

VIRCO MFG CORPORATION

Form 10-Q

June 09, 2006

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**Quarterly Report under Section 13 or 15(d)**  
**of the Securities Exchange Act of 1934**  
**FORM 10-Q**

**For Quarter Ended**                      **April 30, 2006**                                      **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  
(I.R.S. Employer Identification No.)

2027 Harpers Way, Torrance, CA  
(Address of principal executive offices)

90501  
(Zip Code)

Registrant's telephone number, including area code: (310) 533-0474

No change

Former name, former address and former fiscal year, if changed since last report.

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (check one):

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

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

The number of shares outstanding for each of the registrant's classes of common stock, as of the latest practicable date:

Common Stock, \$.01 par value    13,137,288 shares as of May 31, 2006.

VIRCO MFG. CORPORATION  
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Exhibit 31.1 Certification of Robert A. Virtue, President, pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 Certification of Robert E. Dose, Vice President, Finance, pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**PART I****Item 1. Financial Statements**

VIRCO MFG. CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS

	4/30/2006	1/31/2006	4/30/2005
	(In thousands, except share data)		
	Unaudited (Note 1)		Unaudited (Note 1)
Assets			
Current assets:			
Cash	\$ 752	\$ 1,489	\$ 495
Trade accounts receivable	18,247	17,470	16,112
Less allowance for doubtful accounts	234	200	262
Net trade accounts receivable	18,013	17,270	15,850
Other receivables	224	377	179
Inventories:			
Finished goods, net	19,641	11,070	12,611
Work in process, net	22,816	13,796	24,546
Raw materials and supplies, net	9,194	6,751	8,438
	51,651	31,617	45,595
Prepaid expenses and other current assets	1,041	1,493	1,153
Total current assets	71,681	52,246	63,272
Property, plant and equipment:			
Land and land improvements	3,591	3,591	3,253
Buildings and building improvements	49,581	49,581	49,542
Machinery and equipment	106,981	106,475	104,319
Leasehold improvements	1,302	1,289	1,289
	161,455	160,936	158,403
Less accumulated depreciation and amortization	111,374	109,513	103,535
Net property, plant and equipment	50,081	51,423	54,868
Goodwill and other intangible assets, net	2,323	2,324	2,334
Other assets	8,727	8,727	8,889
Total assets	\$ 132,812	\$ 114,720	\$ 129,363

See Condensed Consolidated Financial Statements.

VIRCO MFG. CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS

	4/30/2006	1/31/2006	4/30/2005
	(In thousands, except share data)		
	Unaudited (Note 1)		Unaudited (Note 1)
Liabilities			
Current liabilities:			
Checks released but not yet cleared bank	\$ 2,276	\$ 2,030	\$ 2,909
Accounts payable	23,474	17,504	19,350
Accrued compensation and employee benefits	5,063	6,047	5,094
Current portion of long-term debt	5,012	5,012	5,012
Other accrued liabilities	5,974	6,165	5,073
Total current liabilities	41,799	36,758	37,438
Non-current liabilities:			
Accrued self-insurance retention and other	3,104	2,703	3,723
Accrued pension expenses	15,024	14,618	13,288
Long-term debt, less current portion	36,511	21,541	31,327
Total non-current liabilities	54,639	38,862	48,338
Commitments and contingencies			
Stockholders' equity:			
Preferred stock			
Authorized 3,000,000 shares, \$.01 par value; none issued or outstanding			
Common stock			
Authorized 25,000,000 shares, \$.01 par value; issued 13,137,288 shares at 4/30/2006 and 1/31/2006, and 13,099,825 shares at 4/30/2005	131	131	131
Additional paid-in capital	108,684	108,143	107,888
Retained deficit	(68,248)	(64,981)	(61,090)
Accumulated comprehensive loss	(4,193)	(4,193)	(3,342)
Total stockholders' equity	36,374	39,100	43,587
Total liabilities and stockholders' equity	\$ 132,812	\$ 114,720	\$ 129,363

See Notes to Condensed Consolidated Financial Statements.

VIRCO MFG. CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 Unaudited (Note 1)

	Three months ended	
	4/30/2006	4/30/2005
	(In thousands, except share data)	
Net sales	\$ 34,515	\$ 33,254
Costs of goods sold	23,021	23,847
Gross profit	11,494	9,407
Selling, general and administrative expenses	13,875	14,557
Interest expense	886	533
Loss before income taxes	(3,267)	(5,683)
Provision for income taxes		
Net loss	\$ (3,267)	\$ (5,683)
Net loss per common share		
Basic	\$ (0.25)	\$ (0.43)
Weighted average shares outstanding		
Basic	13,137	13,100

See Notes to Condensed Consolidated Financial Statements.

VIRCO MFG. CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
Unaudited (Note 1)

	Three months ended	
	4/30/2006	4/30/2005
	(In thousands)	
Operating activities		
Net loss	\$ (3,267)	\$ (5,683)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,861	2,406
Provision for doubtful accounts	25	37
Loss on sale of property, plant and equipment		20
Changes in assets and liabilities		
Trade accounts receivable	(768)	110
Other receivables	153	(14)
Inventories	(20,034)	(19,548)
Income taxes	10	2,244
Prepaid expenses and other current assets	452	187
Accounts payable and accrued liabilities	6,380	6,826
Other		(91)
Net cash used in operating activities	(15,188)	(13,506)
Investing activities		
Capital expenditures	(519)	(437)
Proceeds from sale of property, plant and equipment		32
Net cash used in investing activities	(519)	(405)
Financing activities		
Issuance of long-term debt	14,970	13,209
Proceeds from issuance of common stock		5
Net cash provided by financing activities	14,970	13,214
Net decrease in cash	(737)	(697)
Cash at beginning of year	1,489	1,192
Cash at end of year	\$ 752	\$ 495
Supplemental disclosures of cash flow information		
Cash paid (received) during the year for:		
Interest, net of amounts capitalized	\$ 886	\$ 533
Income tax, net	5	(2,254)



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Non-cash activities

Accrued asset retirement obligations

\$ 11

\$ 11

Deferred compensation

541

See Notes to Condensed Consolidated Financial Statements.

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VIRCO MFG. CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
April 30, 2006

Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended April 30, 2006, are not necessarily indicative of the results that may be expected for the year ending January 31, 2007. The balance sheet at January 31, 2006, has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended January 31, 2006.

Note 2. Seasonality

The market for educational furniture is marked by extreme seasonality, with over 50% of the Company's total sales typically occurring from June to September each year, which is the Company's peak season. Hence, the Company typically builds and carries significant amounts of inventory during and in anticipation of this peak summer season to facilitate the rapid delivery requirements of customers in the educational market. This requires a large up-front investment in inventory, labor, storage and related costs as inventory is built in anticipation of peak sales during the summer months. As the capital required for this build-up generally exceeds cash available from operations, the Company has historically relied on third-party bank financing to meet cash flow requirements during the build-up period immediately preceding the peak season.

In addition, the Company typically is faced with a large balance of accounts receivable during the peak season. This occurs for two primary reasons. First, accounts receivable balances typically increase during the peak season as shipments of products increase. Second, many customers during this period are government institutions, which tend to pay accounts receivable more slowly than commercial customers.

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

Note 3. New Accounting Standards

In February 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 155, Accounting for Certain Hybrid Financial Instruments (SFAS 155). SFAS 155 establishes, among other things, the accounting for certain derivatives embedded in other financial instruments. This statement permits fair value remeasurement for any hybrid financial instrument containing an embedded derivative that would otherwise require bifurcation. It also requires that beneficial interests in securitized financial assets be accounted for in accordance with SFAS No. 133. SFAS 155 is effective for fiscal years beginning after September 15, 2006, and is not expected to have a material impact on the Company's financial operations or financial positions.

Note 4. Inventories

Year end financial statements at January 31, 2006 reflect inventories verified by physical counts with the material content valued by the LIFO method. At April 30, 2006 and 2005, there was no physical verification of inventory quantities. Cost of sales is recorded at current cost. The effect of penetrating LIFO layers is not recorded at interim dates unless the reduction in inventory is expected to be permanent. No such adjustments have been made for the periods ended April 30, 2006 and 2005. LIFO reserves at April 30, 2006 and January 31, 2006 were \$6,423,000. LIFO reserves at April 30, 2005 were \$6,201,000. Management continually monitors production costs, material costs and inventory levels to determine that interim inventories are fairly stated.

Note 5. Debt

The Company has entered into a revolving credit facility with Wells Fargo Bank, amended and restated in December 2005, which provides a term loan of \$20,000,000 and a secured revolving line of credit that varies as a percentage of inventory and receivables, up to a maximum of \$40,000,000. The revolving line of credit increases to \$50,000,000 between May and September. The term note is a two-year loan amortizing at \$5,000,000 per year with interest payable monthly at a fluctuating rate equal to the Bank's prime rate (7.50% at April 30, 2006) plus a 2% margin.

The revolving line has a 24-month maturity with interest payable monthly at a fluctuating rate equal to the bank's prime rate plus a fluctuating margin similar to the term note. The revolving line typically provides for advances of 80% on eligible accounts receivable and 20% - 60% on eligible inventory. The advance rates fluctuate depending on the time of the year and the types of assets. The agreement has an unused commitment fee of 0.375%. Approximately \$15,656,000 was available for borrowing as of April 30, 2006.

The revolving credit facility with Wells Fargo Bank is subject to various financial covenants including a minimum requirement, minimum EBITDA and an annual cleandown. The agreement also places certain restrictions on capital expenditures, new operating leases, dividends and the repurchase of the Company's common stock. The revolving credit facility is secured by the Company's accounts receivable, inventories, equipment and property. The Company is in compliance with its covenants at April 30, 2006, January 31, 2006 and April 30, 2005. The \$21,421,000 due under Wells Fargo Bank's line of credit will be payable on February 15, 2008, if the agreement is not renewed. The Company currently intends to renew the agreement.

Note 6. 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 Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. Deferred income taxes are recognized for differences between the financial statement and tax basis of assets and liabilities at enacted statutory tax rates in effect for the years in which the differences are expected to reverse. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. In assessing the realizability of deferred tax assets, we consider 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. We consider the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based on this consideration, we believe it is more likely than not that the net deferred tax assets will not be realized, and a valuation allowance has been recorded against the net deferred tax assets at April 30, 2006, January 31, 2006 and April 30, 2005.

Note 7. Net Loss per Share

For the three months ended April 30, 2006, net loss per share was calculated based on basic shares outstanding due to the anti-dilutive effect of the inclusion of common stock equivalent shares. The following table sets forth the computation of loss per share:

	Three Months Ended	
	4/30/2006	4/30/2005
	(In thousands, except per share data)	
Net loss	\$ (3,267)	\$ (5,683)

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Average shares outstanding	basic	13,137	13,100
Net effect of dilutive stock options based on the treasury stock method using average market price		68	281
Totals	Assuming dilution	13,205	13,381
Net loss per share	basic	\$ (0.25)	\$ (0.43)

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## Note 8. Stock Based Compensation

## Stock Option Plans

The Company's two stock plans are the 1997 Employee Incentive Plan (the 1997 Plan) and the 1993 Employee Incentive Stock Plan (the 1993 Plan). Under the 1993 Plan, the Company may grant an aggregate of 707,384 shares (as adjusted for stock splits and stock dividends) to its employees in the form of stock options. The 1993 Plan expired in 2003 and had 47,182 unexercised options outstanding at April 30, 2006. Under the 1997 Plan, the Company may grant an aggregate of 724,729 shares (as adjusted for stock splits and stock dividends) to its employees in the form of stock options or awards. As of April 30, 2006, the 1997 Plan had 234,594 unexercised option outstanding. Options granted under the plans have an exercise price equal to the market price at the date of grant, have a maximum term of 10 years and generally become exercisable ratably over a five-year period. The Company did not grant any stock options to any of the employees during the quarter ended April 30, 2006.

The shares of common stock issued upon exercise of a previously granted stock option are considered new issuances from shares reserved for issuance upon adoption of the various plans. While the Company does not have a formal written policy detailing such issuance, it requires that the option holders provides a written notice of exercise to the stock plan administrator and payment for the shares prior to issuance of the shares.

## Accounting for the Plans

Prior to February 1, 2006, the Company accounted for incentive stock plans in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB 25 ), and related Interpretations, as permitted by FASB Statement No. 123, Accounting for Stock Based Compensation . No stock based employee compensation was reflected in net income, as all options granted under those plans had an exercise price equal to the fair value of the underlying common stock on the date of grant. Effective February 1, 2006 the Company adopted the fair value recognition provisions of FASB Statement No. 123(R), Share-Based Payment , using the modified prospective-transition. The modified prospective method will be applied to those unvested options issued prior to the Company's adoption that have historically been accounted for under the Intrinsic Value Method. All outstanding options were 100% vested prior to the adoption. Accordingly, no compensation expense was recorded on the Company's options during the quarter ended April 30, 2006. For the three months ended April 30, 2005 we accounted for stock based compensation plans under APB Opinion No. 25 Accounting for Stock Issued to Employees. The following table illustrates the impact on net earnings and earnings per common share if the fair value method had been applied.

	Three Months Ended	
	4/30/2006	4/30/2005
	(In thousands, except per share data)	
Net loss, as reported	\$ (3,267)	\$ (5,683)
Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects		13
Pro forma net loss	\$ (3,267)	\$ (5,696)
Net loss per share basic, as reported	\$ (0.25)	\$ (0.43)

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Weighted average shares outstanding	basic	13,137	13,100
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The Company has estimated the fair value of all stock option awards as of the date of grant by applying the Black-Scholes pricing valuation model. The application of this valuation model involves assumptions that are judgmental and sensitive in the determination of compensation expense. Historical information was the primary basis for the selection of the expected volatility and life of the option. The risk-free interest rate was selected based upon the yield of the U.S. Treasury issue with a term equal to the expected life of the option being valued.

Stock option activity during the three months ended April 30, 2006 is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in yrs.)	Aggregate Intrinsic Value
Outstanding at February 1, 2006	292,571	\$ 11.56	2.49	
Lapsed	(10,795)	13.30		
Exercised				
Granted				
Outstanding at April 30, 2006	281,776	11.50	2.25	\$
Exercisable at April 30, 2006	281,776	11.50	2.25	\$

As all options had vested prior to February 1, 2006, there was no effect on the statement of operations or cash flows due to the adoption of FASB Statement No. 123(R).

#### Restricted Stock Unit Awards

On June 30, 2004, the Company granted a total of 270,000 restricted stock units, with an estimated fair value of \$6.92 per unit and exercise price of \$0.01 per unit, to eligible employees under the 1997 Plan. Participants vest their interest in notional stock units ratably over five years, with such units being 20% vested at each anniversary date. As such, 204,000 of the units remain outstanding as of April 30, 2006. Compensation expense is recognized based on the estimated fair value of restricted stock units and vesting provisions. Compensation expense incurred in connection with this award was \$88,000 and \$99,000 for quarters ended April 30, 2006 and 2005, respectively. As of April 30, 2006, there was approximately \$1,118,000 of unrecognized compensation cost related to non-vested restricted stock unit award, which is expected to be recognized through June 30, 2009.

On January 13, 2006, the Company granted a total of 73,881 restricted stock units, with an estimated fair value of \$5.21 per unit and exercise price of \$0.01 per unit, to non-employee directors under the 1997 Plan. Participants vest their interest in notional stock units ratably over the vesting period, with such units being 100% vested at July 5, 2006. Compensation expense is recognized based on the estimated fair value of restricted stock units and vesting provisions. For the quarter ended April 30, 2006, compensation expense incurred in connection with this award was \$206,000. As of April 30, 2006, there was approximately \$137,000 of unrecognized compensation cost related to non-vested restricted stock unit Awards. The cost is expected to be recognized during the second quarter ending July 31, 2006. All units granted remain outstanding at April 30, 2006.

As the compensation cost for the restricted stock units was measured using the estimated fair value on the date of grant and recognized over the vesting period, there was no effect on the statements of operations, due to the adoption of FASB Statement No. 123(R). At February 1, 2006, the Company recorded a transitional reclassification of \$247,000 from current liabilities to additional paid-in capital.

Note 9. Comprehensive Loss



Comprehensive loss for the three and nine months ended April 30, 2006 and 2005 was the same as net loss reported on the statements of operations. Accumulated comprehensive loss at April 30, 2006 and 2005 and January 31, 2006 is composed of minimum pension liability adjustments.

Note 10. Retirement Plans

The Company and its subsidiaries cover all employees under a noncontributory defined benefit retirement plan, the Virco Employees Retirement Plan (the Plan ). Benefits under the Plan are based on years of service and career average earnings. As more fully described in the Form 10-K for the period ending January 31, 2006, benefit accruals under this plan were frozen effective December 31, 2003.

The Company also provides a supplementary retirement plan for certain key employees, the VIP Retirement Plan (the VIP Plan ). The VIP Plan provides a benefit of up to 50% of average compensation for the last five years in the VIP Plan, offset by benefits earned under the Plan. As more fully described in the Form 10-K for the period ending January 31, 2005, benefit accruals under this plan were frozen effective December 31, 2003.

The Company also provides a non-qualified plan for non-employee directors of the Company (the Non-Employee Directors retirement Plan ). The Non-Employee Directors Retirement Plan provides a lifetime annual retirement benefit equal to the director's annual retainer fee for the fiscal year in which the director terminates his or her position with the Board, subject to the director providing 10 years of service to the Company. As more fully described in the Form 10-K for the period ending January 31, 2006, benefit accruals under this plan were frozen effective December 31, 2003.

The net periodic pension costs for the Plan, the VIP Plan, and the Non-Employee Directors Retirement Plan for the three months each ended April 30, 2006 and 2005 were as follows (in thousands):

	Pension Plan		VIP Retirement Plan		Non-Employee Directors Retirement Plan	
	2006	2005	2006	2005	2006	2005
Service cost	\$ 43	\$ 55	\$ 53	\$ 58	\$ 6	\$ 6
Interest cost	352	337	85	89	6	6
Expected return on plan assets	(246)	(248)			0	0
Amortization of transition amount	(9)	(9)			0	0
Amortization of prior service cost	117	107	(134)	(125)	22	22
Recognized net actuarial (Gain) or loss	41	33	34	27	(7)	(7)
Settlement and curtailment						
Net periodic pension cost	\$ 298	\$ 275	\$ 38	\$ 49	\$ 27	\$ 27

#### Note 11. Warranty

The Company provides a product warranty on most products. It generally warrants 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. The following is a summary of the Company's warranty claim activity for the three months each ended April 30, 2006 and 2005: