

VIRCO MFG CORPORATION

Form 10-K

April 16, 2010

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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, 2010.**

**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)

(IRS Employer Identification No.)

2027 Harpers Way, Torrance, California

90501

(Address of principal executive offices)

(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

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.

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 held by non-affiliates of the registrant on July 31, 2009, was \$35.6 million (based upon the closing price of the registrant's common stock on such day, as reported by the NASDAQ).

As of April 1, 2010, there were 14,153,044 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 2010 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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*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 potential or contemplated acquisitions; 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, and competition.*

*In this report, words such as anticipates, believes, expects, will continue, future, intends, plans, estimates, projects, 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, 2006, January 31, 2007, January 31, 2008, January 31, 2009 and January 31, 2010 are referred to as years 2005, 2006, 2007, 2008 and 2009, respectively.*

**Item 1. Business****Introduction**

Designing, producing and distributing high-value furniture for a diverse family of customers is a 60-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® and the recently introduced Metaphor® and Telos® classroom furniture collections, as well as I.Q.® Series items for educational settings; Ph.D.® and Ph.D. Executive seating lines; and the wide-ranging Plateau® Series.

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. Virco plans to further expand the use of our flat metal forming capabilities in 2010 to produce lateral files, vertical files and mobile pedestals.

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

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forming capabilities are used to manufacture Parameter products. Additional Parameter desks, as well as Parameter mobile pedestals and wire management accessories, are targeted for release in the second half of 2010.

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. Other products manufactured with the use of Virco's flat metal forming capabilities are also targeted to be offered at multiple price points in 2010. As of January 31, 2010, the Company's employment force was approximately 1,100 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 furniture, fixtures and equipment 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; trade, technical and vocational schools; 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 furniture, fixtures and equipment 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 early 2000s, 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



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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 2009, 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 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 furniture, fixtures and equipment 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. Since this record-breaking launch, ZUMA sales have continued to grow. 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. 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 Telo® Series, a wide-ranging product line with ergonomically contoured Fortified Recycled Wood components. 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. Virco also carries traditional folding and banquet tables, activity tables and office tables, as well as the computer tables and mobile tables described below.

**COMPUTER FURNITURE** 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. Moreover, Plateau Office Solutions bookcases in popular sizes are available for 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, Teles®, 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 Virco mobile tables, while classrooms benefit from the spacious storage capacity of Virco mobile cabinets. An array of Virco product lines include 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 for Children and 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 for Children and Schools Program. All of the models in the Company's most recently introduced product lines including TEXT and Lunada® tables, as well as Flip-Top Technology tables and Parameter desks, returns and credenzas 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 2009.

In addition to product offerings, Virco also offers various levels of service and delivery. Products can be purchased FOB factory, FOB destination (including delivery), with Virco full service including installation in the classroom, and with full project management for the acquisition of FF&E items for new schools or renovations of schools. These services are only offered in connection with the purchase of Virco products. Revenues from these service levels are included in the purchase price of the furniture items.

Please note that this report includes trademarks of Virco, including, but not limited to, the following: ZUMA®, ZUMAFrd, Ph.I®, I.Q.® Virtuoso®, Classic Series, Martest 21®, Lunada®, Plateau®, Core-a-Gator®, Future Access®,

Sigma<sup>®</sup>, Metaphor<sup>®</sup>, Telos<sup>®</sup>, TEXT<sup>®</sup> and Parameter . Solely for convenience, from time to time we refer to our trademarks in this prospectus without the <sup>®</sup> and 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.

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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 2009.

### ***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. Additionally, 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. In the latter portion of the 2008, the cost of these materials declined, and remained relatively stable during 2009.

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 2010.

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 these contracts that allow 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 quarter. 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 2004, 2005, and 2008. 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.

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,

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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. Sales to this market include 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 2009. 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 40% 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 40% of Virco's sales in 2009, 40% of sales in 2008, and 35% of sales in 2007. In the third quarter of 2008, the Company was awarded a three-year contract with this purchasing organization extending through 2011. In addition, 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 2009 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 vast majority of shipments occurring from June to September 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 Wells Fargo 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 two 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. 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.

Virco's working capital requirements during, and in anticipation of, the peak summer season 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



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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 Sagus International LLC (which markets product under Artco-Bell, American Desk, and Midwest Folding Products), Hon (HNI), KI Inc., Royal, Bretford, Smith System, Columbia, Scholarcraft and VS America. The largest competitor that purchases and re-sells furniture is School Specialty (SCHS). 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., KI 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, 2010, totaled \$13.0 million and approximated six weeks of sales, compared to \$16.5 million at January 31, 2009, and \$15.2 million at January 31, 2008. Substantially all of the backlog will ship during 2010.

***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.<sup>®</sup> chairs, I.Q.<sup>®</sup> Series furniture, the ZUMAFrd family of products, and the ZUM® 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 tradenames 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 tradenames 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 tradename, except perhaps Virco, which the Company has protected and enhanced as an emblem of quality educational furniture for over 60 years.

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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, 2010, Virco and its subsidiaries employed approximately 1,100 full-time employees at various locations. Of this number, approximately 900 are involved in manufacturing and distribution, approximately 125 in sales and marketing and approximately 75 in administration.

**Environmental Compliance**

Virco is subject to numerous 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 designation in 2005 and 2004 from the Waste Reduction Awards Program in California, 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 by the United States Environmental Protection Agency. Additionally, all ZUMA® and ZUMAFrd® products, and hundreds of other Virco furniture items including all models in the Company's recently introduced, TEX® and Lunada® table lines, as well as Flip-Top Technology tables and Parameter® desks, returns and credenzas have been certified according to the GREENGUARD® Environmental Institute's stringent indoor air quality standard for children and schools. Moreover, all Virco products covered by the Consumer Product Safety Improvement Act of 2008 (CPSIA) are in compliance with this legislation. All affected Virco models are also in compliance with the California Air Resources Board (CARB) rule implemented on January 1, 2009, concerning formaldehyde emissions from composite wood products. Nevertheless, it is possible that the Company's operations may result in noncompliance with, or liability for remediation pursuant to, environmental laws. 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. See 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 2009, Virco derived 6-7% of its revenues from customers located outside of the United States (primarily in Canada and Panama). During the previous two fiscal years, Virco derived approximately 4-5% 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 2009, 2008 and 2007, the Company did not have any long-lived assets outside of the United States.

**Executive Officers of the Registrant**

As of April 1, 2010, 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, 2010	Has Held Office Since
 R. A. Virtue (1)		77	1990

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	President, Chairman of the Board and Chief Executive Officer		
D. A. Virtue (2)	Executive Vice President	51	1992
S. Bell (3)	Vice President General Manager, Conway Division	53	2004
R. E. Dose (4)	Vice President Finance, Secretary and Treasurer	53	1995
A. Gamble (5)	Vice President Human Resources	41	2004
P. Quinones (6)	Vice President Logistics and Marketing Services	46	2004
D. R. Smith (7)	Vice President Marketing	61	1995
L. L. Swafford (8)	Vice President & Corporate Counsel	45	1998
N. Wilson (9)	Vice President General Manager, Torrance Division	62	2004
L. O. Wonder (10)	Vice President Sales	58	1995
B. Yau (11)	Corporate Controller, Assistant Secretary and Assistant Treasurer	51	2004

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- (1) Appointed Chairman in 1990; has been employed by the Company for 53 years and has served as the President since 1982.
- (2) Appointed in 1992; has been employed by the Company for 24 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 21 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 19 years and

has served as the Corporate Controller, and currently as Vice President-Finance, Secretary and Treasurer.

- (5) Appointed in 2004; has been employed by the Company for 11 years and has served as Manager of Human Resources, as Director of Human Resources, and currently as Vice President of Human Resources.
- (6) Appointed in 2004; has been employed by the Company for 18 years in a variety customer and marketing service positions, and currently as Vice President of Logistics and Marketing Services.
- (7) Appointed in 1995; has been employed by the Company for 25 years in a variety of sales and marketing positions, and currently as Vice President of Marketing.
- (8) Appointed in 1998; has been employed by the Company for 14 years and has served as Associate

Corporate Counsel,  
and currently as  
Vice President &  
Corporate Counsel.

(9) Appointed in 2004;  
has been employed  
by the Company  
for 43 years in a  
variety of  
manufacturing,  
warehousing, and  
transportation  
positions, and  
currently as Vice  
President General  
Manager, Torrance  
Division.

(10) Appointed in 1995;  
has been employed  
by the Company  
for 32 years in a  
variety of sales and  
marketing  
positions, and  
currently as Vice  
President of Sales.

(11) Appointed in 2004;  
has been employed  
by the Company  
for 13 years and  
has served as  
Corporate  
Controller, and  
currently as  
Corporate  
Controller,  
Assistant Secretary  
and Assistant  
Treasurer.

None of the Company's officers have employment contracts.

***Available Information***

Virco files annual, quarterly and special 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 Station Place, 100 F Street, N.E., Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the 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).

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In addition, Virco makes available to its stockholders, free of charge through its Internet world-wide 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).



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### **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 decrease, which would adversely affect our business and results of operations.**

Our sales are significantly impacted by the level of education spending 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. Any significant and sustained decline 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, with more funding to be distributed at later dates. Significant portions of this money were used to avoid reductions-in-force at educational institutions. When stimulus money is no longer available to states, substantial additional reductions in school budgets may be required. At this time it is not known what impact the stimulus funding will have on the demand for school furniture, fixtures and equipment.

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.

**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 other than 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 margins could decline.

**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

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Company may receive significant orders during the first and second quarters for delivery in the second and third quarter. 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, 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.

**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 2009, 2008 and 2007. 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.

**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. If the price of petroleum-based products, the cost of operating our manufacturing facilities, and our transportation costs continue to increase, these increases could have a negative impact on our gross margins and profitability.

**Approximately 40% 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 40% of Virco's sales in 2009 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, 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**

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**receivables during the summer delivery season. Restrictions imposed by the terms of our existing credit facility may limit our operating and financial flexibility.**

Our credit facility prevents us from incurring any additional indebtedness, limits capital expenditures, restricts dividends, and requires a reduced level of borrowing during the fourth quarter. Our credit facility also subjects us to quarterly covenants, which currently includes certain funded debt to EBITDA and fixed-charge requirements. As a result of the foregoing, our operation 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.

A breach of any of the covenants in our credit facility could result in a default, which, if not cured or waived, may permit acceleration of the indebtedness under our credit facility. 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.

**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 renew our credit facility with Wells Fargo Bank, our primary lender for the past 20 years. 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 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 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

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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, 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. The remediation costs and our allocated share at some of these CERCLA sites are unknown. 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.

**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, 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 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.



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**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 45% 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.

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

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.

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**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. During the third quarter of 2008, the Company extended the lease for an additional five-year period expiring on February 28, 2015. As part of the extension, the Company received a \$600,000 tenant improvement allowance that was utilized and accounted for as capital expenditure prior to December 31, 2009. 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 and injection-molded plastic components at this facility. 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. The Company sold a 150,000 sq. ft. finished goods warehouse in the third quarter of 2008. This facility was leased to a third party on a month-to-month basis until the date of sale.

**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.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Table of Contents****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 31, 2010, there were approximately 306 registered stockholders according to transfer agent records. There were approximately 800 beneficial stockholders.

**Dividend Policy**

It is 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 \$.025 per share. During 2008 and 2009 the Company paid four quarterly dividends of \$0.025 per share. Actual payment of cash dividends must be approved by the Board of Directors each quarter. Due to the timing of regularly scheduled Board of Directors meetings, declaration dates may fall in the quarter prior to the payment date, as was the case in the 2<sup>nd</sup> and 4<sup>th</sup> quarter of 2008 and 2009. The current line of credit with Wells Fargo restricts the amount of cash that can be used for stock repurchases and paying cash dividends.

**Quarterly Dividend and Stock Market Information**

	Cash Dividends		Common Stock Range			
	Declared		2009		2008	
	2009	2008	High	Low	High	Low
1st Quarter	\$ 0.050	\$ 0.050	\$ 3.81	\$ 1.65	\$ 6.69	\$ 4.10
2nd Quarter			3.57	2.78	5.24	4.20
3rd Quarter	0.050	0.050	3.20	2.74	4.71	2.20
4th Quarter			3.99	2.73	3.94	1.66

**Table of Contents****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, the Hemsco Group Index, and (ii) the NASDAQ Market Index. The graph assumes \$100 was invested on February 1, 2005, 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.

**COMPARISON OF 5-YEAR CUMULATIVE TOTAL RETURN  
AMONG VIRCO MFG. CORPORATION, NASDAQ MARKET INDEX,  
MORNINGSTAR INDEX AND HEMSCOTT GROUP INDEX  
ASSUMES \$100 INVESTED ON FEB. 01, 2005  
ASSUMES DIVIDEND REINVESTED**

<b>Company/Index/Market</b>	<b>Fiscal Year Ending</b>					
	<b>1/31/2005</b>	<b>1/31/2006</b>	<b>1/31/2007</b>	<b>1/31/2008</b>	<b>1/31/2009</b>	<b>1/31/2010</b>
Virco Mfg. Corporation	\$ 100.00	\$ 84.59	\$ 114.52	\$ 81.79	\$ 27.81	\$ 48.07
NASDAQ Market Index	\$ 100.00	\$ 112.43	\$ 120.60	\$ 117.76	\$ 73.39	\$ 107.80
Morningstar Business Equipment	\$ 100.00	\$ 99.03	\$ 114.46	\$ 89.60	\$ 44.23	\$ 58.45
Hemsco Group Index	\$ 100.00	\$ 104.16	\$ 122.00	\$ 96.45	\$ 47.48	\$ 64.76

The current composition of Morningstar Business Equipment is as follows: Access to Money, Inc., American Locker Group, Inc., aVinci Media Corporaton, BioAuthorize Holdings, Inc., Coinstar, Inc., Comtrex Systems Corporation, Diebold Incorporated, Energy Focus, Inc., Franklin Electronic Publishers, Inc., Global Payment Technologies, Inc., Gunther International, Ltd., Herman Miller, Inc., HNI Corporation, Hypercom Corporation, Inscape Corporation, International Lottery & Totalizator Systems, Kimball International, Inc., Knoll, Inc., Koala Corporation, LSI Industries, Inc., New Medium Enterprise, NFinanSe, Inc., Optimal Group, Inc., PAR Technology Corp., Pitney Bowes Inc., Prevention Insurance.com, Reconditioned Systems, Inc., Steelcase, Inc., TechLite, Inc., VeriFone Holdings, Inc., Virco Mfg. Corporation, Xerox Corporation.

The current composition of Hemsco Group 313 Business Equipment is as follows: All the companies listed above and Rahaxi, Inc.

**Table of Contents****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****Five Year Summary of Selected Financial Data**

In thousands, except per share data	2009	2008	2007	2006	2005
Summary of Operations					
Net sales	\$ 190,513	\$ 212,003	\$ 229,565	\$ 223,107	\$ 214,450
Net income (loss)	\$ 300	\$ 1,210	\$ 22,219	\$ 7,545	\$ (9,574)
Income (Loss) per share data					
Net income (loss) (a)					
Basic	\$ 0.02	\$ 0.08	\$ 1.54	\$ 0.56	\$ (0.73)
Assuming dilution	\$ 0.02	\$ 0.08	\$ 1.53	\$ 0.55	\$ (0.73)
Cash dividends declared per share	\$ 0.10	\$ 0.10	\$ 0.025	\$	\$

(a) 2005 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.

**Other Financial Data**

In thousands, except per share data	2009	2008	2007	2006	2005
Total assets	\$ 118,100	\$ 118,075	\$ 127,185	\$ 116,277	\$ 114,720
Working capital	\$ 33,980	\$ 30,991	\$ 32,756	\$ 22,994	\$ 15,488
Current ratio	2.5/1	2.2/1	2.0/1	1.6/1	1.4/1
Total long-term obligations	\$ 30,236	\$ 25,104	\$ 21,129	\$ 30,101	\$ 38,862
Stockholders' equity	\$ 64,938	\$ 66,163	\$ 72,148	\$ 48,878	\$ 39,100
Shares outstanding at year-end	14,163	14,239	14,429	14,380	13,137
Stockholders' equity per share	\$ 4.59	\$ 4.65	\$ 5.00	\$ 3.40	\$ 2.98

**Financial Highlights**

In thousands, except per share data	2009	2008	2007	2006	2005
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## Summary of Operations

Net sales (3) (4)	\$ 190,513	\$ 212,003	\$ 229,565	\$ 223,107	\$ 214,450
Net income (loss)	\$ 300	\$ 1,210	\$ 22,219	\$ 7,545	\$ (9,574)
Net income (loss) per share (1)	\$ 0.02	\$ 0.08	\$ 1.53	\$ 0.55	\$ (0.73)
Stockholder's equity	64,938	66,163	72,148	48,878	39,100
Stockholder's equity per share (2)	4.59	4.65	5.00	3.40	2.98
In thousands, except per share data	2004	2003	2002	2001	2000

## Summary of Operations

Net sales (3) (4)	\$ 199,854	\$ 191,852	\$ 244,355	\$ 257,462	\$ 287,342
Net income (loss) before change in accounting methods (5)	\$ (13,995)	\$ (23,607)	\$ 282	\$ 246	\$ 4,313
Change in accounting methods (4)					(297)
Net income (loss)	\$ (13,995)	\$ (23,607)	\$ 282	\$ 246	\$ 4,016
Net income (loss) per share (1)	\$ (1.07)	\$ (1.80)	\$ 0.02	\$ 0.02	\$ 0.29
Stockholder's equity	49,265	62,352	82,774	90,223	94,141
Stockholder's equity per share (2)	3.76	4.76	6.31	6.71	6.90

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- (1) Based on average number of shares outstanding each year after giving retroactive effect to stock dividends and stock split.
- (2) Based on number of shares outstanding at year-end giving effect to stock dividends and stock split.
- (3) The prior period statements of operations contain certain reclassifications to conform to the presentation required by EITF No. 00-10, Accounting for Shipping and Handling Fees and Costs, which the Company adopted during the fourth quarter of the fiscal year ended January 31, 2001.
- (4) During the fourth quarter of the fiscal year ended January 31, 2001, the Company



changed its method of accounting for revenue recognition in accordance with Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements. Pursuant to Financial Accounting Standards Board Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, effective February 1, 2000, the Company recorded the cumulative effect of the accounting change.

- (5) For 2003, an adjustment of \$1.6 million of income tax expense was made to reflect tax effect of minimum pension liability.

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

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, statements regarding plans and objectives of management for future operations, including plans and objectives relating to products, pricing, marketing, expansion, manufacturing processes and potential or contemplated acquisitions; 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, and competition.

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.

**Table of Contents****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; trade, technical and vocational schools; 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 FF&E requirements from one source.

Virco's product offering consists primarily of items manufactured by Virco, complemented with product sourced from other furniture manufacturers. The product offering is continually enhanced with an ongoing new product development program that incorporates internally developed product 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 2009, 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 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 turbulent during the last 10 years. Schools suffered significant budgetary pressures from 2001 to 2005 following the dot com bust, and more recently in 2008 and 2009 as a result of the recession. In addition, the furniture industry in general, including the market for school furniture, has been significantly impacted by low cost competition from China. In the years 2004, 2005, and 2008 commodity prices for some of the Company's primary raw materials, particularly steel and plastic, were extremely volatile.

The years 2008 and 2009 were particularly challenging for the Company and the educational furniture industry in general. 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. While funding from bond financing was relatively stable in 2008 and 2009 (and has been over the past several years), school operating budgets experienced significant strain in 2008 and 2009. 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. The Company was well-positioned to weather these challenges, however, as it had maintained its reduced cost structure from prior restructurings, including a reduced workforce, wage and hiring freezes and workforce flexibility, and reacted early to the deteriorating conditions, reducing headcount through attrition, reducing production hours, and controlling inventory.

Cost reduction has been a focus of management since 2001 and the Company has achieved great success in this arena. For example, headcount of permanent employees as of January 31, 2010, was approximately 1,100 compared to a peak of nearly 2,950 in August 2000, and factory overhead was less than \$48 million in each of the fiscal years ended January 31, 2008, 2009 and 2010, compared to over \$72 million in the fiscal year ended January 31, 2001.

In addition, in 2008 and 2009, Virco continued to invest in new products, which positively impacted sales. For example, in 2008, the Company launched the TEXT® and Lunada® table series and in 2009 the Company introduced

Flip-Top Technology tables for computer classrooms. The Company also utilized its new flat metal forming capabilities to introduce an array of desks, returns and bookcases. Most recently, in 2010, the Company introduced, Parameter , an invigorating collection of desks, returns and credenzas, and plans to further expand the use of our flat metal forming capabilities to produce lateral files, vertical files and mobile pedestals.

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

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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 decline in 2010 as a result of the persistence of weak economic conditions. The Company expects that completion of bond-funded school and college construction projects will be lower in 2010 than in each of 2008 and 2009 and that school budgets will remain strained. Completion of K-12 projects are expected to decline by 10-15% and completion of college projects by 5-10%.

Management also anticipates reduced demand for replacement furniture due to the significant financial pressures being placed on school operating budgets because of the current economic crisis. The impact of the American Recovery and Reinvestment Act of 2009 (ARRA) on furniture sales has been difficult to quantify, as many of the funds have been used to reduce layoffs of teachers and administrators. It is unlikely that the ARRA will have a material impact on demand for school furniture during the first half of 2010. The Company, however, plans to maintain its core work force at current levels for the near future, supplemented with temporary labor as considered 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 short-term economic conditions impacting the Company's core customer base are not positive, 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 expanded its domestic manufacturing capabilities, recently adding flat metal forming processes to its manufacturing capabilities and bringing production into its factories of products 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. Finally, the financial health of the competition, both manufacturers and dealers, may have been adversely impacted by the downturn in the economy, creating opportunities for suppliers that can provide dependable delivery of quality products and services. The current credit environment may make it difficult for competitors to finance the significant seasonal nature of school furniture and equipment deliveries.

**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, management evaluates such estimates, including those related to revenue recognition, allowance for doubtful accounts, valuation of inventory including, LIFO and 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:

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**Revenue Recognition:** The Company recognizes revenue in accordance with FASB ASC Topic 605 Revenue Recognition . Sales are recorded when title passes and collectability is reasonably assured under its various shipping terms. The Company reports sales as net of sales returns and allowances and sales taxes imposed by various government authorities.

**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 1.4% 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. The Company uses the LIFO (last-in, first-out) method of accounting for the material component of inventory and FIFO (first in, first out) method for labor and overhead. The Company maintains allowances for estimated obsolete inventory to reflect the difference between the cost of inventory and the estimated market value. Allowances for 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 2007, 2008, and 2009 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 discount rate ranging from 5.75% to 6.75% for 2009, 2008, and 2007. 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 2010 will be comparable to the retention levels for 2009.

**Warranty Reserve:** The Company provides a product warranty on most products. 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 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 Employee Plan and the Directors Plan at a 5.75% and the VIP Plan at a 6.00% discount

rate in 2009, a 6.75% discount rate for all plans in 2008, and a 6.00% discount rate for all plans in 2007. The Company utilized a 5.0% assumed rate of increase in compensation rates, and estimated a 6.5% return on 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 pensions. These investment losses will cause future pension costs to increase, and will require future cash contributions to adequately fund these pensions. Although the Company does not anticipate any change in these rates in the coming year, any moderate change



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should not have a significant effect on the Company's financial position, results of operations or cash flows. Effective December 31, 2003, the Company froze new benefit accruals under all three plans. The effect of freezing future benefit accruals minimizes the impact of future raises in compensation, but introduced a new assumption related to the plan freeze. During 2007 and 2008 it was the Company's intent to resume some form of a retirement benefit when the profitability and the financial condition of the Company allowed, and the actuarial valuations assumed the plans would be frozen for one additional year. During 2009 the Company determined that the freeze would likely become permanent, and the Company recorded a plan curtailment gain of \$29,000. If the Company had assumed a permanent freeze, pension expense for 2008 and 2007 would have (decreased) / increased by (\$145,000) and \$64,000, respectively. 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. Due to operating losses, the Company established a valuation allowance against the net deferred tax assets in 2003. For the year ended January 31, 2007, based on this consideration, the Company anticipated that it is more likely than not that the net deferred tax assets would not be realized, and a valuation allowance was recorded against the net deferred tax assets. During the fiscal year ended January 31, 2008, the results of operations of the Company were such that the Company determined that it was more likely than not that all of the deferred tax asset would be realized, and a \$10,700,000 favorable adjustment to the valuation allowance was recorded in the third quarter ended October 31, 2007. This was a non-cash benefit, resulting in a \$10,700,000 net adjustment to deferred tax assets recorded in the third quarter. At January 31, 2010, the Company has net operating loss carryforwards for federal and state income tax purposes, expiring at various dates through 2029. Federal net operating losses that can potentially be carried forward totaled approximately \$4,524,000 at January 31, 2010. State net operating losses that can potentially be carried forward totaled approximately \$27,355,000 at January 31, 2010. 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 of \$490,000 and \$927,000 on the deferred tax assets at January 31, 2010 and 2009, respectively. In June 2006, the Financial Accounting Standards Board (the FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48) now codified as part of FASB ASC Topic 740. ASC Topic 740 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under EITF 06-4, now codified under ASC Topic 740, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. ASC Topic 740 also provides guidance on derecognition, classification, interest and penalties on income taxes, and accounting in interim periods and requires increased disclosures. The Company adopted the provisions of ASC Topic 740 on February 1, 2007, the beginning of fiscal 2007. There was no material impact as a result of the implementation of ASC Topic 740.

**Results of Operations (2009 vs. 2008)****Financial Results and Cash Flow**

For the fiscal year ended January 31, 2010, the Company earned net income of \$300,000 on net sales of \$190,513,000 compared to net income of \$1,210,000 on net sales of \$212,003,000 in the same period last year. The prior year results benefitted from a \$1,131,000 gain from sale of real estate offset by an impairment charge of \$2,284,000 for goodwill and other intangible assets. The current year was not affected by similar events. Net income per share was \$0.02 for

the fiscal year ended January 31, 2010, compared to net income per share of \$0.08 in the prior year. Cash flow used in operations was \$2,795,000 in 2009 compared to cash flow provided by operations of \$11,160,000 in the prior year.

**Sales**

Virco's sales decreased by 10.1% in 2009 to \$190,513,000 compared to \$212,003,000 in 2008. This decrease in sales was attributable to a decline in unit volume which was driven by unfavorable economic conditions experienced

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during the year, offset by price increases of approximately 1%. Prices only modestly increased in 2009 as commodity prices were relatively stable, and competitive conditions as a result of the weak economy made it difficult to increase prices. Sales of Virco's new products, including Sage<sup>®</sup>, Metaphor<sup>®</sup>, and Text<sup>®</sup> increased in 2009 compared to 2008, but were offset by reductions in other product lines.

For 2010 the Company anticipates that the persistence of weak economic conditions will continue to cause the amount of school furniture sold to decline compared to 2009. Any such decline will place continued pressure on selling prices. 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 market share during 2010, the Company has added modestly to its direct sales force, and when market conditions warrant, the Company will compete based on direct prices and may reduce its prices to build or maintain its market share.

**Cost of Sales**

Cost of sales was 67.1% of sales in 2009 and 67.6% of sales in 2008. As a percent of sales, raw material costs decreased by slightly more than 1% compared to the prior year due to the stability of raw material costs in 2009 compared to 2008. 2008 was marked by significant volatility in steel and plastic prices. This volatility was modestly mitigated by a LIFO gain of approximately \$733,000. Current year costs of sales benefited from a decrement in certain LIFO layers and a related gain of approximately \$54,000. In 2009, direct labor costs as a percent of sales were flat compared to 2008. Manufacturing overhead costs increased slightly as a percent of sales. Production hours in 2009 were comparable to 2008.

The Company is beginning 2010 with more inventory than in 2009. Production levels, which vary depending upon selling volumes, are anticipated to be comparable to or slightly higher in 2010 than 2009. In addition, the Company expects production hours to increase in 2010 compared to 2009 due to the addition of flat metal forming capabilities at its Conway, Arkansas facility. This capability was acquired in 2009; the Company formerly sourced these items from domestic suppliers.

In 2010, the Company intends to more tightly integrate the ATS model with its marketing programs, product development programs, and product stocking and Quick Ship plan. This anticipated improvement in execution of ATS should allow the Company to offer a variety of products while improving on-time delivery performance.

During 2010 the Company anticipates continued uncertainty and volatility in costs, particularly in the areas of certain raw materials, transportation, and energy. The Company does not anticipate that this volatility will be as dramatic in 2010 as experienced in 2008, but that it could be more volatile than in 2009. For more information, please see the section below entitled *Inflation and Future Change in Prices*.

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

Selling, general and administrative expenses for the fiscal year ended January 31, 2010, decreased by approximately \$3.0 million, or 4.6%, from the prior year, and were 32.3% of sales as compared to 30.4% in the prior year. Freight and installation costs decreased in both dollars and as a percentage of sales due to reduced selling volumes, continued focus on a tiered price structures that increased prices on small orders requiring freight and installation services, and efficiencies from implementation of a new warehouse management system. Selling expenses increased slightly in dollars and increased as a percentage of sales due to expanded selling efforts. G&A spending increased due to higher pension expense primarily attributable to amortization of investment losses incurred during 2009, but was otherwise flat compared to the prior year.

For 2010 the Company plans to modestly increase its direct selling force, but intends to make other modifications in selling expenses to compensate for the increased headcount. The Company anticipates that pension expense will decrease by approximately \$400,000 as investment gains in 2009 mitigated a portion of the significant investment loss in 2008.

Interest expense was \$325,000 less in 2009 compared to 2008 as a result of lower interest rates.

**Provision for Income Taxes**

At January 31, 2010, the Company had net operating losses carried forward for federal and state income tax purposes, expiring at various dates through 2029 if not utilized. Federal net operating losses that can potentially be carried forward totaled approximately \$4,524,000 at January 31, 2010. State net operating losses that can potentially be

carried forward totaled approximately \$27,355,000 at January 31, 2010. 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

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has provided a valuation allowance of \$490,000 and \$927,000 on the deferred tax assets at January 31, 2010 and 2009 respectively.

**Results of Operations (2008 vs. 2007)****Financial Results and Cash Flow**

For the fiscal year ended January 31, 2009, the Company earned pre-tax income of \$1,509,000 on net sales of \$212,003,000 compared to pre-tax income of \$12,192,000 on net sales of \$229,565,000 for the prior year end. The 2008 results were affected by a \$1,131,000 gain from sale of real estate and an impairment charge of \$2,284,000 for goodwill and other intangible assets. Net income for the fiscal year ended January 31, 2009, was \$1,210,000 compared to \$22,219,000 the prior year end. The 2007 year was significantly impacted by a \$10,700,000 favorable adjustment to the valuation allowance for deferred income taxes. Net income per share was \$0.08 for 2008, compared to net income per share of \$1.54 in 2007. Cash flow from operations was \$11,160,000 in 2008 compared to \$16,884,000 in 2007.

**Sales**

Virco's sales decreased by nearly 7.7% in 2008 to \$212,003,000 compared to \$229,565,000 in 2007. The decrease in sales was attributable to a decline in unit volume offset by a increased prices of approximately 4%. Sales of Virco's new Sage<sup>®</sup>, Metaphor<sup>®</sup>, and Telos<sup>®</sup> product lines increased, but were offset by reductions in other product lines. Orders and sales volumes declines were driven by the unfavorable economic conditions experienced during the year. During the first half of the year, the reduction in business activity was primarily attributable to states that had significant real estate exposure. During the second half of the year, the reduction spread nationwide. At the beginning of 2008, the Company raised prices modestly, and in response to dramatic increases in the cost of steel and plastic in the second quarter, raised prices for new orders in the third quarter. Due to the extreme seasonality of the Company's business, the mid-year price increase only impacted about one-third of the orders received during the year.

**Cost of Sales**

Cost of sales was 67.6% of sales in 2008 and 63.6% of sales in 2007. Cost of sales as a percentage of sales increased from 2007 to 2008 for two primary reasons. First, the Company incurred a dramatic increase in the costs of steel and plastic, particularly in the second quarter. The cost of steel increased by over 80% between the months of March and July of 2008. The Company raised prices modestly for orders received in the third quarter, but the increase was late in the year, and not adequate to compensate for the increased commodity costs. In addition, the cost of petroleum (which impacts the cost of plastic, resin, inbound freight, and utilities) increased during 2008. Second, in order to reduce inventory during uncertain economic times, the Company reduced production hours by nearly 22% in 2008 compared to 2007. The largest portion of this reduction occurred in the Company's fourth quarter.

Commodity costs decreased significantly in the fourth quarter of 2008, but not until after the Company's summer season when most shipping activity occurs and not to the price levels at the beginning of 2008. During the fourth quarter of 2008, when the Company significantly reduced production levels and inventory, the Company benefited from a LIFO gain of approximately \$733,000 by penetrating old layers of inventory.

The net impact of increased commodities costs, before the LIFO gain was approximately \$7,000,000 for 2008. During 2008, the Company incurred approximately \$4,800,000 of increased overhead variances, primarily due to reductions in production.

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

Selling, general and administrative expenses for the fiscal year ended January 31, 2009, decreased by approximately \$4.6 million, and were 30.5% of sales as compared to 30.1% in the prior year. Freight and installation costs decreased in both dollars and as a percentage of sales due to tiered price structures that increased prices on small orders requiring freight and installation services. Selling expenses increased in dollars and as a percentage of sales due to expanded selling efforts.

Interest expense was \$824,000 less in 2008 compared to 2007 as a result of borrowing levels and interest rates being lower than in 2007.

**Table of Contents****Gain on Real Estate**

Results for 2008 included a gain on sale of real estate. During the third quarter of 2008, the Company sold a former manufacturing and distribution facility located in Conway, Arkansas. This building was not used in the Company's furniture operations and had been held as rental property. The Company recorded a gain on sale of \$1,131,000 and generated \$2,392,000 of net cash proceeds from the transaction.

**Goodwill Impairment**

The Company identified a single reporting unit (the Company itself) as no components have been identified beneath it. In the fourth quarter of 2008, our market capitalization decreased significantly, which decreased the calculated fair value used in the Company's annual impairment test in accordance with ASC Topic 350 Intangibles—Goodwill and Other. Based on this assessment, our management concluded that, as of January 31, 2009, the carrying value of our reporting unit (\$2,200,000) exceeded its fair value (\$0) and thus goodwill was fully impaired. Therefore, the Company recorded a pre-tax, non-cash goodwill impairment charge of \$2,200,000. We further note that after recording the impairment charge, we had no goodwill remaining on our Consolidated Balance Sheet as of January 31, 2009.

For the fourth quarter of 2008 impairment test, we determined the fair value of the reporting unit based on a weighting of market capitalization analysis and a discounted cash flow analysis. The market capitalization is calculated by multiplying the share price of our common stock at the measurement date by the number of outstanding common shares and adding a control premium. A control premium was applied to the minority basis value to arrive at the reporting unit's estimated fair value on a controlling basis. In addition to these financial considerations, qualitative factors such as business descriptions, market served, and profitability were considered in our analysis. The selection and weighting of the fair value techniques may result in a higher or lower fair value. Judgment is applied in determining the weightings that are most representative of fair value. Management has performed a sensitivity analysis on its significant assumptions and has determined that a change in its assumptions within selected sensitivity testing levels would not impact its conclusion.

**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. Based on these considerations, at January 31, 2007, the Company believed that it was more likely than not that the net deferred tax assets would not be realized, and a 100% valuation allowance was recorded against the net deferred tax assets at January 31, 2007. During the year ended January 31, 2008, the operating results of the Company demonstrated the second consecutive year of significantly improved pre-tax operating results. A significant portion of the net deferred tax asset relating to NOL carryforwards was realized, and at the third quarter ending October 31, 2007, the Company determined that it was more likely than not that the net deferred tax assets would be realized. In the third quarter, the Company recorded a \$10.7 million favorable adjustment to the valuation allowance against the net deferred tax assets.

Because the Company benefited from NOL carryforwards for 2007, the effective income tax expense was very low, with income tax expense being primarily attributable to alternative minimum taxes combined with income and franchise taxes as required by various states. The tax rates experienced during this year, and the significant adjustment to the valuation allowance in 2007, are not expected to recur in 2010. The Company anticipates an effective federal income tax rate of 34-35% in 2010.

In addition, as discussed above, the Company adopted the provisions of EITF 06-4, now codified under ASC Topic 740, on February 1, 2007. There was no material impact as a result of the implementation of ASC Topic 740.

**Inflation and Future Change in Prices**

Inflation rates had a material impact on the Company in 2008, and a modest impact on the Company in 2009 and 2007. During 2008, the Company incurred a dramatic increase in the costs of steel and plastic, particularly in the second quarter. The cost of steel increased by more than 80% between the months of March and July of 2008. The Company raised prices modestly for orders received in the third quarter, but the increase was late in the year, and not adequate to compensate for the increased commodity costs. In addition, the cost of petroleum (which impacts

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the cost of plastic, resin, inbound freight, and utilities) increased during 2008. During 2009 and 2007, the volatility of pricing for raw materials was substantially more moderate when compared to 2008.

For 2010, the Company anticipates continued volatility in costs, particularly with respect to certain raw materials, transportation, energy and employee benefits. Anticipated volatility for 2010 is not expected to be as severe as experienced in 2008. There is continued uncertainty with respect to raw material costs that are affected by the price of oil, especially plastics. 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 freight carriers that compete 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 2010, 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 2007 and 2008. Due to current economic conditions, the Company anticipates significant price competition in 2010, 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 2010 as experienced in 2008. 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 2010, as a percentage of sales, could be higher than in 2009. No assurance can be given that the Company will experience stable, modest or substantial increases in raw material prices in 2010. 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.

The Company uses the LIFO method of accounting for the material component of inventory. Under this method, the cost of products sold as reported in the Company's financial statements approximates current cost, and reduces the distortion in reported income due to increasing costs. Depreciation expense represents an allocation of historic acquisition costs and is less than if based on the current cost of productive capacity consumed.

**Liquidity and Capital Resources**

**Working Capital Requirements**

Virco addresses liquidity and 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 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 addition, Virco finances its largest balance of accounts receivable during the peak season. This occurs for two 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.

As the capital required for the summer season generally exceeds cash available from operations, Virco has historically relied on third-party bank financing to meet seasonal cash flow requirements. Virco has established a

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long-term (20 years) relationship with its primary lender, Wells Fargo Bank. On an annual basis, the Company prepares a forecast of seasonal working capital requirements, and renews its revolving line of credit. On January 29, 2010, the Company renewed its revolving line of credit with Wells Fargo Bank, entering into a third amendment to its amended and restated credit facility with Wells Fargo Bank. Available borrowing under the line ranges from \$20-\$50 million depending upon the period of the seasonal business cycle. The interest rate paid under the loan adjusts quarterly depending upon rolling 12 month EBITDA. The Company can elect either LIBOR or Prime-based rate. The revolving line has a 23-month maturity.

The line of credit is secured by the Company's accounts receivable, inventories, and equipment and property. The credit facility with Wells Fargo Bank is subject to various financial covenants and places certain restrictions on capital expenditures, new operating leases, dividends and the repurchase of the Company's common stock. In addition, there is a "clean down" provision that requires the Company to reduce borrowings under the line to less than \$10 million for a period of 30 days each fiscal year. The Company believes that normal operating cash flow will allow it to meet the "clean down" requirement with no adverse impact of the Company's liquidity. Approximately \$14,091,000 was available for borrowing as of January 31, 2010.

During 2009, 2008 and 2007 the Company maintained the strength of its balance sheet and available liquidity through three primary methods. First, the Company earned a net income of approximately \$300,000 in 2009, \$1.2 million in 2008, and \$22.2 million in 2007. The 2007 results included a \$10,700,000 adjustment to deferred tax assets, but despite this large non-cash item, the Company still recorded operating cash flow of (\$2,795,000) in 2009, \$11,160,000 in 2008, and \$16,884,000 in 2007. The primary reason for the change in operating cash flow between 2009 and 2008 is the difference in change in inventory levels. In 2008, the Company reduced inventory by approximately \$10 million. In 2009, the Company built additional inventory in the fourth quarter to facilitate the transition from purchasing flat metal formed product to manufacturing flat metal formed product. The Company hopes to produce flat metal products in-house without significant additions to its production staff by more fully utilizing productive capacity in the traditionally slow fourth quarter. Second, our continued disciplines over capital expenditures resulted in depreciation expense in excess of capital expenditures by approximately \$0.6 million in 2008 and \$1.8 million in 2007. Third, the Company reduced assets employed in the business by selling a building for \$2,392,000 in 2008 and controlling levels of inventory and receivables.

Management believes cash generated from operations and from the previously described sources will be adequate to meet its capital requirements in the next 12 months.

**Long-Term Capital Requirements**

In addition to short-term liquidity considerations, the Company continually evaluates long-term capital requirements. From 1997 through 2000, the Company completed two large capital projects, which have had significant subsequent effects on cash flow. The first project was the implementation of the SAP enterprise resources planning system. The second project was the expansion and re-configuration of the Conway, Arkansas, manufacturing and distribution facility.

Upon completion of these projects, the Company dramatically reduced capital spending. During 2001-2005 capital expenditures ranged from 25%-40% of depreciation expense. Management intends to limit future capital spending until growth in sales volume fully utilizes the new plant and distribution capacity. Capital expenditures will continue to focus on new product development along with the tooling and new processes required to produce new products. The Company has established a goal of limiting capital spending to less than \$5,000,000 for 2010, which is slightly less than anticipated depreciation expense.

**Asset Impairment**

As more fully discussed in the results of operations for 2008, the Company recorded a \$2,200,000 pre-tax, non-cash impairment to goodwill in the fourth quarter of 2008. After the impairment charge, the Company had no goodwill on its Consolidated Balance Sheet at January 31, 2010 or January 31, 2009.

In December 2003, the Company acquired certain assets of Corex Products, Inc., a manufacturer of compression-molded components, for approximately \$1 million. These assets have been transferred to the Company's Conway, Arkansas, location where they have been integrated with the Company's existing compression-molding operation. In connection with this acquisition, the Company acquired certain patents and other intangible assets.

During the fourth quarter of 2008, the Company determined that it would not utilize one of the patents acquired, and took an \$84,000 pre-tax impairment charge. After the impairment charge, the Company has no intangible assets on its Consolidated Balance Sheet at January 31, 2010 or January 31, 2009.

The Company made substantial investments in its infrastructure in 1998, 1999, and 2000. The investments included a new factory, new warehouse, and new production and distribution equipment. The factory, warehouse, and

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equipment acquired are used to produce, store, and ship a variety of product lines, and the use of any one piece of equipment is not dependent on the success or volume of any individual product. New products are designed to use as many common or existing components as practical. As a result, both our ATS inventory components and the machines used to produce them become more versatile. The Company evaluates the potential for impaired assets on a quarterly basis. As of January 31, 2010, there has been no impairment to the long-lived assets of the Company, other than described above.

**Contractual Obligations**

The Company leases manufacturing, transportation, and office equipment, as well as real estate under a variety of operating leases. The Company leases substantially all vehicles, including trucks and passenger cars under operating leases where the lessor provides fleet management services for the Company. The fleet management services provide Virco with operating efficiencies relating to the acquisition, administration, and operation of leased vehicles. Real estate leases have been used where the Company did not want to make a long-term commitment to a location, or when economic conditions favored leasing. The Torrance manufacturing and distribution facility is leased under an operating lease that expires on February 28, 2015. The Company does not have any lease obligations or purchase commitments in excess of normal recurring obligations. Leasehold improvements and tenant improvement allowances are depreciated over the lesser of the expected life of the asset or the lease term.

Contractual Obligations  
Payments Due by Period

(In thousands)	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt obligations	\$ 6,924	\$ 12	\$ 6,901	\$ 11	\$
Interest on long-term debt obligations	347	1	345	1	
Operating lease obligations	29,701	6,367	11,340	10,046	1,948
Purchase obligations	16,633	16,633			
	\$ 53,605	\$ 23,013	\$ 18,586	\$ 10,058	\$ 1,948

We may be required to make significant cash outlays related to our unrecognized tax benefits. However, due to the uncertainty of the timing of future cash flows associated with our unrecognized tax benefits, we are unable to make reasonably reliable estimates of the period of cash settlement, if any, with the respective taxing authorities.

Accordingly, unrecognized tax benefits of \$636,000 as of January 31, 2010, have been excluded from the contractual obligations table above. For further information related to unrecognized tax benefits, see Note 7, Income Taxes, to the consolidated financial statements included in this report.

Virco's largest market is publicly funded school districts. A significant portion of this business is awarded on a bid basis. Many school districts require that a bid bond be posted as part of the bid package. In addition to bid bonds, many districts require a performance bond when the bid is awarded. At January 31, 2010, the Company had bonds outstanding valued at approximately \$2,543,000. To the best of management's knowledge, in over 60 years of selling to schools, Virco has never had a bid or performance bond called.

The Company provides a warranty against all substantial defects in material and workmanship. In 2005 the Company extended its standard warranty from five years to 10 years. The Company's warranty is not a guarantee of service life, which depends upon events outside the Company's control and may be different from the warranty period. The Company accrues an estimate of its exposure to warranty claims based upon both product sales data, and an analysis of actual warranty claims incurred. At the current time, management cannot reasonably determine whether warranty claims for the upcoming fiscal year will be less than, equal to, or greater than warranty claims incurred in 2009. The following is a summary of the Company's warranty-claim activity during 2009 and 2008.

(In thousands)	January 31,	
	2010	2009
Beginning balance	\$ 1,950	\$ 1,750
Provision	710	1,184
Costs incurred	(985)	(984)
Ending balance	\$ 1,675	\$ 1,950

**Table of Contents****Retirement Obligations**

The Company provides retirement benefits to employees and non-employee directors under three defined benefit retirement plans; the Employee Plan, the VIP Plan, and the Directors Plan. The Employee Plan is a qualified retirement plan that is funded through a trust held at Wells Fargo Bank (Trustee). The other two plans are non-qualified retirement plans. Benefits under the VIP Plan is secured by life insurance policies held in a rabbi trust and the Directors Plan is not funded.

Accounting policy regarding pensions requires management to make complex and subjective estimates and assumptions relating to amounts which are inherently uncertain. Three primary economic assumptions influence the reported values of plan liabilities and pension costs. The Company takes the following factors into consideration. The discount rate represents an estimate of the rate of return on a portfolio of high-quality fixed-income securities that would provide cash flows that match the expected benefit payment stream from the plans. When setting the discount rate, the Company utilizes a spot-rate yield curve developed from high-quality bonds currently available which reflects changes in rates that have occurred over the past year. This assumption is sensitive to movements in market rates that have occurred since the preceding valuation date, and therefore may change from year to year. Virco discounted the pension obligations for the Employee Plan and the Directors Plan at a 5.75% and the VIP Plan at a 6.00% discount rate in 2009, a 6.75% discount rate for all plans in 2008, and a 6.00% discount rate for all plans in 2007.

Because the Company froze future benefit accruals for all three defined benefit plans, the compensation increase assumption had no impact on pension expense, accumulated benefit obligation or projected benefit obligation for the period ended January 31, 2010 or 2009.

The assumed rate of return on plan assets represents an estimate of long-term returns available to investors who hold a mixture of stocks, bonds, and cash equivalent securities. When setting its expected return on plan asset assumptions, the Company considers long-term rates of return on various asset classes (both historical and forecasted, using data collected from various sources generally regarded as authoritative) in the context of expected long-term average asset allocations for its defined benefit pension plan. For 2009, 2008 and 2007 the Company used a 6.5% expected return on plan assets, net of expenses.

Effective December 31, 2003, benefit accruals were frozen for all three plans. Employees can continue to vest under the benefits earned to date, but no covered participants will earn additional benefits under the plan freeze. In 2003, as a result of the freeze, the projected benefit obligation decreased by approximately \$7,500,000.

The effect of freezing future benefit accruals minimizes the impact of future raises in compensation, but introduced a new assumption related to the plan freeze. During 2007 and 2008 it was the Company's intent to resume some form of a retirement benefit when the profitability and the financial condition of the Company allowed, and the actuarial valuations assumed the plans would be frozen for one additional year. During 2009 the Company determined that the freeze would likely become permanent, and the Company recorded a plan curtailment gain of \$29,000. If the Company had assumed a permanent freeze, pension expense for 2008 and 2007 would have (decreased) / increased by (\$145,000) and \$64,000, respectively. The Company obtains annual actuarial valuations for all three plans.

During 2008 the Company incurred a large loss on assets held for investment in the qualified pension trust. This loss has adversely impacted the funded status of the plan, and required the Company to record a \$6.8 million increase in pension liability offset by an increase in other comprehensive loss. These losses could require the Company to increase cash contributions to the plan over the next several years, and increased pension expense for 2009 by over \$1 million as compared to 2008 pension expense.

It is the Company's policy to contribute adequate funds to the trust accounts to cover benefit payments under the VIP Plan and Director Plan and to maintain the funded status of the Employee Plan at a level which is adequate to avoid significant restrictions to the Employee Plan under the Pension Protection Act of 2006. The Company contributed \$4.3 million to the trust in 2009. The Company contributed \$2.1 million during the 13 month period from January 1, 2008 through January 31, 2009, and \$3.1 million in 2007. Contributions during 2010 will depend upon actual investment results and benefit payments, but are anticipated to range from \$1-2 million. During 2009, 2008, and 2007, the Company paid approximately \$476,000, \$485,000, and \$370,000 in benefits per year under the non-qualified plans. It is anticipated that contributions to non-qualified plans will be approximately \$559,000 for 2010. At

January 31, 2010, accumulated other comprehensive loss of approximately \$13.1 million (\$9.6 million net of tax) is attributable to the pension plans.

The Company does not anticipate making any significant changes to the pension assumptions in the near future. If the Company were to have used different assumptions in the fiscal year ended January 31, 2010, a 1% reduction in

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investment return would have increased expense by approximately \$200,000, a 1% change in the rate of compensation increase would have had no impact, and a 1% reduction in the discount rate would have increased expense by \$143,000. A 1% reduction in the discount rate would have increased the pension benefit obligations by approximately \$2.8 million.

**Stockholders Equity**

Prior to 2003, Virco had established a track record of paying cash dividends to its stockholders for more than 20 consecutive years. As a result of operating losses, the Company discontinued paying dividends in the second quarter of 2003. The Company initiated a \$0.025 per share quarterly cash dividend in the fourth quarter of 2007 and continued to pay the \$0.025 quarterly dividend through 2009. The Board of Directors intends to continue payment of a quarterly cash dividend as long as the results of operations and cash flow allow. The Board must approve each quarterly dividend payment. The Company's current line of credit with Wells Fargo Bank restricts funds used for cash dividends and stock repurchases to a maximum of \$5 million. During 2009, the Company paid cash dividends of \$1,421,000 and repurchased \$652,000 of stock. During 2008, the Company paid cash dividends of \$1,445,000 and repurchased \$950,000 of stock. The Company did not repurchase any shares of stock during 2007.

Virco issued a 10% stock dividend or 3/2 stock split every year beginning in 1982 through 2002. Although the stock dividend has no cash consequences to the Company, the accounting methodology required for 10% dividends has affected the equity section of the balance sheet. When the Company records a 10% stock dividend, 10% of the market capitalization of the Company on the date of the declaration is reclassified from retained earnings to additional paid-in capital. During the period from 1982 through 2002, the cumulative effect of the stock dividends has been to reclassify over \$122 million from retained earnings to additional paid-in capital. The equity section of the balance sheet on January 31, 2010, reflects additional paid-in capital of approximately \$114 million and deficit retained earnings of approximately \$39.8 million. Other than the losses incurred during 2003, 2004, and 2005, the retained deficit is a result of the accounting reclassification, and is not the result of accumulated losses.

**Environmental and Contingent Liabilities**

The Company and other furniture manufacturers are subject to federal, state, and local laws and regulations relating to the discharge of materials into the environment and the generation, handling, storage, transportation, and disposal of waste and hazardous materials. In addition to policies and programs designed to comply with environmental laws and regulations, Virco has enacted programs for recycling and resource recovery that have earned repeated commendations, including the 2001 through 2005 California Waste Reduction Awards Program, designation in 2003 as a Charter Member of the WasteWise Hall of Fame, in 2002 as a WasteWise Partner of the Year, and in 2001 as a WasteWise Program Champion for Large Businesses by the United States Environmental Protection Agency. More recently, Virco was honored in 2007, 2008 and 2009 with a Certificate of Recognition by The Sanitation Districts of Los Angeles County for compliance with industrial waste water discharge guidelines. Also in 2009, Virco was recognized as a Waste Reduction Awards Program (WRAP) winner by the California Integrated Waste Management Board (CIWMB), and presented with the SoCAL Environmental Excellence and Development (SEED) Award for Waste Reduction and Recycling by the South Bay Business Environmental Coalition. Despite these significant accomplishments, 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 expects to continue to spend, significant amounts in the future to comply with environmental laws. 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. Despite our significant dedication to operating in compliance with applicable laws, there is a risk that the Company could fail to comply with a regulation or that applicable laws and regulations could change. Should such eventualities occur, the Company records liabilities for remediation costs when remediation costs are probable and can be reasonably estimated.

In 2009 and 2008, the Company was self-insured for product and general liability losses of 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. In prior years the Company has been self-insured for workers' compensation, automobile, product, and general liability losses. The Company has purchased insurance to cover losses in excess of the self-insured retention or deductible up to a limit of \$30,000,000. For the insurance year beginning April 1, 2010, the Company will be self-insured for product and general liability losses 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. In future years, the Company's exposure to self-insured retentions will vary depending upon the market conditions in the insurance industry and the availability of cost-effective insurance coverage.

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During the past 12 years the Company has aggressively pursued a program to improve product quality, reduce product liability claims and losses, and to more aggressively litigate product liability cases. This program has continued through 2009 and has resulted in reductions in product liability claims and litigated product liability cases. In addition, the Company has active safety programs to improve plant safety and control workers' compensation losses. Management does not anticipate that any related settlement, after consideration of the existing reserves for claims and potential insurance recovery, would have a material adverse effect on the Company's financial position, results of operations, or cash flows.

**Off-Balance Sheet Arrangements**

The Company did not enter into any material off-balance sheet arrangements during its 2009 fiscal year, nor did the Company have any material off-balance sheet arrangements outstanding at January 31, 2010.

**New Accounting Pronouncements**

In December 2008, the FASB issued new guidance impacting FASB ASC 715-20-50, Compensation Retirement Benefits - Defined Benefit Plans - Disclosure (formerly FSP FAS 132(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets), which expands the disclosure requirements related to an employer's defined benefit pension or other postretirement plan. The guidance requires additional disclosure information, including how a company makes investment allocation decisions, the fair value of each major category of plan assets and the nature and amount of concentration risk within or across those plan asset categories. Additionally, the guidance requires disclosures about the valuation of plan assets, including the level within the fair value hierarchy in which fair value measurements of plan assets fall and information about the inputs and valuation techniques used to measure the fair value of plan assets. The guidance, which applies only to disclosures, is effective for fiscal years ending after December 15, 2009. We have adopted these new requirements, which are included in Note 4 to these consolidated financial statements.

In October 2009, the FASB issued ASU 2009-13, Revenue Recognition (ASC 605) - Multiple Deliverable Arrangements, which modifies the requirements for determining whether a deliverable in a multiple element arrangement can be treated as a separate unit of accounting by removing the criteria that objective and reliable evidence of fair value exists for the undelivered elements. The new guidance requires consideration be allocated to all deliverables based on their relative selling price using vendor specific objective evidence (VSOE) of selling price, if it exists; otherwise selling price is determined based on third-party evidence (TPE) of selling price. If neither VSOE nor TPE exist, management must use its best estimate of selling price (ESP) to allocate the arrangement consideration. The Company will adopt this update effective February 1, 2010. The Company does not expect the adoption of the amendments in ASU 2009-13 will have a material impact on its consolidated financial position and the results of its operations.

In August 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-05 (ASU 2009-05), an update to ASC 820, Fair Value Measurements and Disclosures. ASU 2009-05 amends ASC 820 by providing additional guidance (including illustrative examples) clarifying the measurement of liabilities at fair value. When a quoted price in an active market for the identical liability is not available, the amendments in ASU 2009-05 require that the fair value of a liability be measured using one or more of the listed valuation techniques that should maximize the use of relevant observable inputs and minimize the use of unobservable inputs. In addition, the amendments in ASU 2009-05 clarify that when estimating the fair value of a liability, an entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. The amendments also clarify how the price of a traded debt security, (i.e., an asset value) should be considered in estimating the fair value of the issuer's liability. The amendments in ASU 2009-05 are effective the first reporting period (including interim periods) beginning after its issuance, or as of October 31, 2009, for the Company. The adoption had no impact to the financial statements.

In June 2009, the FASB issued FAS 167 now codified as ASC 810 - Amendments to FASB Interpretation No. 46(R), the objective of which is to improve financial reporting by enterprises involved with variable interest entities. FAS 167 is effective for annual reporting periods that begin after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Early application is not permitted. We expect to adopt this statement during our fiscal 2010 first quarter. The adoption of this statement is not expected to have a material impact on our financial position or results of operations.

In July 2009, we adopted Statement of Financial Accounting Standard (SFAS) 165 now codified as FASB ASC Topic 855 Subsequent Events , which establishes accounting and reporting standards for events that occur after the balance sheet date but before financial statements are issued or are available to be issued. FASB ASC Topic 855

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was effective for fiscal years and interim periods ending after June 15, 2009. The adoption of FASB ASC Topic 855 did not have a material impact on the Company's consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168 now codified as ASC 105-10 The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (SFAS No. 168). SFAS No. 168 establishes the FASB Accounting Standards Codification (the Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial standards in conformity with US GAAP. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative US GAAP for SEC registrants. SFAS No. 168 is effective for financial statements issued by us for interim and annual periods after September 15, 2009. On the effective date of SFAS No. 168, all then-existing non-SEC accounting and reporting standards are superseded, with the exception of certain promulgations listed in SFAS No. 168. The adoption of SFAS No. 168 did not have a significant effect on our condensed consolidated financial statements as the purpose of the Codification is not to create new accounting and reporting guidance. Rather, the Codification is meant to simplify user access to all authoritative US GAAP. References to US GAAP in our published financial statements included herein have been updated, as appropriate, to cite the Codification.

In June 2008, the FASB issued EITF 03-6-1 now codified as ASC 260-10 Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. Under FASB ASC Topic 505, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents, whether they are paid or unpaid, are considered participating securities and should be included in the computation of earnings per share pursuant to the two-class method. FASB ASC Topic 505 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. FASB ASC Topic 505 also requires all prior period earnings per share data presented to be adjusted retrospectively and early application is not permitted. The Company adopted FASB ASC Topic 505 on February 1, 2009, and the adoption did not have an impact on its financial statements.

In September 2006, the FASB issued SFAS No. 157, which is now codified as FASB ASC Topic 820, Fair Value Measurements. This standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. FASB ASC Topic 820 is effective for financial statements issued for fiscal years beginning after November 15, 2007, which is the fiscal year beginning February 1, 2008, for the Company. The Company adopted FASB ASC Topic 820 effective February 1, 2008. The adoption of FASB ASC Topic 820 for financial assets and liabilities held by the Company did not have a material effect on the Company's financial statements or notes thereto.

In February 2008, the FASB issued FSP FAS 157-2, which is now codified as FASB ASC Topic 820, Fair Value Measurements permits a one-year deferral of the application of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company adopted SFAS No. 157 for non-financial assets and non-financial liabilities on February 1, 2009, and the provisions did not have a material effect on the Company's results of operations, financial position or cash flows.

In December 2007, the FASB issued SFAS No. 141 (Revised) now codified as FASB ASC Topic 805, Business Combinations and SFAS No. 160 now codified as FASB ASC Topic 810, Non-controlling Interests in Consolidated Financial Statements An Amendment of ARB No. 51 ( FASB ASC Topic 810 ). FASB ASC Topic 805 broadens its scope by applying the acquisition method to all transactions and other events in which one entity obtains control over one or more other businesses, and requires, among other things, that assets acquired and liabilities assumed be measured at fair value as of the acquisition date, that liabilities related to contingent considerations be recognized at the acquisition date and remeasured at fair value in each subsequent reporting period, that acquisition-related costs be expensed as incurred, and that income be recognized if the fair value of the net assets acquired exceeds the fair value of the consideration transferred. FASB ASC Topic 810 establishes accounting and reporting standards for non-controlling interests (i.e., minority interests) in a subsidiary, including changes in a parent's ownership interest in a subsidiary and requires, among other things, that non-controlling interests in subsidiaries be classified as a separate component of equity. Except for the presentation and disclosure requirements which are to be applied retrospectively

for all periods presented, FASB ASC Topic 805 and FASB ASC Topic 810 are to be applied prospectively in financial statements issued for fiscal years beginning after December 15, 2008. The adoption of FASB ASC Topic 805 and FASB ASC Topic 810 on February 1, 2009, did not have any material impact on the Company's financial statements. In March 2008, the FASB issued SFAS No. 161 now codified as FASB ASC Topic 815, Disclosures about Derivative Instruments and Hedging Activities ( FASB ASC Topic 815 ). FASB ASC Topic 815 requires companies with derivative instruments to disclose information that should enable readers of financial statements to understand how and why a company uses derivative instruments, how derivative instruments and related hedged

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items are accounted for under FASB ASC Topic 815 and how derivative instruments and related hedged items affect a company's financial position, financial performance and cash flows. FASB ASC Topic 815 was effective for the Company on February 1, 2009. The adoption of FASB ASC Topic 815 did not have an effect on the Company's financial position, results of operations or cash flows.

**Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

The Company is subject to interest rate risk related to its seasonal borrowings used to finance additional inventory and receivables. Rising interest rates may adversely affect the Company's results of operations and cash flows related to its variable-rate bank borrowings under the credit line with Wells Fargo Bank. Accordingly, a 100 basis point upward fluctuation in the lender's base rate would have caused the Company to incur additional interest charges of approximately \$120,000 for the 12 months ended January 31, 2010. The Company would have benefited from a similar interest savings if the base rate were to have fluctuated downward by a like amount.

The Company has used derivative financial instruments to reduce interest rate risks. The Company does not hold or issue derivative financial instruments for trading purposes. All derivatives are recognized as either assets or liabilities in the statement of financial condition and are measured at fair value. At January 31, 2010 and 2009, the Company had no derivative instruments.

The Company's business is subject to changes in the price of raw materials used to manufacture its products, such as steel, plastic, wood, aluminum, polyethylene, polypropylene, plywood, particleboard, and cartons, as well as the price of petroleum, which not only affects the cost of plastic, but also the Company's transportation costs and costs of operating its manufacturing facilities. 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 that allow 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 its business, the Company may receive significant orders during the first and second quarters for delivery in the second and third quarter. 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 2004, 2005, and 2008. The Company typically benefits from any decreases in raw material costs under the contracts described above as well.

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**Item 8. Financial Statements and Supplementary Data**  
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**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management of Virco Mfg. Corporation (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting and for the assessment of the effectiveness of internal control over financial reporting. As defined by the Securities and Exchange Commission, internal control over financial reporting is a process designed by, or supervised by, the Company's principal executive and principal financial officers, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles.

The Company's internal control over financial reporting is supported by written policies and procedures, that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company's assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of the Company's management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In connection with the preparation of the Company's annual financial statements, management of the Company has undertaken an assessment of the effectiveness of the Company's internal control over financial reporting as of January 31, 2010, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management's assessment included an evaluation of the design of the Company's internal control over financial reporting and testing of the operational effectiveness of the Company's internal control over financial reporting.

Based on this assessment, management did not identify any material weakness in the Company's internal control, and management has concluded that the Company's internal control over financial reporting was effective as of January 31, 2010.

Ernst & Young LLP, the independent registered public accounting firm that audited the Company's financial statements, has issued a report on internal control over financial reporting, a copy of which is included in this Annual Report.



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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

**The Board of Directors and Stockholders of  
Virco Mfg. Corporation**

We have audited Virco Mfg. Corporation's internal control over financial reporting as of January 31, 2010, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Virco Mfg. Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Virco Mfg. Corporation maintained, in all material respects, effective internal control over financial reporting as of January 31, 2010, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of January 31, 2010 and 2009, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended January 31, 2010 of Virco Mfg. Corporation and our report dated April 16, 2010, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Los Angeles, California  
April 16, 2010

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**The Board of Directors and Stockholders of  
Virco Mfg. Corporation**

We have audited the accompanying consolidated balance sheets of Virco Mfg. Corporation as of January 31, 2010 and 2009, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended January 31, 2010. Our audits also included the financial statement schedule listed in the Index at Items 15. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Virco Mfg. Corporation at January 31, 2010 and 2009, and the consolidated results of its operations and its cash flows for each of the three years in the period ended January 31, 2010, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set for the therein.

As discussed in Note 4 to the consolidated financial statements, on February 1, 2008, the Company changed its method of accounting for endorsement split-dollar life insurance arrangements in accordance with ASC 715-60. We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Virco Mfg. Corporation's internal control over financial reporting as of January 31, 2010, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 16, 2010, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Los Angeles, California  
April 16, 2010

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

	January 31,	
	2010	2009
	(In thousands)	
Assets		
Current assets		
Cash	\$ 1,045	\$ 4,387
Trade accounts receivables (net of allowance for doubtful accounts of \$200 in 2009 and 2008)	14,127	14,193
Other receivables	141	410
Income tax receivable	259	358
Inventories		
Finished goods, net	10,683	10,720
Work in process, net	18,653	14,848
Raw materials and supplies, net	7,334	7,417
	36,670	32,985
Deferred tax assets, net	3,150	3,808
Prepaid expenses and other current assets	1,514	1,658
Total current assets	56,906	57,799
Property, plant and equipment		
Land and land improvements	3,329	3,379
Buildings and building improvements	47,796	47,888
Machinery and equipment	116,425	116,559
Leasehold improvements	2,688	1,911
	170,238	169,737
Less accumulated depreciation and amortization	125,804	125,122
Net property, plant and equipment	44,434	44,615
Deferred tax assets, net	10,502	9,372
Other assets	6,258	6,289
Total assets	\$ 118,100	\$ 118,075

*See accompanying notes.*



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

	January 31,	
	2010	2009
	(In thousands, except share data)	
Liabilities		
Current liabilities		
Checks released but not yet cleared bank	\$ 2,360	\$ 4,996
Accounts payable	11,641	10,728
Accrued compensation and employee benefits	4,396	5,136
Current portion of long-term debt	12	69
Other accrued liabilities	4,517	5,879
Total current liabilities	22,926	26,808
Non-current liabilities		
Accrued self-insurance retention and other	4,918	4,119
Accrued pension expenses	17,286	19,777
Income tax payable	1,120	1,161
Long-term debt, less current portion	6,912	47
Total non-current liabilities	30,236	25,104
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 14,163,044 shares in 2009 and 14,238,994 shares in 2008	142	142
Additional paid-in capital	114,152	114,067
Accumulated deficit	(39,785)	(38,664)
Accumulated other comprehensive loss	(9,571)	(9,382)
Total stockholders' equity	64,938	66,163
Total liabilities and stockholders' equity	\$ 118,100	\$ 118,075

*See accompanying notes.*

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**Virco Mfg. Corporation**  
**Consolidated Statements of Income**

	Year ended January 31,		
	2010	2009	2008
	(In thousands, except per share data)		
Net sales	\$ 190,513	\$ 212,003	\$ 229,565
Costs of goods sold	127,808	143,402	145,901
Gross profit	62,705	68,601	83,664
Selling, general and administrative expenses	61,494	64,487	69,213
Gain on sale of property, plant and equipment and other, net	(80)	(1,131)	(17)
Goodwill and intangible impairment		2,284	
Interest expense, net	1,127	1,452	2,276
Income before income taxes	164	1,509	12,192
Income tax (benefit) expense	(136)	299	(10,027)
Net income	\$ 300	\$ 1,210	\$ 22,219
Dividend declared:			
Cash	\$ 0.10	\$ 0.10	\$ 0.03
Net income per common share:			
Basic	\$ 0.02	\$ 0.08	\$ 1.54
Diluted	\$ 0.02	\$ 0.08	\$ 1.53
Weighted average shares outstanding:			
Basic	14,155	14,390	14,401
Diluted	14,196	14,434	14,539
<i>See accompanying notes.</i>			

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**Virco Mfg. Corporation**  
**Consolidated Statements of Stockholders Equity**

In thousands, except share data	Shares	Amount	Additional Paid-in Capital	Accumulated Deficit	Other Comprehensive Income (Loss)	Accumulated Other Comprehensive Loss	Total
Balance at January 31, 2007	14,379,506	143	113,737	(59,082)		(5,920)	48,878
Net income				22,219	22,219		22,219
Pension adjustments, net of tax effect of \$553					830	830	830
Comprehensive income					23,049		
Stock-based payments under stock compensation plans	49,156	1	581				582
Cash dividends				(361)			(361)
Balance at January 31, 2008	14,428,662	144	114,318	(37,224)		(5,090)	72,148
Net income				1,210	1,210		1,210
Pension adjustments, net of tax effect of \$2,275					(4,292)	(4,292)	(4,292)
Comprehensive loss					(3,082)		
Adoption of ASC 715-60 (formerly EITF 06-4), net of tax effect of \$679				(1,151)			(1,151)
Adoption of SFAS 158, net of tax effect of \$36				(54)			(54)
Shares vested	107,039	1	(159)				(158)
Stock compensation expense			855				855
Stock repurchased	(296,707)	(3)	(947)				(950)
Cash dividends				(1,445)			(1,445)
Balance at January 31, 2009	14,238,994	\$ 142	\$ 114,067	\$ (38,664)		\$ (9,382)	\$ 66,163
Net income				300	300		300
Pension adjustments, net of tax effect of \$147					(189)	(189)	(189)
Comprehensive income					111		

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Shares vested	118,845	2	(120)		(118)
Stock compensation expense			857		857
Stock repurchased	(194,795)	(2)	(652)		(654)
Cash dividends				(1,421)	(1,421)
Balance at January 31, 2010	14,163,044	\$ 142	\$ 114,152	\$ (39,785)	\$ (9,571) \$ 64,938

*See accompanying notes.*



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**Virco Mfg. Corporation**  
**Consolidated Statements of Cash Flows**

	Year Ended January 31,		
	2010	2009	2008
	(In thousand, except share data)		
Operating activities			
Net income	\$ 300	\$ 1,210	\$ 22,219
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	5,387	5,673	6,643
Provision for doubtful accounts	127	7	53
Loss (gain) on sale of property, plant and equipment	2	(1,131)	(17)
Deferred income taxes	(326)	(358)	(10,654)
Goodwill and intangible assets impairment		2,284	
Stock-based compensation	857	855	678
Changes in operating assets and liabilities			
Trade accounts receivable	(61)	1,274	3,070
Other receivables	269	(126)	(56)
Inventories	(3,685)	10,023	(5,171)
Income taxes	58	193	(379)
Prepaid expenses and other current assets	146	(165)	(290)
Accounts payable and accrued liabilities	(5,869)	(8,579)	788
Net cash (used in) provided by operating activities	(2,795)	11,160	16,884
Investing activities			
Capital expenditures	(5,345)	(5,056)	(4,832)
Proceeds from sale of property, plant and equipment	27	2,392	17
Net investment in life insurance	36	(50)	(116)
Net cash used in investing activities	(5,282)	(2,714)	(4,931)
Financing activities			
Proceeds from long-term debt	6,877		3,582
Repayment of long-term debt	(69)	(3,730)	(15,000)
Purchase of treasury stock	(652)	(950)	
Cash dividend paid	(1,421)	(1,445)	(361)
Net cash provided by (used in) financing activities	4,735	(6,125)	(11,779)
Net (decrease) increase in cash	(3,342)	2,321	174
Cash at beginning of year	4,387	2,066	1,892
Cash at end of year	\$ 1,045	\$ 4,387	\$ 2,066

Supplemental disclosures of cash flow information

Cash paid during the year for:

Interest	\$ 1,127	\$ 1,452	\$ 2,276
Income tax, net	176	464	1,006
Non-cash activities			
(Decrease) Increase in accrued asset retirement obligations	\$ (200)	\$ 113	\$ 669

*See accompanying notes.*

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**VIRCO MFG. CORPORATION**  
**Notes to Financial Statements**  
**January 31, 2010**

**1. Summary of Business and Significant Accounting Policies**

**Business**

Virco Mfg. Corporation (the Company), which operates in one business segment, is engaged in the design, production and distribution of quality furniture for the commercial and education markets. Over 60 years of manufacturing has resulted in a wide product assortment. Major products include mobile tables, mobile storage equipment, desks, computer furniture, chairs, activity tables, folding chairs and folding tables. The Company manufactures its products in Torrance, California, and Conway, Arkansas, for sale primarily in the United States.

The Company operates in a seasonal business, and requires significant amounts of working capital under its credit facility to fund acquisitions of inventory and finance receivables during the summer delivery season. Restrictions imposed by the terms of the Company's credit facility may limit the Company's operating and financial flexibility. However, management believes that its existing cash and available borrowings under its credit facility, and any cash generated from operations will be sufficient to fund its working capital requirements, capital expenditures and other obligations through the next 12 months.

**Principles of Consolidation**

The consolidated financial statements include the accounts of Virco Mfg. Corporation and its wholly owned subsidiaries. All material intercompany balances and transactions have been eliminated in consolidation.

**Management Use of Estimates**

Preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Significant estimates made by management include, but are not limited to, valuation of: inventory; deferred tax assets and liabilities; useful lives of property, plant, and equipment; intangible assets; liabilities under pension, warranty, self-insurance, and environmental claims; and the ultimate collection of accounts receivable. Actual results could differ from these estimates.

**Fiscal Year End**

Fiscal years 2009, 2008 and 2007, refer to the fiscal years ended January 31, 2010, 2009 and 2008, respectively.

**Concentration of Credit Risk**

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of accounts receivable. The Company performs ongoing credit evaluations of its customers and maintains allowances for potential credit losses. Sales to the Company's recurring customers are generally made on open account with terms consistent with the industry. Credit is extended based on an evaluation of the customer's financial condition and payment history. Past due accounts are determined based on how recently payments have been made in relation to the terms granted. Amounts are written off against the allowance in the period that the Company determines that the receivable is not collectable. The Company purchases insurance on receivables from certain commercial customers to minimize the Company's credit risk. The Company does not typically obtain collateral to secure credit risk. Customers with inadequate credit are required to provide cash in advance or letters of credit. The Company does not assess interest on receivable balances. A substantial percentage of the Company's receivables come from low-risk government entities. No customer exceeded 10% of the Company's sales for each of the three years ended January 31, 2010. Foreign sales were less than 7% of the Company's sales for 2009, and less than 5% of the Company's sales for 2008 and 2007.

No single customer accounted for more than 10% of the Company's accounts receivable at January 31, 2010 or 2009. Because of the short time between shipment and collection, the net carrying value of receivables approximates the fair value for these assets.

**Fair Values of Financial Instruments**



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The fair values of the Company's cash, accounts receivable, and accounts payable approximate their carrying amounts due to their short-term nature.

Financial assets measured at fair value on a recurring basis are classified in one of the three following categories, which are described below:

Level 1 Valuations based on unadjusted quoted prices for identical assets in an active market.

Level 2 Valuations based on quoted prices in markets where trading occurs infrequently or whose values are based on quoted prices of instruments with similar attributes in active markets.

Level 3 Valuations based on inputs that are unobservable and involve management judgment and our own assumptions about market participants and pricing.

**Inventories**

Inventories are stated at the lower of cost or market. Cost is determined using the last-in, first-out ( LIFO ) method of valuation for the material content of inventories and the first-in, first-out ( FIFO ) method for labor and overhead. The Company uses LIFO as it results in a better matching of costs and revenues. The Company records the cost of excess capacity as a period expense, not as a component of capitalized inventory valuation.

**Property, Plant and Equipment**

Property, plant and equipment are stated at cost, less accumulated depreciation. Depreciation and amortization are computed on the straight-line method for financial reporting purposes based upon the following estimated useful lives:

Land improvements	5 to 25 years
Buildings and building improvements	5 to 40 years
Machinery and equipment	3 to 10 years
Leasehold improvements	shorter of lease or useful life

The Company did not capitalize interest costs as part of the acquisition cost of property, plant and equipment for the years ended January 31, 2010, 2009 and 2008. The Company capitalizes the cost of significant repairs that extend the life of an asset. Repairs and maintenance that do not extend the life of an asset are expensed as incurred. Depreciation and amortization expense was \$5,387,000, \$5,673,000 and \$6,643,000 for the fiscal years ended January 31, 2010, 2009 and 2008, respectively.

The Company capitalizes costs associated with software developed for its own use. Such costs are amortized over three to seven years from the date the software becomes operational. At January 31, 2010 and 2009, the Company had no capitalized software.

The Company leased certain computer equipment under a capital lease. The cost and accumulated depreciation are included in the property, plant, and equipment accounts. Depreciation expense was \$0, \$58,000 and \$61,000 for the fiscal years ended January 31, 2010, 2009 and 2008, respectively. The Company did not acquire assets under the capital lease in fiscal 2009, 2008, and 2007. The Company did not have any future capital lease payment obligations as of January 31, 2010.

The Company subleased space at one of its facilities on a month-to-month basis during 2009, 2008 and 2007. Rental income for fiscal 2009, 2008, and 2007 was \$40,000, \$267,000, and \$379,000, respectively. This facility was sold in the third quarter of 2008.

The Company has established asset retirement obligations related to leased manufacturing facilities in accordance with FASB ASC Topic 410, Asset Retirement and Environmental Obligations. Accrued asset retirement obligations are recorded at net present value and discounted over the life of the lease. Asset retirement obligations, included in other non-current liabilities were \$627,000 and \$818,000 at January 31, 2010 and 2009, respectively.

	2009	2008
Balance at beginning of period	\$ (818,000)	\$ (669,000)
Decrease in (addition to) obligation	200,000	(113,000)
Accretion expense	(9,000)	(36,000)
Balance at end of period	\$ (627,000)	\$ (818,000)

**Impairment of Long-Lived Assets**

An impairment loss is recognized in the event facts and circumstances indicate the carrying amount of an intangible asset may not be recoverable, and an estimate of future undiscounted cash flows is less than the carrying amount of the asset. Impairment is recorded based on the excess of the carrying amount of the impaired asset over the fair value. Generally, fair value represents the Company's expected future cash flows from the use of an asset or group of assets, discounted at a rate commensurate with the risks involved.

**Table of Contents****Net Income Per Share**

Basic net income per share is calculated by dividing net income by the weighted-average number of common shares outstanding. Diluted net income per share is calculated by dividing net income by the weighted-average number of common shares outstanding plus the dilution effect of common equivalent shares from common stock options and warrants. The following table sets forth the computation of basic and diluted income per share:

In thousands, except per share data	2009	2008	2007
Numerator			
Net income	\$ 300	\$ 1,210	\$ 22,219
Denominator			
Weighted-average shares basic	14,155	14,390	14,401
Common equivalent shares from common stock options and warrants	41	44	138
Weighted-average shares diluted (1)	14,196	14,434	14,539
Net income per common share			
Basic	\$ 0.02	\$ 0.08	\$ 1.54
Diluted	0.02	0.08	1.53

(1) Effective June 6, 2006, in connection with a stock purchase agreement, the Company issued warrants to purchase 268,010 shares of common stock at an exercise price of \$6.06. Effective September 31, 2006, in connection with a stock purchase agreement, the Company issued warrants to purchase 14,364 shares of common stock at an exercise price of \$6.53. The warrants expire five years from the date of

issue.

### **Goodwill and Other Intangible Assets**

The Company accounts for goodwill and other intangible assets in accordance with FASB ASC Topic 805, Business Combinations, and FASB ASC Topic 350, Intangibles Goodwill and Other Assets. Under FASB ASC Topic 350, goodwill and intangible assets deemed to have an indefinite life are not amortized but are subject to annual impairment tests. Impairment tests are prepared in the fourth quarter of each fiscal year or more frequently if events or circumstances occur that would indicate a reduction in the fair value. Other intangible assets are amortized on a straight line basis over their useful lives (3-17 years).

### **Impairment of Goodwill**

The Company identified a single reporting unit (the Company itself) as no components have been identified beneath it. In the fourth quarter of 2008, the Company's market capitalization decreased significantly, which decreased the calculated fair value used in the Company's annual impairment test. Based on this assessment, management concluded that, as of January 31, 2009, the carrying value of the Company's reporting unit (\$2,200,000) exceeded its fair value (\$0) and that goodwill was fully impaired. Therefore, the Company recorded a pre-tax, non-cash goodwill impairment charge of \$2,200,000. After recording the impairment charge in fiscal 2008, the Company had no goodwill remaining on its Consolidated Balance Sheet as of January 31, 2010 and 2009.

For the fourth quarter of 2008 impairment test, the Company determined the fair value of the reporting unit based on a weighting of market capitalization analysis and a discounted cash flow analysis. The market capitalization was calculated by multiplying the share price of the Company's common stock at the measurement date by the number of outstanding common shares and adding a control premium. A control premium was applied to the minority basis value to arrive at the reporting unit's estimated fair value on a controlling basis. In addition to these financial considerations, qualitative factors such as business descriptions, market served, and profitability were considered in the analysis. The selection and weighting of the fair value techniques may result in a higher or lower fair value. Judgment is applied in determining the weightings that are most representative of fair value. Management has performed a sensitivity analysis on its significant assumptions and has determined that a change in its assumptions within selected sensitivity testing levels would not impact its conclusion.

### **Impairment of Intangible Assets**

In December 2003, the Company acquired certain assets of Corex Products, Inc., a manufacturer of compression-molded components, for approximately \$1 million. These assets have been transferred to the Company's Conway, Arkansas, location where they have been integrated with the Company's existing compression-molding operation. In connection with this acquisition, the Company acquired certain patents and other finite lived intangible assets. During the fourth quarter of 2008, the Company determined that it would not utilize one of the patents acquired, and



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took an \$84,000 pre-tax impairment charge. After the impairment charge was recorded during fiscal 2008, the Company has no intangible assets on its Consolidated Balance Sheet at January 31, 2010 and 2009. Information regarding the Company's goodwill and other intangible assets as of January 31, 2010 is as follows (in thousands):

In thousands	Gross Amount	Accumulated Amortization	Impairment Charge	Net Amount
Goodwill (not amortized)	\$ 2,200	\$	\$ 2,200	\$
Intangible assets	150	66	84	
	\$ 2,350	\$ 66	\$ 2,284	\$

**Environmental Costs**

The Company is subject to numerous 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. Normal, recurring expenses related to operating the factories in a manner that meets or exceeds environmental laws and regulations are matched to the cost of producing inventory.

Despite our efforts to comply with existing laws and regulations, 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. We reserve amounts for such matters when expenditures are probable and reasonably estimable.

Costs incurred to investigate and remediate environmental waste are expensed, unless the remediation extends the useful life of the assets employed at the site. At January 31, 2010 and 2009, the Company had not capitalized any remediation costs and had not recorded any amortization expense in fiscal years 2009, 2008 and 2007.

**Advertising Costs**

Advertising costs are expensed in the period during which the advertising space is run. Selling, general and administrative expenses include advertising costs of \$1,726,000 in 2009, \$2,022,000 in 2008 and \$1,883,000 in 2007. Prepaid advertising costs reported as an asset on the balance sheet at January 31, 2010 and 2009, were \$277,000 and \$421,000, respectively.

**Product Warranty Expense**

The Company provides a product warranty on most products. 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 generally provides 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 Company recorded warranty reserves of \$1,675,000 and \$1,950,000 as of January 31, 2010 and 2009, respectively.

**Self-Insurance**

In 2009 and 2008, the Company was self-insured for product and general liability losses 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. In prior years the Company had been self-insured for workers' compensation, automobile, product, and general liability losses. Actuaries assist the Company in determining its liability for the self-insured component of claims, which have been discounted to their net present value utilizing a discount rate of 6.00% in 2009 and 6.75% in 2008.

**Stock-Based Compensation Plans**

The Company has two stock-based compensation plans, which are described more fully in Note 5, Stock-Based Compensation. Effective February 1, 2006, the Company adopted FASB ASC Topic 718, Compensation Stock Compensation using the modified prospective application method for transition for its two stock-based compensation plans. Accordingly, prior year amounts have not been restated.

**Table of Contents****Reclassifications**

Certain reclassifications have been made to the prior year balance sheet to conform to the current year presentation.

**Revenue Recognition**

The Company recognizes all sales when title passes under its various shipping terms, when installation services are performed and when collectability is reasonably assured. The Company reports sales net of sales returns and allowances and sales tax imposed by various government authorities.

**Shipping and Installation Fees**

Revenues related to shipping and installation are included as revenue in net sales. Costs related to shipping and installations are included in operating expenses. For the fiscal years ended January 31, 2010, 2009 and 2008, shipping and installation costs of approximately \$16,380,000, \$20,783,000 and \$23,612,000, respectively, were included in selling, general and administrative expenses.

**Accounting 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 FASB ASC Topic 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. A valuation allowance against deferred tax assets is recorded when it is determined to be more likely than not that the asset will not be realized.

In June 2006, the Financial Accounting Standards Board (the FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48) now codified as FASB ASC Topic 740. FASB ASC Topic 740 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties on income taxes, and accounting in interim periods and requires increased disclosures. The Company adopted the provisions of FASB ASC Topic 740 on February 1, 2007, the beginning of fiscal 2007. There was no material impact as a result of the implementation of FASB ASC Topic 740.

**Accounting for Pensions and Other Postretirement Plans**

In September 2006, the FASB issued FASB ASC Topic 715, Compensation Retirement Benefits. This standard requires an employer to: (a) recognize in its statement of financial position the funded status of a benefit plan; (b) recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise but are not recognized as components of net periodic benefit costs pursuant to prior existing guidance; (c) enhance additional disclosure requirements; and (d) measure defined benefit plan assets and obligations as of the end of the employer's fiscal year (with limited exceptions). FASB ASC Topic 715 provides recognition and disclosure elements to be effective as of the end of the fiscal years ending after December 15, 2006, and measurement elements to be effective for fiscal years ending after December 15, 2008. The Company adopted the recognition provisions of FASB ASC Topic 715 and applied them to the funded status of its defined benefit plans resulting in a decrease in Stockholders' Equity of \$1,900,000 as of January 31, 2007. During 2008 the Company adopted the measurement elements of FASB ASC Topic 715 and recorded a \$90,000 increase in accrued pension liability with an offset to retained earnings (\$54,000 net of taxes).

**New Accounting Pronouncements**

In December 2008, the FASB issued new guidance impacting FASB ASC 715-20-50, Compensation Retirement Benefits Defined Benefit Plans Disclosure (formerly FSP FAS 132(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets), which expands the disclosure requirements related to an employer's defined benefit pension or other postretirement plan. The guidance requires additional disclosure information, including how a company makes investment allocation decisions, the fair value of each major category of plan assets and the nature and amount of

concentration risk within or across those plan asset categories. Additionally, the guidance requires disclosures about the valuation of plan assets, including the level within the fair value hierarchy in which fair value

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measurements of plan assets fall and information about the inputs and valuation techniques used to measure the fair value of plan assets. The guidance, which applies only to disclosures, is effective for fiscal years ending after December 15, 2009. We have adopted these new requirements, which are included in Note 4 to these consolidated financial statements.

In August 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-05 ( ASU 2009-05 ), an update to ASC 820, Fair Value Measurements and Disclosures . ASU 2009-05 amends ASC 820 by providing additional guidance (including illustrative examples) clarifying the measurement of liabilities at fair value. When a quoted price in an active market for the identical liability is not available, the amendments in ASU 2009-05 require that the fair value of a liability be measured using one or more of the listed valuation techniques that should maximize the use of relevant observable inputs and minimize the use of unobservable inputs. In addition, the amendments in ASU 2009-05 clarify that when estimating the fair value of a liability, an entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. The amendments also clarify how the price of a traded debt security, (i.e., an asset value) should be considered in estimating the fair value of the issuer s liability. The amendments in ASU 2009-05 are effective the first reporting period (including interim periods) beginning after its issuance, or as of October 31, 2009, for the Company. The adoption had no impact to the financial statements.

In June 2009, the FASB issued FAS 167 now codified as ASC 810 Amendments to FASB Interpretation No. 46(R) , the objective of which is to improve financial reporting by enterprises involved with variable interest entities. FAS 167 is effective for annual reporting periods that begin after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Early application is not permitted. We expect to adopt this statement during our fiscal 2010 first quarter. The adoption of this statement is not expected to have a material impact on our financial position or results of operations.

In July 2009, we adopted Statement of Financial Accounting Standard (SFAS) 165 now codified as FASB ASC Topic 855 Subsequent Events , which establishes accounting and reporting standards for events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In addition, FASB ASC Topic 855 requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for selecting that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. FASB ASC Topic 855 was effective for fiscal years and interim periods ending after June 15, 2009. The adoption of FASB ASC Topic 855 did not have a material impact on the Company s consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168 now codified as part of ASC 105-10, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (SFAS No. 168). SFAS No. 168 establishes the FASB Accounting Standards Codification (the Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial standards in conformity with US GAAP. Rules and interpretive releases of the Securities and Exchange Commission ( SEC ) under authority of federal securities laws are also sources of authoritative US GAAP for SEC registrants. SFAS No. 168 is effective for financial statements issued by us for interim and annual periods after September 15, 2009. On the effective date of SFAS No. 168, all then-existing non-SEC accounting and reporting standards are superseded, with the exception of certain promulgations listed in SFAS No. 168. The adoption of SFAS No. 168 did not have a significant effect on our condensed consolidated financial statements as the purpose of the Codification is not to create new accounting and reporting guidance. Rather, the Codification is meant to simplify user access to all authoritative US GAAP. References to US GAAP in our published financial statements included herein have been updated, as appropriate, to cite the Codification.

In June 2008, the FASB issued EITF 03-6-1 now codified as ASC 260-10 Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities . Under FASB ASC Topic 505, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents, whether they are paid or unpaid, are considered participating securities and should be included in the computation of earnings per share pursuant to the two-class method. FASB ASC Topic 505 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. FASB ASC Topic 505 also requires all prior period earnings per share data presented to be adjusted retrospectively and early application is not permitted. The

Company adopted FASB ASC Topic 505 on February 1, 2009 and the adoption did not have an impact on its financial statements.

In September 2006, the FASB issued SFAS No. 157, which is now codified as FASB ASC Topic 820, Fair Value Measurements . This standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. FASB ASC Topic 820 is effective for financial statements issued for fiscal years beginning after November 15, 2007, which is the fiscal year

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beginning February 1, 2008, for the Company. The Company adopted FASB ASC Topic 820 effective February 1, 2008. The adoption of FASB ASC Topic 820 for financial assets and liabilities held by the Company did not have a material effect on the Company's financial statements or notes thereto.

In February 2008, the FASB issued FSP FAS 157-2, which is now codified as FASB ASC Topic 820, "Fair Value Measurements" permits a one year deferral of the application of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company adopted SFAS No. 157 for non-financial assets and non-financial liabilities on February 1, 2009, and the provisions did not have a material effect on the Company's results of operations, financial position or cash flows.

In December 2007, the FASB issued SFAS No. 141 (Revised) now codified as FASB ASC Topic 805, "Business Combinations" and SFAS No. 160 now codified as FASB ASC Topic 810, "Non-controlling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51 (FASB ASC Topic 810)". FASB ASC Topic 805 broadens its scope by applying the acquisition method to all transactions and other events in which one entity obtains control over one or more other businesses, and requires, among other things, that assets acquired and liabilities assumed be measured at fair value as of the acquisition date, that liabilities related to contingent considerations be recognized at the acquisition date and remeasured at fair value in each subsequent reporting period, that acquisition-related costs be expensed as incurred, and that income be recognized if the fair value of the net assets acquired exceeds the fair value of the consideration transferred. FASB ASC Topic 810 establishes accounting and reporting standards for non-controlling interests (i.e., minority interests) in a subsidiary, including changes in a parent's ownership interest in a subsidiary and requires, among other things, that non-controlling interests in subsidiaries be classified as a separate component of equity. Except for the presentation and disclosure requirements which are to be applied retrospectively for all periods presented, FASB ASC Topic 805 and FASB ASC Topic 810 are to be applied prospectively in financial statements issued for fiscal years beginning after December 15, 2008. The adoption of FASB ASC Topic 805 and FASB ASC Topic 810 on February 1, 2009, did not have any material impact on the Company's financial statements. In March 2008, the FASB issued SFAS No. 161 now codified as FASB ASC Topic 815, "Disclosures about Derivative Instruments and Hedging Activities" (FASB ASC Topic 815). FASB ASC Topic 815 requires companies with derivative instruments to disclose information that should enable readers of financial statements to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for under FASB ASC Topic 815 and how derivative instruments and related hedged items affect a company's financial position, financial performance and cash flows. FASB ASC Topic 815 was effective for the Company on February 1, 2009. The adoption of FASB ASC Topic 815 did not have an effect on the Company's financial position, results of operations or cash flows.

**2. Inventories**

The current material cost for inventories exceeded LIFO cost by \$8,316,000 and \$9,531,000 at January 31, 2010 and 2009, respectively. Liquidation of prior year LIFO layers due to a reduction in certain inventories increased income by \$54,000, \$733,000 and \$54,000 in the years ended January 31, 2010, 2009 and 2008, respectively.

Details of inventory amounts, including the material portion of inventory which is valued at LIFO, at January 31, 2010 and 2009, are as follows (in thousands):

	Material Content at FIFO	January 31, 2010		Total
		LIFO Reserve	Labor, Overhead and Other	
Finished goods	\$ 7,582	\$ (1,857)	\$ 4,958	\$ 10,683
Work in process	13,334	(3,575)	8,894	18,653
Raw materials and supplies	10,209	(2,884)	9	7,334

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Total	\$ 31,125	\$ (8,316)	\$ 13,861	\$ 36,670
			January 31, 2009	
	Material Content		Labor,	
	at	LIFO	Overhead	
	FIFO	Reserve	and Other	Total
Finished goods	\$ 9,066	\$ (2,306)	\$ 3,960	\$ 10,720
Work in process	12,074	(3,904)	6,678	14,848
Raw materials and supplies	10,728	(3,321)	10	7,417
Total	\$ 31,868	\$ (9,531)	\$ 10,648	\$ 32,985



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

In thousands, except per share data	January 31,	
	2010	2009
Revolving credit line with Wells Fargo Bank	\$ 6,877	\$
Other	47	116
Total long-term debt	6,924	116
Less current portion	12	69
Non-current portion	\$ 6,912	\$ 47

At January 31, 2010, the Company borrowed under an asset based line of credit. The revolving line typically provided for advances of 80% on eligible accounts receivable and 20% - 60% on eligible inventory. The advance rates fluctuated depending on the time of year and the types of assets. The agreement had an unused commitment fee of 0.375%.

Interest was at prime or LIBOR +2.5%. Availability under the line was \$14,091,000 at January 31, 2010.

Effective as of February 1, 2010, the Company entered into the Third Amended and Restated Credit Agreement (the "Agreement"), dated as of March 27, 2009, with Wells Fargo Bank, National Association (the "Lender") and a related Revolving Line of Credit Note, dated as of March 27, 2009, in favor of the Lender. The Agreement provides the Company with an increased secured revolving line of credit (the "Revolving Credit") of up to \$50,000,000, with seasonal adjustments to the credit limit, and includes a sub-limit of up to \$10,000,000 for the issuance of letters of credit. The Revolving Credit is secured by the maintenance by the Lender of a first priority perfected security interest in certain of the personal and real property of the Company and its subsidiaries.

The Revolving Credit will mature on March 1, 2012, with interest payable monthly at a fluctuating rate equal to the Wells Fargo Bank's prime rate or LIBOR plus a fluctuating margin. The Agreement has an unused commitment fee of 0.375%.

The Revolving Credit with Wells Fargo Bank is subject to various financial covenants including a leverage requirement, a cash flow coverage requirement and profitability requirements. 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 was in compliance with its covenants at January 31, 2010. Long-term debt repayments are approximately as follows (in thousands):

**Year ending January 31,**

2011	\$ 12
2012	6,889
2013	12
2014	11
2015	
Thereafter	

Management believes that the carrying value of debt approximated fair value at January 31, 2010 and 2009, as all of the long-term debt bears interest at variable rates based on prevailing market conditions.

**4. Retirement Plans****Pension Plans**

The Company maintains three defined benefit pension plans, the Virco Employees Retirement Plan ("Employee Plan"), the Virco Important Performers Retirement Plan ("VIP Plan"), and the Non-Employee Directors Retirement Plan ("Directors Plan"). The Company and its subsidiaries cover all employees under a qualified non-contributory defined benefit retirement plan, the Employee Plan. Benefits under the Employee Plan are based on years of service and career

average earnings.

The Company also provides a supplementary retirement plan for certain key employees, the VIP Plan. The VIP Plan provides a benefit up to 50% of average compensation for the last five years in the VIP Plan, offset by benefits earned under the Employees Plan. Plan amendments are prepared periodically to optimize the portion of the

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benefits payable under the Qualified Plan. The VIP Plan benefits are secured by a life insurance program. The cash surrender values of the policies securing the VIP Plan were \$2,839,000 and \$2,797,000 at January 31, 2010 and 2009, respectively. These cash surrender values are included in other assets in the consolidated balance sheets. The Company maintains a rabbi trust to hold assets related to the VIP Retirement Plan. Substantially all assets securing the VIP Plan are held in the rabbi trust.

In April 2001, the Board of Directors established the Directors Plan, a non-qualified plan for non-employee directors of the Company. The Directors 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. At January 31, 2010, the Directors Plan did not hold any assets.

The annual measurement date for all plans for the fiscal years ended January 31, 2010 and 2009 is January 31. For prior fiscal years the annual measurement date was December 31. Effective December 31, 2003, the Company froze all future benefit accruals under the plans. Employees can continue to vest under the benefits earned to date, but no covered participants will earn additional benefits under the plan freeze.

Accounting policy regarding pensions requires management to make complex and subjective estimates and assumptions relating to amounts which are inherently uncertain. Three primary economic assumptions influence the reported values of plan liabilities and pension costs. The Company takes the following factors into consideration. The discount rate represents an estimate of the rate of return on a portfolio of high-quality fixed-income securities that would provide cash flows that match the expected benefit payment stream from the plans. When setting the discount rate, the Company utilizes a spot-rate yield curve developed from high-quality bonds currently available which reflects changes in rates that have occurred over the past year. This assumption is sensitive to movements in market rates that have occurred since the preceding valuation date, and therefore, may change from year to year.

Because the Company froze future benefit accruals for all three defined benefit plans, the compensation increase assumption had no impact on pension expense, accumulated benefit obligation or projected benefit obligation for the period ended January 31, 2010 or 2009. The effect of freezing future benefit accruals minimizes the impact of future raises in compensation, but introduced a new assumption related to the plan freeze. During 2007 and 2008 it was the Company's intent to resume some form of a retirement benefit when the profitability and the financial condition of the Company allowed, and the actuarial valuations assumed the plans would be frozen for one additional year. During 2009 the Company determined that the freeze would likely become permanent, and the Company recorded a plan curtailment gain of \$29,000. If the Company had assumed a permanent freeze, pension expense for 2008 and 2007 would have (decreased) / increased by (\$145,000) and \$64,000, respectively.

The assumed rate of return on plan assets represents an estimate of long-term returns available to investors who hold a mixture of stocks, bonds, and cash equivalent securities. When setting its expected return on plan asset assumptions, the Company considers long-term rates of return on various asset classes (both historical and forecasted, using data collected from various sources generally regarded as authoritative) in the context of expected long-term average asset allocations for its defined benefit pension plan.

Two of the Company's defined benefit pension plans (the VIP Plan and the Directors Plan) are executive benefit plans that are not funded and are subject to the Company's creditors. Because these plans are not funded, the assumed rate of return has no impact on pension expense or the funded status of the plans.

The Company maintains a trust for and funds the pension obligations for the Employee Plan. The Board of Directors appoints a Retirement Plan Committee that establishes a policy for investment and funding strategies. Approximately 75% of the trust assets are managed by investment advisors and held in common trust funds with the balance managed by the Retirement Plan Committee. The Retirement Plan Committee has established target asset allocations to its investment advisors, who invest the trust assets in a variety of institutional collective trust funds. The long-term asset allocation target provided to the investment advisors is 80% stock and 20% bond, with maximum allocations of 80% large cap stocks, 30% small cap stocks, and 30% international stock. The Company has established a custom benchmark derived from a variety of stock and bond indices that are weighted to approximate the asset allocation provided to the investment advisors. The investment advisors' performance is compared to the custom index as part of the evaluation of the investment advisors' performance. The Retirement Plan Committee receives monthly reports from the investment advisors and meets periodically with them to discuss investment performance.

At January 31, 2010 and 2009, the amount of the plan assets invested in bond or short-term investment funds was 15% and 1%, respectively, and the balance of the trust was held in equity funds or investments. The trust does not hold any Company stock. It is the Company's policy to contribute adequate funds to the trust accounts to cover benefit payments under the VIP Plan and Directors Plan and to maintain the funded status of the Employee Plan at

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level which is adequate to avoid significant restrictions to the Qualified Plan under the Pension Protection Act of 2006.

During 2008, the Company incurred a large loss on assets held for investment in the qualified pension trust. This loss has adversely impacted the funded status of the Employee Plan, and required the Company to record a \$6.8 million increase in pension liability offset by an increase in other comprehensive loss. These losses could require the Company to increase cash contributions to the Employee Plan over the next several years, and increased pension expense for 2009 by over \$1 million as compared to 2008 pension expense.

Payments from the Employee Plan pension trust to plan participants are estimated to be \$1,646,000 during the fiscal year ending January 31, 2011. It is anticipated that the Company will contribute approximately \$1-2 million to the trust in 2010. Actual contributions will depend upon investment return on the plan assets. Payments made under the Employee Plan are made from the trust fund. It is anticipated that the Company will be required to contribute approximately \$560,000 to the non-qualified plans during the fiscal year ending January 31, 2011. Payments made under the VIP Plan and Directors Plan are made by the Company.

The following table sets forth (in thousands) the funded status of the Company's pension plans at January 31, 2010, and 2009:

	Employee Plan		VIP Plan		Directors Plan	
	01/31/2010	01/31/2009	01/31/2010	01/31/2009	01/31/2010	01/31/2009
<b>Change in Benefit Obligation</b>						
Benefit obligation at beg. of year	\$ 22,516	\$ 24,194	\$ 5,238	\$ 5,820	\$ 464	\$ 470
Service cost						
Interest cost	1,467	1,549	338	361	30	30
Participant contributions						
Amendments	(1,395)		1,703			
Actuarial (gains) losses	3,759	(1,795)	(727)	(458)	(31)	(36)
Benefits paid	(1,079)	(1,432)	(476)	(485)		
Benefit obligation at end of year	\$ 25,268	\$ 22,516	\$ 6,076	\$ 5,238	\$ 463	\$ 464
<b>Change in Plan Assets</b>						
Fair value at beg. of year	\$ 10,213	\$ 17,334	\$	\$	\$	\$
Actual return on plan assets	2,691	(8,089)				
Company contributions	4,367	2,400	476	485		
Benefits paid	(1,079)	(1,432)	(476)	(485)		
Fair value at end of year	\$ 16,192	\$ 10,213	\$	\$	\$	\$
<b>Funded Status</b>						
Unfunded status of the plan	\$ (9,076)	\$ (12,303)	\$ (6,076)	\$ (5,238)	\$ (463)	\$ (464)

**Amounts Recognized in Statement of Financial Position**

Current liabilities			(496)	(455)	(63)	(51)
Non-current liabilities	(9,076)	(12,303)	(5,580)	(4,783)	(400)	(413)
Accrued benefit cost	\$ (9,076)	\$ (12,303)	\$ (6,076)	\$ (5,238)	\$ (463)	\$ (464)

**Items not yet Recognized as a Component  
of Net Periodic Pension Expense, Included in AOCI**

Unrecognized net actuarial (gain) loss	\$ 12,609	\$ 11,746	\$ 554	\$ 1,379	\$ (77)	\$ (231)
Unamortized prior service costs		1,741		(1,886)		
Net initial asset recognition	\$ 12,609	\$ 13,487	\$ 554	\$ (507)	\$ (77)	\$ (231)

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	Employee Plan		VIP Plan		Directors Plan	
	01/31/2010	01/31/2009	01/31/2010	01/31/2009	01/31/2010	01/31/2009
<b>Other Changes in Plan Assets and Benefit Obligations Recognized in Other Comprehensive Income</b>						
Net (gain) / loss	\$ 1,785	\$ 7,595	\$ (727)	\$ (458)	\$ (31)	\$ (36)
Prior service cost / (credit)						
Amortization of gain / (loss)	(922)	(206)	(98)	(155)	184	35
Amortization of prior service cost	(1,741)	(553)	1,886	344		
Amortization of initial asset						
Total recognized in other comprehensive income	\$ (878)	\$ 6,836	\$ 1,061	\$ (269)	\$ 153	\$ (1)
<b>Items to be Recognized as a Component of 2010 Periodic Pension Cost</b>						
Prior service cost	\$		\$		\$	
Net actuarial loss	972				(31)	
	\$ 972		\$		\$ (31)	
<b>Supplemental Data</b>						
Projected benefit obligation	\$ 25,268	\$ 22,516	\$ 6,076	\$ 5,238	\$ 463	\$ 464
Accumulated benefit obligation	25,268	22,516	6,076	5,238	463	464
Fair value of plan assets	16,192	10,213				
	Employee Plan		VIP Plan		Directors Plan	
	01/31/2010	01/31/2009	01/31/2010	01/31/2009	01/31/2010	01/31/2009
<b>Components of Net Periodic Benefit Cost</b>						
Service cost	\$	\$	\$	\$	\$	\$
Interest cost	1,467	1,430	338	334	30	28
Expected return on plan assets	(717)	(1,201)				
Curtailment (gain) / loss	(164)		135			
Amortization of prior service cost	510	510	(318)	(318)	(184)	
Recognized net actuarial loss	923	190	98	143		(32)
Benefit cost	\$ 2,019	\$ 929	\$ 253	\$ 159	\$ (154)	\$ (4)
<b>Estimated Future Benefit Payments</b>						
FYE 01-31-2011	\$ 1,646		\$ 496		\$ 63	
FYE 01-31-2012	1,558		474		63	
FYE 01-31-2013	1,502		450		58	
FYE 01-31-2014	2,054		430		54	
FYE 01-31-2015	1,681		406		59	

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FYE 01-31-2016 to 2020	8,545	1,727	179
Total	\$ 16,986	\$ 3,983	\$ 476



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	Employee Plan		VIP Plan		Directors Plan	
	01/31/2010	01/31/2009	01/31/2010	01/31/2009	01/31/2010	01/31/2009
<b>Weighted Average Assumptions to Determine Benefit Obligations at Year-End</b>						
Discount rate	5.75%	6.75%	6.00%	6.75%	5.75%	6.75%
Rate of compensation increase	N/A	N/A	N/A	N/A	N/A	N/A
<b>Weighted Average Assumptions to Determine Net Periodic Pension Cost</b>						
Discount rate	6.75%	6.00%	6.75%	6.00%	6.75%	6.00%
Expected return on plan assets	6.50%	6.50%	N/A	N/A	N/A	N/A
Rate of compensation increase	N/A	N/A	N/A	N/A	N/A	N/A

**Fair Value Measurements of Plan Assets**

## Employee Plan

	01/31/2010	01/31/2009
Level 1 Measurement		
Cash & Cash Equivalents	\$ 215	\$ 35
Bond Index Fund	2,264	16
Large Cap Growth Index Fund	2,085	2,194
Large Cap Value Index Fund	2,858	2,901
Russell 2000 Index Fund	2,373	1,832
International Equity Index Fund	2,421	550
Managed Investment Fund	538	
Common Stock	3,438	2,685
Total Level 1	\$ 16,192	\$ 10,213
Level 2 Measurement		
None	N/A	N/A
Level 3 Measurement		
None	N/A	N/A

**Implementation of FASB ASC Topic 715**

The Company adopted the recognition provisions of FASB ASC Topic 715 Compensation Retirement Benefits and initially applied them to the funded status its defined benefit plans as of December 31, 2006. The initial recognition of the funded status of its defined benefit plans resulted in a decrease in Stockholders' Equity of \$1,900,000. The Company adopted the measurement date provisions of SFAS No. 158 in 2008 which required the Company to measure the plan assets and projected benefit obligations as of January 31, 2009. The Company previously used December 31 as the measurement date. The impact of this change was to increase liability for pension obligations by \$90,000 and reduce Stockholders' Equity by \$54,000 (net of tax).

**401(k) Retirement Plan**

The Company's retirement plan, which covers all U.S. employees, allows participants to defer from 1% to 50% of their eligible compensation through a 401(k) retirement program. Through December 31, 2001, the plan included an employee stock ownership component. The plan continues to include Virco stock as one of the investment options. At January 31, 2010 and 2009, the plan held 767,445 shares and 710,641 shares of Virco stock, respectively. For the fiscal years ended January 31, 2010, 2009 and 2008, there was no employer match and therefore no compensation cost

to the Company.

**Life Insurance**

The Company provided current and post-retirement life insurance to certain salaried employees with split-dollar life insurance policies under the Dual Option Life Insurance Plan. Effective January 2004, the Company terminated this plan for active employees. Cash surrender values of these policies, which are included in other assets in the consolidated balance sheets, were \$3,069,000 and \$3,061,000 at January 31, 2010 and 2009, respectively. The Company maintains a rabbi trust to hold assets related to the Dual Options Life Insurance Plan. Substantially all assets securing this plan are held in the rabbi trust. In the first quarter of fiscal year ending January 31, 2009, the Company implemented ASC 715-60 (previously EITF 06-04) which required the Company record a liability equal

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to the present value of death benefits promised to participants. In the first quarter of 2008 the Company recorded a liability of \$1,820,000. The Company has purchased life insurance on the lives of the participants that will pay death benefits of approximately \$6,000,000.

	01/31/2010	01/31/2009
Liability beginning of year	\$ 1,894,000	\$
Implement ASC 715-60 (previously EITF 06-04)		1,820,000
Accretion expense	103,000	106,000
Present value of death benefits paid		(32,000)
Liability end of year	\$ 1,997,000	\$ 1,894,000

**5. Stock-Based Compensation and Stockholders Rights****Stock Incentive Plans**

The Company's two stock plans are the 2007 Employee Stock Incentive Plan (the 2007 Plan) and the 1997 Employee Incentive Stock Plan (the 1997 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 granted 432,354 awards during fiscal 2009. As of January 31, 2010, there were approximately 256,615 shares available for future issuance under the 2007 Plan.

The 1997 Plan expired in 2007 and had 12,100 unexercised options outstanding at January 31, 2010. Stock options awarded to employees under the 1997 Plan must be at exercise prices equal to the fair market value of the Company's common stock on the date of grant. Stock options generally have a maximum term of 10 years and generally become exercisable ratably over a five-year period.

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**

A summary of the Company's stock option activity, and related information for the years ended January 31, is as follows:

	2010		2009		2008	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at beginning of year	102,869	\$ 10.79	161,433	\$ 11.46	234,594	\$ 12.53
Granted						
Exercised						
Forfeited	(90,769)	11.06	(58,564)	12.64	(73,161)	14.89
Outstanding at end of year	12,100	8.82	102,869	10.79	161,433	11.46
Exercisable at end of year	12,100	8.82	102,869	10.79	161,433	11.46

The data included in the above table has been retroactively adjusted, if applicable, for stock dividends.

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Information regarding stock options outstanding as of January 31, 2010, is as follows:

Options Outstanding			Remaining Contractual Life	Options Exercisable	
Price	Number of Shares	Number of Shares		Price	
\$ 8.82	12,100	12,100	1.55	\$ 8.82	

The aggregate intrinsic value of options outstanding and exercisable is \$0 as of January 31, 2010 and 2009.

**Restricted Stock Unit Awards**

The following table presents a summary of restricted stock and stock unit awards:

	Expense for 12 months ended			Unrecognized Compensation Cost at 1/31/2010
	1/31/2010	1/31/2009	1/31/2008	
<b>2007 Plan</b>				
382,500 Restricted Stock Units, issued 6/16/2009, vesting over 5 years	\$ 178,000			\$ 1,160,000
49,854 Restricted Stock Units, issued 6/16/2009, vesting over 1 year	116,000			58,000
262,500 Restricted Stock Units, issued 6/19/2007, vesting over 5 years	357,000	\$ 356,000	\$ 238,000	832,000
35,644 Grants of Restricted Stock, issued 6/17/2008, vesting over 1 year	58,000	117,000		
12,887 Grants of Restricted Stock, issued 6/19/2007, vesting over 1 year		29,000	58,000	
<b>1997 Plan</b>				
270,000 Restricted Stock Units, issued 6/30/2004, vesting over 5 years	147,000	353,000	353,000	
17,640 Grants of Restricted Stock, issued 6/20/2006, vesting over 1 year			29,000	
Totals for the period	\$ 856,000	\$ 855,000	\$ 678,000	\$ 2,050,000

A summary of the Company's restricted stock unit awards activity, and related information for the following years ended January 31, is as follows:

2010	2009	2008
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	Restricted stock units	Weighted- average fair value of restricted stock units	Restricted stock units	Weighted- average fair value of restricted stock units	Restricted stock units	Weighted- average fair value of restricted stock units
Outstanding at beginning of year	296,644	\$ 6.59	364,500	\$ 6.82	153,000	\$ 6.91
Granted	432,354	3.51	35,644	4.91	275,387	6.79
Vested	(139,144)	3.52	(103,500)	4.95	(63,887)	6.64
Forfeited						
Outstanding at end of year	589,854	4.38	296,644	6.59	364,500	6.82
Weighted-average fair value of restricted stock units granted during the year		\$ 3.51		\$ 4.91		\$ 6.79

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**Table of Contents****Stockholders Rights**

On October 15, 1996, the Board of Directors declared a dividend of one preferred stock purchase right (the Rights) for each outstanding share of the Company's common stock. Each of the Rights entitles a stockholder to purchase for an exercise price of \$50.00 (\$20.70, as adjusted for stock splits and stock dividends), subject to adjustment, one one-hundredth of a share of Series A Junior Participating Cumulative Preferred Stock of the Company, or under certain circumstances, shares of common stock of the Company or a successor company with a market value equal to two times the exercise price. The Rights are not exercisable, and would only become exercisable for all other persons when any person has acquired or commences to acquire a beneficial interest of at least 20% of the Company's outstanding common stock. The Rights have no voting privileges, and may be redeemed by the Board of Directors at a price of \$.001 per Right at any time prior to the acquisition of a beneficial ownership of 20% of the outstanding common stock. There are 200,000 shares (483,153 shares as adjusted by stock splits and stock dividends) of Series A Junior Participating Cumulative Preferred Stock reserved for issuance upon exercise of the Rights. On July 31, 2007, the Company and Mellon Investor Services LLC entered into an amendment to the Rights Agreement governing the Rights. The amendment, among other things, extended the term of the Rights issued under the Rights Agreement to October 25, 2016, removed the dead-hand provisions from the Rights Agreement, and formally replaced the former Rights Agent, The Chase Manhattan Bank, with its successor-in-interest, Mellon Investor Services LLC.

**6. Comprehensive Income (Loss)**

Comprehensive income (loss) was \$111,000, (\$3,082,000) and \$23,049,000 for the years ended January 31, 2010, 2009 and 2008, respectively. Accumulated other comprehensive loss at January 31, 2010 and 2009, is composed of minimum pension liability adjustments.

**7. Income Taxes**

The income tax expense (benefit) for the last three years is reconciled to the statutory federal income tax rate using the liability method as follows (in thousands):

	Year ended January 31,		
	2010	2009	2008
Statutory	\$ 56	\$ 513	\$ 4,145
State taxes (net of federal tax)	116	49	458
Change in valuation allowance	(437)	86	(14,750)
State rate adjustment	(26)	(239)	
Other	155	(110)	120
	\$ (136)	\$ 299	\$ (10,027)

Significant components of the expense (benefit) for income taxes (in thousands) attributed to continuing operations are as follows:

	January 31,		
	2010	2009	2008
Current			
Federal	\$ (17)	\$ 5	\$ 284
State	207	652	343
	190	657	627
Deferred			

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Federal	115	205	3,927
State	(4)	(649)	169
	111	(444)	4,096
Change in valuation allowance	(437)	86	(14,750)
	(326)	(358)	(10,654)
	\$ (136)	\$ 299	\$ (10,027)



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Deferred tax assets and liabilities (in thousands) are comprised of the following:

	January 31,	
	2010	2009
Deferred tax assets		
Accrued vacation and sick leave	\$ 1,027	\$ 1,165
Retirement plans	6,497	6,853
Insurance reserves	978	874
Inventory	1,155	1,107
Warranty	694	726
Net operating loss carryforwards	3,751	3,369
Intangibles	427	482
Other	1,458	595
	15,987	15,171
Deferred tax liabilities		
Tax in excess of book depreciation	(1,766)	(1,024)
Other	(79)	(40)
	(1,845)	(1,064)
Valuation allowance	(490)	(927)
Net deferred tax asset	\$ 13,652	\$ 13,180

Reported as:

Current deferred tax assets	\$ 3,150	\$ 3,808
Long-term deferred tax assets	10,502	9,372

The Company adopted the provisions of FASB ASC 740, *Income Taxes* on February 1, 2007, the beginning of fiscal 2008. There was no material impact as a result of the implementation of FASB ASC 740. The following table summarizes the activity related to our gross unrecognized tax benefits from February 1, 2008 to January 31, 2010 (in thousands):

	January 31,	
	2010	2009
Balance as of February 1,	\$ 642	\$ 525
Increases related to prior year tax positions	101	271
Decreases related to prior year tax positions	(144)	(197)
Increases related to current year tax positions	37	43
Decreases related to settlements with taxing authorities		
Decreases related to lapsing of statute of limitations		
Balance as of January 31,	\$ 636	\$ 642

At January 31, 2010, the Company's unrecognized tax benefits associated with uncertain tax positions were \$636,000, of which \$420,000 if recognized, would favorably affect the effective tax rate.

The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense which is consistent with the recognition of the items in prior reporting. The Company had recorded a liability for interest and penalties related to unrecognized tax benefits of \$484,000 at January 31, 2010, and \$519,000 at January 31, 2009. The Internal Revenue Service (the "IRS") has completed the examination of all

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federal income tax returns through 2003 with no issues pending or unresolved. The years 2006 through 2009 remain open for examination by the IRS. The Company is under examination by the IRS for its 2006 federal income tax return. The years 2004 through 2008 remain open for examination by state tax authorities. The Company is not currently under state examination.

The specific timing of when the resolution of each tax position will be reached is uncertain. As of January 31, 2010, 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.

At January 31, 2010, the Company has net operating loss carry forwards for federal and state income tax purposes, expiring at various dates through 2029. Federal net operating losses that can potentially be carried forward total approximately \$4,524,000 at January 31, 2010. State net operating losses that can potentially be carried forward total approximately \$27,355,000 at January 31, 2010. 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 of \$490,000 and \$927,000 on the deferred tax assets at January 31, 2010 and 2009, respectively.

**8. Commitments**

The Company has operating leases on real property and equipment, that expire at various dates. The Torrance, CA manufacturing and distribution facility is leased under a 5-year operating lease that expires on February 28, 2015. One of the Conway, AR manufacturing facility is leased under a 10-year operating lease that expires on March 31, 2018. The Company leases machinery and equipment under a 5-year operating lease arrangement. The Company has the option of buying out the assets at the end of the lease period. The Company leases trucks, automobiles, and forklifts under operating leases that include certain fleet management and maintenance services. Certain of the leases contain renewal, purchase options and require payment for property taxes and insurance.

Minimum future lease payments (in thousands) for operating leases in effect as of January 31, 2010, are as follows:

**Year ending January 31,**

2011	\$ 6,367
2012	5,831
2013	5,509
2014	5,230
2015	4,816
Thereafter	1,948

Rent expense relating to operating leases was as follows (in thousands):

**Year ended January 31,**

2010	\$ 8,258
2009	7,953
2008	7,491

The Company has issued purchase commitments for raw materials at January 31, 2010, of approximately \$16,633,000. There were no commitments in excess of normal operating requirements. All purchase commitments will be settled in the fiscal year ending January 31, 2010.

**9. Contingencies**

The Company and other furniture manufacturers are subject to federal, state and local laws and regulations relating to the discharge of materials into the environment and the generation, handling, storage, transportation and disposal of waste and hazardous materials. The Company has expended, and expects to continue to spend, significant amounts in the future to comply with environmental laws. Normal recurring expenses relating to operating the Company factories in a manner that meets or exceeds environmental laws are matched to the cost of producing inventory. Despite the Company's significant dedication to operating in compliance with applicable laws, there is a risk that the Company could fail to comply with a regulation or that applicable laws and regulations change. On these occasions, the Company records liabilities for remediation costs when remediation costs are probable and can be reasonably estimated.

The Company is subject to contingencies pursuant to environmental laws and regulations that in the future may require the Company to take action to correct the effects on the environment of prior disposal practices or releases of

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chemical or petroleum substances by the Company or other parties. The Company has 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 it. 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. The Company reserves amounts for such matters when expenditures are probable and reasonably estimable. At January 31, 2010 and 2009, the Company had reserves of approximately \$150,000 and \$100,000 for such environmental contingencies. An estimate of liability in excess of this amount cannot be made.

The Company has a self-insured retention for product and general liability losses up to \$250,000 per occurrence, workers' compensation liability losses up to \$250,000 per occurrence, and for automobile liability losses up to \$50,000 per occurrence. The Company has purchased insurance to cover losses in excess of the retention up to a limit of \$30,000,000. The Company has obtained an actuarial estimate of its total expected future losses for liability claims and recorded a liability equal to the net present value of \$2,614,000 and \$2,345,000 at January 31, 2010 and 2009, respectively, based upon the Company's estimated payout period of five years using a 6.00% and 5.75% discount rate respectively.

Workers' compensation, automobile, general and product liability claims may be asserted in the future for events not currently known by management. Management does not anticipate that any related settlement, after consideration of the existing reserve for claims incurred and potential insurance recovery, would have a material adverse effect on the Company's financial position, results of operations or cash flows. Estimated payments under the self-insurance programs are as follows (in thousands):

**Year ending January 31,**

2011	\$ 650
2012	550
2013	550
2014	550
2015	550
Total	2,850
Discount to net present value	(236)
Thereafter	\$ 2,614

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

**10. Warranty**

The Company accrues an estimate of its exposure to warranty claims based upon both current and historical product sales data and warranty costs incurred. Most of the Company's products sold through January 31, 2005 carry a five-year warranty. Effective February 1, 2005, the Company extended its standard warranty period to 10 years. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary. The warranty liability is in accrued liabilities in the accompanying consolidated balance sheets. Changes in the Company's warranty liability were as follows (in thousands):

	January 31,	
	2010	2009

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Beginning balance	\$ 1,950	\$ 1,750
Provision	710	1,184
Costs incurred	(985)	(984)
Ending balance	\$ 1,675	\$ 1,950

**Table of Contents****11. Subsequent Events**

The Company has evaluated events subsequent to January 31, 2010, to assess the need for potential recognition or disclosure in this report. Such events were evaluated through the date these financial statements were issued. Based upon this evaluation, it was determined that no other subsequent events occurred that require recognition or additional disclosure in the financial statements.

**12. Quarterly Results (Unaudited)**

The Company's quarterly results for the years ended January 31, 2010 and 2009, are summarized as follows (in thousands, except per share data):

	Q1	Q2	Q3	Q4
Year ended January 31, 2010				
(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.				

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures**

Not applicable.

**Item 9A. Controls and Procedures*****Disclosure Controls and Procedures***

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in reports filed with the Commission pursuant to the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including its President and Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Assessing the costs and benefits of such controls and procedures necessarily involves the exercise of judgment by management, and such controls and procedures, by their nature, can provide only reasonable assurance that management's objectives in establishing them will be achieved.

Virco carried out an evaluation, under the supervision and with the participation of the Company's management, including its President and Chief Executive Officer along with its Chief Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures as of the end of the period covered by this Annual Report pursuant to Exchange Act Rule 13a-15. Based upon the foregoing, the Company's President and Chief Executive Officer along with the Company's Chief Financial Officer concluded that Virco's disclosure controls and procedures are effective in ensuring that (i) information required to be disclosed by the Company in the reports that it files or

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submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms and (ii) information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

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

There was no change in the Company's internal control over financial reporting during the fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. See Management's Report on Internal Control Over Financial Reporting and Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting on pages 39 and 40, respectively.

**Item 9B. Other Information**

None.



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**PART III**

**Item 10. Directors, Executive Officers of the Registrant and Corporate Governance**

Except for the information disclosed in Part 1 under the heading "Executive Officers" of the Registrant, the information required by this Item regarding directors shall be incorporated by reference to information set forth in the Company's definitive Proxy Statement to be filed within 120 days after the end of the Company's fiscal year end of January 31, 2010.

**Item 11. Executive Compensation**

The information required by this Item is incorporated by reference to information set forth in the Company's definitive Proxy Statement to be filed within 120 days after the end of the Company's fiscal year end of January 31, 2010.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by this Item is incorporated by reference to information set forth in the Company's definitive Proxy Statement to be filed within 120 days after the end of the Company's fiscal year end of January 31, 2010.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information required by this Item is incorporated by reference to information set forth in the Company's definitive Proxy Statement to be filed within 120 days after the end of the Company's fiscal year end of January 31, 2010.

**Item 14. Principal Accounting Fees and Services**

The information required by this Item is incorporated by reference to information set forth in the Company's definitive Proxy Statement to be filed within 120 days after the end of the Company's fiscal year end of January 31, 2010.

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**PART IV**

**Item 15. Exhibits, Financial Statement Schedules**

1. The following consolidated financial statements of Virco Mfg. Corporation are set forth in Item 8 of this report.

<u>Report of Independent Registered Public Accounting Firm</u>	41
<u>Consolidated balance sheets January 31, 2010 and 2009</u>	42
<u>Consolidated statements of income Years ended January 31, 2010, 2009, and 2008</u>	44
<u>Consolidated statements of stockholders equity Years ended January 31, 2010, 2009, and 2008</u>	45
<u>Consolidated statements of cash flows Years ended January 31, 2010, 2009, and 2008</u>	46
<u>Notes to consolidated financial statements January 31, 2010</u>	47

2. The following consolidated financial statement schedule of Virco Mfg. Corporation is included in Item 15:

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**VIRCO MFG. CORPORATION AND SUBSIDIARIES**  
**SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS AND RESERVES**  
**FOR THE YEARS ENDED JANUARY 31, 2010, 2009 AND 2008**

(In Thousands)

Col. A	Col. B Beginning Balance	Col. C Charged to Expenses	Col. E Deductions from Reserves	Col. F Ending Balance
Allowance for doubtful accounts for the period ended:				
January 31, 2010	\$ 200	\$ 127	\$ 127	\$ 200
January 31, 2009	\$ 200	\$ 7	\$ 7	\$ 200
January 31, 2008	\$ 200	\$ 53	\$ 53	\$ 200
Inventory valuation reserve for the period ended:				
January 31, 2010	\$ 2,150	\$	\$ 50	\$ 2,100
January 31, 2009	\$ 1,650	\$ 500	\$	\$ 2,150
January 31, 2008	\$ 1,400	\$ 250	\$	\$ 1,650
Warranty reserve for the period ended:				
January 31, 2010	\$ 1,950	\$ 710	\$ 985	\$ 1,675
January 31, 2009	\$ 1,750	\$ 1,184	\$ 984	\$ 1,950
January 31, 2008	\$ 1,750	\$ 938	\$ 938	\$ 1,750
Product, general, workers' compensation and automobile liability reserves for the period ended:				
January 31, 2010	\$ 2,345	\$ 269	\$	\$ 2,614
January 31, 2009	\$ 3,305	\$	\$ 960	\$ 2,345
January 31, 2008	\$ 2,835	\$ 470	\$	\$ 3,305
Deferred tax valuation allowance for the period ended:				
January 31, 2010	\$ 927	\$ 269	\$ 706	\$ 490
January 31, 2009	\$ 841	\$ 86	\$	\$ 927
January 31, 2008	\$ 15,591	\$	\$ 14,750	\$ 841

All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are not required under the related instructions, are inapplicable, or are included in the Financial Statements or Notes thereto, and therefore are not required to be presented under this Item.

**3. Exhibits**

See Index to Exhibits. The exhibits listed in the accompanying Index to Exhibits are filed as part of this report.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

VIRCO MFG. CORPORATION

Date: April 16, 2010

By: /s/ Robert A. Virtue  
Robert A. Virtue  
Chairman of the Board and Chief Executive  
Officer

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KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Robert A. Virtue and Robert E. Dose his/her true and lawful attorney-in-fact and agent, with full power of substitution and, for him/her and in his/her name, place and stead, in any and all capacities to sign any and all amendments to this report on Form 10-K, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he/she might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, or his/her substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
/s/ Robert A. Virtue Robert A. Virtue	Chairman of the Board, Chief Executive Officer, President and Director (Principal Executive Officer), Director	April 16, 2010
/s/ Douglas A. Virtue Douglas A. Virtue	Executive Vice President, Director	April 16, 2010
/s/ Robert E. Dose Robert E. Dose	Vice President Finance, Secretary and Treasurer (Principal Financial Officer)	April 16, 2010
/s/ Bassey Yau Bassey Yau	Corporate Controller (Principal Accounting Officer)	April 16, 2010
/s/ Donald S. Friesz Donald S. Friesz	Director	April 16, 2010
/s/ Thomas J. Schulte Thomas J. Schulte	Director	April 16, 2010
/s/ Robert K. Montgomery Robert K. Montgomery	Director	April 16, 2010
/s/ Albert J. Moyer Albert J. Moyer	Director	April 16, 2010
/s/ Glen D. Parish Glen D. Parish	Director	April 16, 2010

Glen D. Parish

/s/ Donald A. Patrick

Director

April 16, 2010

Donald A. Patrick

/s/ James R. Wilburn

Director

April 16, 2010

James R. Wilburn

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**VIRCO MFG. CORPORATION  
EXHIBITS TO FORM 10-K ANNUAL REPORT  
For the Year Ended January 31, 2010**

Exhibit Number	Description
3.1	Certificate of Incorporation of the Company dated April 23, 1984, as amended (incorporated by reference to Exhibit 4.4 to the Company's Form S-8 Registration Statement (Commission File No. 33-65098), filed with the Commission on June 25, 1993).
3.2	Amended and Restated Bylaws of the Company dated September 10, 2001 (incorporated by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q (Commission File No. 001-08777), filed with the Commission on September 14, 2001).
4.1	Rights Agreement dated as of October 18, 1996, by and between the Company and Mellon Investor Services (as assignee of The Chase Manhattan Bank), as Rights Agent incorporated by reference to Exhibit 1 to the Company's Form S-8 Registration Statement (Commission File No. 001-08777), filed with the Commission on October 25, 1996.
4.2	Amendment dated as of April 30, 2007 by and between the Company and Mellon Investor Services LLC to the Rights Agreement by and between the Company and The Chase Manhattan Bank dated as of October 18, 1996, as incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q filed with the Commission on June 8, 2007.
10.1	Form of Virco Mfg. Corporation Employee Stock Ownership Plan (the "ESOP") (incorporated by reference to Exhibit 4.1 to the Company's Form S-8 Registration Statement (Commission File No. 33-65098), filed with the Commission on June 25, 1993).
10.2	Trust Agreement for the ESOP (incorporated by reference to Exhibit 4.2 to the Company's Form S-8 Registration Statement (Commission File No. 33-65098), filed with the Commission on June 25, 1993).
10.3	Form of Registration Rights Agreement for the ESOP (incorporated by reference to Exhibit 4.3 to the Company's Form S-8 Registration Statement (Commission File No. 33-65098), filed with the Commission on June 25, 1993).
10.5	1993 Stock Incentive Plan of the Company (incorporated by reference to Exhibit 4.1 to the Company's Form S-8 Registration Statement (Commission File No. 33-65098), filed with the Commission on June 1993).
10.6	Lease dated February 1, 2006, between FHL Group, a California Corporation, as landlord and Virco Mfg. Corporation, a Delaware Corporation, as tenant (incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed with the Commission on February 3, 2006).
10.7	Amended and Restated Credit Agreement dated as of January 27, 2004, between the Company and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K filed with the Commission on January 30, 2004).
10.8	Amendment No. 2 to Amended and Restated Credit Agreement dated as of January 21, 2006, between the Company and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 99.2 to the

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Company's Current Report on Form 8-K filed with the Commission on January 27, 2006).

- 10.9 Subsidiary Guaranty dated as of January 27, 2004, by Virco Mgmt. Corporation in favor of Wells Fargo Bank, National Association (incorporated by reference to Exhibit 99.3 to the Company's Current Report on Form 8-K filed with the Commission on January 30, 2004).
- 10.10 Subsidiary Guaranty dated as of January 27, 2004, by Virco, Inc. in favor of Wells Fargo Bank, National Association (incorporated by reference to Exhibit 99.4 to the Company's Current Report on Form 8-K filed with the Commission on January 30, 2004).



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Exhibit Number	Description
10.11	Amended and Restated Security Agreement dated as of January 27, 2004, among the Company, Virco Mgmt. Corporation, Virco, Inc. and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 99.7 to the Company's Current Report on Form 8-K filed with the Commission on January 30, 2004).
10.12	Revolving Line of Credit Note dated March 26, 2007, between the Company and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 10.12 to the Company's Form 10-K filed with the Commission on April 16, 2007).
10.13	Term Note dated March 26, 2007, between the Company and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 10.13 to the Company's Form 10-K filed with the Commission on April 16, 2007).
10.14	Amendment No. 4 to Amended and Restated Credit Agreement dated as of March 26, 2007, between the Company and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 10.4 to the Company's Form 10-K filed with the Commission on April 16, 2007).
10.15	Stock Purchase Agreement dated June 6, 2006, between the Company and Wedbush, Inc. and Wedbush Morgan Securities, Inc. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on June 8, 2006).
10.16	Warrant Agreement dated June 6, 2006, between the Company and Wedbush, Inc. (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the Commission on June 8, 2006).
10.17	Warrant Agreement dated June 6, 2006, between the Company and Wedbush Morgan Securities, Inc. (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the Commission on June 8, 2007).
10.18	Amended Stock Purchase Agreement dated August 29, 2006, between the Company and Steve Presley, Ed Gyenes, Nick Wilson, Scotty Bell, Patty Quinones, Eric Nordstrom, Larry Maddox, James Simms, Bassey Yau, Robert Virtue, Doug Virtue and Evan Gruber (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed with the Commission on December 11, 2006).
10.19	Design Agreement dated January 21, 2008, between the Company and Peter Glass Design, LLC, and Hedgehog Design, LLC. (incorporated by reference to Exhibit 10.1 and 10.2 to the Company's Current Report on Form 8-K filed with the Commission on January 25, 2008).
10.20	Second Amended and Restated Credit Agreement, dated as of March 12, 2008, between Virco Mfg. Corporation and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on March 24, 2008).
10.21	Revolving Line of Credit Note, dated as of March 12, 2008, by Virco Mfg. Corporation in favor of Wells Fargo Bank, National Association (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the Commission on March 24, 2008).

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- 10.22 Master Reaffirmation Agreement, dated as of March 12, 2008, among Virco Mfg. Corporation, Virco Mgmt. Corporation, Virco Inc. and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the Commission on March 24, 2008).
- 10.23 Amended and Restated Mortgage, dated as of March 12, 2008, by Virco Mfg. Corporation in favor of Wells Fargo Bank, National Association (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed with the Commission on March 24, 2008).

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Exhibit Number	Description
10.24	Amendment No. 1 to the Second Amended and Restated Credit Agreement, dated as of July 31, 2008, between Virco Mfg. Corporation and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10Q filed with the Commission on September 9, 2008).
10.25	Amendment No. 2 to Second Amended and Restated Credit Agreement, dated as of March 27, 2009, by Virco Mfg. Corporation and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 10.25 to the Company's Annual Report on Form 10K filed with the Commission on April 16, 2009).
10.26	Lease amendment dated August 14, 2008, between AMB Property, L.P., a Delaware Limited Partnership, as landlord and Virco Mfg. Corporation, a Delaware Corporation, as tenant (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10Q filed with the Commission on September 9, 2008).
10.27*	Amendment No. 3 to Second Amended and Restated Credit Agreement, dated as of March 27, 2009, by Virco Mfg. Corporation and Wells Fargo Bank, National Association.
21.1*	List of All Subsidiaries of Virco Mfg. Corporation.
23.1*	Consent of Independent Registered Public Accounting Firm.
31.1*	Certification of the Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of the Chief Financial Officer Pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350.

\* Filed herewith.