VIRCO MFG CORPORATION
Form 10-Q
September 11, 2015

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

FORM 10-Q

ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended July 31, 2015

OR

¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File number 1-8777

VIRCO MFG. CORPORATION
(Exact Name of Registrant as Specified in its Charter)

Delaware	95-1613718
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
2027 Harpers Way, Torrance, CA	90501
(Address of Principal Executive Offices)	(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 ý No ¨

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

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

Large accelerated filer ¨		Accelerated filer	¨
Non-accelerated filer ¨	(Do not check if a smaller reporting company)	Smaller reporting company	ý

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

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 — 14,998,187 shares as of September 5, 2015.

TABLE OF CONTENTS

PART I. Financial Information
Item 1. Financial Statements

Virco Mfg. Corporation
Condensed Consolidated Balance Sheets

	7/31/2015	1/31/2015	7/31/2014
	(In thousands, except share data)		
	Unaudited (Note 1)		Unaudited (Note 1)
Assets			
Current assets			
Cash	$1,490	$470	$1,130
Trade accounts receivables, net	33,883	10,614	29,414
Other receivables	141	43	47
Income tax receivable	288	267	317
Inventories			
Finished goods	16,998	5,602	20,145
Work in process	13,961	11,487	15,161
Raw materials and supplies	10,827	9,589	9,977
	41,786	26,678	45,283
Deferred tax assets, net	156	156	203
Prepaid expenses and other current assets	1,334	743	1,350
Total current assets	79,078	38,971	77,744
Property, plant and equipment			
Land	1,671	1,671	1,671
Land improvements	851	851	1,189
Buildings and building improvements	46,443	47,047	47,047
Machinery and equipment	107,275	110,060	113,152
Leasehold improvements	1,895	1,909	1,957
	158,135	161,538	165,016
Less accumulated depreciation and amortization	122,849	126,317	128,970
Net property, plant and equipment	35,286	35,221	36,046
Deferred tax assets, net	569	624	305
Other assets	6,953	6,995	6,990
Total assets	$121,886	$81,811	$121,085

See accompanying notes.

Virco Mfg. Corporation
Condensed Consolidated Balance Sheets

	7/31/2015	1/31/2015	7/31/2014
	(In thousands, except share data)		
	Unaudited (Note 1)		Unaudited (Note 1)
Liabilities			
Current liabilities			
Accounts payable	$19,240	$9,901	$20,382
Accrued compensation and employee benefits	4,793	4,199	3,860
Current portion of long-term debt	24,708	3,366	27,545
Deferred tax liabilities	—	—	—
Other accrued liabilities	7,818	3,939	7,293
Total current liabilities	56,559	21,405	59,080
Non-current liabilities			
Accrued self-insurance retention	2,379	1,730	2,020
Accrued pension expenses	27,907	28,986	23,132
Income tax payable	37	42	37
Long-term debt, less current portion	6,153	6,153	6,000
Other accrued liabilities	976	922	1,092
Total non-current liabilities	37,452	37,833	32,281
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 and outstanding 14,998,187 shares at 7/31/2015 and 14,852,640 at 1/31/2015 and 7/31/2014	150	149	148
Additional paid-in capital	116,385	116,348	116,105
Accumulated deficit	(69,416)	(73,690)	(73,191)
Accumulated other comprehensive loss	(19,244)	(20,234)	(13,338)
Total stockholders' equity	27,875	22,573	29,724
Total liabilities and stockholders' equity	$121,886	$81,811	$121,085

See accompanying notes.

Virco Mfg. Corporation
Condensed Consolidated Statements of Income
Unaudited (Note 1)

	Three months ended	
	7/31/2015	7/31/2014
	(In thousands, except per share data)	
Net sales	$61,072	$53,042
Costs of goods sold	37,076	32,346
Gross profit	23,996	20,696
Selling, general and administrative expenses	16,055	14,620
Gain on sale of property, plant & equipment	—	—
Restructuring expense	—	62
Operating income (loss)	7,941	6,014
Interest expense, net	453	505
Income (loss) before income taxes	7,488	5,509
Income tax expense (benefit)	38	306
Net income (loss)	$7,450	$5,203
Net income (loss) per common share:		
Basic	$0.50	$0.35
Diluted	$0.49	$0.35
Weighted average shares outstanding:		
Basic	14,887	14,725
Diluted	15,176	14,874

See accompanying notes.

Virco Mfg. Corporation
Condensed Consolidated Statements of Income
Unaudited (Note 1)

	Six months ended	
	7/31/2015	7/31/2014
	(In thousands, except per share data)	
Net sales	$84,120	$76,425
Costs of goods sold	51,930	47,699
Gross profit	32,190	28,726
Selling, general and administrative expenses	27,097	26,195
Gain on sale of property, plant & equipment	(8)	—
Restructing expense	—	62
Operating income (loss)	5,101	2,469
Interest expense, net	750	834
Income (loss) before income taxes	4,351	1,635
Income tax expense (benefit)	77	287
Net income (loss)	$4,274	$1,348
Net income (loss) per common share:		
Basic	$0.29	$0.09
Diluted	$0.28	$0.09
Weighted average shares outstanding:		
Basic	14,856	14,687
Diluted	15,139	14,839

See accompanying notes.

6

Virco Mfg. Corporation
Condensed Consolidated Statements of Comprehensive Income (Loss)
Unaudited (Note 1)

	Three months ended	
	7/31/2015	7/31/2014
	(In thousands)	
Net income (loss)	$7,450	$5,203
Other comprehensive income (loss) :		
Pension adjustments	495	321
Comprehensive income (loss)	$7,945	$5,524

See accompanying notes.

7

Virco Mfg. Corporation
Condensed Consolidated Statements of Comprehensive Income (Loss)
Unaudited (Note 1)

	Six months ended	
	7/31/2015	7/31/2014
	(In thousands)	
Net income (loss)	$4,274	$1,348
Other comprehensive income (loss) :		
Pension adjustments	990	642
Comprehensive income (loss)	$5,264	$1,990

See accompanying notes.

Virco Mfg. Corporation
Condensed Consolidated Statements of Cash Flows
Unaudited (Note 1)

	Six months ended	
	7/31/2015	7/31/2014
	(In thousands)	
Operating activities		
Net income (loss)	$4,274	$1,348
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,312	2,168
Provision for doubtful accounts	43	60
(Gain) loss on sale of property, plant and equipment	(8)	—
Deferred income taxes	55	275
Stock-based compensation	244	259
Amortization of net actuarial (gain) loss for pension plans, net of tax	990	642
Changes in operating assets and liabilities:		
Trade accounts receivable	(23,312)	(20,978)
Other receivables	(98)	5
Inventories	(15,108)	(17,504)
Income taxes	(27)	(27)
Prepaid expenses and other current assets	(550)	244
Accounts payable and accrued liabilities	13,436	10,324
Net cash provided by (used in) operating activities	(17,749)	(23,184)
Investing activities		
Capital expenditures	(2,375)	(1,904)
Proceeds from sale of property, plant and equipment	8	—
Net cash provided by (used in) investing activities	(2,367)	(1,904)
Financing activities		
Proceeds from long-term debt	31,960	33,545
Repayment of long-term debt	(10,618)	(8,248)
Common stock repurchased	(206)	(130)
Net cash provided by (used in) financing activities	21,136	25,167
Net increase (decrease) in cash	1,020	79
Cash at beginning of year	470	1,051
Cash at end of year	$1,490	$1,130

See accompanying notes.

VIRCO MFG. CORPORATION
Notes to unaudited Condensed Consolidated Financial Statements
July 31, 2015
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 pursuant to the rules and regulations of the Securities and Exchange Commission. 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 six months ended July 31, 2015, are not necessarily indicative of the results that may be expected for the fiscal year ending January 31, 2016. The balance sheet at January 31, 2015, 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 fiscal year ended January 31, 2015 ("Form 10-K"). Certain reclassifications have been made to the prior year statement of operations to conform to the current year presentation. Reclassifications did not have a material impact to the statement of operations. All references to the "Company" refer to Virco Mfg. Corporation and its subsidiaries.
Note 2. Correction of Immaterial Errors
In connection with the preparation of the January 31, 2015 consolidated financial statements, the Company determined that certain payments directly made to customers, which were previously included in selling, general, and administrative expenses, should instead be reflected as decreases to net sales. The current year Condensed Consolidated Statement of Operations properly reflects payments directly made to customers as decreases to net sales. While the amounts included in prior year were considered to be immaterial, the Company elected to revise the presentation of previously reported amounts to be consistent with the presentation for the quarter ended July 31, 2015. The change resulted in decreases to net sales, gross margin and selling, general, and administrative expenses of $150,000 and $297,000 for the three and six months ended July 31, 2014, respectively.
Note 3. Seasonality
The market for educational furniture is marked by extreme seasonality, with approximately 50% of the Company's total sales typically occurring from June to August each year, the Company's peak season. Hence, the Company typically builds and carries significant amounts of inventory during and in anticipation of this peak summer season to facilitate the rapid delivery requirements of customers in the educational market. This requires a large up-front investment in inventory, labor, storage and related costs as inventory is built in anticipation of peak sales during the summer months. As the capital required for this build-up generally exceeds cash available from operations, the Company has 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 ongoing basis, management evaluates its estimates, including those related to market demand, labor costs, and stocking inventory.
Note 4. New Accounting Standards
In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09") an updated standard on revenue recognition. This ASU will supersede the revenue recognition requirements in Accounting Standards Codification Topic 605, Revenue Recognition, and most industry-specific guidance. ASU 2014-09 provides enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies reporting using US GAAP and International Financial Reporting Standards. The core principle of the new standard is

for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the Company expects to be entitled in exchange for those goods or services. In doing so the Company may be required to use more judgment and make more estimates than under current authoritative guidance. ASU 2014-09 will be effective for the Company in the first quarter of fiscal

2017 and may be applied on a full retrospective or modified retrospective approach. The Company is currently evaluating the impact the adoption of this standard will have on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements-Going Concern (Subtopic 205-40), Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. This standard sets forth management's responsibility to evaluate, each reporting period, whether there is substantial doubt about our ability to continue as a going concern, and if so, to provide related footnote disclosures. The standard is effective for annual and interim reporting periods ending after December 15, 2016. We are currently evaluating this new standard and expect it to have no impact on our financial position and results of operations.

In April 2015, the FASB issued an Accounting Standards Update that requires reporting entities to present debt issuance costs as a direct deduction from the face amount of that note payable presented in the balance sheet. The Accounting Standards Update is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted. A reporting entity is required to apply the amendments in the Accounting Standards Update retrospectively to all prior periods. We are currently assessing the potential impact that the adoption of the Accounting Standards Update will have on our consolidated financial statements.

Note 5. Inventories

Inventories primarily consist of raw materials, work in progress, and finished goods of manufactured products. In addition, the Company maintains an inventory of finished goods purchased for resale. Inventories are stated at lower of cost or market and consist of materials, labor, and overhead. The Company determines the cost of inventory by the first-in, first-out method. The value of inventory includes any related production overhead costs incurred in bringing the inventory to its present location and condition. The Company records the cost of excess capacity as a period expense, not as a component of capitalized inventory valuation.

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

Note 6. Debt

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

	7/31/2015	1/31/2015	7/31/2014
	(in thousands)		
Revolving credit line	$30,708	$9,366	$33,545
Other	153	153	—
Total debt	30,861	9,519	33,545
Less current portion	24,708	3,366	27,545
Non-current portion	$6,153	$6,153	$6,000

On December 22, 2011, the Company entered into a Revolving Credit and Security Agreement (the "Credit Agreement") with PNC Bank, National Association ("PNC"). The credit agreement currently matures on December 22, 2017 and has a maximum availability of $50,000,000, including sub-lines for letters of credit and equipment financing. Borrowings under the Credit Agreement bear interest at either the Alternate Base Rate (as defined in the Credit Agreement) plus 0.75% to 1.75% or the Eurodollar Currency Rate (as defined in the Credit Agreement) plus 1.75% to 2.75%. The interest rate at July 31, 2015 was 4%. Approximately $25,595,000 was available for borrowing as of July 31, 2015.

The Credit Agreement prohibits the Company from issuing dividends or making payments with respect to the Company's capital stock, and contains numerous other covenants, including these financial covenants: (1) minimum tangible net worth, (2) fixed charge coverage ratio, and (3) minimum EBITDA amount, in each case as of the end of the relevant monthly, quarterly or annual measurement period. The Company was in compliance with its covenants during the first two quarters of 2015. Pursuant to the Credit Agreement, substantially all of the Company's accounts receivable are automatically and promptly swept to repay amounts outstanding under the Revolving Credit Facility upon receipt by the Company. In addition, the Credit Agreement contains a clean down provision that requires the Company to reduce borrowings under the line to less than $6,000,000 for a period of 60 consecutive days each fiscal year. On June 18, 2015, the Company entered into Amendment No.

10 to the Credit Agreement which, among other things, increased the borrowing availability for the period from June 18, 2015 through August 15, 2015.

The Company believes that the Revolving Credit Facility will provide sufficient liquidity to meet its capital requirements for at least in the next 12 months. Management believes that the carrying value of debt approximated fair value at July 31, 2015 and 2014, as all of the long-term debt bears interest at variable rates based on prevailing market conditions.

Note 7. Income Taxes

The Company recognizes deferred income taxes under the asset and liability method of accounting for income taxes in accordance with the provisions of ASC No. 740, Accounting for Income Taxes. Deferred income taxes are recognized for differences between the financial statement and tax basis of assets and liabilities at enacted statutory tax rates in effect for the years in which the differences are expected to reverse. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. In assessing the realizability of deferred tax assets, the Company considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income or reversal of deferred tax liabilities during the periods in which those temporary differences become deductible. Based on this consideration, the Company determined the realization of a majority of the net deferred tax assets do not meet the more likely than not criteria and a valuation allowance was recorded against the majority of the net deferred tax assets at July 31, 2015. The effective tax rate for the quarter ended July 31, 2015 was impacted by the valuation allowance recognized against state deferred tax assets and discrete items associated with non-taxable permanent differences.

The years ended January 31, 2012, January 31, 2014 and subsequent years remain open for examination by the IRS. The fiscal years ended January 31, 2011 and subsequent years remain open for examination by state tax authorities. The Company is not currently under IRS or state examination.

As of July 31, 2015, the Company has $37,000 of uncertain tax positions accrued. The specific timing of when the resolution of each tax position will be reached is uncertain. As of July 31, 2015, we do not believe that there are any positions for which it is reasonably possible that the total amount of unrecognized tax benefits will significantly increase or decrease within the next 12 months.

Note 8. Net Income (Loss) per Share

	Three Months Ended		Six Months Ended	
	7/31/2015	7/31/2014	7/31/2015	7/31/2014
	(In thousands, except per share data)			
Net income (loss)	$7,450	$5,203	$4,274	$1,348
Weighted average shares outstanding	14,887	14,725	14,856	14,687
Net effect of dilutive share-based on the treasury stock method using average market price	289	149	283	152
Totals	15,176	14,874	15,139	14,839
Net income (loss) per share - basic	$0.50	$0.35	$0.29	$0.09
Net income (loss) per share - diluted	$0.49	$0.35	$0.28	$0.09

Note 9. Stock-Based Compensation and Stockholders' Rights

Stock Incentive Plans

The Company's two stock plans are the 2011 Employee Stock Incentive Plan (the "2011 Plan") and the 2007 Employee Incentive Stock Plan (the "2007 Plan"). Under the 2011 Plan, the Company may grant an aggregate of 2,000,000 shares to its employees and non-employee directors in the form of stock options or awards. Restricted stock or stock units awarded under the 2011 Plan are expensed ratably over the vesting period of the awards. The Company determines the fair value of its restricted stock unit awards and related compensation expense as the difference between the market value of the awards on the date of grant less the exercise price of the awards granted. The Company granted 75,174 awards under the 2011 Plan during the three and six month periods ended July 31, 2015. As of July 31, 2015, there were approximately 803,520 shares available for future issuance under the 2011 Plan.

Under the 2007 Plan, the Company may grant an aggregate of 1,000,000 shares to its employees and non-employee directors in the form of stock options or awards. Restricted stock or stock units awarded under the 2007 Plan are expensed ratably over the vesting period of the awards. The Company determines the fair value of its restricted stock unit awards and related compensation expense as the difference between the market value of the awards on the date of grant less the exercise price of the awards granted. The Company granted 0 awards under the 2007 Plan during 2014 and 0 awards under the 2007 Plan during the quarter ended July 31, 2015. As of July 31, 2015, there were approximately 13,075 shares available for future issuance under the 2007 Plan.

Accounting for the Plans

Restricted Stock Unit Awards

The following table presents a summary of restricted stock and stock unit awards at July 31, 2015 and 2014:

			Expense for 3 months ended		Expense for 6 months ended		Unrecognized Compensation Cost at
Date of Grants	Units Granted	Terms of Vesting	7/31/2015	7/31/2014	7/31/2015	7/31/2014	7/31/2015
2011 Stock Incentive Plan							
6/22/2015	48,000	4 years	$5,000	$—	5,000	$—	$127,000
6/22/2015	27,174	1 year	13,000	—	13,000	—	62,000
6/24/2014	28,626	1 year	6,000	13,000	25,000	13,000	—
6/24/2014	490,000	5 years	61,000	43,000	125,000	43,000	920,000
12/3/2013	10,000	1 year	—	6,000	—	12,000	—
6/25/2013	71,430	1 year	—	13,000	—	50,000	—
6/19/2012	520,000	5 years	38,000	39,000	77,000	79,000	270,000
2007 Stock Incentive Plan							
6/16/2009	382,500	5 years	—	15,000	—	62,000	—
Totals for the period			$123,000	$129,000	$245,000	$259,000	$1,379,000

Note 10. Stockholders' Equity