Virco Mfg. Corporation

2000 Annual Report

Company Profile

Virco Mfg. Corporation, founded in 1950 and headquartered in Torrance, California, is a leader in the furniture manufacturing industry and the nation's largest producer of educational furniture.

value:

It's the relationship between what you pay and what you get. Since 1950, we've responded to our customers' needs for maximum value.

products

availability

quality

reliability

service

price

2000 Annual Report

1 Financial Highlights

2 To Our Stockholders

16 Management's Statement

17 Management's Discussion and Analysis and Results of Operations

23 Five Year Summary of Selected Financial Data

24 Report of Independent Auditors

25 Consolidated Balance Sheets

27 Consolidated Statements of Income

28 Consolidated Statements of Stockholders' Equity

29 Consolidated Statements of Cash Flows

30 Notes to Consolidated Financial Statements

43 Supplemental Stockholders' Information

44 Directors, Officers and Facilities

Financial Highlights

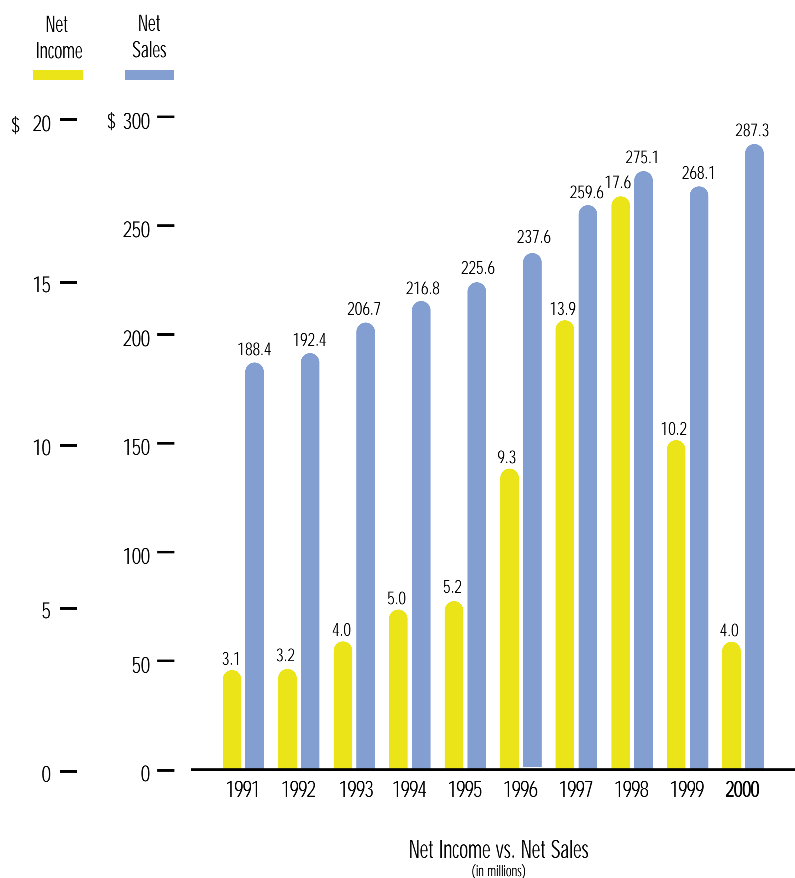
In thousands, except per share data	2000	1999	1998	1997	1996	1995	1994	1993	1992	1991
Summary of Operations										
Net sales - continuing operations (3, 4)	$ 287,342	$ 268,079	$ 275,096	$ 259,586	$ 237,551	$ 225,559	$ 216,822	$ 206,738	$ 192,356	$ 188,395
Net income										
Continuing operations	4,313	10,166	17,630	13,852	9,326	5,209	5,001	4,302	3,827	3,453
Discontinued operations	–	---	---	---	---	---	–	–	(668)	(347)
Change in accounting methods	(297)	---	---	---	---	–	–	(275)	–	–
	$ 4,016	$ 10,166	$ 17,630	$ 13,852	$ 9,326	$ 5,209	$ 5,001	$ 4,027	$ 3,159	$ 3,106
Net income per share (1)	$ 0.35	$ .87	$ 1.45	$ 1.14	$ 0.78	$ 0.44	$ 0.42	$ 0.34	$ 0.27	$ 0.26
Stockholders' equity	94,141	93,834	88,923	77,077	63,921	55,386	50,466	45,637	41,937	39,164
Stockholders' equity per share (2)	8.34	8.26	7.62	6.52	5.42	4.70	4.29	3.88	3.56	3.33

(1) Based on average number of shares outstanding each year after giving retroactive effect for stock dividends and 3 for 2 stock split.

(2) Based on number of shares outstanding at year-end giving effect for stock dividends and 3 for 2 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 year ended January 31, 2001.

(4) During the fourth quarter of 2000, 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.



Net Income vs. Net Sales
(in millions)

Net sales increased 7.2% in fiscal 2000, but earnings declined from $10,200,000 to $4,000,000. Higher operating costs and unnecessarily low prices contributed equally to the deterioration in profitability. Both issues have been addressed, the first with a corporate reorganization completed in December, 2000, and the second with a general price increase that has resulted in improved margins early in 2001.

To Our Stockholders

Robert A. Virtue
President and CEO

Our performance for the year 2000 was, on the whole, disappointing. Sales increased 7.2% from $268,079,000 to $287,342,000, but profits declined from $10,166,000 to $4,016,000. Included in the profit figures were one-time gains from the sale of our former Torrance warehouse, recorded in April, 2000, and the settlement of a claim, recorded in October. Absent these gains, we would have recorded a loss from continuing operations of approximately $3,400,000.

I want to begin by reassuring you that these results were not due to any fundamental changes in our markets or our business model. We simply moved too slowly on a long-planned corporate consolidation, and we committed the error of lowering prices to try and fill up our new factory. Both of these matters have been addressed.

For over thirty years Virco's Conway and Torrance divisions functioned as independent profit centers, with their own production plans, inventories and pricing practices. Autonomous management teams in each division were rewarded for achieving profits that were heavily dependent on both sales volume and overhead absorption. This autonomy had the unintended effect of sometimes fostering pricing competition between the two divisions.

As more of our customers became national in scope, the inconsistencies in product, pricing and service created by this structure became untenable. We found in many cases that we were our own worst enemy, with sales representatives in one division losing orders to another Virco rep halfway across the country. We also incurred significant duplicate costs in the form of inventories and staffs that were maintained for separate divisional reasons at the expense of overall corporate results.

We had planned to execute two consolidations in early 2000, one between the Conway and Torrance divisions, and the other within the Conway division itself, where we were operating a total of three factories, seven warehouses, a truck repair shop and an outlet store. We did not complete these consolidations until December, 2000, which caused us to operate for virtually the entire year with excessive staffs and inventories.

Our Mojave™ line of modular furniture provides solutions for today's technology-driven offices and classrooms.

products

Virco's diverse product lines incorporate innovative features designed to satisfy the specific needs of our customers.

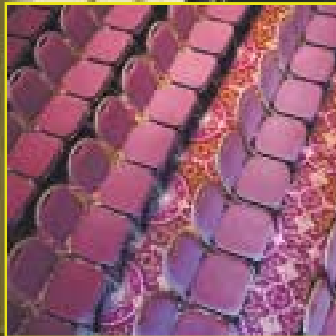
Vespers® chairs replace pews in multi-use sanctuaries.

Classic Series™ chair desks: the foundation of America's classrooms.

From classrooms to convention centers, our Quick Ship program gets customers the furniture they need when they need it.

availability

Thanks to the largest educational and commercial Quick Ship program in the industry, availability is a hallmark of Virco furniture.



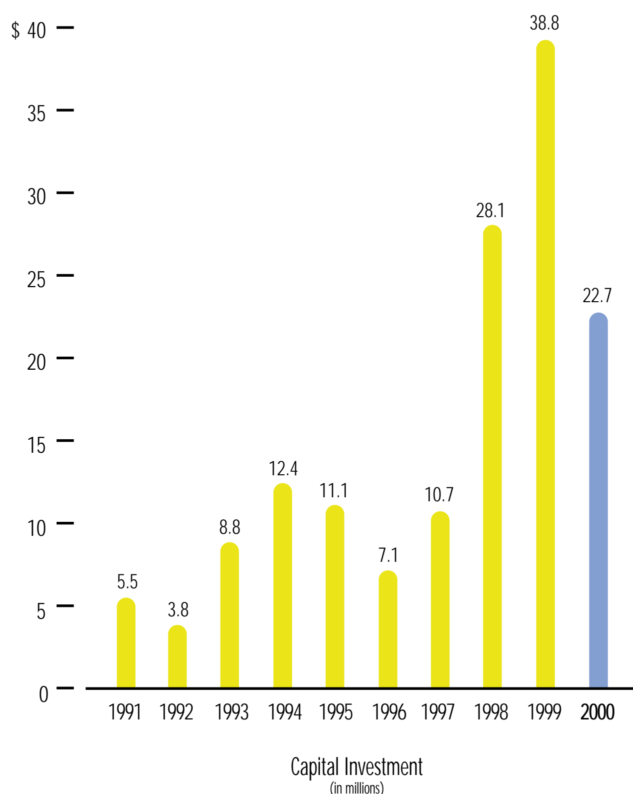
Traditional hospitality seating.

Core-a-Gator®: finest lightweight folding tables available.

To Our Stockholders (continued)

Corporate operating expenses have now been reduced to approximately the same levels as 1999, adjusted for sales volume. We define operating expenses as all costs except raw material. Included are payroll, insurance, utilities, leases, interest, depreciation, amortization, outside services such as auditing and consulting, etc. This total measure of the company's underlying cost structure is the best indicator we have of efficiency.

Our new facility in Conway, especially the 800,000 square foot, high-cube warehouse, allowed us to close five other leased warehouses located nearby. A sixth warehouse, our former woodshop, is now for sale. Shipping out of a single warehouse will eliminate non-productive material handling between buildings and concentrate the abilities of our distribution team. We also expect to see a reduction in damage and shipping lead times.



Capital Investment
(in millions)

A major cycle of capital investment concluded in 2000, positioning Virco for several years of growth with only limited additional investment. Major projects included the completion of our 800,000 square foot warehouse in Conway, Arkansas, and an upgrade to our SAP management information system. Capital expenditures are budgeted at $7,000,000 for fiscal 2001, which is roughly half our total depreciation of $14,000,000 per year. This effectively contributes the difference, or $7,000,000, to available cash flow. We plan to maintain this reduced rate of investment for the next three years, using the surplus cash to pay down debt.

Our larger-scale corporate restructuring, necessary for both cost control and customer service reasons, was feasible at least in part because of SAP, the management information system we implemented in 1999. Our old legacy system was actually two systems, with both Conway and Torrance running their own mainframes and similar, but individualized software. This made true corporate unification impossible, and argued strongly for an integrated, enterprise-wide operating system like SAP. We are now beginning to take advantage of its capabilities, with new functionality such as Sales Force Automation that allows our field sales representatives and their customers to log directly into the system for order entry, inventory checks and product information.

Although the reorganization has returned operating expenses to appropriate levels, we think the greater benefits will be in morale and customer service. For the first time in our history, all managers are working under a unified incentive plan focused on consolidated corporate profit. This has already led to much greater cooperation between the two divisions, including aggressive sharing of inventories, a standardized national pricing strategy, and cooperation between sales and marketing representatives.

The second error we made in 2000 was not charging enough for our products and services. Thinking of overhead absorption first, we tried to achieve rapid utilization of our new Conway factory with price reductions. Unfortunately, we re-learned two lessons that we thought we had mastered in the mid-1990's, namely, that all costs are variable, including the costs of so-called "marginal business", and that in our markets it is nearly impossible to generate meaningful additional volume merely through discounting.

The majority of our public and private facility manager/customers are not making discretionary purchases based on opportunistic pricing. Rather, they are filling specific needs, often through the public bid process, where it makes little sense for us to be lower than low bid. Our unnecessarily low prices last year were caused by internal mistakes of judgment, not competitive pressures that will put a long-term lid on margins.

Because our customers' contracts take effect at different times of the year, the effect of the increase is difficult to estimate. So far we have seen a slight improvement in incoming order margins. By mid-summer, when the bulk of our orders are received, we will have a clearer picture of the actual impact of our pricing schedules.

Intelligent ergonomics and a reasonable price: our I.Q.® chairs pass the test.

quality

Virco combines the insights of leading designers with proven manufacturing techniques to deliver unsurpassed product quality.

Vespers® seating for places of worship.

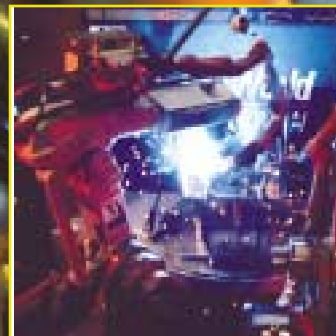
Virtuoso® chairs: clever comfort.

Nested desk frames illustrate the concept of Assemble-to-Ship: standard components densely stacked, awaiting assembly to match customer specifications.

reliability

The finest raw materials and superior workmanship give Virco products their distinctive reliability.

Reliability starts with our people.

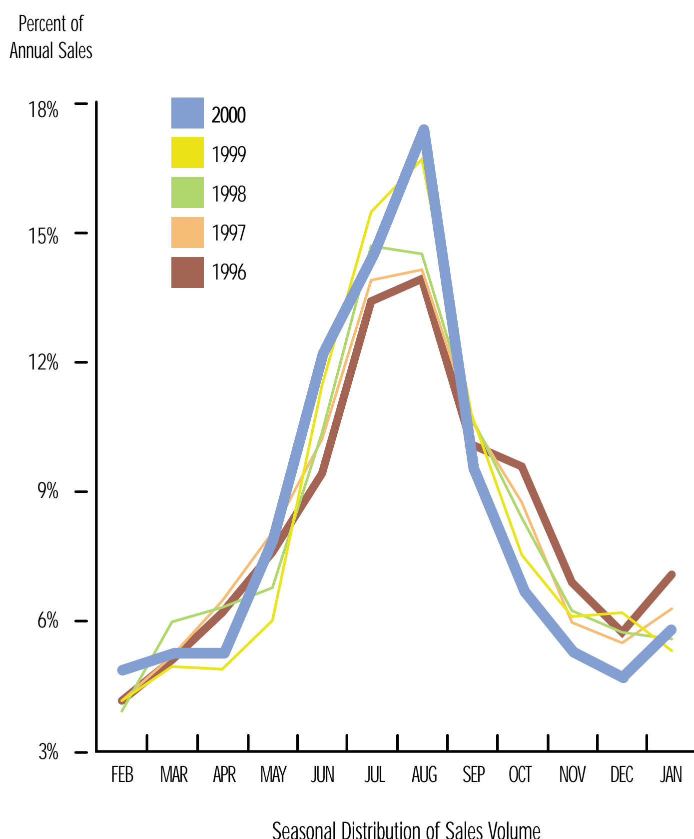


Modern manufacturing: repeatable reliability.

As reported in both our third and fourth quarters, higher prices have not caused us to lose any significant customers. On the contrary, we have added several key accounts, including the New York Public Schools; Clark County Public Schools (Las Vegas, Nevada); and the Chicago Public Schools.

Incoming orders at the end of April, 2001, were trailing last year's by 9%. We believe this reflects the growing seasonality of the public school market, and not an underlying deterioration of demand. However, if incoming order rates do not improve by late May, we are prepared to reduce production levels and associated costs to match customer demand.

The overwhelming reality of our business is depicted in the graph below. With each passing year, more of our shipping volume has been compressed into the three months of June, July and August. This pattern is exacerbated by a similar compression of incoming orders, which used to peak in May and now peak in July. Advanced visibility of customer needs has been proportionately reduced, forcing us to develop production schedules based on prior sales history and recent bid results.



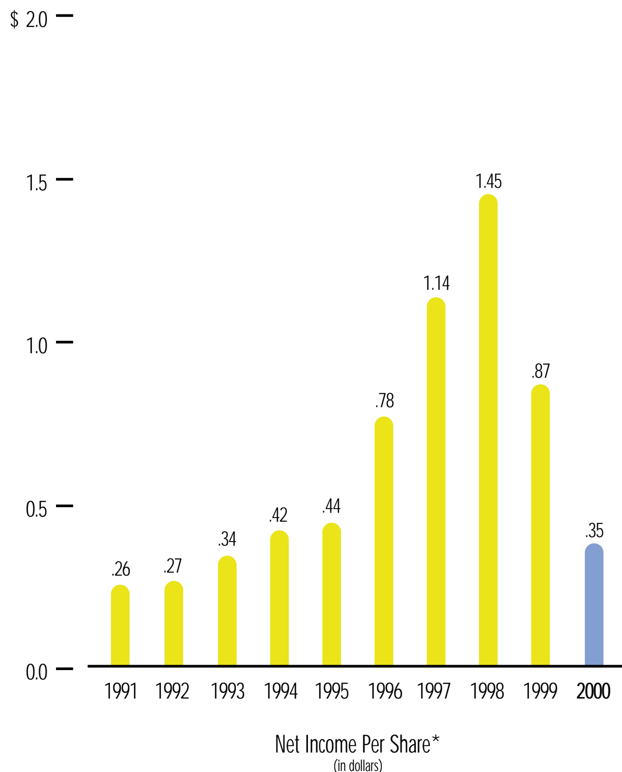
Seasonal Distribution of Sales Volume

The seasonality of our business continued to intensify in 2000. This reflects the needs of our public school customers, who prefer to receive their furniture when students are on summer vacation. An associated compression of incoming orders, which used to peak in May but now peak in July, has encouraged us to develop new methods of forecasting and production. Assemble-to-Ship, described in this report, uses stockpiles of standard components that can be configured to match customer specifications immediately prior to shipment. Our continued ability to manage this seasonal spike is one of our greatest competitive strengths.

This seasonality reflects the traditional calendar of the majority of our public school customers. It also reflects their growing reluctance to place purchase orders until annual budgets are approved, which generally occurs on or about July 1.

The compression of business activity puts a considerable financial strain on us and our competitors. The need to build inventory during the off-season has made financing an increasingly important element of competition.

Concepts such as Just-in-Time (JIT), which companies in other industries have used as an alternative to building inventory, do not work with a 4:1 seasonal shipping ratio like we have. The simple challenge of hiring enough temporary labor to quadruple output while maintaining quality is difficult enough. The additional capital demands created by having sufficient peak production capacity simply make JIT unworkable for us.



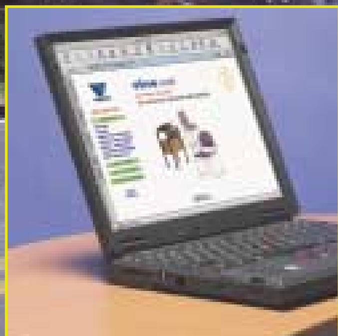
Excessive costs and low prices contributed to a second year of reduced earnings per share. Both of these issues have been addressed, which should return the company to a positive cycle of earnings growth similar to that of the late 1990's.

** Based on average number of shares outstanding each year after giving retroactive effect for stock dividends and 3 for 2 stock split.*

Virco's own fleet is part of an integrated service chain, from manufacturing to installation.

service

Virco's dedicated sales force, in-house service and installation team, industry-leading Quick Ship program and interactive website define our commitment to customer service.



Customer Self-Service via virco.com.

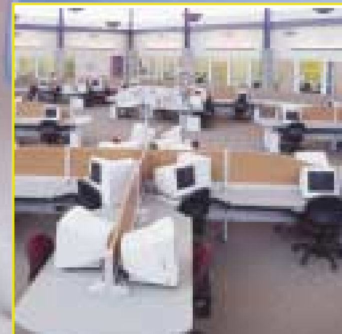
Furniture awaiting the summer rush.

From technology support to the traditional classroom, Virco supplies furniture for learning.

price

The acid test of the value equation is repeat business. It confirms that we've achieved the right balance between price and customer needs.

Plateau® tables and Virtuoso® chairs.



Mojave™ technology stations with Egg® chairs.

We have struggled to come up with practical ideas about how to balance seasonality, financial performance and quality without sacrificing service or market share. Since 1995, when we completed the relocation of our old Los Angeles plant to Torrance, we have been refining an operating model we now call Assemble-to-Ship (ATS). We think ATS offers a better solution to seasonality than JIT or other alternatives.

ATS is our version of the mass-customization recently made popular by Dell Computer, which assembles standard, stocked components into customized configurations moments before shipment. In our case, the concept is complicated by the bulkiness and relatively low value of our furniture. An interesting fact is that we average only about $1.75 per pound across all of our product lines, as opposed to something like $150-$200 per pound for a laptop computer.

Nonetheless, ATS held such promise during initial trials at Torrance that we designed the new Conway factory and warehouse to function under this model. ATS 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 costly assembly until the last moment, and reducing the amount of warehouse space needed to store finished goods.

In addition to changing the way we think about product and communicate its availability to our customers, ATS has encouraged an additional adaptation in the form of seasonal reassignments of employees. This year we will be offering seasonal pay increases for volunteers who transfer from fabrication to assembly and transportation jobs during the summer. In coming years, we intend to seasonalize much of our workforce by running component fabrication at peak levels during the fall, winter and spring, then shifting a number of employees to assembly and transportation in June.

As with all major initiatives involving our workforce, we are being careful to communicate and train before moving forward. The full benefits of ATS are probably several years away, but we are confident that it provides an additional tool to compete successfully in this very difficult environment. This year we expect to support only about one-third of our total volume through ATS, while the remainder will be supported with traditional finished goods. As we move forward, several of our older product lines will be re-engineered to take advantage of the ATS concept. All new product lines are being developed with the maximum versatility of components in mind.

To Our Stockholders (continued)

It is appropriate here to thank our partner, Wells Fargo Bank, for their support of our operating strategy and new ideas such as ATS. They have taken the time to understand our business and provide the crucial working capital to help it succeed.

Several investors have asked for a clarification of our business model. We have developed a graphic representation of it that we call The Value Equation. We use it both to tell customers the advantages of doing business with Virco, and to periodically check the relationship of our activities (and associated costs) to our customers' needs. Here is the equation:

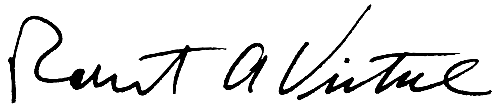
$$\text{Value} = \frac{\text{Products} + \text{Availability} + \text{Quality} + \text{Reliability} + \text{Service}}{\text{Price}}$$

It's crucial to understand that in this equation, our customers assign the relative importance, and therefore the value, to everything from our furniture to our services. If we engage in activities that don't improve the value equation but result in increased expense, we undermine our competitive position. We did a certain amount of that last year by adding the fixed costs of the Conway facility and SAP without a rapid, offsetting consolidation of corporate expense. Our poor execution in no way invalidates the value equation; in fact, it reinforces the equation's unyielding nature and encourages us not to make the same mistakes again.

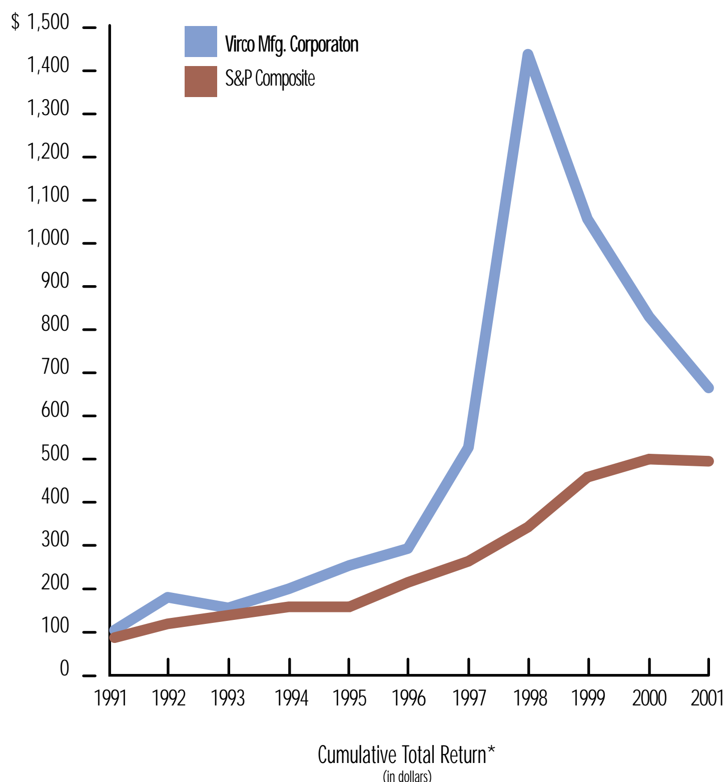
Virco is not a company that retools its business model every few years. We also don't generate predictable results quarter-to-quarter because of our seasonal business, which is why we refuse to offer earnings guidance. In evaluating whether Virco is a suitable investment, you should be aware that we execute our strategy on a very long timeline, typically five years or more, and that we are probably unable to accelerate this cycle.

The chart to the right compares Virco's stock performance, including the assumed reinvestment of cash and stock dividends, with the Standard and Poors 500 over the past decade. It shows that although our stock has behaved somewhat erratically, on the whole it has proven to be comparable or slightly better than the S&P composite. By making this comparison we are not guaranteeing any results, since we can neither predict the future of the stock market nor our performance relative to it.

As always, I want to thank all of you for your support. Never is it more appreciated than following a tough year like the one we just had. You can be certain that our dedicated, experienced employees are doing everything possible to return Virco to traditional levels of profitability.



Robert A. Virtue
President and CEO



Cumulative Total Return*
(in dollars)

Assuming reinvestment of both cash and stock dividends, a $100 investment in Virco made in 1991 would be worth over $650 today. The same investment in the Standard and Poors Composite would be worth slightly less than $500. Although it yields somewhat uneven results, we believe our long-term strategy, executed in 5- to 10-year cycles, provides us with sufficient competitive advantages. As an investment, Virco is probably most appropriate for investors with a similar long-term approach.

** Assumes $100 invested on 1/31/1991. Assumes dividend reinvested fiscal year ending 1/31/2001.*

Source: Data provided by Media General Financial Services.

Management's Statement

The financial statements of Virco Mfg. Corporation were prepared by management, which is responsible for the integrity and objectivity of the data presented, including amounts that must necessarily be based on judgments and estimates. The statements were prepared in conformity with accounting principles generally accepted in the United States, and in situations where acceptable alternative accounting principles exist, management selected the method that was most appropriate in the circumstances.

Virco depends upon the Corporation's system of internal controls in meeting its responsibilities for reliable financial statements. This system is designed to provide reasonable assurance that assets are safeguarded and transactions are properly recorded and executed in accordance with management's authorization. Judgments are required to assess and balance the relative cost and expected benefits of these controls.

The financial statements have been audited by our independent auditors, Ernst & Young LLP. The independent auditors provide an objective, independent review as to management's discharge of its responsibilities insofar as they relate to the fairness of reported operating results and financial condition. They obtain and maintain an understanding of Virco's accounting and financial controls, and conduct such tests and procedures, as they deem necessary to arrive at an opinion on the fairness of the financial statements.

The Audit Committee of the Board of Directors, which is composed primarily of Directors from outside the Company, maintain an ongoing appraisal of the effectiveness of audits and the independence of the auditors. The Committee meets periodically with the auditors and management. The independent auditors have free access to the Committee, without management present, to discuss the results of their audit work and their opinions on the adequacy of internal financial controls and the quality of financial reporting.

Based on a review and discussions of the Company's 2000 audited consolidated financial statements with management and discussions with the independent auditors, the Audit Committee recommended to the Board of Directors that the Company's 2000 audited consolidated financial statements be included in the Company's annual report in Form 10-K. The Board of Directors concurred.

Management's Discussion and Analysis and Results of Operations

Revenue and Income

2000 vs. 1999

For the year ended January 31, 2001, sales increased 7.2% to $287,300,000, compared to $268,100,000 for the same period last year. Approximately 90% of the increase in sales for the year ended January 31, 2001, was from education sales, with the balance from commercial sales. The increase in revenues was attributable to the Company pursuing an aggressive pricing policy during the educational bidding season of late 1999/early 2000. The attained sales growth was substantially less than the Company had planned to achieve with this pricing strategy.

Education sales, which are primarily composed of sales to publicly funded K-12 schools and represent 64% of corporate revenues, increased by $17,300,000 to $184,100,000 from $166,800,000 in the prior year. Sales of our newer computer furniture, Plateau® tables, Core-a-Gator® lightweight folding tables, mobile tables and mobile cabinets improved, as did many of our older product lines. Due to aggressive pricing, the sales increase was achieved primarily by unit volume, not price increases.

Virco's commercial sales include private schools, pre-schools, churches, convention centers, agencies at city, county, state and federal levels, furniture distributors, retailers and catalog retailers. Commercial sales, which represent 36% of corporate revenues, increased by $1,900,000 to $103,200,000 from $101,300,000 in the prior year. The breadth of Virco's product line for target niche markets, and the continuing success of its Quick Ship stocking program favorably affected sales for the commercial sales channels.

During the 1999 fiscal year, the Company initiated production at a new manufacturing plant and implemented a new enterprise resources planning system. The combined effect of these two significant events resulted in inadequate levels of customer service during the summer of 1999. In addition, the new manufacturing facility provided the Company with enhanced capacity to support a substantial sales increase. In order to address both of these concerns, the Company pursued two objectives in 2000, which adversely affected gross margins. The first objective was to substantially improve the levels of customer service by increasing the stocking plan for inventories to ensure better service during the summer delivery season. The second objective was to increase sales and utilize the new factory capacity through aggressive pricing. To support these two objectives, the Company ran its factories at high levels of output for the first eight months of the year in order to build to the enhanced stocking plan and in anticipation of increased sales. The aggressive pricing strategy did increase sales, but not to the extent anticipated. In order to return inventories to more normal levels, the Company significantly reduced production in the third and fourth quarters, resulting in unfavorable manufacturing variances. The Company reduced its work force and spending in the fourth quarter, but not in time to prevent the decline in manufacturing efficiency related to the sharply curtailed production levels. The aggressive pricing strategy affected the entire sales volume, not only at the margin, and the Company experienced a slight reduction in prices for the year, while absorbing cost increases related to some materials, labor and benefit costs, and additional capacity from the plant expansion. As a result of the events described above, gross profits for the year ended January 31, 2001, as a percent of sales, decreased by 5.5% to 29.1% from 34.6% in the prior year.

Selling, general and administrative expense for the year ended January 31, 2001, increased both in total dollars and as a percentage of sales compared to the same period last year. The higher selling, freight and warehousing expense was primarily attributable to growth in unit sales volume, increased freight rates, costs incurred during the consolidation of our Conway warehouses, and reduction in selling prices, which increased these costs as a percentage of sales. The increase in general and administration expense was primarily attributable to greater depreciation expense, as well as system maintenance services, training costs and other expenses relating to the implementation of sales force automation, a business-to-business website, and an upgrade of the Company's SAP enterprise resource planning system.

Interest expense increased by $2,577,000 for the year ended January 31, 2001, compared to the same period last year. This was attributable to increases in interest rates during the year, and a larger average borrowing balance due to increased levels of inventory and the completion of the Company's capital expansion in Conway, Arkansas.

In December, the Company announced a corporate reorganization and reduction in force. As part of this reorganization, the Company reduced its workforce by 141 employees. This reduction was distributed proportionately among managerial, administrative, and support positions at both divisions and at the Corporate headquarters. The reduction in force did not include any direct labor. In the fourth quarter ended January 31, 2001, the Company incurred approximately $1,500,000 in severance costs related to this reduction in force.

Management's Discussion and Analysis and Results of Operations

1999 vs. 1998

For the year ended January 31, 2000, sales declined 2.6% to $268,100,000, compared to $275,100,000 for the same period last year. The Company believes two factors contributed to the decline in sales. First, the Company experienced some very aggressive regional price competition that resulted in a slight reduction in year-to-date educational sales. Second, sales and orders of commercial furniture declined as a result of the Company's strategic decision to reduce business with mass merchandisers. This decision, which was initiated in 1995, was substantially completed in 1999. The Company does not anticipate further significant impact on sales volume relating to this market segment. The reduction in sales to mass merchandisers has been partially offset by increases in sales to hospitality markets, convention centers, churches, and the General Services Administration. The Company continues to believe that its long-term interests will be served by avoiding the low-margin mass merchandising commodity business and emphasizing higher margin products and customers. For 1999, the Company continued to be more selective and more disciplined in the business it pursued in terms of product mix, customer mix and pricing in order to emphasize profitable business, rather than pursue sales volume increases. As the Company has grown in more profitable markets and products, it has reduced business in certain commodity type products, which typically generate lower profit margins.

Education sales, which represented 62% of corporate revenues, decreased slightly by $1,400,000 to $166,800,000 from $168,200,000 in the prior year. Sales of the Company's newer computer furniture, its line of Core-a-Gator® lightweight folding tables and mobile tables improved, but were offset by reductions in some older product lines.

Commercial sales, which represented 38% of corporate revenues, decreased by $5,500,000 to $101,300,000 from $106,800,000 in the prior year. Commercial sales were affected more significantly by the Company's efforts to reduce sales to mass merchandisers. The reduction in business to mass merchants was partially offset by an increase in sales to other markets. Sales of Core-a-Gator® lightweight tables, the breadth of the Company's product line for target niche markets, and the continuing success of Virco's Quick Ship stocking program favorably affected sales for the other commercial sales channels.

Gross profits for the year ended January 31, 2000, as a percent of sales, were comparable to the prior year. During 1999, the Company incurred increased overhead costs related to the start up of the new factory in Conway, Arkansas. These increased overhead costs were offset by a more favorable product mix and stable material costs.

Selling, general and administrative expense for the year ended January 31, 2000, increased both in total dollars and as a percentage of sales compared to the same period last year. The increase in selling, general and administrative expense was partially attributable to product mix. The reduction in mass merchant business, which was typically sold FOB factory, was replaced in part by sales to commercial customers, which frequently include freight and installation. In addition, the inefficiencies related to the plant start up mentioned above, combined with the concurrent "go live" of the SAP system, contributed to some additional costs incurred in the delivery and installation of furniture. The Company also incurred additional selling expenses relating to the hiring of additional direct sales representatives and product development expenses. The rise in general and administration expense was primarily attributable to an increase in depreciation expense, system maintenance services, training costs and other expenses relating to the implementation of an SAP enterprise resources planning system.

Interest expense increased by $1,300,000 for the year ended January 31, 2000, compared to the same period in the prior year. The increase was attributable to a higher average borrowing balance offset by interest capitalized relating to assets under construction.

Other Operating Activities

In August 1997, the Board of Directors authorized an expansion and re-configuration of the Conway, Arkansas, manufacturing and distribution facilities. In late 1997 and early 1998, the Company acquired approximately 100 acres of land in Conway, which can support up to 1,700,000 sq. ft. of manufacturing, warehousing, office, and showroom facilities. Phase one of the project consisted of a 400,000 sq. ft. manufacturing plant and was completed in March 1999. This plant replaced an existing 150,000 sq. ft. facility, providing an additional 250,000 sq. ft., which was earmarked for new manufacturing processes to support product development efforts, as well as future growth in sales. This plant utilizes a manufacturing cell concept, which has proved successful in the Company's Torrance, California facility. The Conway manufacturing facility contains new equipment, which was selected to improve manufacturing efficiency and flexibility, as well as improve product quality. In March 1999, substantially all of the production equipment from the existing 150,000 sq. ft. facility was transferred to the new plant. New processes and equipment are being brought on line, as capacity and process requirement demand. The 150,000 sq. ft. facility, which is adjacent to the main factory in Conway, was converted to a finished goods warehouse.

Phase two of the Conway project consists of an 800,000 sq. ft. assembly, warehouse and distribution facility. Construction on the first 400,000 sq. ft. segment began in March 1999 and was completed and fully operational in December 1999. The Company vacated two rental facilities in late 1999 with the completion of this first segment. The second segment was substantially completed in July 2000. With the completion of the second segment, the Company vacated two additional rental facilities in November 2000, as well as a building which was sold subsequent to fiscal year end, and a building in Newport, Tennessee, which is held for sale. The final stage of this consolidation will occur when the Company sells a 150,000 sq. ft. manufacturing plant located in Conway. The Company converted this plant to a finished goods warehouse in 1999 and expects to store finished goods at this location until the building is sold.

This new production and manufacturing complex will enable the Company to pursue manufacturing strategies which are expected to support growth in sales volume without a proportional increase in inventory. In addition, it will allow all finished goods manufactured at Conway to be stored in one location, and substantially reduce costs related to material handling. Conway's warehouse facility has been equipped with high-density storage systems, features over 70 dock doors dedicated to out-bound freight, and has substantial yard capacity for storing and staging trailers. The Company believes that this facility will significantly improve its ability to support increased sales during the peak delivery season and enhance the efficiency with which orders are filled.

On March 1, 1999, the Company went live with its newly implemented ERP system. As a result of this installation, the Company incurred additional depreciation and support costs, and experienced some inefficiencies related to production scheduling, distribution, and installation of furniture.

In the first quarter of 2000, the Company distributed laptop computers to its entire sales force to provide them with an efficient link between Virco's factories and customers. At the same time, the Company unveiled its new business-to-business website designed to provide Virco's sales force and existing customers with the ability to access the Company's ERP system through the Internet. In November 2000, the Company successfully upgraded the ERP system to the most current version of the SAP application software, as well as more current versions of Oracle database and UNIX operating systems. These significant investments in technology have entailed a considerable cost to the Company; not just in cash, but in the extraordinary amount of management time and effort necessary to implement information systems. The Company is beginning to realize benefits from this investment, and will continue to benefit as its workforce more fully utilizes the capabilities of this technology.

At the end of January 31, 1999, the Company closed two of its distribution facilities, one in Atlanta, Georgia, and one in Columbus, Ohio. This leaves the Company with its main distribution facilities at the Torrance and Conway factories, and one satellite facility in Pennsylvania.

In October 2000, the Company entered into a confidential settlement of a dispute involving past services related to the installation of non-manufacturing equipment for which it received a final cash payment in November 2000. This payment is a non-recurring amount unrelated to the Company's ongoing operations. In the third quarter ended October 31, 2000, the Company recognized $4,052,000 in other income from this settlement.

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. The Company has expended, and can be expected to expend, significant amounts in the future for the investigation of environmental conditions, installation of environmental control equipment, and remediation of environmental contamination.

Currently, the Company is self-insured for Product Liability losses up to $100,000 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 $100,000 up to a limit of $30,000,000. In 1993 the Company initiated a program to reduce product liability losses and to more aggressively litigate product liability cases. This program has continued through 2000 and has resulted in reductions in litigated product liability cases. 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.

Management's Discussion and Analysis and Results of Operations

Inflation and Future Change in Prices

Inflation rates in the U.S. did not have a significant impact on the Company's operating results for the fiscal year just ended. Material and labor costs increased modestly in 2000. The Company anticipates upward pressure on costs, particularly in the areas of transportation, energy costs, certain raw materials, labor and benefits in the coming year. Total material costs for 2001, as a percentage of sales, could be slightly higher than in 2000. However, no assurance can be given that the Company will experience stable, modest or substantial increases in prices in 2001. 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.

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 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. The Company has made significant fixed asset acquisitions during the last three fiscal years. The assets acquired will result in higher depreciation charges, but due to technological advances should result in operating cost savings. In addition, some depreciation charges will be offset by a reduction in lease expense.

The Company is also subject to interest rate risk related to its $48,555,000 of borrowings on January 31, 2001 and any seasonal borrowings used to finance additional inventory and receivables during the summer. Fluctuating interest rates may adversely impact the Company's results of operations and cash flows for its variable rate bank borrowings. In February 2000, the Company entered into an interest rate swap agreement with Wells Fargo Bank to reduce exposure due to changes in interest rates. The initial notional swap amount is $30,000,000 for the period February 22, 2000 through February 28, 2001. The notional swap amount then decreases to $20,000,000 until the end of the swap agreement, March 3, 2003. Under this agreement, interest is payable monthly at 7.23% plus a fluctuating margin of 1.25% to 1.50%.

Liquidity

In December 2000, the Company renewed its loan facility with Wells Fargo Bank, extending the agreement to a three-year commitment, maturing on October 1, 2003. Under the terms of this agreement, the Company can borrow up to the aggregate principal amount of $50,000,000 from December 1, 2000 through and including April 30, 2001; $60,000,000 from May 1, 2001 through and including August 31, 2001; and $50,000,000 from September 1, 2001 through the maturity date. In addition, the Company borrowed $30,000,000 that will be repaid in three annual $10,000,000 installments, the first of which was paid on January 31, 2001. The Company is currently obligated to pay commitment fees equal to 0.25% to 0.375% per annum on the unused amount of the credit facility. The credit facility includes certain restrictive financial and operating covenants. The terms of the facility are described in more detail in Note 3 of the notes to the consolidated financial statements. This facility also allows the Company the option to borrow under 30, 60, and 90 day fixed term rates at LIBOR plus 1.25% to 1.50%. The applicable LIBOR margin is adjusted quarterly based on the Company's funded debt to EBITDA ratio. Under the revolving line, there is a letter of credit sub-feature, under which the Company issues commercial and standby letters of credit. This loan facility is intentionally large enough to finance more production in the early part of the year in order to have adequate inventories available for the summer/fall educational delivery season.

In April 1998, the Board of Directors approved a stock buy-back program giving authorization to buy back up to $5,000,000 of Company stock. In January 1999, the Board increased the authorization to $7,000,000 and subsequently increased it to $14,000,000. As of January 31, 2001 the Company had repurchased approximately 690,000 shares at a cost of approximately $11,539,000. The Company intends to continue buying back shares of Virco common stock as long as the Company feels the shares are undervalued, and either operating cash flow or borrowing capacity under the Wells Fargo Bank line is available.

In 1997, the Company initiated two large capital projects, which had significant cash flow effects on the 1998, 1999, and 2000 fiscal years. The first project is the implementation of the SAP enterprise resources planning system, initiated in October 1997. The Company went live with the new system in March 1999, implemented a business-to-business website along with sales force automation in the first quarter of 2000, and upgraded to the most current version of SAP in the fourth quarter of 2000. General Electric Capital Corporation (GECC) financed the initial portion of this project under a lease arrangement, which is treated as a capital lease for book purposes and an operating lease for tax purposes. As of January 31, 2001, the Company has expended $13,100,000 relating to this project. Capital and training costs not funded by the lease are financed by cash flows from operations and from the loan facility with Wells Fargo Bank.

The second project is the expansion and re-configuration of the Conway, Arkansas, manufacturing and distribution facility. During the fourth quarter of 1997, the Company expended approximately $1,200,000 to acquire roughly 70 acres of land for the expansion. In 1998, the Company expended approximately $20,600,000 to buy an additional 30 acres of land, initiate construction of a 400,000 sq. ft. manufacturing facility and purchase production equipment for the Conway, Arkansas location. During 1999, the Company expended approximately $29,200,000 to complete construction of the factory, purchase additional production equipment, construct and complete the first 400,000 sq. ft. segment of the planned 800,000 sq. ft. distribution facility, and initiate the construction of a second 400,000 sq. ft. segment of that facility. In 2000, the Company expended approximately $15,974,000 to complete the expansion and to acquire high-density racking and material handling systems. This project was financed with the loan facility with Wells Fargo, operating leases from GECC, and operating cash flow.

With the completion of these substantial capital projects, the Company intends to limit further capital spending until growth in sales volume fully utilizes the new plant and distribution capacity. The Company has established a goal of limiting capital spending to approximately $7,0000,000 for 2001, which is approximately one-half of anticipated depreciation expense.

The Company is currently marketing three properties for sale, which have a cumulative estimated market value of approximately $8,000,000. One of these properties, a former production facility in Conway, Arkansas, is currently being utilized as a finished goods warehouse. A second property, located in Los Angeles, California, is currently leased to a third party. The third property, a former production facility located in Newport, Tennessee, is vacant.

Subsequent to year-end, the Company sold a building in Conway, Arkansas, that had been most recently used to warehouse inventory. The sale generated approximately $490,000 in cash and resulted in a $25,000 pre-tax gain on sale.

In April 2000, the Company sold its 200,000 sq. ft. warehouse located on 8.5 acres of land in Torrance, California. The Company received approximately $9,500,000 in cash and recorded a pre-tax gain of approximately $7,900,000 on disposition in the first quarter of 2000.

In the second quarter of 1998, the Company sold its manufacturing facility in Southern Pines, North Carolina. This sale generated approximately $945,000 in cash and resulted in a $128,000 pre-tax loss on disposition.

Management believes cash generated from operations and raised from the previously described sources will be adequate to meet its capital requirements in the short term.

Financial Strategy

Virco's financial strategy is to continue to increase levels of profitability by targeting specific profitable market segments and customers. The Company has organized its sales force, developed products, and acquired production and distribution facilities for the specific needs of these customers. During the last three years, the Company has made significant capital expenditures to support future sales growth in these targeted markets. For the next several years, the Company intends to increase sales to these markets, and to service these sales without making further significant investments in facilities.

The Company has not provided an allowance against the deferred tax assets recorded in the financial statements. The Company has a net deferred tax liability of $2,753,000 at January 31, 2001. The gross deferred tax asset represents approximately 25% of current pre-tax earnings. Management believes that it is more likely than not that future earnings will be sufficient to recover deferred tax assets.

The Company discounts the pension obligations under the Virco Employees Retirement Plan and the Virco Important Performers (VIP) Plan utilizing an 8% discount rate. Although the Company does not anticipate any change in this rate in the coming year, any such change would not have a significant effect on the Company's financial position, results of operations or cash flows.

Management's Discussion and Analysis and Results of Operations

Forward-Looking Statements

From time to time, the Company or its representatives have made or may make forward-looking statements, orally or in writing, including those contained herein. Such forward-looking statements may be included in, without limitation, reports to stockholders, press releases, oral statements made with the approval of an authorized executive officer of the Company and filings with the Securities and Exchange Commission. The words or phrases "plans," "anticipates," "expects," "will continue," "estimates," "projects," "budgets," or similar expressions are intended to identify forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The results contemplated by the Company's forward-looking statements are subject to certain risks and uncertainties that could cause actual results to vary materially from anticipated results, including without limitation, the economic climate, the availability and cost of energy, raw material, the availability and cost of labor and employee benefits, demand for the Company's products, and competitive conditions affecting selling prices and margins.

Accounting Pronouncements

The Financial Accounting Standards Board has issued Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation." The Interpretation addresses implementation practice issues in accounting for compensation costs under existing rules prescribed by Accounting Principles Board No. 25. The new rules are applied prospectively to all new awards, modifications to outstanding awards and changes in grantee status after July 1, 2000, with certain exceptions. The Company did not grant or modify any options subsequent to July 1, and will consider the impact of the new rules when granting any options at a future date.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," or SAB 101. SAB 101 summarizes certain of the SEC Staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. The Company recorded the cumulative effect of this accounting change in the fourth quarter of the current fiscal year. The Company does not expect this SAB to significantly affect annual revenues, but due to the seasonality of education sales, its application can cause a shift of revenues from the second to the third fiscal quarters.

The Financial Accounting Standards Board has issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities-An Amendment of FASB Statement 133," which require the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not designated as hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings.

Upon initial application of SFAS Nos. 133 and 138 on February 1, 2001, the Company adjusted its interest rate swap agreement to fair value with an offsetting charge to comprehensive income of approximately $552,000, net of income taxes.

Five Year Summary of Selected Financial Data

In thousands, except per share data	2000	1999	1998	1997	1996
Summary of Operations					
Net sales (4,5)	$ 287,342	$ 268,079	$ 275,096	$ 259,586	$ 237,551
Net income before cumulative effect of change in accounting principle	$ 4,313	$ 10,166	$ 17,630	$ 13,852	$ 9,326
Cumulative effect of change in accounting principle, net of $191 tax benefit (5)	(297)	–	–	–	–
Net income	$ 4,016	$ 10,166	$ 17,630	$ 13,852	$ 9,326
Per share data:					
Income before cumulative effect of change in accounting principle (1)					
Basic	$ 0.38	$ 0.89	$ 1.48	$ 1.17	$ 0.79
Assuming dilution	0.38	0.87	1.45	1.14	0.78
Cumulative effect of change in accounting principle (1)					
Basic	(0.03)	–	–	–	–
Assuming dilution	(0.03)	–	–	–	–
Net income (1)					
Basic	0.35	0.89	1.48	1.17	0.79
Assuming dilution	0.35	0.87	1.45	1.14	0.78
Pro forma amounts assuming the accounting change is applied retroactively					
Net income (5)	$ 4,313	$ 10,186	$ 17,663	$ 13,963	$ 9,310
Per share data:					
Net income					
Basic	0.38	0.89	1.48	1.18	0.79
Assuming dilution	0.38	0.87	1.45	1.15	0.78
Dividends declared per share, adjusted for 10% stock dividend					
Cash dividends	$ .08	$ .07	$ .06	$ .06	$ .05
Other Financial Data					
Total assets	$ 199,549	$ 190,863	$ 151,380	$ 122,015	$ 118,020
Working capital	43,173	51,423	47,405	43,784	45,099
Current ratio	1.9/1	2.3/1	2.4/1	2.5/1	2.6/1
Total long-term obligations	55,075	53,995	25,690	13,512	25,396
Stockholders' equity	94,141	93,834	88,923	77,077	63,921
Shares outstanding at year-end (3)	11,283	11,364	11,669	11,828	11,792
Stockholders' equity per share (2)	8.34	8.26	7.62	6.52	5.42

(1) Based on average number of shares outstanding each year after giving retroactive effect for stock dividends and 3 for 2 stock split.

(2) Based on number of shares outstanding at year-end after giving effect for stock dividends and 3 for 2 stock split.

(3) Adjusted for stock dividends and 3 for 2 stock split.

(4) 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 year ended January 31, 2001.

(5) During the fourth quarter of 2000, 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.

Report of Independent Auditors

The Board of Directors and Stockholders
Virco Mfg. Corporation

We have audited the accompanying consolidated balance sheets of Virco Mfg. Corporation as of January 31, 2001 and 2000, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended January 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the 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, 2001 and 2000, and the consolidated results of its operations and its cash flows for each of the three years in the period ended January 31, 2001, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 1 to the consolidated financial statements, during the year ended January 31, 2001, the Company changed its method of revenue recognition for certain of its product sales.

Long Beach, California
March 19, 2001

Consolidated Balance Sheets

In thousands, except per share data	January 31 2001	2000
Assets		
Current assets:		
Cash	$ 351	$ 1,072
Trade accounts receivable (less allowance for doubtful accounts: $200 in 2000 and 1999)	24,559	26,457
Other receivables	586	927
Inventories:		
Finished goods	27,009	35,795
Work in process	14,442	9,260
Raw materials and supplies	16,588	12,003
	58,039	57,058
Income taxes receivable	2,508	1,753
Prepaid expenses and other current assets	1,150	1,288
Deferred income taxes	1,780	1,371
Total current assets	88,973	89,926
Property, plant and equipment:		
Land and land improvements	3,880	4,871
Buildings	50,382	43,240
Machinery and equipment	98,024	87,238
Leasehold improvements	1,218	966
	153,504	136,315
Less accumulated depreciation and amortization	58,859	48,378
Net property, plant and equipment	94,645	87,937
Other assets	15,931	13,000
Total assets	$ 199,549	$ 190,863

Consolidated Balance Sheets (continued)

In thousands, except per share data	January 31 2001	2000
Liabilities and stockholders' equity		
Current liabilities:		
Checks released but not yet cleared bank	$ 2,216	$ 4,786
Accounts payable	13,930	19,749
Accrued compensation and employee benefits	15,210	10,333
Current portion of long-term debt	12,101	1,998
Other accrued liabilities	2,343	1,637
Total current liabilities	45,800	38,503
Noncurrent liabilities:		
Accrued self-insurance retention	2,598	2,560
Accrued pension expenses	8,736	5,408
Long-term debt, less current portion	43,741	46,027
Total noncurrent liabilities	55,075	53,995
Deferred income taxes	4,533	4,531
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 12,032,233 shares in 2000 and 10,952,350 shares in 1999	120	110
Additional paid-in capital	97,656	84,635
Retained earnings	10,645	20,242
Less treasury stock at cost (749,246 shares in 2000 and 621,874 shares in 1999)	(12,009)	(10,692)
Less unearned ESOP shares	(696)	(41)
Less accumulated comprehensive loss	(1,575)	(420)
Total stockholders' equity	94,141	93,834
Total liabilities and stockholders' equity	$ 199,549	$ 190,863

See accompanying notes.

Consolidated Statements of Income

In thousands, except per share data	Year ended January 31 2001	2000	1999
Net sales	$ 287,342	$ 268,079	$ 275,096
Costs of goods sold	203,765	175,247	180,554
Gross profit	83,577	92,832	94,542
Selling, general and administrative expenses	83,192	73,360	63,839
Provision for doubtful accounts	156	188	530
Interest expense, net	4,962	2,385	1,111
(Gain) loss on sale of assets	(7,667)	206	160
Other income	(4,052)	–	–
Income before income taxes and cumulative effect of change in accounting principle	6,986	16,693	28,902
Provision for income taxes	2,673	6,527	11,272
Income before cumulative effect of change in accounting principle	4,313	10,166	17,630
Cumulative effect of change in accounting principle	(297)	–	–
Net income	$ 4,016	$ 10,166	$ 17,630
Amounts per common share - basic			
Income before cumulative effect of change in accounting principle	$ 0.38	$ 0.89	$ 1.48
Cumulative effect of change in accounting principle	(0.03)	–	–
Net income	$ 0.35	$ 0.89	$ 1.48
Amounts per common share - assuming dilution			
Income before cumulative effect of change in accounting principle	$ 0.38	$ 0.87	$ 1.45
Cumulative effect of change in accounting principle	(0.03)	–	–
Net income	$ 0.35	$ 0.87	$ 1.45
Pro forma amounts assuming the accounting change is applied retroactively			
Net income	$ 4,313	$ 10,186	$ 17,663
Net income per common share - basic	0.38	0.89	1.48
Net income per common share - assuming dilution	0.38	0.87	1.45
Weighted average shares outstanding:			
- basic	11,361	11,481	11,904
- assuming dilution	11,475	11,642	12,153

See accompanying notes.

Consolidated Statements of Stockholders' Equity

In thousands, except per share data	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Comprehensive Income	Treasury Stock	ESOP Trust	Accumulated Comprehensive Loss	Total
Balance at January 31, 1998	8,886,794	$ 89	$ 50,301	$ 27,423		$ (172)	$ (316)	$ (248)	$ 77,077
Net income	–	–	–	17,630	$ 17,630	–	–	–	17,630
Minimum pension liability, net of tax	–	–	–	–	(158)	–	–	(158)	(158)
Comprehensive income					$ 17,472				
Unearned ESOP shares	–	–	–	–		–	70	–	70
Stock issued under option plans	134,180	2	690	–		(298)	–	–	394
Stock dividend (10%)	891,213	9	17,370	(17,379)		–	–	–	–
Cash dividends	–	–	–	(746)		–	–	–	(746)
Purchase of treasury stock	(268,260)	–	–	–		(5,344)	–	–	(5,344)
Balance at January 31, 1999	9,643,927	100	68,361	26,928		(5,814)	(246)	(406)	88,923
Net income	–	–	–	10,166	$ 10,166	–	–	–	10,166
Minimum pension liability, net of tax	–	–	–	–	(14)	–	–	(14)	(14)
Comprehensive income					$ 10,152				
Unearned ESOP shares	–	–	–	–		–	205	–	205
Stock issued under option plans	33,261	–	232	–		–	–	–	232
Stock dividend (10%)	947,704	10	16,042	(16,052)		–	–	–	–
Cash dividends	–	–	–	(800)		–	–	–	(800)
Purchase of treasury stock	(294,416)	–	–	–		(4,878)	–	–	(4,878)
Balance at January 31, 2000	10,330,476	110	84,635	20,242		(10,692)	(41)	(420)	93,834
Net income	–	–	–	4,016	$ 4,016	–	–	–	4,016
Minimum pension liability, net of tax	–	–	–	–	(1,155)	–	–	(1,155)	(1,155)
Comprehensive income					$ 2,861				
Unearned ESOP shares	–	–	–	–		–	(655)	–	(655)
Stock issued under option plans	49,783	–	284	–		–	–	–	284
Stock dividend (10%)	1,030,100	10	12,737	(12,747)		–	–	–	–
Cash dividends	–	–	–	(866)		–	–	–	(866)
Purchase of treasury stock	(127,372)	–	–	–		(1,317)	–	–	(1,317)
Balance at January 31, 2001	11,282,987	$ 120	$ 97,656	$ 10,645		$ (12,009)	$ (696)	$ (1,575)	$ 94,141

See accompanying notes.

Consolidated Statements of Cash Flows

In thousands, except per share data	Year ended January 31 2001	2000	1999
Operating activities			
Net income	$ 4,016	$ 10,166	$ 17,630
Adjustments to reconcile net income to net cash provided by operating activities:			
Cumulative effect of accounting change	297	–	–
Depreciation and amortization	13,412	9,993	7,132
Provision for doubtful accounts	156	188	530
(Gain) loss on sale of property, plant and equipment	(7,667)	112	113
Deferred income taxes	(407)	2,735	420
Changes in assets and liabilities:			
Trade accounts receivable	1,742	3,820	(5,292)
Other receivables	341	(619)	831
Inventories	(981)	(8,589)	(4,606)
Income taxes	(755)	(2,557)	859
Prepaid expenses and other current assets	138	(347)	311
Accounts payable and accrued liabilities	560	8,182	5,493
Other	(4,383)	(2,506)	(506)
Net cash provided by operating activities	6,469	20,578	22,915
Investing activities			
Capital expenditures	(22,711)	(38,849)	(28,142)
Proceeds from sale of property, plant and equipment	10,258	128	945
Net investment in life insurance	–	(956)	(1,024)
Net cash used in investing activities	(12,453)	(39,677)	(28,221)
Financing activities			
Dividends paid	(866)	(800)	(746)
Issuance of long-term debt	19,817	26,794	13,109
Repayment of long-term debt	(12,000)	(2,468)	(2,312)
Issuance of common stock	284	232	394
Purchase of treasury stock	(1,317)	(4,878)	(5,344)
ESOP loan	(655)	205	70
Net cash provided by financing activities	5,263	19,085	5,171
Net decrease increase in cash	(721)	(14)	(135)
Cash at beginning of year	1,072	1,086	1,221
Cash at end of year	$ 351	$ 1,072	$ 1,086
Supplemental disclosures of cash flow information			
Cash paid during the year for:			
Interest, net of amounts capitalized	$ 4,953	$ 2,277	$ 2,069
Income taxes	3,835	6,416	10,106

See accompanying notes.

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Business

Virco Mfg. Corporation, which operates in one business segment, is engaged in the design, production and distribution of quality furniture for the commercial and education markets. Over 50 years of manufacturing have resulted in a wide product range. Major products include student 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.

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. Certain reclassifications have been made to the 1999 and 1998 information to conform to the 2000 presentation.

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. The Company purchases insurance on receivables from commercial sales to minimize the Company's credit risk. No customers exceeded 10% of the Company's sales for each of the three years in the period ended January 31, 2001. Foreign sales were less than 5% for each of the three years in the period ended January 31, 2001.

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.

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 (including improvements)	5 to 40 years
Machinery and equipment	3 to 10 years
Leasehold improvements	Life of lease

Certain assets are depreciated under accelerated methods for income tax purposes.

Interest costs, amounting to $453,000, $1,461,000 and $375,000 for the years ended January 31, 2001, 2000 and 1999, respectively, have been capitalized as part of the acquisition cost of property, plant and equipment.

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. The net book value of capitalized software was $10,004,000 and $11,492,000 at January 31, 2001 and 2000, respectively.

The book value of assets held under capital leases included in machinery and equipment amounted to $2,856,000 and $3,417,000 at January 31, 2001 and 2000, respectively. Amortization of capital leases is included in depreciation expense.

Impairment of Long-Lived Assets

An impairment loss is recognized in the event facts and circumstances indicate the carrying amount of an 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.

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 convertible securities. The following table sets forth the computation of basic and diluted earnings per share before cumulative effect of the accounting change:

	2000	1999	1998
Numerator:			
Income before cumulative effect of the accounting change	$ 4,313,000	$ 10,166,000	$ 17,630,000
Denominator:			
Denominator for basic earnings per share – weighted-average shares	11,360,774	11,480,660	11,903,660
Dilutive potential common shares	114,216	161,098	249,675
Denominator for diluted earnings per share – adjusted weighted-average shares and assumed conversions	11,474,990	11,641,758	12,153,335

On August 15, 2000, the Company's board of directors authorized a 10% stock dividend payable on September 29, 2000, to stockholders of record as of September 7, 2000. This resulted in the issuance of 1,030,100 additional shares of common stock. All per share and weighted-average share amounts have been restated to reflect this stock dividend and any splits or dividends previously declared.

Intangible Assets

Intangible assets, which consist principally of deferred pension assets and which are included in other noncurrent assets, are recorded at cost and are amortized over their estimated useful lives using the straight-line method.

Environmental Costs

Costs incurred to investigate and remediate environmental waste are expensed as incurred, unless the remediation extends the useful life of the assets employed at the site. Remediation costs that extend the useful life of assets are capitalized and amortized over the useful life of the assets.

Advertising Costs

Advertising costs are expensed in the period in which they occur. Selling, general and administrative expenses include advertising costs of $3,517,000 in 2000, $3,775,000 in 1999 and $3,535,000 in 1998.

Notes to Consolidated Financial Statements (continued)

Self-Insurance

The Company has a self-insured retention for general and product liability claims. Consulting actuaries assist the Company in determining its liability for the self-insured component of claims, which have been discounted to their net present value.

Stock-Based Compensation Plans

Stock-based compensation is recognized using the intrinsic-value method. For disclosure purposes, pro forma net income and earnings per share impacts are provided as if the fair-value method had been applied. The Financial Accounting Standards Board issued Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation." The Interpretation addressed implementation practice issues in accounting for compensation costs under existing rules prescribed by Accounting Principles Board No. 25. The new rules were applied by the company prospectively after July 1, 2000.

Use of Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Revenue Recognition

Effective February 1, 2000, the Company changed its method of accounting for revenue recognition in accordance with Staff Accounting Bulletin (SAB) No. 101, "Revenue Recognition in Financial Statements." Previously, the Company had recognized revenue upon shipment of merchandise to the customer even though at each fiscal year-end and quarter a portion of its merchandise was shipped FOB destination. The Company believes it had given up substantially all the risks and rewards of ownership upon shipment. Under the new accounting method adopted retroactive to February 1, 2000, the Company now recognizes all sales when title passes under its various shipping terms. The cumulative effect of the change on prior years resulted in a charge to income of $297,000 (net of income taxes of $191,000), which is included in income for the year ended January 31, 2001. There was no effect on the Company's net income for the year ended January 31, 2001, before the cumulative effect of the accounting change was made. The pro forma amounts presented in the income statement were calculated assuming the accounting change was made retroactively to prior periods.

Shipping and Handling Fees and Costs

The Company adopted EITF No. 00-10, "Accounting for Shipping and Handling Fees and Costs," during fiscal year 2000. EITF 00-10 requires that the amounts billed related to shipping and handling be classified as revenue and that the classification of shipping and handling costs is an accounting policy decision that should be disclosed. Accordingly, shipping and handling fees are included as revenue in net sales. Costs related to shipping and handling are included in operating expenses. For the years ended January 31, 2001, 2000, and 1999, shipping and handling costs of approximately $31,903,000, $24,656,000, and $22,861,000, respectively, were included in selling, general and administrative expenses. The adoption of this EITF has no effect on the Company's results of operations.

Fiscal Year End

Fiscal years 2000, 1999 and 1998, refer to the years ended January 31, 2001, 2000 and 1999, respectively.

Future Accounting Requirements

The Financial Accounting Standards Board has issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities-An Amendment of FASB Statement 133," which require the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not designated as hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings.

Upon initial application of SFAS Nos. 133 and 138 on February 1, 2001, the Company adjusted its interest rate swap agreement to fair value with an offsetting charge to comprehensive income of approximately $552,000, net of income taxes.

2. Inventories

The current material cost for inventories exceeded LIFO cost by $3,585,000 and $2,462,000 at January 31, 2001 and 2000, respectively. Liquidation of prior year LIFO layers due to a reduction in certain inventories increased income by $111,000, $59,000 and $8,000 in the years ended January 31, 2001, 2000 and 1999, respectively.

Details of inventory amounts, including the material portion of inventory which is valued at LIFO, at January 31, 2001 and 2000, are as follows (in thousands):

	January 31, 2001			
	Material Content at FIFO	LIFO Reserve	Labor, Overhead and Other	Total
Finished goods	$ 18,858	$ (1,211)	$ 9,362	$ 27,009
Work in process	8,626	(1,059)	6,875	14,442
Raw materials and supplies	17,903	(1,315)	–	16,588
Total	$ 45,387	$ (3,585)	$ 16,237	$ 58,039

	January 31, 2000			
	Material Content at FIFO	LIFO Reserve	Labor, Overhead and Other	Total
Finished goods	$ 19,954	$ (964)	$ 16,805	$ 35,795
Work in process	5,017	(718)	4,961	9,260
Raw materials and supplies	12,783	(780)	–	12,003
Total	$ 37,754	$ (2,462)	$ 21,766	$ 57,058

3. Notes Payable

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

	January 31	
	2001	2000
Revolving credit line with Wells Fargo Bank [(a)]	$ 28,555	$ 38,739
Term loan with Wells Fargo Bank [(a)]	20,000	–
IRB with the City of Torrance [(b)]	4,124	5,037
Equipment credit line with GECC [(c)]	1,857	2,779
Other	1,306	1,470
	55,842	48,025
Less current portion	12,101	1,998
	$ 43,741	$ 46,027
Outstanding stand-by letters of credit	$ 3,163	$ 5,481

(a) *A revolving credit facility with Wells Fargo Bank, amended and restated December 2000, provides a secured revolving line of credit of up to $50,000,000. The credit facility increases from $50,000,000 to $60,000,000 from May 1, 2001 to August 30, 2001 to allow for additional working capital requirements during the Company's traditional peak period. At September 1, 2001, the available commitment reduces back to $50,000,000. This is a three-year non-amortizing line with interest payable monthly at a fluctuating rate equal to the Bank's prime rate (9.00% at January 31, 2001). The line also allows the Company the option to borrow under 30- 60- and 90-day fixed term rates at LIBOR plus a margin of 1.25% to 1.50%. Approximately $18,282,000 was available for borrowing as of January 31, 2001.*

The Company also extended a $30,000,000 three year fully amortizing term loan in December 2000. The term loan requires monthly interest payments and annual principal payments of $10,000,000 at January 2001, January 2002 and a final payment at January 2003. The Company made its first required principal payment in January 2001, reducing the balance to $20,000,000. The term loan carries the same interest rates as the revolving credit facility.

On February 22, 2000, the Company entered into an interest rate swap agreement with Wells Fargo Bank. The initial notional swap amount is $30,000,000 for the period February 22, 2000 through February 28, 2001. The notional swap amount then decreases to $20,000,000 until the end of the swap agreement on March 3, 2003. The swap agreement is in consideration for a fixed rate at 7.23% plus a fluctuating margin of 1.25% to 1.50%. The revolving credit facility and the term loan with Wells Fargo Bank are subject to various financial covenants including a liquidity requirement, a leverage requirement, a cash flow coverage requirement and profitability requirements. The agreement also places certain restrictions on capital expenditures, dividends and the repurchase of the Company's common stock. The revolving credit facility and the term loan are secured by the Company's accounts receivable, inventory and equipment.

(b) *Ten-year $8,900,000 IRB issued through the City of Torrance. This 5.994% fixed interest rate bond is payable in monthly installments of $99,000, including interest, through December 2004.*

(c) *In October 1998, the Company finalized a credit agreement with General Electric Capital Corporation (GECC) to finance the initial portion of the new business information system. This is a four-year amortizing capital lease with principal and interest (approximately 7.5%) payable of $87,500 monthly. The Company has the option of buying out the lease three years into the lease period.*

Long-term debt repayments are approximately as follows (in thousands):

Year ending January 31	
2002	$ 12,101
2003	12,053
2004	30,633 *
2005	1,055
	$ 55,842

* *The $28,555,000 due under Wells Fargo Bank's line of credit will be payable in the fiscal year ending January 31, 2004, if the agreement is not renewed. The Company intends to renew the agreement.*

The Company believes that the carrying value of debt under the Wells Fargo credit facility approximates fair value at January 31, 2001 and 2000, as the majority of the long-term debt bears interest at variable rates or is fixed for periods equal to or less than 90 days. The carrying value of other debt instruments approximates their fair value given the Company's incremental borrowing rate for similar types of financing arrangements.

The Company guarantees a $1,500,000 line of credit from Wells Fargo Bank to the Virco Employee Stock Ownership Plan (ESOP). At January 31, 2001 and 2000, $696,000 and $41,000, respectively, was outstanding under the line.

4. Retirement Plans

The Company and its subsidiaries cover all employees under a noncontributory defined benefit retirement plan, the Virco Employees' Retirement Plan (the Plan). Benefits under the Plan are based on years of service and career average earnings. The Company's general funding policy is to contribute amounts deductible for federal income tax purposes. Minimum pension liability adjustments for the years 2000, 1999, and 1998 were $1,155,000, $14,000, and $158,000 respectively (net of taxes of $716,000, 9,000 and $98,000 respectively) and are included in comprehensive income. Assets of the Plan are invested in common trust funds.

The following table sets forth (in thousands) the funded status of the Plan at December 31, 2000 and 1999:

	Pension Benefits	
	2000	1999
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 15,916	$ 10,603
Service cost	930	752
Interest cost	1,425	1,091
Plan amendments	2,384	2,992
Actuarial loss	384	2,325
Benefit paid	(1,604)	(1,847)
Benefit obligation at end of year	$ 19,435	$ 15,916
Change in plan assets:		
Fair value at beginning of year	$ 11,657	$ 9,843
Actual return on plan assets	(1,099)	1,867
Company contributions	1,239	1,794
Benefits paid	(1,604)	(1,847)
Fair value at end of year	$ 10,193	$ 11,657
Funded status of plan	$ (9,242)	$ (4,259)
Unrecognized net transition amount	(267)	(309)
Unrecognized prior service cost	4,555	2,698
Unrecognized net actuarial loss	5,415	2,991
Net amount recognized	$ 461	$ 1,121
Statements of financial position:		
Accrued benefit liability	$ (6,718)	$ (2,278)
Intangible asset	4,555	2,698
Accumulated other comprehensive income	2,624	701
Net amount recognized	$ 461	$ 1,121
Weighted average assumptions:		
Discount rate	8.00%	8.00%
Expected return on plan assets	9.75%	9.75%
Rate of compensation increase	5.00%	5.00%

The total pension expense for the Plan (in thousands) included the following components:

		December 31	
	2000	1999	1998
Components of net cost:			
Service cost	$ 930	$ 752	$ 794
Interest cost	1,425	1,091	765
Expected return on plan assets	(1,089)	(936)	(818)
Amortization of transition amount	(42)	(42)	(42)
Amortization of prior service cost	528	294	–
Recognized net actuarial loss	148	128	134
Benefit cost	$ 1,900	$ 1,287	$ 833

The Company also provides a supplementary retirement plan for certain key employees, the VIP Retirement Plan (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 Virco Employees' Retirement Plan. The VIP Plan is funded by a life insurance program. The cash surrender values of the policies funding the VIP Plan were $1,977,000 and $3,405,000 at January 31, 2001 and 2000, respectively. These cash surrender values are included in other assets in the consolidated balance sheets.

The following table sets forth (in thousands) the funded status of the VIP Plan at January 31, 2001 and 2000:

	Nonqualified Pension	
	2000	1999
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 4,004	$ 5,794
Service cost	417	296
Interest cost	299	254
Plan amendments	(1,240)	(2,519)
Actuarial loss	1,166	501
Benefit paid	(348)	(322)
Benefit obligation at end of year	$ 4,298	$ 4,004
Change in plan assets:		
Company contributions	$ 348	$ 322
Benefits paid	(348)	(322)
Fair value at end of year	$ –	$ –
Funded status of plan	$ (4,298)	$ (4,004)
Unrecognized prior service cost	(2,964)	(2,037)
Unrecognized net actuarial loss	2,420	1,410
Accrued benefit cost	$ (4,842)	$ (4,631)
Statements of financial position:		
Accrued benefit liability	$ (4,842)	$ (4,631)
Net amount recognized	$ (4,842)	$ (4,631)
Weighted average assumptions:		
Discount rate	8.00%	8.00%
Expected return on plan assets	9.75%	9.75%
Rate of compensation increase	5.00%	5.00%

The total plan expense for the VIP retirement plan included the following components (in thousands):

	December 31		
	2000	1999	1998
Components of net cost:			
Service cost	$ 417	$ 296	$ 212
Interest cost	299	254	426
Amortization of transition amount	–	–	4
Amortization of prior service cost	(314)	(181)	111
Recognized net actuarial loss	159	369	65
Benefit cost	$ 559	$ 738	$ 818

The Company's Employee Stock Ownership Plan, which covers all U.S. employees, allows participants to defer from 1% to 15% of their eligible compensation through a 401(k) retirement program. One of the four investment options is the Virco Stock Fund. Shares owned by the ESOP are held by the Plan Trustee, U.S. Trust Company of California. At January 31, 2001, the Plan held 596,535 shares of Virco Stock including 539,879 shares allocated to participants' accounts. Using the January 31, 2001 closing price of $10.00, the unallocated account has 56,656 shares valued at $566,560. At January 31, 2001, the Plan had borrowed $696,000 directly from Wells Fargo Bank. This loan is secured by the unallocated shares and guaranteed by Virco. Allocated shares held by the Trust are included in shares outstanding and the related dividends are charged to retained earnings. For the fiscal years ended January 31, 2001, 2000 and 1999 there was no employer match and therefore no compensation cost to the Company.

The Company provides current and post-retirement life insurance to certain salaried employees with split dollar life insurance policies under the Dual Option Life Insurance Plan. Cash surrender values of these policies, which are included in other assets in the consolidated balance sheets, were $3,550,000 and $3,551,000 at January 31, 2001 and 2000, respectively.

The Company established, effective January 1, 1997, a Deferred Compensation Plan, which allows certain key employees to defer up to a maximum of 90% of their base annual salary and/or up to 90% of their annual bonus on a pretax basis. The total participant deferrals were $1,226,000 and $976,000 for the years ended January 31, 2001 and 2000, respectively.

The Company maintains a Rabbi Trust to hold assets related to the VIP Retirement Plan, the Dual Option Life Insurance Plan, and the Deferred Compensation Plan. Substantially all assets funding these Plans are held in the Rabbi Trust.

5. Stock Options and Stockholders' Rights

The Company's two stock plans are the 1997 Employee Incentive Plan (the 1997 Plan) and the 1993 Employee Incentive Stock Plan (the 1993 Plan). Under these stock plans, the Company may grant an aggregate of 1,183,565 shares (as adjusted for the stock split and stock dividends) to its employees in the form of stock options. Non-employee directors automatically receive a grant for options to purchase 1,000 shares of common stock on the first business day following each annual meeting of the Company's stockholders. Subsequent to the year ended January 31, 2001, this was increased to 2000 shares. As of January 31, 2001, 252,900 shares remain available for future grant. Options granted under the plans have an exercise price equal to the market price at the date of grant, have a maximum term of 10 years and generally become exercisable ratably over a five-year period. During the year, certain optionees satisfied the exercise price of their options by exchanging shares already owned rather than paying cash. As a result, 983 and 8,791 shares were recorded as treasury stock for the years ended January 31, 2001 and 2000, respectively.

Pro forma information regarding net income and earnings per share is required by SFAS No. 123, and has been determined as if the Company had accounted for its employee stock options under the fair-value method of SFAS No. 123. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following ranges of weighted-average assumptions: risk-free interest rates of 4.83% to 6.26%; dividend yield of 0.10% to 0.98%; volatility factor of the expected market price of the Company's common stock of 0.26 to 0.39; and a weighted-average expected life of the option of five years.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The pro forma effect only takes into account options granted since January 1, 1993, and is likely to increase in future years as additional options are granted and amortized ratably over the vesting period. The Company's pro forma information follows (in thousands except for net income per share information):

	Year ended January 31		
	2001	2000	1999
Pro forma net income	$ 3,914	$ 9,698	$ 17,401
Pro forma net income per share – assuming dilution	$ 0.34	$ 0.83	$ 1.43

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

	2001		2000		1999	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at beginning of year	**635,511**	**$ 10.85**	562,452	$ 7.80	671,268	$ 7.09
Granted	**5,500**	**11.38**	141,570	13.36	75,928	15.47
Exercised	**(50,368)**	**5.61**	(68,511)	3.39	(184,744)	3.83
Outstanding at end of year	**590,643**	**11.30**	635,511	10.85	562,452	9.31
Exercisable at end of year	**493,525**	**$ 10.77**	530,978	$ 10.50	424,745	$ 8.46
Weighted-average fair value of options granted during the year		**$ 3.96**		$ 5.64		$ 6.36

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

Information regarding stock options outstanding as of January 31, 2001, is as follows:

	Options Outstanding			Options Exercisable	
Price Range	Number of Shares	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
$ 2.27 to 7.70	240,834	1.72 years	$ 5.24	227,266	$ 5.10
10.34 to 15.29	223,464	7.66	13.90	141,911	13.31
18.22 to 19.44	126,345	6.01	18.25	124,348	18.23
	590,643	4.89	11.30	493,525	10.77

On October 15, 1996, the Board of Directors declared a dividend of one preferred stock purchase right (a Right) for each outstanding share of the Company's common stock. Each Right entitles a stockholder to purchase for an exercise price of $50.00 ($25.05, as adjusted for the stock split and stock dividend), 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 expire on October 25, 2006, 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 shares. There are 200,000 shares (399,300 shares as adjusted by the stock split and stock dividend) of Series A Junior Participating Cumulative Preferred Stock reserved for issuance upon exercise of the Rights.

6. Provision for Income Taxes

The Company uses the liability method to determine the provision for income taxes. Deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

The provisions for the last three years are reconciled to the statutory federal income tax rate using the liability method as follows:

	January 31		
	2001	2000	1999
Statutory	**34.0%**	35.0%	35.0%
State taxes (net of federal tax)	**3.2**	3.1	3.2
Nondeductible expenses	**1.1**	1.0	.8
	38.3%	39.1%	39.0%

Significant components of the provision for income taxes (in thousands) attributes to income before income taxes and cumulative effect of the accounting change are as follows:

	January 31		
	2001	2000	1999
Current:			
Federal	**$ 2,690**	$ 2,952	$ 9,425
State	**390**	840	1,427
	3,080	3,792	10,852
Deferred:			
Federal	**(350)**	2,347	376
State	**(57)**	388	44
	(407)	2,735	420
	$ 2,673	$ 6,527	$ 11,272

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

	January 31	
	2001	2000
Deferred tax assets:		
Accrued vacation and sick leave	**$ 1,242**	$ 1,179
Retirement plans	**2,678**	2,017
Insurance reserves	**1,410**	1,371
Inventory	**322**	196
Other	**216**	339
	$ 5,868	$ 5,102
Deferred tax liabilities:		
Tax in excess of book depreciation	**4,381**	3,654
Capitalized software development costs	**4,240**	4,608
	8,621	8,262
Net deferred tax liability	**$ (2,753)**	$ (3,160)

7. Commitments

The Company has long-term leases on real property and equipment, which expire at various dates. 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, 2001, are as follows:

Year ending January 31	
2002	$ 9,250
2003	9,784
2004	7,633
2005	6,143
2006	3,142
Thereafter	1,301
	$ 37,253

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

Year ending January 31	
2001	$ 12,937
2000	10,516
1999	9,438

The Company leases machinery and equipment from GECC under a 10-year operating lease arrangement. The total amount of machinery and equipment leased in 2000 and 1999 was $0 and $8,800,000, respectively. The Company has the option of buying out the leases three to five years into the lease period.

Minimum future lease-receipts (in thousands) for leases relating to properties owned or subleased as of January 31, 2001 are as follows:

Year ending January 31	
2002	$ 730
2003	572
2004	572
2005	572
2006	525
Thereafter	2,623
	$ 5,594

8. 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 may be expected to expend significant amounts for the investigation of environmental conditions, installation of environmental control equipment and remediation of environmental contamination.

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 chemical or petroleum substances by the Company or other parties. At January 31, 2001 and 2000, there are no required reserves for such environmental contingencies.

The Company has a self-insured retention for product and general liability losses up to $100,000 per occurrence. The Company has purchased insurance to cover losses in excess of $100,000 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 the net present value of $3,657,000 at January 31, 2001, based upon the Company's estimated payout period of four years using a 10% discount rate.

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.

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 that the ultimate outcome of all such matters will not materially affect the Company's financial position, results of operations or cash flows.

9. Gain on Sale of Assets and Other Income

On April 25, 2000, the Company completed the sale of its Torrance, California, warehouse which was held as rental property. The Company received $9,385,000 in cash and recorded a $7,945,000 pre-tax gain on disposition during the quarter ended April 30, 2000.

In October 2000, the Company entered into a confidential settlement of a dispute involving past services related to the installation of non-manufacturing equipment for which it received a final cash payment in November 2000. This payment is a non-recurring amount unrelated to the Company's ongoing operations. In the third quarter ended October 31, 2000, the Company recognized $4,052,000 in other income from this settlement.

10. Quarterly Results (Unaudited)

The Company's quarterly results for the years ended January 31, 2001 and 2000, are summarized as follows (in thousands, except per share data):

	Previously Reported April 30	Restated April 30 (1,3)	Previously Reported July 30	Restated July 30 (1,3)	Previously Reported Oct. 31	Restated Oct. 31 (1,3)	Jan. 31
Year ended January 31, 2001:							
Net sales (3)	$ 46,258	$ 46,432	$ 98,917	$ 96,578	$ 95,866	$ 99,016	$ 45,316
Gross profit (3)	14,106	14,481	32,144	31,768	28,316	29,593	7,735
Income (loss) before cumulative effect of accounting change	2,607	2,617	4,757	4,262	4,240	4,713	(7,279)
Cumulative effect of accounting change, net of tax:							
Revenue recognition (1)	–	(297)	–	–	–	–	–
Net income (loss)	$ 2,607	$ 2,320	$ 4,757	$ 4,262	$ 4,240	$ 4,713	$ (7,279)
Per common share: (2)							
Income (loss) before cumulative effect of accounting changes:							
Basic	$ 0.23	$ 0.23	$ 0.42	$ 0.38	$ 0.37	$ 0.42	$ (0.64)
Assuming dilution	0.23	0.23	0.41	0.37	0.37	0.41	(0.64)
Net income:							
Basic	0.23	0.20	0.42	0.38	0.37	0.42	(0.64)
Assuming dilution	0.23	0.20	0.41	0.37	0.37	0.41	(0.64)
Year ended January 31, 2000:							
Net sales (3)	$ 37,479	$ 37,681	$ 88,224	$ 88,700	$ 93,895	$ 94,401	$ 47,297
Gross profit (3)	11,361	11,563	30,468	30,944	33,683	34,189	16,136
Net (loss) income	(1,965)	(1,965)	6,527	6,527	6,414	6,414	(810)
Net (loss) income per common share: (2)							
Basic	(0.17)	(0.17)	0.57	0.57	0.56	0.56	(0.07)
Assuming dilution	(0.17)	(0.17)	0.56	0.56	0.55	0.55	(0.07)
Pro forma amounts assuming the accounting change is applied retroactively:							
Net (loss) income	$ (1,899)		$ 5,950		$ 6,839		$ (705)
Net (loss) income per common share:							
Basic	(0.17)		0.52		0.60		(0.06)
Assuming dilution	(0.17)		0.51		0.59		(0.06)

(1) During the fourth quarter of 2000, 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 and accordingly, the quarterly information for the first three quarters of 2000 which had been previously reported has been restated. No restatement of 1999 information was necessary.

(2) Net income per share has been adjusted to reflect the 10% stock dividends declared in August 2000 and 1999.

(3) Net sales and gross profit have been adjusted to reflect 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 for the year ended January 31, 2001.

Supplemental Stockholders' Information

Annual Meeting

The Annual Meeting of Virco stockholders will be held on Tuesday, June 12, 2001, at 2:00 p.m., at 2027 Harpers Way, Torrance, California. The record date for this meeting is April 27, 2001. The Proxy Statement and Proxy pertaining to this meeting will be mailed on or about May 14, 2001.

SEC Form 10-K

A copy of the annual report to the Securities and Exchange Commission on Form 10-K may be obtained without charge upon written request to:

Corporate Secretary
Virco Mfg. Corporation
2027 Harpers Way
Torrance, CA 90501

Virco Common Stock

The American Stock exchange is the principal market on which Virco Mfg. Corporation (VIR) stock is traded. As of April 17, 2001, there were approximately 365 Registered Stockholders according to the transfer agent records. There are approximately 1,900 Beneficial Stockholders.

Stockholder Records

Records pertaining to stockholdings and dividends are maintained by Mellon Investor Services. Inquiries with respect to these matters, as well as notices of address changes, should be directed to: Mellon Investor Services, 85 Challenger Road, Ridgefield Park, NJ 07660, telephone 1-800-356-2017.

If a stock certificate is lost or mutilated, immediately communicate with Mellon Investor Services at the above address.

Additional Services for Stockholders

Information about the Company is now available to stockholders at the Company's website (www.virco.com). A brief description of Virco's product line is offered together with illustrations showing a sampling of our furniture.

Quarterly Dividend and Stock Market Information

	Cash Dividends Declared		Common Stock Range			
	1-31-2001	1-31-2000	1-31-2001		1-31-2000	
			High	Low	High	Low
1st Quarter	$ 0.02	$ 0.02	$ 11.76	$ 8.86	$ 16.17	$ 11.47
2nd Quarter	0.02	0.02	13.52	9.09	15.91	12.45
3rd Quarter	0.02	0.02	13.25	11.02	14.89	12.67
4th Quarter	0.02	0.02	11.25	8.50	13.98	10.91

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

Directors, Officers and Facilities

Directors

Robert A. Virtue
President, Chairman of the Board
and Chief Executive Officer

Donald S. Friesz
Former Vice President - Sales and
Marketing

Robert K. Montgomery
Partner, Gibson, Dunn & Crutcher

George W. Ott
President, Ott and Hansen, Inc.

Glen D. Parish
Vice President and General Manager
Conway Division

Donald A. Patrick
Management Consultant
Diversified Business Resources, Inc.

John H. Stafford
Former Partner of
KPMG Peat Marwick LLP
(certified public accountants)

Douglas A. Virtue
Executive Vice President

Dr. James R. Wilburn
Dean of the School of Public Policy,
Pepperdine University

Officers

Robert A. Virtue
President, Chairman of the Board
and Chief Executive Officer

Robert E. Dose
Vice President - Finance,
Secretary and Treasurer

Robert J. Mills
Vice President - Engineering
and Product Development

Glen D. Parish
Vice President and General Manager
Conway Division

D. Randal Smith
Vice President - Marketing

Lori L. Swafford
Vice President - Legal Affairs

Douglas A. Virtue
Executive Vice President

Larry O. Wonder
Vice President - Sales

Independent Auditors

Ernst & Young LLP
One World Trade Center
Long Beach, California 90831

Legal Counsel

Gibson, Dunn & Crutcher
2029 Century Park East
Los Angeles, California 90067

Corporate Headquarters

2027 Harpers Way
Torrance, California 90501
(310) 533-0474

Major Facilities

Torrance Division
2027 Harpers Way
Torrance, California 90501

Conway Division
Highway 65, South
Conway, Arkansas 72032

Virco Mfg. Corporation

2000 Annual Report

VIRCO

2027 HARPERS WAY
TORRANCE, CA 90501

HIGHWAY 65, SOUTH
CONWAY, AR 72032

PHONE: 800-448-4726
WWW.VIRCO.COM

REF# 01036
Printed in the U.S.A. 5/01