales of Virco's new products, including Parameter®, Sage™, and Text® increased in 2011 compared to 2010, but were offset by reductions in other product lines. Sales for project orders in fiscal 2011 were level with project orders in fiscal 2010. The reduction in shipments occurred in the second and third quarters of the year, but the reduction in order rates was concentrated in two months. Approximately 65% of the annual reduction in orders occurred in the months of April and May. Order rates for the balance of the year declined, but to a lesser extent.

## Cost of Sales

Cost of sales was 71.1% of sales in 2011 and 71.6% of sales in 2010. This decrease was due to an increase in selling prices, offset by increases in material costs and a reduction in factory utilization.

As a percentage of sales, raw material costs were 0.2% lower than the prior year. The Company increased selling prices at the beginning of the year in effort to improve gross margins. During the second quarter, steel prices increased by approximately 30%. Costs for certain plastics used in production increased by approximately 30% during the course of the second and third quarters. These cost increases offset the impact of the price increase for the material component of cost of sales. Direct labor costs as a percentage of sales decreased by approximately 0.5%, primarily due to increased selling prices. Manufacturing overhead as a percentage of sales increased by 0.2%. This increase was primarily attributable to a decrease in production hours and the related impact on factory utilization. Production hours, which decreased by nearly 12% compared to the prior year, were reduced in response to a reduction in sales combined with an effort to reduce inventory at year end.

## Selling, General and Administrative and Other Expenses

Selling, general and administrative expenses for the fiscal year ended January 31, 2012, increased by approximately \$1.9 million compared to the fiscal year ended January 31, 2011, and were 36.4% of sales as compared to 32.5% in the fiscal year ended January 31, 2011. The primary reason for this increase was the nearly \$4.6 million of severance costs incurred in the third and fourth quarters related to the early retirement program offered by the Company in the third quarter of 2011. Approximately 150 employees, or 15% of the Company's workforce, accepted the offer. Most severed their employment in the third quarter. A few employees remained into the fourth quarter to assist an orderly transition of responsibilities. When combined with normal attrition of employees that were not replaced, at January 31, 2012, the Company reduced the number of full-time employees by approximately 205, or 20% of the workforce at January 31, 2011. The early retirement program was a cash payment to employees that was based upon years of service. Virco disbursed nearly \$2.6 million to severed employees under this program. Because the majority of the employees accepting the offer were longer-term employees with vested pension benefits, the Company incurred nearly \$2.0 million of pension settlement costs during the third and fourth quarters. The reduction in employees was

evenly distributed between direct labor and other overhead, sales support, and G&A positions.

Warehousing, freight and installation costs decreased in dollars and remained flat as a percentage of sales. Selling costs declined due to a reduction in volume but increased as a percentage of sales. G&A spending increased slightly, in part due to an increase in retirement plan expense, but was otherwise stable compared to the prior year.

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Interest expense was \$45,000 more in 2011 compared to 2010 as a result of increased levels of borrowing.

Provision for Income Taxes

During 2011 and 2010 the Company incurred significant operating losses. When combined with operating results from 2009 the Company has incurred a cumulative operating loss for three consecutive years. While the Company has taken significant measures to return to profitability, the short-term outlook for the school furniture market is challenging. Based on these considerations, at January 31, 2012 and January 31, 2011, the Company determined the realization of a majority of the net deferred tax assets no longer met the more likely than not criteria, and a valuation allowance was recorded against the majority of the net deferred tax assets. The Company has determined that it is more likely than not that some portion of the state net operating loss and credit carryforwards will not be realized and has provided a valuation allowance on a portion of the state net operating losses. At January 31, 2012, the Company had net operating losses carried forward for federal and state income tax purposes, expiring at various dates through 2032 if not utilized. Federal net operating losses that can potentially be carried forward totaled approximately \$21,980,000 at January 31, 2012. State net operating losses that can potentially be carried forward totaled approximately \$45,785,000 at January 31, 2012.

Because the Company has recorded a valuation allowance for the majority of deferred tax assets, the effective tax rate for 2012 may be low, with income tax being primarily income and franchise taxes as required by various states.

Inflation and Future Change in Prices

We commit to annual contracts that determine selling prices for goods and services for periods of one year, and occasionally longer. Though the Company has negotiated flexibility under many of these contracts that may allow the Company to increase prices on future orders, the Company does not have the ability to raise prices on orders received prior to any announced price increase. Due to the intensely seasonal nature of our business, the Company may receive significant orders during the first and second quarters for delivery in the second and third quarters. With respect to any of the contracts described above, if the costs of providing our products or services increase between the date the orders are received and the shipping date, we may not be able to implement corresponding increases in our sales prices for such products or services in order to offset the related increased costs. During 2012, the costs for raw materials purchased by the Company were stable. During 2011, the Company incurred an increase of approximately 30% in the cost of steel during the second quarter, and nearly a 30% increase in the cost of certain plastics over the second and third quarter. These cost increases adversely impacted gross margins for products shipped during the summer season. During 2010, the Company incurred increased costs for steel, but most other costs increased only modestly.

For 2013, the Company anticipates continued volatility in costs, particularly with respect to certain raw materials, transportation, and energy. Anticipated volatility for 2013 is not expected to be as severe as experienced in 2011. There is continued uncertainty with respect to steel and other raw material costs, especially of plastics, that are affected by the price of oil. Transportation costs may be adversely affected by increased oil prices, in the form of increased operation costs for our fleet, and surcharges on freight paid to third-party carriers. Furthermore, as a result of current adverse economic conditions, there has been a reduction in the number of freight carriers competing for Virco's business. Virco expects to incur continued pressure on employee benefit costs. The Company has renewed health insurance contracts for its employees through December 2013, but costs subsequent to that date may be adversely impacted by current legislation. Virco has aggressively addressed these costs by reducing headcount, freezing pension benefits, passing on a portion of increased medical costs to employees, and hiring temporary workers who are not eligible for benefit programs.

To recover the cumulative impact of increased costs, the Company raised the list prices for Virco's products in 2013, 2012 and 2011. Due to current economic conditions, the Company anticipates continued significant price competition in 2013, and may not be able to raise prices without risk of losing market share. The Company anticipates that the volatility of commodity costs will not be as significant in 2013 as experienced in 2011. As a significant portion of Virco's business is obtained through competitive bids, the Company is carefully considering material and transportation costs as part of the bidding process. Total material costs for 2013, as a percentage of sales, could be higher than in 2012. The Company is working to control and reduce costs by improving production and distribution methodologies, investigating new packaging and shipping materials, and searching for new sources of purchased components and raw materials.



Liquidity and Capital Resources

Working Capital Requirements

Virco addresses liquidity and working capital requirements in the context of short-term seasonal requirements and long-term capital requirements of the business. The Company's core business of selling furniture to publicly funded educational

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institutions is extremely seasonal. The seasonal nature of this business permeates most of Virco's operational, capital, and financing decisions.

The Company's working capital requirements during and in anticipation of the peak summer season oblige management to make estimates and judgments that affect Virco's assets, liabilities, revenues and expenses. Management expends a significant amount of time during the year, and especially in the first quarter, developing a stocking plan and estimating the number of employees, the amount of raw materials, and the types of components and products that will be required during the peak season. If management underestimates any of these requirements, Virco's ability to fill customer orders on a timely basis or to provide adequate customer service may be diminished. If management overestimates any of these requirements, the Company may be required to absorb higher storage, labor and related costs, each of which may affect profitability. On an ongoing basis, management evaluates such estimates, including those related to market demand, labor costs, and inventory levels, and continually strives to improve Virco's ability to correctly forecast business requirements during the peak season each year.

As part of Virco's efforts to address seasonality, financial performance and quality without sacrificing service or market share, management has been refining the Company's ATS operating model. ATS is Virco's version of mass-customization, which assembles standard, stocked components into customized configurations before shipment. The Company's ATS program reduces the total amount of inventory and working capital needed to support a given level of sales. It does this by increasing the inventory's versatility, delaying assembly until the last moment, and reducing the amount of warehouse space needed to store finished goods. In order to provide "one stop shopping" for all FF&E needs, Virco purchases and re-sells certain finished goods from other furniture manufacturers. When practical, these furniture items are drop shipped from the Company's supplier. Where cost effective, the Company will bring the item into the Virco warehouse and the third party products will be shipped along with product manufactured by Virco. The Company did not carry material amounts of vendor inventory during the fiscal years ended January 31, 2013, 2012, or 2011, respectively.

In addition, Virco finances its largest balance of accounts receivable during the peak season. This occurs for three primary reasons. First, accounts receivable balances naturally increase during the peak season as shipments of products increase. Second, many customers during this period are government institutions, which tend to pay accounts receivable more slowly than commercial customers. Third, many summer deliveries may be "projects" where the Company provides furniture for a new school or significant refurbishment of an existing school. Projects may require architect sign off, school board approval prior to payment, or punch list completion, all of which can delay payment. As a result of the seasonality of our business, our manufacturing capacity is dictated by the capacity requirement during the months of June, July, and August. Because of this seasonality, factory utilization is lower during the slow season. The Company utilizes a variety of tactics to address the seasonality of its business. During the summer months, which comprise our second and third fiscal quarters, our personnel utilization generally is at or close to full capacity. The Company utilizes temporary labor and significant overtime to meet the seasonal requirements. During the slow portions of the year, temporary labor and overtime are eliminated to moderate the off-season costs. Our manufacturing facility capacity utilization generally remains less than 100% during these summer months; because physical structure ca