

GOLDMAN SACHS GROUP INC

Form 424B2

October 04, 2018

Filed Pursuant to Rule 424(b)(2)

Registration Statement No. 333-219206

The information in this preliminary prospectus supplement is not complete and may be changed. This preliminary pricing supplement is not an offer to sell nor does it seek an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

Subject to Completion. Dated October 3, 2018.

GS Finance Corp.

\$

Callable Contingent Coupon Underlier-Linked Notes due
guaranteed by

The Goldman Sachs Group, Inc.

The notes will not pay a fixed coupon and may pay no coupon on a payment date. The amount that you will be paid on your notes is based on the performances of the EURO STOXX 50[®] Index, the iShares[®] MSCI EAFE ETF and the SPDR[®] S&P[®] Oil & Gas Exploration & Production ETF. The notes will mature on October 12, 2022, unless we redeem them.

The return on your notes is linked, in part, to the performances of the iShares[®] MSCI EAFE ETF and the SPDR[®] S&P[®] Oil & Gas Exploration & Production ETF (each, an ETF), and not to that of the MSCI EAFE Index or the S&P Oil & Gas Exploration & Production Select Industry Index, respectively (each, an underlying index), on which the respective ETF is based. The ETFs follow a strategy of "representative sampling", which in each case means an ETF's holdings are not the same as those of its underlying index. The performance of any ETF may significantly diverge from that of its underlying index.

We may redeem your notes at 100% of their face amount plus any coupon then due on the coupon payment dates occurring in January, April, July and October of each year on or after the coupon payment date in October 2019 up to the coupon payment date in July 2022.

Coupon payment dates are expected to be the 12th day of each month, commencing in November 2018 and ending on the stated maturity date.

If we do not redeem your notes, on each coupon observation date (expected to be the tenth scheduled trading day for all underliers prior to each coupon payment date), if the closing level of each underlier is greater than or equal to 60% of its initial level (set on the trade date, expected to be October 9, 2018), you will receive on the applicable coupon payment date a coupon of \$6.25 for each \$1,000 face amount of your notes. If the closing level of any underlier on a coupon observation date is less than 60% of its initial level, you will not receive a coupon on the applicable coupon payment date.

If we do not redeem your notes, the amount that you will be paid on your notes at maturity, in addition to the final coupon, if any, is based on the performance of the lesser performing underlier (the underlier with the lowest underlier return). The underlier return for each underlier is the percentage increase or decrease in the final level (the closing level of the underlier on the determination date) from its initial level.

At maturity, for each \$1,000 face amount of your notes you will receive an amount in cash equal to:

if the underlier return of each underlier is greater than or equal to -40% (the final level of each underlier is greater than or equal to 60% of its initial level), \$1,000 plus the final coupon of \$6.25; or

if the underlier return of any underlier is less than -40% (the final level of any underlier is less than 60% of its initial level), the sum of (i) \$1,000 plus (ii) the product of (a) the lesser performing underlier return times (b) \$1,000. You will receive less than 60% of the face amount of your notes and you will not receive a final coupon.

You should read the disclosure herein to better understand the terms and risks of your investment, including the credit risk of GS Finance Corp. and The Goldman Sachs Group, Inc. See page S-12.

The estimated value of your notes at the time the terms of your notes are set on the trade date is expected to be between \$900 and \$940 per \$1,000 face amount. For a discussion of the estimated value and the price at which Goldman Sachs & Co. LLC would initially buy or sell your notes, if it makes a market in the notes, see the following

page.

Original issue date: expected to be October 12, 2018 Original issue price: 100% of the face amount*

Underwriting discount: % of the face amount* Net proceeds to the issuer: % of the face amount

*The original issue price will be % for certain investors; see “Summary Information — Key Terms — Supplemental plan of distribution; conflicts of interest” on page S-5.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense. The notes are not bank deposits and are not insured by the Federal Deposit Insurance Corporation or any other governmental agency, nor are they obligations of, or guaranteed by, a bank.

Goldman Sachs & Co. LLC

Pricing Supplement No. dated , 2018.

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The issue price, underwriting discount and net proceeds listed above relate to the notes we sell initially. We may decide to sell additional notes after the date of this pricing supplement, at issue prices and with underwriting discounts and net proceeds that differ from the amounts set forth above. The return (whether positive or negative) on your investment in notes will depend in part on the issue price you pay for such notes.

GS Finance Corp. may use this prospectus in the initial sale of the notes. In addition, Goldman Sachs & Co. LLC, or any other affiliate of GS Finance Corp., may use this prospectus in a market-making transaction in a note after its initial sale. Unless GS Finance Corp. or its agent informs the purchaser otherwise in the confirmation of sale, this prospectus is being used in a market-making transaction.

Estimated Value of Your Notes

The estimated value of your notes at the time the terms of your notes are set on the trade date (as determined by reference to pricing models used by Goldman Sachs & Co. LLC (GS&Co.) and taking into account our credit spreads) is expected to be between \$900 and \$940 per \$1,000 face amount, which is less than the original issue price. The value of your notes at any time will reflect many factors and cannot be predicted; however, the price (not including GS&Co.'s customary bid and ask spreads) at which GS&Co. would initially buy or sell notes (if it makes a market, which it is not obligated to do) and the value that GS&Co. will initially use for account statements and otherwise is equal to approximately the estimated value of your notes at the time of pricing, plus an additional amount (initially equal to \$ per \$1,000 face amount).

Prior to , the price (not including GS&Co.'s customary bid and ask spreads) at which GS&Co. would buy or sell your notes (if it makes a market, which it is not obligated to do) will equal approximately the sum of (a) the then-current estimated value of your notes (as determined by reference to GS&Co.'s pricing models) plus (b) any remaining additional amount (the additional amount will decline to zero on a straight-line basis from the time of pricing through). On and after , the price (not including GS&Co.'s customary bid and ask spreads) at which GS&Co. would buy or sell your notes (if it makes a market) will equal approximately the then-current estimated value of your notes determined by reference to such pricing models.

About Your Prospectus

The notes are part of the Medium-Term Notes, Series E program of GS Finance Corp., and are fully and unconditionally guaranteed by The Goldman Sachs Group, Inc. This prospectus includes this pricing supplement and the accompanying documents listed below. This pricing supplement constitutes a supplement to the documents listed below and should be read in conjunction with such documents:

General terms supplement no. 1,734 dated July 10, 2017

Prospectus supplement dated July 10, 2017

Prospectus dated July 10, 2017

The information in this pricing supplement supersedes any conflicting information in the documents listed above. In addition, some of the terms or features described in the listed documents may not apply to your notes.

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SUMMARY INFORMATION

We refer to the notes we are offering by this pricing supplement as the “offered notes” or the “notes”. Each of the offered notes has the terms described below. Please note that in this pricing supplement, references to “GS Finance Corp.”, “we”, “our” and “us” mean only GS Finance Corp. and do not include its subsidiaries or affiliates, references to “The Goldman Sachs Group, Inc.”, our parent company, mean only The Goldman Sachs Group, Inc. and do not include its subsidiaries or affiliates and references to “Goldman Sachs” mean The Goldman Sachs Group, Inc. together with its consolidated subsidiaries and affiliates, including us. Also, references to the “accompanying prospectus” mean the accompanying prospectus, dated July 10, 2017, references to the “accompanying prospectus supplement” mean the accompanying prospectus supplement, dated July 10, 2017, for Medium-Term Notes, Series E, and references to the “accompanying general terms supplement no. 1,734” mean the accompanying general terms supplement no. 1,734, dated July 10, 2017, in each case of GS Finance Corp. and The Goldman Sachs Group, Inc. The notes will be issued under the senior debt indenture, dated as of October 10, 2008, as supplemented by the First Supplemental Indenture, dated as of February 20, 2015, each among us, as issuer, The Goldman Sachs Group, Inc., as guarantor, and The Bank of New York Mellon, as trustee. This indenture, as so supplemented and as further supplemented thereafter, is referred to as the “GSFC 2008 indenture” in the accompanying prospectus supplement.

This section is meant as a summary and should be read in conjunction with the section entitled “Supplemental Terms of the Notes” on page S-16 of the accompanying general terms supplement no. 1,734. Please note that certain features described in the accompanying general terms supplement no. 1,734 are not applicable to the notes. This pricing supplement supersedes any conflicting provisions of the accompanying general terms supplement no. 1,734.

Key Terms

Issuer: GS Finance Corp.

Guarantor: The Goldman Sachs Group, Inc.

Underliers: the EURO STOXX 50[®] Index (Bloomberg symbol, “SX5E Index”), as sponsored and maintained by STOXX Limited, the iShares[®] MSCI EAFE ETF (Bloomberg symbol, “EFA UP Equity”) and the SPDR[®]S&P[®] Oil & Gas Exploration & Production ETF (Bloomberg symbol, “XOP UP”); see “The Underliers” on page S-21

Underlying indices: with respect to the iShares[®] MSCI EAFE ETF, the MSCI EAFE Index, as published by MSCI, Inc. (“MSCI”) and with respect to the SPDR[®]S&P[®] Oil & Gas Exploration & Production ETF, the S&P Oil & Gas Exploration & Production Select Industry Index, as published by S&P Dow Jones Indices LLC

Specified currency: U.S. dollars (“\$”)

Face amount: each note will have a face amount equal to \$1,000; \$ in the aggregate for all the offered notes; the aggregate face amount of the offered notes may be increased if the issuer, at its sole option, decides to sell an additional amount of the offered notes on a date subsequent to the date of this pricing supplement

Denominations: \$1,000 and integral multiples of \$1,000 in excess thereof

Purchase at amount other than face amount: the amount we will pay you for your notes on the stated maturity date or upon any early redemption of your notes will not be adjusted based on the issue price you pay for your notes, so if you acquire notes at a premium (or discount) to face amount and hold them to the stated maturity date or date of early redemption, it could affect your investment in a number of

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ways. The return on your investment in such notes will be lower (or higher) than it would have been had you purchased the notes at face amount. See “Additional Risk Factors Specific to Your Notes — If You Purchase Your Notes at a Premium to Face Amount, the Return on Your Investment Will Be Lower Than the Return on Notes Purchased at Face Amount and the Impact of Certain Key Terms of the Notes Will Be Negatively Affected” on page S-14 of this pricing supplement

Supplemental discussion of U.S. federal income tax consequences: you will be obligated pursuant to the terms of the notes — in the absence of a change in law, an administrative determination or a judicial ruling to the contrary — to characterize each note for all tax purposes as an income-bearing pre-paid derivative contract in respect of the underliers, as described under “Supplemental Discussion of Federal Income Tax Consequences” herein. Pursuant to this approach, it is the opinion of Sidley Austin LLP that it is likely that any coupon payment will be taxed as ordinary income in accordance with your regular method of accounting for U.S. federal income tax purposes. If you are a United States alien holder of the notes, we intend to withhold on coupon payments made to you at a 30% rate or at a lower rate specified by an applicable income tax treaty. In addition, upon the sale, exchange, redemption or maturity of your notes, it would be reasonable for you to recognize capital gain or loss equal to the difference, if any, between the amount of cash you receive at such time (excluding amounts attributable to any coupon payment) and your tax basis in your notes.

Cash settlement amount: subject to our redemption right, for each \$1,000 face amount of your notes, we will pay you on the stated maturity date an amount in cash equal to:

- if the underlier return of each underlier is greater than or equal to -40%, \$1,000 plus the final coupon; or
- if the underlier return of any underlier is less than -40%, the sum of (i) \$1,000 plus (ii) the product of (a) the lesser performing underlier return times (b) \$1,000.

Early redemption right: we have the right to redeem your notes, in whole but not in part, at a price equal to 100% of the face amount plus any coupon then due, on the coupon payment dates occurring in January, April, July and October of each year, commencing in October 2019 and ending in July 2022, subject to at least ten business days’ prior notice

Lesser performing underlier return: the underlier return of the lesser performing underlier

Lesser performing underlier: the underlier with the lowest underlier return

Underlier return: with respect to each underlier on the determination date, the quotient of (i) the final underlier level minus the initial underlier level divided by (ii) the initial underlier level, expressed as a positive or negative percentage

Coupon: subject to our redemption right, on each coupon payment date, for each \$1,000 face amount of your notes, we will pay you an amount in cash equal to:

- if the closing level of each underlier on the related coupon observation date is greater than or equal to 60% of its initial underlier level, \$6.25; or
- if the closing level of any underlier on the related coupon observation date is less than 60% of its initial underlier level, \$0

Initial underlier level (to be set on the trade date): with respect to each underlier, the closing level of such underlier on the trade date

Final underlier level: with respect to each underlier, the closing level of such underlier on the determination date, subject to anti-dilution adjustments (with respect to the iShares[®] MSCI EAFE ETF and the SPDR[®] S&P[®] Oil & Gas Exploration & Production ETF only) as described under “Supplemental Terms of the Notes — Anti-dilution Adjustments for Exchange-Traded Funds” on page S-28 of the accompanying general terms supplement no. 1,734, except in the limited circumstances described under “Supplemental Terms of the Notes — Consequences of a Market Disruption Event or a Non-Trading Day” on page S-23 of the accompanying general terms supplement no. 1,734 and subject to adjustment as provided under “Supplemental Terms of the Notes — Discontinuance or Modification of an Underlier” on page S-27 of the accompanying general terms supplement no. 1,734

Closing level: with respect to each underlier, as further described under “Supplemental Terms of the Notes — Special Calculation Provisions — Closing Level” on page S-31 of the accompanying general terms supplement no. 1,734, subject to anti-dilution adjustments (with respect to the iShares[®] MSCI EAFE ETF and the SPDR[®] S&P[®] Oil & Gas Exploration & Production ETF only) as described under “Supplemental Terms of the Notes — Anti-dilution Adjustments for Exchange-Traded Funds” on page S-28 of the accompanying general terms supplement no. 1,734

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Defeasance: not applicable

No listing: the offered notes will not be listed or displayed on any securities exchange or interdealer market quotation system

Business day: as described under “Supplemental Terms of the Notes — Special Calculation Provisions — Business Day” on page S-30 of the accompanying general terms supplement no. 1,734

Trading day: as described under “Supplemental Terms of the Notes — Special Calculation Provisions — Trading Day” on page S-31 of the accompanying general terms supplement no. 1,734

Trade date: expected to be October 9, 2018

Original issue date (settlement date) (to be set on the trade date): expected to be October 12, 2018

Stated maturity date (to be set on the trade date): expected to be October 12, 2022, subject to adjustment as described under “Supplemental Terms of the Notes — Stated Maturity Date” on page S-16 of the accompanying general terms supplement no. 1,734

Determination date (to be set on the trade date): the last coupon observation date, expected to be September 28, 2022, subject to adjustment as described under “Supplemental Terms of the Notes — Payment of Principal on Stated Maturity Date — Determination Date” on page S-17 of the accompanying general terms supplement no. 1,734

Coupon observation dates (to be set on the trade date): expected to be the tenth scheduled trading day for all underliers prior to each coupon payment date, subject to adjustment as described under “Supplemental Terms of the Notes — Coupon Payments— Coupon Observation Dates” on page S-25 of the accompanying general terms supplement no. 1,734 (for purposes of postponement as described in such section, each coupon payment date will be treated as if it were ten scheduled business days following the applicable coupon observation date). For the avoidance of doubt, if a coupon payment date is postponed due to a non-business day as provided under “Coupon payment dates” below, such postponement of a coupon payment date will not postpone the related coupon observation date.

Coupon payment dates (to be set on the trade date): expected to be the 12th day of each month, beginning November 2018 and ending on the stated maturity date, subject to adjustment as described under “Supplemental Terms of the Notes — Coupon Payments — Coupon Payment Dates” on page S-25 of the accompanying general terms supplement no. 1,734 (for purposes of postponement as described in such section, each coupon payment date will be treated as if it were ten scheduled business days following the applicable coupon observation date)

Regular record dates: the scheduled business day immediately preceding the day on which payment is to be made (as such payment date may be adjusted)

Use of proceeds and hedging: as described under “Use of Proceeds” and “Hedging” on page S-94 of the accompanying general terms supplement no. 1,734

ERISA: as described under “Employee Retirement Income Security Act” on page S-95 of the accompanying general terms supplement no. 1,734

Supplemental plan of distribution; conflicts of interest: as described under “Supplemental Plan of Distribution” on page S-96 of the accompanying general terms supplement no. 1,734 and “Plan of Distribution — Conflicts of Interest” on page 94 of the accompanying prospectus; GS Finance Corp. estimates that its share of the total offering expenses, excluding underwriting discounts and commissions, will be approximately \$.

GS Finance Corp. expects to agree to sell to Goldman Sachs & Co. LLC (“GS&Co.”), and GS&Co. expects to agree to purchase from GS Finance Corp., the aggregate face amount of the offered notes specified on the front cover of this pricing supplement. GS&Co. proposes initially to offer the notes to the public at the original issue price set forth on the cover page of this pricing supplement, and to certain securities dealers at such price less a concession not in excess of % of the face amount. The original issue price for notes purchased by certain retirement accounts and certain fee-based advisory accounts will be % of the face amount of the notes, which will reduce the underwriting discount specified on the cover of this pricing supplement with respect to such notes to %.

GS&Co. is an affiliate of GS Finance Corp. and The Goldman Sachs Group, Inc. and, as such, will have a “conflict of interest” in this offering of notes within the meaning of Financial Industry Regulatory Authority, Inc. (FINRA) Rule 5121. Consequently, this offering of notes will be conducted in compliance with the provisions of FINRA Rule 5121.

GS&Co. will not be permitted to sell notes in this offering to an account over which it exercises discretionary authority without the prior specific written approval of the account holder.

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We expect to deliver the notes against payment therefor in New York, New York on October 12, 2018. Under Rule 15c6-1 of the Securities Exchange Act of 1934, trades in the secondary market generally are required to settle in two business days, unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade notes on any date prior to two business days before delivery will be required to specify alternative settlement arrangements to prevent a failed settlement.

We have been advised by GS&Co. that it intends to make a market in the notes. However, neither GS&Co. nor any of our other affiliates that makes a market is obligated to do so and any of them may stop doing so at any time without notice. No assurance can be given as to the liquidity or trading market for the notes.

Calculation agent: GS&Co.

CUSIP no.: 40056E7J1

ISIN no.: US40056E7J17

FDIC: the notes are not bank deposits and are not insured by the Federal Deposit Insurance Corporation or any other governmental agency, nor are they obligations of, or guaranteed by, a bank

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HYPOTHETICAL EXAMPLES

The following examples are provided for purposes of illustration only. They should not be taken as an indication or prediction of future investment results and are intended merely to illustrate (i) the impact that various hypothetical closing levels of the underliers on a coupon observation date could have on the coupon payable on the related coupon payment date and (ii) the impact that the various hypothetical closing levels of the lesser performing underlier on the determination date could have on the cash settlement amount at maturity assuming all other variables remain constant. The examples below are based on a range of underlier levels that are entirely hypothetical; no one can predict what the underlier level of any underlier will be on any day throughout the life of your notes, what the closing level of any underlier will be on any coupon observation date and what the final underlier level of the lesser performing underlier will be on the determination date. The underliers have been highly volatile in the past — meaning that the underlier levels have changed substantially in relatively short periods — and their performance cannot be predicted for any future period.

The information in the following examples reflects the hypothetical rates of return on the offered notes assuming that they are purchased on the original issue date at the face amount and held to the stated maturity date or date of early redemption. If you sell your notes in a secondary market prior to the stated maturity date or date of early redemption, as the case may be, your return will depend upon the market value of your notes at the time of sale, which may be affected by a number of factors that are not reflected in the examples below such as interest rates, the volatility of the underliers, the creditworthiness of GS Finance Corp., as issuer, and the creditworthiness of The Goldman Sachs Group, Inc., as guarantor. In addition, the estimated value of your notes at the time the terms of your notes are set on the trade date (as determined by reference to pricing models used by GS&Co.) is less than the original issue price of your notes. For more information on the estimated value of your notes, see “Additional Risk Factors Specific to Your Notes — The Estimated Value of Your Notes At the Time the Terms of Your Notes Are Set On the Trade Date (as Determined By Reference to Pricing Models Used By GS&Co.) Is Less Than the Original Issue Price Of Your Notes” on page S-12 of this pricing supplement. The information in the examples also reflect the key terms and assumptions in the box below.

Key Terms and Assumptions

Face amount	\$1,000
Hypothetical initial underlier level of the EURO STOXX 50 [®] Index	3,400
Hypothetical initial underlier level of iShares [®] MSCI EAFE ETF	\$75
Hypothetical initial underlier level of SPDR [®] S&P [®] Oil & Gas Exploration & Production ETF	\$45
Coupon	\$6.25

Neither a market disruption event nor a non-trading day occurs on the originally scheduled coupon observation date or the originally scheduled determination date

No change in or affecting any of the underlier stocks or the method by which the applicable underlier sponsor calculates any underlier

Notes purchased on original issue date at the face amount and held to the stated maturity date or date of early redemption

Moreover, we have not yet set the initial underlier levels that will serve as the baseline for determining the coupon payable on each coupon payment date, if any, if the notes will be redeemed, the underlier returns and the amount that we will pay on your notes, if any, at maturity. We will not do so until the trade date. As a result, the actual initial underlier levels may differ substantially from the underlier levels prior to the trade date. They may also differ substantially from the underlier levels at the time you purchase your notes.

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For these reasons, the actual performance of the underliers over the life of your notes, the actual underlier levels on any coupon observation date, as well as the coupon payable, if any, on each coupon payment date, may bear little relation to the hypothetical examples shown below or to the historical underlier levels shown elsewhere in this pricing supplement. For information about the underlier levels during recent periods, see “The Underliers — Historical Closing Levels of the Underliers” on page S-31. Before investing in the notes, you should consult publicly available information to determine the underlier levels between the date of this pricing supplement and the date of your purchase of the notes.

Also, the hypothetical examples shown below do not take into account the effects of applicable taxes. Because of the U.S. tax treatment applicable to your notes, tax liabilities could affect the after-tax rate of return on your notes to a comparatively greater extent than the after-tax return on the underlier stocks.

Hypothetical Coupon Payments

The examples below show hypothetical performances of each underlier as well as the hypothetical coupons, if any, that we would pay on each coupon payment date with respect to each \$1,000 face amount of the notes if the closing level of each underlier on the applicable coupon observation date were the hypothetical closing levels shown and 60% of the hypothetical initial underlier levels were 2,040, \$45 and \$27 for the EURO STOXX 50[®] Index, iShares[®] MSCI EAFE ETF and SPDR[®] S&P[®] Oil & Gas Exploration & Production ETF, respectively.

Scenario 1

Hypothetical Coupon Observation Date	Hypothetical Closing Level of the EURO STOXX 50 [®] Index	Hypothetical Closing Level of the iShares [®] MSCI EAFE ETF	Hypothetical Closing Level of SPDR [®] S&P [®] Oil & Gas Exploration & Production ETF	Hypothetical Coupon
First	3,500	\$80	\$18	\$0
Second	3,000	\$65	\$35	\$6.25
Third	2,000	\$55	\$18	\$0
Fourth	2,100	\$70	\$47	\$6.25
Fifth	1,900	\$50	\$16	\$0
Sixth	1,800	\$40	\$45	\$0
Seventh	1,700	\$60	\$18	\$0
Eighth	1,600	\$40	\$25	\$0
Ninth	1,650	\$75	\$26	\$0
Tenth	1,700	\$60	\$24	\$0
Eleventh	2,050	\$55	\$18	\$0
Twelfth - Forty-Eighth	1,900	\$60	\$19	\$0
Total Hypothetical Coupons				\$12.5

In Scenario 1, the hypothetical closing level of each underlier increases and decreases by varying amounts on each hypothetical coupon observation date. Because the hypothetical closing level of each underlier on the second and fourth hypothetical coupon observation dates is greater than or equal to 60% of its hypothetical initial underlier level, the total of the hypothetical coupons in Scenario 1 is \$12.5. Because the hypothetical closing level of at least one underlier on all other hypothetical coupon observation dates is less than 60% of its hypothetical initial underlier level, no further coupons will be paid, including at maturity.

Scenario 2

Hypothetical Coupon Observation Date	Hypothetical Closing Level of the EURO STOXX 50 [®] Index	Hypothetical Closing Level of the iShares [®] MSCI EAFE ETF	Hypothetical Closing Level of SPDR [®] S&P [®] Oil & Gas Exploration & Production ETF	Hypothetical Coupon
First	1,500	\$75	\$18	\$0
Second	1,550	\$60	\$18	\$0
Third	1,525	\$57	\$16	\$0
Fourth	1,800	\$58	\$47	\$0

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Fifth	1,500	\$59	\$18	\$0
Sixth	3,450	\$80	\$17	\$0
Seventh	1,600	\$65	\$17	\$0
Eighth	1,550	\$71	\$16	\$0
Ninth	1,600	\$75	\$19	\$0
Tenth	1,550	\$60	\$42	\$0
Eleventh	1,500	\$55	\$18	\$0
Twelfth - Forty-Eighth	1,550	\$70	\$17	\$0
			Total Hypothetical Coupons	\$0

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In Scenario 2, the hypothetical closing level of each underlier increases and decreases by varying amounts on each hypothetical coupon observation date. Because in each case the hypothetical closing level of at least one of the underliers on the related coupon observation date is less than 60% of its hypothetical initial underlier level, you will not receive a coupon payment on the applicable hypothetical coupon payment date. Since this occurs on every hypothetical coupon observation date, the overall return you earn on your notes will be less than zero. Therefore, the total of the hypothetical coupons in Scenario 2 is \$0.

Scenario 3

Hypothetical Coupon Observation Date	Hypothetical Closing Level of the EURO STOXX 50® Index	Hypothetical Closing Level of the iShares® MSCI EAFE ETF	Hypothetical Closing Level of SPDR® S&P® Oil & Gas Exploration & Production ETF	Hypothetical Coupon
First	1,500	\$40	\$18	\$0
Second	1,550	\$25	\$18	\$0
Third	1,525	\$40	\$16	\$0
Fourth	1,800	\$37	\$20	\$0
Fifth	1,500	\$28	\$18	\$0
Sixth	1,500	\$39	\$17	\$0
Seventh	1,550	\$30	\$17	\$0
Eighth	1,525	\$35	\$16	\$0
Ninth	1,800	\$41	\$19	\$0
Tenth	1,500	\$30	\$18	\$0
Eleventh	1,900	\$25	\$17	\$0
Twelfth	2,450	\$80	\$40	\$6.25
			Total	
			Hypothetical Coupons	\$6.25

In Scenario 3, the hypothetical closing level of each underlier is less than 60% during the first eleven hypothetical coupon observation dates, but increases to a level that is greater than 60% of its hypothetical initial underlier level on the twelfth hypothetical coupon observation date. Further, we also exercise our early redemption right with respect to the twelfth hypothetical coupon payment date (which is also the first hypothetical date with respect to which we could exercise such right). Therefore, on the twelfth coupon payment date (the redemption date), in addition to the hypothetical coupon of \$6.25, you will receive an amount in cash equal to \$1,000 for each \$1,000 face amount of your notes.

Hypothetical Payment at Maturity

If the notes are not redeemed, the cash settlement amount we would deliver for each \$1,000 face amount of your notes on the stated maturity date will depend on the performance of the lesser performing underlier on the determination date, as shown in the table below. The table below assumes that the notes have not been redeemed, does not include the final coupon, if any, and reflects hypothetical cash settlement amounts that you could receive on the stated maturity date. If the final underlier level of the lesser performing underlier (as a percentage of the initial underlier level) is less than 60%, you will not be paid a final coupon at maturity.

The levels in the left column of the table below represent hypothetical final underlier levels of the lesser performing underlier and are expressed as percentages of the initial underlier level of the lesser performing underlier. The amounts in the right column represent the hypothetical cash settlement amounts, based on the corresponding hypothetical final underlier level of the lesser performing underlier (expressed as a percentage of the initial underlier level of the lesser performing underlier), and are expressed as percentages of the face amount of a note (rounded to the

nearest one-thousandth of a percent). Thus, a hypothetical cash settlement amount of 100.000% means that the value of the cash payment that we would deliver for each \$1,000 of the outstanding face amount of the offered notes on the stated maturity date would equal 100.000% of the face amount of a note, based on the corresponding hypothetical final underlier level of the lesser performing underlier (expressed as a percentage of the initial underlier level of the lesser performing underlier) and the assumptions noted above.

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The Notes Have Not Been Redeemed

Hypothetical Final Underlier Level of the Lesser Performing Underlier (as Percentage of Initial Underlier Level)	Hypothetical Cash Settlement Amount at Maturity if the Notes Have Not Been Redeemed (as Percentage of Face Amount)
175.000%	100.000%*
150.000%	100.000%*
125.000%	100.000%*
100.000%	100.000%*
90.000%	100.000%*
80.000%	100.000%*
60.000%	100.000%*
59.999%	59.999%
50.000%	50.000%
40.000%	40.000%
35.000%	35.000%
25.000%	25.000%
10.000%	10.000%
0.000%	0.000%

*Does not include the final coupon

If, for example, the notes have not been redeemed and the final underlier level of the lesser performing underlier were determined to be 25.000% of its initial underlier level, the cash settlement amount that we would deliver on your notes at maturity would be 25.000% of the face amount of your notes, as shown in the table above. As a result, if you purchased your notes on the original issue date at the face amount and held them to the stated maturity date, you would lose 75.000% of your investment (if you purchased your notes at a premium to face amount you would lose a correspondingly higher percentage of your investment). In addition, if the notes have not been redeemed and the final underlier level of the lesser performing underlier were determined to be 175.000% of its initial underlier level, the cash settlement amount that we would deliver on your notes at maturity would be limited to 100.000% of each \$1,000 face amount of your notes, as shown in the table above. As a result, if you held your notes to the stated maturity date, you would not benefit from any increase in the final underlier level over the initial underlier level.

The cash settlement amounts shown above are entirely hypothetical; they are based on market prices for the underlier stocks that may not be achieved on the determination date and on assumptions that may prove to be erroneous. The actual market value of your notes on the stated maturity date or at any other time, including any time you may wish to sell your notes, may bear little relation to the hypothetical cash settlement amounts shown above, and these amounts should not be viewed as an indication of the financial return on an investment in the offered notes. The hypothetical cash settlement amounts on notes held to the stated maturity date in the examples above assume you purchased your notes at their face amount and have not been adjusted to reflect the actual issue price you pay for your notes. The return on your investment (whether positive or negative) in your notes will be affected by the amount you pay for your notes. If you purchase your notes for a price other than the face amount, the return on your investment will differ from, and may be significantly lower than, the hypothetical returns suggested by the above examples. Please read “Additional Risk Factors Specific to Your Notes — The Market Value of Your Notes May Be Influenced by Many Unpredictable Factors” on page S-3 of the accompanying general terms supplement no. 1,734.

Payments on the notes are economically equivalent to the amounts that would be paid on a combination of other instruments. For example, payments on the notes are economically equivalent to a combination of an interest-bearing bond bought by the holder and one or more options entered into between the holder and us (with one or more implicit option premiums paid over time). The discussion in this paragraph does not modify or affect the terms of the notes or the U.S. federal income tax treatment of the notes, as described elsewhere in this pricing supplement.

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We cannot predict the actual closing levels of the underliers on any day, the final underlier levels of the underliers or what the market value of your notes will be on any particular trading day, nor can we predict the relationship between the closing levels of the underliers and the market value of your notes at any time prior to the stated maturity date. The actual coupon payment, if any, that a holder of the notes will receive on each coupon payment date, the actual amount that you will receive at maturity, if any, and the rate of return on the offered notes will depend on whether or not the notes are redeemed and the actual initial underlier levels, which we will set on the trade date, and on the actual closing levels of the underliers and the actual final underlier levels determined by the calculation agent as described above. Moreover, the assumptions on which the hypothetical examples are based may turn out to be inaccurate. Consequently, the coupon to be paid in respect of your notes, if any, and the cash amount to be paid in respect of your notes on the stated maturity date, if any, may be very different from the information reflected in the examples above.

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ADDITIONAL RISK FACTORS SPECIFIC TO YOUR NOTES

An investment in your notes is subject to the risks described below, as well as the risks and considerations described in the accompanying prospectus, in the accompanying prospectus supplement and under “Additional Risk Factors Specific to the Notes” in the accompanying general terms supplement no. 1,734. You should carefully review these risks and considerations as well as the terms of the notes described herein and in the accompanying prospectus, the accompanying prospectus supplement and the accompanying general terms supplement no. 1,734. Your notes are a riskier investment than ordinary debt securities. Also, your notes are not equivalent to investing directly in the underlier stocks, i.e., with respect to an underlier to which your notes are linked, the stocks comprising such underlier. You should carefully consider whether the offered notes are suited to your particular circumstances.

The Estimated Value of Your Notes At the Time the Terms of Your Notes Are Set On the Trade Date (as Determined By Reference to Pricing Models Used By GS&Co.) Is Less Than the Original Issue Price Of Your Notes

The original issue price for your notes exceeds the estimated value of your notes as of the time the terms of your notes are set on the trade date, as determined by reference to GS&Co.’s pricing models and taking into account our credit spreads. Such estimated value on the trade date is set forth above under “Estimated Value of Your Notes”; after the trade date, the estimated value as determined by reference to these models will be affected by changes in market conditions, the creditworthiness of GS Finance Corp., as issuer, the creditworthiness of The Goldman Sachs Group, Inc., as guarantor, and other relevant factors. The price at which GS&Co. would initially buy or sell your notes (if GS&Co. makes a market, which it is not obligated to do), and the value that GS&Co. will initially use for account statements and otherwise, also exceeds the estimated value of your notes as determined by reference to these models. As agreed by GS&Co. and the distribution participants, this excess (i.e., the additional amount described under “Estimated Value of Your Notes”) will decline to zero on a straight line basis over the period from the date hereof through the applicable date set forth above under “Estimated Value of Your Notes”. Thereafter, if GS&Co. buys or sells your notes it will do so at prices that reflect the estimated value determined by reference to such pricing models at that time. The price at which GS&Co. will buy or sell your notes at any time also will reflect its then current bid and ask spread for similar sized trades of structured notes.

In estimating the value of your notes as of the time the terms of your notes are set on the trade date, as disclosed above under “Estimated Value of Your Notes”, GS&Co.’s pricing models consider certain variables, including principally our credit spreads, interest rates (forecasted, current and historical rates), volatility, price-sensitivity analysis and the time to maturity of the notes. These pricing models are proprietary and rely in part on certain assumptions about future events, which may prove to be incorrect. As a result, the actual value you would receive if you sold your notes in the secondary market, if any, to others may differ, perhaps materially, from the estimated value of your notes determined by reference to our models due to, among other things, any differences in pricing models or assumptions used by others. See “Additional Risk Factors Specific to the Notes — The Market Value of Your Notes May Be Influenced by Many Unpredictable Factors” on page S-3 of the accompanying general terms supplement no. 1,734.

The difference between the estimated value of your notes as of the time the terms of your notes are set on the trade date and the original issue price is a result of certain factors, including principally the underwriting discount and commissions, the expenses incurred in creating, documenting and marketing the notes, and an estimate of the difference between the amounts we pay to GS&Co. and the amounts GS&Co. pays to us in connection with your notes. We pay to GS&Co. amounts based on what we would pay to holders of a non-structured note with a similar maturity. In return for such payment, GS&Co. pays to us the amounts we owe under your notes.

In addition to the factors discussed above, the value and quoted price of your notes at any time will reflect many factors and cannot be predicted. If GS&Co. makes a market in the notes, the price quoted by GS&Co. would reflect any changes in market conditions and other relevant factors, including any deterioration in our creditworthiness or perceived creditworthiness or the creditworthiness or perceived creditworthiness of The Goldman Sachs Group, Inc. These changes may adversely affect the value of

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your notes, including the price you may receive for your notes in any market making transaction. To the extent that GS&Co. makes a market in the notes, the quoted price will reflect the estimated value determined by reference to GS&Co.'s pricing models at that time, plus or minus its then current bid and ask spread for similar sized trades of structured notes (and subject to the declining excess amount described above).

Furthermore, if you sell your notes, you will likely be charged a commission for secondary market transactions, or the price will likely reflect a dealer discount. This commission or discount will further reduce the proceeds you would receive for your notes in a secondary market sale.

There is no assurance that GS&Co. or any other party will be willing to purchase your notes at any price and, in this regard, GS&Co. is not obligated to make a market in the notes. See “— Your Notes May Not Have an Active Trading Market” below.

The Notes Are Subject to the Credit Risk of the Issuer and the Guarantor

Although the coupons (if any) and return on the notes will be based on the performance of each underlier, the payment of any amount due on the notes is subject to the credit risk of GS Finance Corp., as issuer of the notes, and the credit risk of The Goldman Sachs Group, Inc., as guarantor of the notes. The notes are our unsecured obligations. Investors are dependent on our ability to pay all amounts due on the notes, and therefore investors are subject to our credit risk and to changes in the market's view of our creditworthiness. Similarly, investors are dependent on the ability of The Goldman Sachs Group, Inc., as guarantor of the notes, to pay all amounts due on the notes, and therefore are also subject to its credit risk and to changes in the market's view of its creditworthiness. See “Description of the Notes We May Offer — Information About Our Medium-Term Notes, Series E Program — How the Notes Rank Against Other Debt” on page S-4 of the accompanying prospectus supplement and “Description of Debt Securities We May Offer – Guarantee by The Goldman Sachs Group, Inc.” on page 42 of the accompanying prospectus.

You May Lose Your Entire Investment in the Notes

You can lose your entire investment in the notes. Subject to our redemption right, the cash settlement amount on your notes, if any, on the stated maturity date will be based on the performance of the lesser performing of the EURO STOXX 50[®] Index, the iShares[®] MSCI EAFE ETF and the SPDR[®] S&P[®] Oil & Gas Exploration & Production ETF as measured from their initial underlier levels (set on the trade date) to their closing levels on the determination date. If the final underlier level of the lesser performing underlier for your notes is less than 60% of its initial underlier level, you will have a loss for each \$1,000 of the face amount of your notes equal to the product of the lesser performing underlier return times \$1,000. Thus, you may lose your entire investment in the notes, which would include any premium to face amount you paid when you purchased the notes.

Also, the market price of your notes prior to the stated maturity date may be significantly lower than the purchase price you pay for your notes. Consequently, if you sell your notes before the stated maturity date, you may receive far less than the amount of your investment in the notes.

You May Not Receive a Coupon on Any Coupon Payment Date

If the closing level of any underlier on the related coupon observation date is less than 60% of its initial underlier level, you will not receive a coupon payment on the applicable coupon payment date. If this occurs on every coupon observation date, the overall return you earn on your notes will be less than zero and such return will be less than you would have earned by investing in a note that bears interest at the prevailing market rate.

On any coupon payment date, although you will receive a coupon if the closing level of each underlier on the related coupon observation date is greater than or equal to 60% of its initial underlier level, the coupon paid on the corresponding coupon payment date will be equal to \$6.25. You should be aware that, with respect to any prior coupon observation dates that did not result in the payment of a coupon, you will not be compensated for any opportunity cost implied by inflation and other factors relating to the time value of money. Further, there is no guarantee that you will receive any coupon payment with respect to the notes at any time and you may lose your entire investment in the notes.

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We Are Able to Redeem Your Notes at Our Option

On the coupon payment dates occurring in January, April, July and October of each year, commencing in October 2019 and ending in July 2022, we will be permitted to redeem your notes at our option. Even if we do not exercise our option to redeem your notes, our ability to do so may adversely affect the value of your notes. It is our sole option whether to redeem your notes prior to maturity and we may or may not exercise this option for any reason. Because of this redemption option, the term of your notes could be anywhere between one year and four years.

The Coupon Does Not Reflect the Actual Performance of the Underliers from the Trade Date to Any Coupon Observation Date or from Coupon Observation Date to Coupon Observation Date

The coupon for each monthly coupon payment date is different from, and may be less than, a coupon determined based on the percentage difference of the closing levels of the underliers between the trade date and any coupon observation date or between two coupon observation dates. Accordingly, the coupons, if any, on the notes may be less than the return you could earn on another instrument linked to the underliers that pay coupons based on the performance of the underliers from the trade date to any coupon observation date or from coupon observation date to coupon observation date.

The Cash Settlement Amount Will Be Based Solely on the Lesser Performing Underlier

If the notes are not redeemed by us, the cash settlement amount will be based on the lesser performing underlier without regard to the performance of the other underliers. As a result, you could lose all or some of your initial investment if the lesser performing underlier return is negative, even if there is an increase in the level of the other underliers. This could be the case even if the other underliers increased by an amount greater than the decrease in the lesser performing underlier.

The Return on Your Notes May Change Significantly Despite Only a Small Change in the Final Underlier Level of the Lesser Performing Underlier

If the final underlier level of the lesser performing underlier is less than 60% of its initial underlier level, you will receive less than the face amount of your notes and you could lose all or a substantial portion of your investment in the notes. This means that while a 40% drop between the initial underlier level of the lesser performing underlier and its final underlier level will not result in a loss of principal on the notes, a decrease in the final underlier level of the lesser performing underlier to less than 60% of its initial underlier level will result in a loss of a significant portion of your investment in the notes despite only a small change in the final underlier level of the lesser performing underlier.

Your Notes May Not Have an Active Trading Market

Your notes will not be listed or displayed on any securities exchange or included in any interdealer market quotation system, and there may be little or no secondary market for your notes. Even if a secondary market for your notes develops, it may not provide significant liquidity and we expect that transaction costs in any secondary market would be high. As a result, the difference between bid and asked prices for your notes in any secondary market could be substantial.

If You Purchase Your Notes at a Premium to Face Amount, the Return on Your Investment Will Be Lower Than the Return on Notes Purchased at Face Amount and the Impact of Certain Key Terms of the Notes Will Be Negatively Affected

The cash settlement amount you will be paid for your notes on the stated maturity date or the amount we will pay you upon any early redemption of your notes will not be adjusted based on the issue price you pay for the notes. If you purchase notes at a price that differs from the face amount of the notes, then the return on your investment in such notes held to the stated maturity date or date of early redemption will differ from, and may be substantially less than, the return on notes purchased at face amount. If you purchase your notes at a premium to face amount and hold them to the stated maturity date or date of early redemption, the return on your investment in the notes will be lower than it would have been had you purchased the notes at face amount or a discount to face amount.

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If the Levels of the Underliers Change, the Market Value of Your Notes May Not Change in the Same Manner
The price of your notes may move differently than the performance of the underliers. Changes in the levels of the underliers may not result in a comparable change in the market value of your notes. Even if the closing level of each underlier is greater than or equal to 60% of its initial underlier level during some portion of the life of the notes, the market value of your notes may not reflect this. We discuss some of the reasons for this disparity under “Additional Risk Factors Specific to Your Notes — The Market Value of Your Notes May Be Influenced by Many Unpredictable Factors” on page S-3 of the accompanying general terms supplement no. 1,734.

The Return on Your Notes Will Not Reflect Any Dividends Paid on the Underliers or the Underlier Stocks, as Applicable

The index sponsor of the EURO STOXX 50[®] Index calculates the value of the EURO STOXX 50[®] Index by reference to the prices of its underlier stocks, without taking account of the value of dividends paid on those stocks. Therefore, the return on your notes will not reflect the return you would realize if you actually owned the underlier stocks and received the dividends paid on those stocks. In addition, the return on your notes will not reflect the return you would realize if you actually owned the iShares[®] MSCI EAFE ETF or the SPDR[®] S&P[®] Oil & Gas Exploration & Production ETF and received the dividends paid on the shares of such ETFs. You will not receive any dividends that may be paid on any of the underlier stocks by the underlier stock issuers or on the shares of the iShares[®] MSCI EAFE ETF or the SPDR[®] S&P[®] Oil & Gas Exploration & Production ETF. See “— You Have No Shareholder Rights or Rights to Receive Any Shares of Any Underlier or Any Underlier Stocks” below for additional information.

You Have No Shareholder Rights or Rights to Receive Any Shares of Any Underlier or Any Underlier Stocks
Investing in your notes will not make you a holder of any shares of any underlier ETF or any underlier stocks. Neither you nor any other holder or owner of your notes will have any rights with respect to an underlier or its underlier stocks, including any voting rights, any right to receive dividends or other distributions, any right to make a claim against the underlier or its underlier stocks or any other rights of a holder of any shares of an underlier or its underlier stocks. Your notes will be paid in cash and you will have no right to receive delivery of any shares of any underlier or any underlier stocks.

We May Sell an Additional Aggregate Face Amount of the Notes at a Different Issue Price

At our sole option, we may decide to sell an additional aggregate face amount of the notes subsequent to the date of this pricing supplement. The issue price of the notes in the subsequent sale may differ substantially (higher or lower) from the issue price you paid as provided on the cover of this pricing supplement.

The Policies of the Investment Advisor of the SPDR[®] S&P[®] Oil & Gas Exploration & Production ETF, SSGA Funds Management, Inc., the Investment Advisor of the iShares[®] MSCI EAFE ETF, BlackRock Fund Advisors, S&P, the Sponsor of the S&P Oil & Gas Exploration & Production Select Industry Index and MSCI, the Sponsor of the MSCI EAFE Index, Could Affect the Amount Payable on Your Notes and Their Market Value

The investment advisor of the SPDR[®] S&P[®] Oil & Gas Exploration & Production ETF, SSGA Funds Management, Inc. (“SSGA”) and the investment advisor of the iShares[®] MSCI EAFE ETF, BlackRock Fund Advisors (“BFA”), may from time to time be called upon to make certain policy decisions or judgments with respect to the implementation of policies of the investment advisor concerning the calculation of the net asset value of the SPDR[®] S&P[®] Oil & Gas Exploration & Production ETF or the iShares[®] MSCI EAFE ETF, additions, deletions or substitutions of securities in the SPDR[®] S&P[®] Oil & Gas Exploration & Production ETF or the iShares[®] MSCI EAFE ETF and the manner in which changes affecting the underlying index for the SPDR[®] S&P[®] Oil & Gas Exploration & Production ETF or the iShares[®] MSCI EAFE ETF are reflected in that underlier that could affect the market price of the shares of that underlier and, therefore, the amount payable on your notes on the stated maturity date. The amount payable on your notes and their market value could also be affected if the investment advisor of an underlier changes these policies, for example, by changing the manner in which it calculates the net asset value of such underlier, or if the investment advisor discontinues or suspends calculation or publication of the net asset value of such underlier, in which case it may become difficult or inappropriate to determine the market value of your notes.

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If events such as these occur, the calculation agent — which initially will be GS&Co. — may determine the closing level of the affected underlier on a coupon determination date or the determination date — and thus the amount payable on a coupon payment date or the stated maturity date, if any — in a manner, in its sole discretion, it considers appropriate. We describe the discretion that the calculation agent will have in determining the closing levels of the underliers on a coupon observation date or the determination date, as applicable, and the amount payable on your notes more fully under “Supplemental Terms of the Notes — Discontinuance or Modification of an Underlier” on page S-27 of the accompanying general terms supplement no. 1,734.

In addition, S&P owns the S&P Oil & Gas Exploration & Production Select Industry Index and MSCI owns the MSCI EAFE Index, and are responsible for the design and maintenance of the respective underlying indices. The policies of an underlying index sponsor concerning the calculation of a particular underlying index, including decisions regarding the addition, deletion or substitution of the equity securities included in that underlying index, could affect the level of that underlying index and, consequently, could affect the market prices of shares of the related underlier and, therefore, the amount payable on your notes and their market value.

The SPDR® S&P® Oil & Gas Exploration & Production ETF is Concentrated in Oil & Gas Companies and Does Not Provide Diversified Exposure

The SPDR® S&P® Oil & Gas Exploration & Production ETF is not diversified. The SPDR® S&P® Oil & Gas Exploration & Production ETF’s assets will be concentrated in oil and gas companies, which means the SPDR® S&P® Oil & Gas Exploration & Production ETF is more likely to be more adversely affected by any negative performance of oil and gas companies than an underlier that has more diversified holdings across a number of sectors. Oil and gas companies develop and produce crude oil and natural gas and provide drilling and other energy resources production and distribution related services. Stock prices for these types of companies are affected by supply and demand both for their specific product or service and for energy products in general. The price of oil and gas, exploration and production spending, government regulation, world events and economic conditions will likewise affect the performance of these companies. Correspondingly, securities of companies in the energy field are subject to swift price and supply fluctuations caused by events relating to international politics, energy conservation, the success of exploration projects, and tax and other governmental regulatory policies. Weak demand for the companies’ products or services or for energy products and services in general, as well as negative developments in these other areas, would adversely impact the performance of the SPDR® S&P® Oil & Gas Exploration & Production ETF. For example, the SPDR® S&P® Oil & Gas Exploration & Production ETF suffered a significant negative performance for each of the years 2014 and 2015 primarily due to negative developments in the oil & gas sector, while the broader S&P® 500 index achieved a positive return for each of the same periods. In addition, oil and gas exploration and production can be significantly affected by natural disasters as well as changes in exchange rates, interest rates, government regulation, world events and economic conditions. Companies in the oil & gas sector may also be at risk for environmental damage claims.

There Are Risks Associated with the SPDR® S&P® Oil & Gas Exploration & Production ETF

Although the SPDR® S&P® Oil & Gas Exploration & Production ETF’s shares are listed for trading on NYSE Arca, Inc. (the “NYSE Arca”) and a number of similar products have been traded on the NYSE Arca or other securities exchanges for varying periods of time, there is no assurance that an active trading market will continue for the shares of the SPDR® S&P® Oil & Gas Exploration & Production ETF or that there will be liquidity in the trading market. In addition, the SPDR® S&P® Oil & Gas Exploration & Production ETF is subject to management risk, which is the risk that the ETF investment advisor’s investment strategy, the implementation of which is subject to a number of constraints, may not produce the intended results. For example, the SPDR® S&P® Oil & Gas Exploration & Production ETF investment advisor may select up to 20% of the SPDR® S&P® Oil & Gas Exploration & Production ETF’s assets to be invested in shares of equity securities that are not included in the underlying index. The SPDR® S&P® Oil & Gas Exploration & Production ETF is also not

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actively managed and may be affected by a general decline in market segments relating to the underlying index. The SPDR® S&P® Oil & Gas Exploration & Production ETF investment advisor invests in securities included in, or representative of, the underlying index regardless of their investment merits. The SPDR® S&P® Oil & Gas Exploration & Production ETF investment advisor does not attempt to take defensive positions in declining markets. In addition, the SPDR® S&P® Oil & Gas Exploration & Production ETF is subject to custody risk, which refers to the risks in the process of clearing and settling trades and to the holding of securities by local banks, agents and depositories. Low trading volumes and volatile prices in less developed markets make trades harder to complete and settle, and governments or trade groups may compel local agents to hold securities in designated depositories that are not subject to independent evaluation. The less developed a country's securities market is, the greater the likelihood of custody problems.

Further, under continuous listing standards adopted by the NYSE Arca, the SPDR® S&P® Oil & Gas Exploration & Production ETF will be required to confirm on an ongoing basis that the components of its underlying index satisfy the applicable listing requirements. In the event that its underlying index does not comply with the applicable listing requirements, the SPDR® S&P® Oil & Gas Exploration & Production ETF would be required to rectify such non-compliance by requesting that the underlying index sponsor modify such underlying index, adopting a new underlying index or obtaining relief from the Securities and Exchange Commission. There can be no assurance that the underlying index sponsor would so modify the underlying index or that relief would be obtained from the Securities and Exchange Commission and, therefore, non-compliance with the continuous listing standards may result in the SPDR® S&P® Oil & Gas Exploration & Production ETF being delisted by the NYSE Arca.

There Are Risks Associated with the iShares® MSCI EAFE ETF

Although the iShares® MSCI EAFE ETF's shares are listed for trading on NYSE Arca, Inc. (the "NYSE Arca") and a number of similar products have been traded on the NYSE Arca or other securities exchanges for varying periods of time, there is no assurance that an active trading market will continue for the shares of the iShares® MSCI EAFE ETF or that there will be liquidity in the trading market.

In addition, the iShares® MSCI EAFE ETF is subject to management risk, which is the risk that the ETF investment advisor's investment strategy, the implementation of which is subject to a number of constraints, may not produce the intended results. For example, the iShares® MSCI EAFE ETF investment advisor may select up to 10% of the iShares® MSCI EAFE ETF's assets to be invested in shares of equity securities that are not included in the underlying index. The iShares® MSCI EAFE ETF is also not actively managed and may be affected by a general decline in market segments relating to the underlying index. The iShares® MSCI EAFE ETF investment advisor invests in securities included in, or representative of, the underlying index regardless of their investment merits. The iShares® MSCI EAFE ETF investment advisor does not attempt to take defensive positions in declining markets.

In addition, the iShares® MSCI EAFE ETF is subject to custody risk, which refers to the risks in the process of clearing and settling trades and to the holding of securities by local banks, agents and depositories. Low trading volumes and volatile prices in less developed markets make trades harder to complete and settle, and governments or trade groups may compel local agents to hold securities in designated depositories that are not subject to independent evaluation. The less developed a country's securities market is, the greater the likelihood of custody problems.

Further, under continuous listing standards adopted by the NYSE Arca, the iShares® MSCI EAFE ETF will be required to confirm on an ongoing basis that the components of its underlying index satisfy the applicable listing requirements. In the event that its underlying index does not comply with the applicable listing requirements, the iShares® MSCI EAFE ETF would be required to rectify such non-compliance by requesting that the underlying index sponsor modify such underlying index, adopting a new underlying index or obtaining relief from the Securities and Exchange Commission. There can be no assurance that the underlying index sponsor would so modify the underlying index or that relief would be obtained from the Securities and Exchange Commission and, therefore, non-compliance with the continuous listing standards may result in the iShares® MSCI EAFE ETF being delisted by the NYSE Arca.

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Each of the iShares[®] MSCI EAFE ETF and the SPDR[®] S&P[®] Oil & Gas Exploration & Production ETF and its Underlying Index are Different and the Performance of Each ETF May Not Correlate with the Performance of its Underlying Index

Each of the iShares[®] MSCI EAFE ETF and the SPDR[®] S&P[®] Oil & Gas Exploration & Production ETF (each, an “ETF” and together, “ETFs”) uses a representative sampling strategy (more fully described under “The Underliers”) to attempt to track the performance of its underlying index. Each ETF may not hold all or substantially all of the equity securities included in its underlying index and may hold securities or assets not included in its underlying index.

Therefore, while the performance of an ETF is generally linked to the performance of its underlying index, the performance of each ETF is also linked in part to shares of equity securities not included in its underlying index and to the performance of other assets, such as futures contracts, options and swaps, as well as cash and cash equivalents, including shares of money market funds affiliated with its ETF investment advisor.

Imperfect correlation between an ETF’s portfolio securities and those in its underlying index, rounding of prices, changes to its underlying index and regulatory requirements may cause tracking error, which is the divergence of an ETF’s performance from that of its underlying index.

In addition, the performance of each ETF will reflect additional transaction costs and fees that are not included in the calculation of the applicable underlying index and this may increase the tracking error of such ETF. Also, corporate actions with respect to the sample of equity securities (such as mergers and spin-offs) may impact the performance differential between each ETF and its underlying index. Finally, because the shares of each ETF are traded on the NYSE Arca and are subject to market supply and investor demand, the market value of one share of an ETF may differ from the net asset value per share of that ETF.

For all of the foregoing reasons, the performance of an ETF may not correlate with the performance of its underlying index. Consequently, the return on the notes will not be the same as investing directly the ETFs or in the underlying indices or in any of the underlier stocks or in any of the underlying index stocks, and will not be the same as investing in a debt security with payments linked to the performance of each underlying index.

An Investment in the Offered Notes Is Subject to Risks Associated with Foreign Securities Markets

The value of your notes is linked, in part, to the iShares[®] MSCI EAFE ETF, which holds stocks issued by foreign companies and, in part, to the EURO STOXX 50[®] Index, which is comprised of stocks from one or more foreign securities markets. Investments linked to the value of foreign equity securities involve particular risks. Any foreign securities market may be less liquid, more volatile and affected by global or domestic market developments in a different way than are the U.S. securities market or other foreign securities markets. Both government intervention in a foreign securities market, either directly or indirectly, and cross-shareholdings in foreign companies, may affect trading prices and volumes in that market. Also, there is generally less publicly available information about foreign companies than about those U.S. companies that are subject to the reporting requirements of the U.S. Securities and Exchange Commission. Further, foreign companies are subject to accounting, auditing and financial reporting standards and requirements that differ from those applicable to U.S. reporting companies.

The prices of securities in a foreign country are subject to political, economic, financial and social factors that are unique to such foreign country's geographical region. These factors include: recent changes, or the possibility of future changes, in the applicable foreign government's economic and fiscal policies; the possible implementation of, or changes in, currency exchange laws or other laws or restrictions applicable to foreign companies or investments in foreign equity securities; fluctuations, or the possibility of fluctuations, in currency

(3,890

)

Financing activities

Proceeds from long-term debt

51,033

36,742

Repayment of long-term debt

(16,681

)

(5,767

)

Payment on deferred financing costs

(124

)

—

Tax withholding payments on share based compensation

(265

)

(339

)

Cash dividends paid

(464

)

—

Net cash provided by financing activities

33,499

30,636

Net increase in cash

575

1,959

Cash at beginning of period

534

788

Cash at end of period

\$

1,109

\$

2,747

See accompanying notes to unaudited condensed consolidated financial statements.

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VIRCO MFG. CORPORATION

Notes to unaudited Condensed Consolidated Financial Statements

July 31, 2018

Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements and are presented in accordance with the requirements of Form 10-Q and Rule 10-01 of Regulation S-X. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2018 ("Form 10-K"). In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the six months ended July 31, 2018, are not necessarily indicative of the results that may be expected for the fiscal year ending January 31, 2019. The balance sheet at January 31, 2018, has been derived from the audited consolidated financial statements at that date, but does not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. All references to the "Company" refer to Virco Mfg. Corporation and its subsidiaries.

Note 2. Seasonality

The market for educational furniture is marked by extreme seasonality, with approximately 50% of the Company's total sales typically occurring from June to August each year, the Company's peak season. Hence, the Company typically builds and carries significant amounts of inventory during and in anticipation of this peak summer season to facilitate the rapid delivery requirements of customers in the educational market. This requires a large up-front investment in inventory, labor, storage and related costs as inventory is built in anticipation of peak sales during the summer months. As the capital required for this build-up generally exceeds cash available from operations, the Company has generally relied on third-party bank financing to meet cash flow requirements during the build-up period immediately preceding the peak season. In addition, the Company typically is faced with a large balance of accounts receivable during the peak season. This occurs for two primary reasons. First, accounts receivable balances typically increase during the peak season as shipments of products increase. Second, many customers during this period are educational institutions and government entities, which tend to pay accounts receivable more slowly than commercial customers.

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

Note 3. New Accounting Pronouncements

Recently Adopted Accounting Updates

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09), and has modified the standard thereafter. The Company adopted ASU 2014-09 effective February 1, 2018 using the modified retrospective method to apply this guidance to all open contracts at the date of initial application. The results of applying Topic 606 were insignificant and did not have a material impact on our consolidated financial condition, results of operations, cash flows, business process, controls or systems.

The Company manufactures, markets and distributes a wide variety of school and office furniture to wholesalers, distributors, educational institutions and governmental entities. Revenue is recorded for promised goods or services when control is transferred to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services.

Contractual Arrangements with Customers

The Company's sales generally involve a single performance obligation to deliver goods pursuant to customer purchase orders. Prices for our products are based on published price lists, and customer agreements. The Company has determined that the performance obligations are satisfied at a point in time when the Company completes delivery per the customer contract. The majority of sales are free on board (FOB) destination where the destination is specified per the customer contract and may

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include delivering the furniture into the classroom, school site or warehouse. Sales of furniture that are sold FOB factory are typically made to resellers of our product who in turn provide logistics to the ultimate customer. Once a product has been delivered per the shipping terms, the customer is able to direct the use of, and obtain substantially all of the remaining benefits from, the asset. The Company considers control to have transferred upon shipment or delivery in accordance with shipping terms because the Company has a present right to payment at that time, the customer has legal title to the asset, the Company has transferred physical possession of the asset, and the customer has significant risks and rewards of ownership of the asset.

Sales are recorded net of discounts, sales incentives and rebates, sales taxes and estimated returns and allowances. The Company offers sales incentives and discounts through various regional and national programs to our customers. These programs include product rebates, product returns allowances and trade promotions. Variable consideration for these programs is estimated in the transaction price at contract inception based on current sales levels and historical experience using the expected value method, subject to constraint.

The Company generates revenue primarily by manufacturing and distributing products through resellers and direct-to-customers. Control transfers to both resellers and direct customers at a point in time when the delivery process is complete as determined by the corresponding shipping terms. Therefore, we do not consider them to be meaningfully different revenue streams given similarities in the nature of the products, performance obligation and distribution processes. Sales are predominately in the United States and to a similar class of customer. We do not manage or evaluate the business based on product line or any other discernable category.

For product produced by and sourced from third parties, management has determined that it is the principal in all cases, since it (i) bears primary responsibility for fulfilling the promise to the customer; (ii) bears inventory risk before and/or after the good or service is transferred to the customer; and (iii) has discretion in establishing the price for the sale of good or service to the customer.

Contract Assets and Liabilities

Payment terms are established on the Company's pre-established credit requirements based upon an evaluation of customers' credit quality. Most customers obtain payment terms between 1-30 days and an asset is recognized for the related accounts receivable.

Contract liabilities are recognized for contracts where payment has been received in advance of delivery. The contract liability balance can vary significantly depending on the timing of when an order is placed and when shipment or delivery occurs. As of July 31, 2018, other than accounts receivable, the Company had no material contract assets, contract liabilities or deferred contract costs recorded on its condensed consolidated balance sheet.

Costs of fulfilling customers' purchase orders, such as shipping, handling and delivery, which occur prior to the transfer of control, are recognized in selling, general and administrative expense when incurred.

Practical Expedients & Optional Exemptions

Significant Financing Component - as we expect the period between when we transfer control of the promised good or service to a customer and when the customer pays for that good or service will be one year or less, the Company elected to apply the practical expedient for significant financing components

Remaining Performance Obligations - due to the short-term duration of the Company's contracts with customers and fulfillment of performance obligations, the Company has elected not to disclose the information regarding the remaining performance obligations as of the end of each reporting period or when the Company expects to recognize

this revenue.

Cost to Obtain a Customer - we pay certain costs to obtain a customer contract such as commissions. As our customer contracts have a contractual term of one year or less, we have elected to apply the practical expedient and expense these costs in selling, general and administrative expense as incurred, which is consistent with our historical practice.

Recently Issued Accounting Updates

In February 2016, the FASB issued ASU No. 2016-02, Leases ("Topic 842"). The new standard requires lessees to recognize most leases, including operating leases, on balance sheet via a right-of-use asset and lease liability. Changes to the lessee accounting model may change key balance sheet measures and ratios, potentially effecting analyst expectations and compliance with financial covenants. The new standard becomes effective for the Company's fiscal year beginning after December 15, 2018 and required a modified retrospective transition approach. However, the FASB issued ASU No. 2018-11, allowing entities the ability to elect not

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to recast the comparative periods presented when transitioning to Topic 842 as was previously required under the modified retrospective transition approach. While still evaluating the effect, the standard will have on consolidated financial statements and related disclosures, the Company has determined that the primary impact will be to recognize on the balance sheet all leases with lease terms greater than 12 months and that we will elect not to recast the comparative periods presented as allowed under ASU No. 2018-11. It is expected that this standard will have a material impact on the Company's consolidated financial statements in recognizing the right-of-use asset and related lease liability.

Other recently issued accounting updates are not expected to have a material impact on the Company's consolidated financial statements.

Note 4. Inventories

Inventories are valued at the lower of cost (determined on a first-in, first-out basis) or net realizable value and includes material, labor, and factory overhead. The Company maintains allowances for estimated slow-moving and obsolete inventory to reflect the difference between the cost of inventory and the estimated net realizable value. Allowances for slow-moving and obsolete inventory are determined through a physical inspection of the product in connection with a physical inventory, a review of slow-moving product, and consideration of active marketing programs. The market for education furniture is traditionally driven by value, not style, and the Company has not typically incurred significant obsolescence expenses. If market conditions are less favorable than those anticipated by management, additional allowances may be required. Due to reductions in sales volume in the past years, the Company's manufacturing facilities are operating at reduced levels of capacity. The Company records the cost of excess capacity as a period expense, not as a component of capitalized inventory valuation.

The following table presents an updated breakdown of the Company's inventories as of July 31, 2018, January 31, 2018 and July 31, 2017 (in thousands):

	7/31/2018	1/31/2018	7/31/2017
Finished goods	\$ 27,055	\$ 13,054	\$ 21,912
WIP	20,331	16,627	16,923
Raw materials	12,910	12,376	12,026
Inventories	\$ 60,296	\$ 42,057	\$ 50,861

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

Note 5. Debt

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

	7/31/2018	1/31/2018	7/31/2017
Revolving credit line	\$43,907	\$ 10,059	\$ 35,924
Other	7,126	6,622	63
Total debt	51,033	16,681	35,987
Less current portion	36,894	4,681	29,987
Non-current portion	\$14,139	\$ 12,000	\$ 6,000

On December 22, 2011, the Company entered into a Revolving Credit and Security Agreement (the "Credit Agreement") with PNC Bank, National Association, as administrative agent and lender ("PNC"). The credit agreement has been amended seventeen times subsequent to that date. On March 19, 2018, the Company entered into amendment No. 17, which amended the Credit Agreement by (i) extending the maturity date of the Credit Agreement for three years until March 19, 2023, (ii) allowing dividends and stock buyback up to \$2,000,000 in aggregate for any fiscal year, (iii) setting forth the minimum EBITDA financial covenant for fiscal quarter ended April 30, 2018 at

(\$3,767,000) and two consecutive fiscal quarters ending July 31, 2018 at \$6,402,000, (iv) increasing the Maximum Revolving Advance Amount from \$50,000,000 to \$60,000,000, and (v) setting forth the minimum fixed charge coverage ratio of not less than 1.10 to 1.00 commencing with the consecutive four fiscal

quarter period ending October 31, 2018 and measured as of the end of each fiscal quarter until the maturity date of the Credit Agreement. In connection with amendment No. 17, the Borrowers also agreed to pay to PNC Bank a non-refundable extension fee of \$250,000.

The Credit Agreement provides the Company ("Borrowers") with a secured revolving line of credit (the "Revolving Credit Facility") of up to \$60,000,000, with seasonal adjustments to the credit limit and subject to borrowing base limitations and includes a sub-limit of up to \$3,000,000 for issuances of letters of credit. In addition, the Credit Agreement provides an equipment line for purchases of equipment up to \$2,500,000. The Revolving Credit Facility is an asset-based line of credit that is subject to a borrowing base limitation and generally provides for advances of up to 85% of eligible accounts receivable, plus a percentage equal to the lesser of 60% of the value of eligible inventory or 85% of the liquidation value of eligible inventory, plus an amount ranging from \$8,000,000 to \$14,000,000 from December 1 through July 31 of each year, minus undrawn amounts of letters of credit and reserves. The Revolving Credit Facility is secured by substantially all of the Borrowers' personal property and certain of the Borrowers' real property. The principal amount outstanding under the Credit Agreement and any accrued and unpaid interest is due no later than March 19, 2023, and the Revolving Credit Facility is subject to certain prepayment penalties upon earlier termination of the Revolving Credit Facility. Prior to the maturity date, principal amounts outstanding under the Credit Agreement may be repaid and reborrowed at the option of the Borrowers without premium or penalty, subject to borrowing base limitations, seasonal adjustments and certain other conditions.

The Revolving Credit Facility bears interest, at the Borrowers' option, at either the Alternate Base Rate (as defined in the Credit Agreement) or the Eurodollar Currency Rate (as defined in the Credit Agreement), in each case plus an applicable margin. The applicable margin for Alternate Base Rate loans is a percentage within a range of 0.50% to 1.50%, and the applicable margin for Eurodollar Currency Rate loans is a percentage within a range of 1.50% to 2.50% in each case based on the EBITDA of the Borrowers at the end of each fiscal quarter, and may be increased at PNC's option by 2.0% during the continuance of an event of default. Accrued interest with respect to principal amounts outstanding under the Credit Agreement is payable in arrears on a monthly basis for Alternative Base Rate loans, and at the end of the applicable interest period but at most every three months for Eurodollar Currency Rate loans. The interest rate at July 31, 2018 was 6.25%.

The Credit Agreement also requires the Company to maintain the following financial maintenance covenants: (i) a minimum fixed charge coverage ratio, and (ii) a minimum EBITDA amount, in each case as of the end of the relevant monthly, quarterly or annual measurement period. As of July 31, 2018, the Credit Agreement required the Company to maintain a minimum EBITDA amount of \$6,402,000 for the three months ended July 31, 2018. The Company achieved EBITDA of \$7,124,000 for the quarter ended July 31, 2018. For the quarter ended July 31, 2018, the Company was in compliance with its financial covenants.

In addition, the Credit Agreement contains a clean down provision that requires the Company to reduce borrowings under the line to less than \$8,000,000 for a period of 30 consecutive days during the fourth quarter of 2019. The Company believes that normal operating cash flow will allow it to meet the clean down requirement with no adverse impact on the Company's liquidity.

Events of default (subject to certain cure periods and other limitations) under the Credit Agreement include, but are not limited to, (i) non-payment of principal, interest or other amounts due under the Credit Agreement, (ii) the violation of terms, covenants, representations or warranties in the Credit Agreement or related loan documents, (iii) any event of default under agreements governing certain indebtedness of the Borrowers and certain defaults by the Borrowers under other agreements that would materially adversely affect the Borrowers, (iv) certain events of bankruptcy, insolvency or liquidation involving the Borrowers, (v) judgments or judicial actions against the Borrowers in excess of \$250,000, subject to certain conditions, (vi) the failure of the Company to comply with Pension Benefit Plans (as defined in the Credit Agreement), (vii) the invalidity of loan documents pertaining to the Credit Agreement, (viii) a change of control of the Borrowers and (ix) the interruption of operations of any of the Borrowers' manufacturing facilities for five consecutive days during the peak season or fifteen consecutive days during any other

time, subject to certain conditions.

Pursuant to the Credit Agreement, substantially all of the Borrowers' accounts receivable are automatically and promptly swept to repay amounts outstanding under the Revolving Credit Facility upon receipt by the Borrowers. Due to this automatic liquidating nature of the Revolving Credit Facility, if the Borrowers breach any covenant, violate any representation or warranty or suffer a deterioration in their ability to borrow pursuant to the borrowing base calculation, the Borrowers may not have access to cash liquidity unless provided by PNC at its discretion. In addition, certain of the covenants and representations and warranties set forth in the Credit Agreement contain limited or no materiality thresholds, and many of the representations and warranties must be true and correct in all material respects upon each borrowing, which the Borrowers expect to occur on an ongoing basis. There can be no assurance that the Borrowers will be able to comply with all such covenants and be able to continue to make such representations and warranties on an ongoing basis.

The Company's line of credit with PNC is structured to provide seasonal credit availability during the Company's peak summer season. The Company believes that the Revolving Credit Facility will provide sufficient liquidity to meet its capital requirements in the next 12 months. Approximately \$15,593,000 was available for borrowing as of July 31, 2018.

Note 6. Income Taxes

The Company recognizes deferred income taxes under the asset and liability method of accounting for income taxes in accordance with the provisions of ASC No. 740, Accounting for Income Taxes. Deferred income taxes are recognized for differences between the financial statement and tax basis of assets and liabilities at enacted statutory tax rates in effect for the years in which the differences are expected to reverse. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. In assessing the realizability of deferred tax assets, the Company considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income or reversal of deferred tax liabilities during the periods in which those temporary differences become deductible. The Company maintains a partial valuation allowance against certain state deferred tax assets that the Company does not believe it is more-likely-than-not to realize.

On December 22, 2017, Staff Accounting Bulletin No. 118 was issued to address the application of US GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Cuts and Jobs Act. In accordance with SAB 118, we have determined that \$4,438,000 of the deferred tax expense recorded in connection with the remeasurement of certain deferred tax assets and liabilities was provisional amount and reasonable estimate at January 31, 2018. Additional work is necessary to do a more detailed analysis. Any subsequent adjustment to these amounts will be recorded to current tax expense in fiscal year 2019 when the analysis is complete. Through July 31, 2018, we have not made any material adjustments to the provisional amount. However, the Company is still analyzing certain aspects of the Act and refining its calculations, which could potentially affect the measurement of these balances or potentially give rise to new deferred tax amounts.

The January 31, 2015 and subsequent years remain open for examination by the IRS and state tax authorities. The Company is not currently under any state examination. The Company is currently under IRS examination for its fiscal year ended January 31, 2016 Federal tax return.

Note 7. Net Income per Share

	Three Months Ended 7/31/2018		Six Months Ended 7/31/2017	
	(In thousands, except per share data)			
Net income	\$5,475	\$ 5,028	\$1,903	\$ 2,817
Weighted average shares of common stock outstanding	15,392	15,211	15,355	15,170
Net effect of dilutive shares - based on the treasury stock method using average market price	43	74	40	63
Totals	15,435	15,285	15,395	15,233
Net income per share - basic	\$0.36	\$ 0.33	\$0.12	\$ 0.19
Net income per share - diluted	\$0.35	\$ 0.33	\$0.12	\$ 0.18

Note 8. Stock-Based Compensation Stock Incentive Plan

Under the 2011 Plan, the Company may grant an aggregate of 2,000,000 shares to its employees and non-employee directors in the form of stock options or awards. Restricted stock or stock units awarded under the 2011 Plan are expensed ratably over the vesting period of the awards. The Company determines the fair value of its restricted stock unit awards and related compensation expense as the difference between the market value of the awards on the date of grant less the exercise price of the awards granted. During second quarter ended July 31, 2018, the Company granted

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55,555 shares of restricted stock awards, vested 226,804 shares of restricted stock awards according to their terms and forfeited 20,000 shares. There were no stock awards granted, vested and forfeited during the first quarter ended April 30, 2018. There were approximately 268,277 shares available for future issuance under the 2011 Plan as of July 31, 2018. As of July 31, 2018, there was \$2,063,000 of unrecognized compensation expense related to unvested restricted stock units, which is expected to be recognized over a weighted average period of approximately 3 years.

During second quarter ended July 31, 2018, stock-based compensation expense related to restricted stock awards recognized in cost of goods sold and selling, general and administrative expenses was \$60,000 and \$151,000, respectively. During second quarter ended July 31, 2017, stock-based compensation expense related to restricted stock awards recognized in cost of goods sold and selling, general and administrative expenses was \$49,000 and \$170,000, respectively.

During the six months ended July 31, 2018, stock-based compensation expense related to restricted stock awards recognized in cost of goods sold and selling, general and administrative expenses was \$120,000 and \$319,000, respectively. During the six months ended July 31, 2017, stock-based compensation expense related to restricted stock awards recognized in cost of goods sold and selling, general and administrative expenses was \$77,000 and \$309,000, respectively.

Note 9. Stockholders' Equity

The Company's Credit Agreement with PNC restricts the Company from issuing dividends or making payments with respect to the Company's capital stock to an annual limit of \$2 million. Such dividends payments are also subject to compliance with financial and other covenants provided in the Credit Agreement. In June 2018, the Company declared a quarterly cash dividend of \$0.015 per share, payable July 10, 2018 to shareholders of record as of June 26, 2018.

Note 10. Retirement Plans

The Company and its subsidiaries cover certain employees under a noncontributory defined benefit retirement plan, entitled the Virco Employees' Retirement Plan (the "Pension Plan"). Benefits under the Employees Retirement Plan are based on years of service and career average earnings. As more fully described in the Form 10-K, benefit accruals under the Employees Retirement Plan were frozen effective December 31, 2003. There is no service cost incurred under this plan.

The Company also provides a supplementary retirement plan for certain key employees, the VIP Retirement Plan (the "VIP Plan"). The VIP Plan provides a benefit of up to 50% of average compensation for the last 5 years in the VIP Plan, offset by benefits earned under the Pension Plan. As more fully described in the Form 10-K, benefit accruals under this plan were frozen since December 31, 2003. There is no service cost incurred under this plan. During the second quarter ended July 31, 2018, the Company, at the retirees request, paid lump-sum distributions for the related benefit obligations. As the amount of the lump-sum settlement exceeded the sum of the service and interest cost for the year, the distribution was treated as a settlement in accordance with U.S. GAAP, resulting in plan settlement loss of \$319,000 recorded in the selling, general, and administrative expenses in the accompanying condensed consolidated statements of income and an actuarial loss on the plan re-measurement of \$1,840,000, net of tax, recorded to accumulated other comprehensive income for the three and six-months ended July 31, 2018.

The net periodic pension cost (income) for the Pension Plan and the VIP Plan for the three months and six months ended July 31, 2018 and 2017 were as follows (in thousands):

	Three Months Ended			
	Pension Plan		VIP Plan	
	7/31/2018	7/31/2017	7/31/2018	7/31/2017
Service cost	—	—	—	—
Interest cost	266	304	89	89
Expected return on plan assets	(407)	(342)	—	—

Plan settlement	319	—	—	—
Amortization of prior service cost	—	—	—	—
Recognized net actuarial (gain) loss	91	179	82	60
Benefit cost	\$269	\$ 141	\$171	\$ 149

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	Six Months Ended			
	Pension Plan		VIP Plan	
	7/31/2018	7/31/2017	7/31/2018	7/31/2017
Service cost	\$—	—	—	—
Interest cost	532	608	178	178
Expected return on plan assets	(814)	(684)	—	—
Plan settlement	319	—	—	—
Amortization of prior service cost	—	—	—	—
Recognized net actuarial (gain) loss	181	358	164	120
Benefit cost	\$218	\$ 282	\$342	\$ 298

401(k) Retirement Plan

The Company's retirement plan, which covers all U.S. employees, allows participants to defer from 1% to 75% of their eligible compensation through a 401(k) retirement program. Through December 31, 2001, the plan included an employee stock ownership component. The plan continues to include Virco stock as one of the investment options. At July 31, 2018 and 2017, the plan held 608,928 shares and 565,591 shares of Virco stock, respectively. For the quarter ended July 31, 2018, the Company made a contribution to employees enrolled in the Plan in connection with an auto enrollment program and initiated a Company match effective January 1, 2018. For the six months ended July 31, 2018, the compensation costs incurred for employer match was \$363,000. There was no employer match for same period ended July 31, 2017.

Note 11. Warranty Accrual

The Company provides an assurance type warranty against all substantial defects in material and workmanship. The standard warranty offered on products sold through January 31, 2013 is 10 years. Effective February 1, 2014 the Company modified its warranty to a limited lifetime warranty. The warranty effective February 1, 2014 is not anticipated to have a significant effect on warranty expense. Effective January 1, 2017, the Company modified the warranty offered to provide specific warranty periods by product component, with no warranty period longer than ten years. The Company's warranty is not a guarantee of service life, which depends upon events outside the Company's control and may be different from the warranty period. The Company accrues an estimate of its exposure to warranty claims based upon both product sales data and an analysis of actual warranty claims incurred.

The following is a summary of the Company's warranty-claim activity for the three months and six months ended July 31, 2018 and 2017.

	Three Months		Six Months	
	Ended		Ended	
	7/31/2018	7/31/2017	7/31/2018	7/31/2017
	(In thousands)			
Beginning balance	\$925	\$ 1,000	\$925	\$ 1,000
Provision	86	112	141	182
Costs incurred	(86)	(112)	(141)	(182)
Ending balance	\$925	\$ 1,000	\$925	\$ 1,000

Note 12. Contingencies

The Company has a self-insured retention for product and general liability losses up to \$250,000 per occurrence, workers' compensation liability losses up to \$250,000 per occurrence, and for automobile liability losses up to \$50,000 per occurrence. The Company has purchased insurance to cover losses in excess of the retention up to a limit of \$30,000,000. The Company has obtained an actuarial estimate of its total expected future losses for liability claims and recorded a liability equal to the net present value.

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

Note 13. Subsequent Events

In September 2018, the Company declared a quarterly cash dividend of \$0.015 per share, payable October 10, 2018 to shareholders of record as of September 26, 2018.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

Three Months Ended July 31, 2018

For the three months ended July 31, 2018, the Company earned a pre-tax profit of \$7,593,000 on sales of \$74,802,000 compared to a pre-tax profit of \$7,877,000 on sales of \$72,636,000 in the prior year.

Net sales for the three months ended July 31, 2018 increased by \$2,166,000 or 3%. This increase was primarily due to an increase in price partially offset by a slight decrease in volume. The Company began the second quarter with a backlog of orders that was approximately \$10.6 million greater than the prior year. Orders for the second quarter increased by approximately 7.6% compared to the prior year. Ending backlog at July 31, 2018 was \$60.1 million compared to \$47.3 million at the same date last year.

The second quarter results reflected continued increase in seasonality of the Company's business. School districts in many parts of the Country have accelerated the beginning of back to school to mid-August, impacting the summer delivery window. Although this would suggest that shipments would be pushed forward into July, the Company experienced an increase in orders that specified delivery in August, effectively moving revenue from the second quarter to the third quarter.

Gross margin as a percentage of sales decreased to 36.3% for the three months ended July 31, 2018 compared to 36.7% in the same period last year. The slight deterioration of the margin in the second quarter is attributable to several components, which may also impact our gross margins in future periods. In response to increased material costs incurred in the prior fiscal year, the Company increased selling prices at the beginning of the fiscal year. The increase in prices attained by the Company was not adequate to cover the significant increases in costs incurred in the prior year when combined with certain unanticipated increased costs incurred during the current year. Tariffs on steel, threatened tariffs on imported furniture from China, and increased prices for oil and the related impact on plastic have significantly increased the material cost component of our product. Also impacting margins was the composition of business in the quarter. The entire growth in sales was driven by full service business, consisting of a mix of our manufactured products accompanied by re-sale products. As discussed in prior year's Form 10K, the Company provides "one-stop-shopping" to schools where a new school can furnish an entire campus with one purchase order to Virco. To facilitate this product offering, the Company purchases and re-sells certain products from third-party furniture manufacturing partners. The gross margin on products purchased for resale are lower than on products manufactured by Virco, but are instrumental to successfully winning projects that include the more profitable Virco manufactured product.

Selling, general and administrative expenses for the three months ended July 31, 2018 increased by \$439,000 compared to the same period last year, but decreased very slightly as a percentage of sales to 25.0% from 25.2%. The increase in selling, general and administrative expenses was attributable to variable service expenses driven by the increased sales volume, and by a pension settlement charge.

Interest expense was more for the three months ended July 31, 2018 compared to the same period last year. There are three components of the increase. First, the three months ended July 31, 2018 includes interest expense on a mortgage related to the purchase of a building in Conway, Arkansas that was completed in the third quarter last year. Second, the Company has borrowed more money to finance production of inventory in anticipation of increased summer shipping activity. Finally, expense increased as a result of higher interest rates.

Six Months Ended July 31, 2018

For the six months ended July 31, 2018, the Company earned a pre-tax profit of \$2,559,000 on net sales of \$97,371,000 compared to a pre-tax profit of \$4,317,000 on net sales of \$95,871,000 in the same period last year. Net sales for the six months ended July 31, 2018 increased by \$1,500,000 compared to the same period last year. This increase was primarily the result of an increase in selling prices partially offset by a reduction in volume. The Company began the year with a backlog of orders that was approximately \$3.6 million greater than the prior year. Order rates for the first six months increased by approximately 9.5% compared to the prior year.

Gross margin as a percentage of sales declined to 35.8% for the six months ended July 31, 2018 compared to 36.6% in the same period last year. Due to the extreme seasonality of our business, second quarter sales represent more than

75% of sales for the first six months. The events articulated above that caused gross margins to decline for the second quarter are consistent with events that impacted the first six months. Such events may continue to have an ongoing impact upon our gross margins in future periods.

Selling, general and administrative expenses for the six months ended July 31, 2018 increased by approximately \$1,021,000 compared to the same period last year and increased as a percentage of sales by 0.5%. The increase in selling, general and

administrative expenses was attributable to variable service expense driven by increased revenue combined with a pension settlement charge.

Interest expense was more for the six months ended July 31, 2018 compared to the same period last year. The events articulated above that caused interest expense to rise for the second quarter are consistent with events that impacted the first six months.

Income Taxes for the three- and six-months ended July 31, 2018

Income tax expense for the second quarter and six months ended July 31, 2018 is less than the prior year, primarily due to the reduction in federal income tax rates for fiscal 2018.

Liquidity and Capital Resources

As discussed in the Company's Form 10-K, approximately 50% of the Company's annual sales volume is shipped in June through August. The Company traditionally manufactures large quantities of inventory during the first and second quarters of each fiscal year in anticipation of seasonally high summer shipments. In addition, the Company finances a large balance of accounts receivable during the peak season. Accounts receivable increased by \$32,724,000 from January 31, 2018 to July 31, 2018. This compares to prior year when accounts receivable grew by \$30,286,000 during the same period. The accounts receivable balance was \$3,908,000 higher at July 31, 2018 than at July 31, 2017 due to increased sales.

For the first six months, the Company increased inventory by approximately \$18,239,000 at July 31, 2018 compared to January 31, 2018. This compares to an increase of \$15,172,000 during the same period last year. Inventory at July 31, 2018 was \$9,435,000 more than the prior year. The increase in inventory compared to the prior year is primarily increased unit volume to fill the increase in order backlog at July 31, 2018 combined with an increase in valuation due to higher commodity costs. The increase in accounts receivable and inventory at July 31, 2018 compared to the January 31, 2018, was financed in part by vendor credit, which naturally increases with increased second quarter business activity, and through the Company's credit facility with PNC Bank.

Interest expense for the six months ended July 31, 2018 is slightly higher the same period last year. Borrowings under the Company's revolving line of credit with PNC Bank at July 31, 2018 is higher than the borrowings at July 31, 2017. In addition, the Company purchased a manufacturing facility in the third quarter of 2018, and has an outstanding mortgage that the Company did not have at July 31, 2017.

Capital spending for the six months ended July 31, 2018 was \$1,686,000 compared to \$3,891,000 for the same period last year. The decrease is not anticipated to continue for the year as the Company is investing more in factory automation and technology. Capital expenditures are being financed through the Company's credit facility with PNC Bank and operating cash flow.

The Company believes that cash flows from operations, together with the Company's unused borrowing capacity with PNC Bank will be sufficient to fund the Company's debt service requirements, capital expenditures and working capital needs for the next twelve months.

Off Balance Sheet Arrangements

None.

Critical Accounting Policies and Estimates

The Company's critical accounting policies are outlined in its Annual Report on Form 10-K for the fiscal year ended January 31, 2018. There have been no significant changes in the quarter ended July 31, 2018, except as disclosed in "Recently Adopted Accounting Updates" in Note 3. New Accounting Pronouncements in the Notes to unaudited Condensed Consolidated Financial Statements in Item 1 to this Quarterly Report on Form 10-Q.

Forward-Looking Statements

From time to time, including in this Quarterly Report on Form 10-Q for the quarterly period ended April 30, 2018, the Company or its representatives have made and may make forward-looking statements, orally or in writing. 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 ("SEC"). The words or phrases "anticipates," "expects," "will continue," "believes," "estimates," "projects," 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, availability of funding for educational institutions, availability and cost of materials, especially steel, availability and cost of labor, demand for the Company's products, competitive conditions affecting selling prices and margins, capital costs and general economic conditions. Such risks and uncertainties are discussed in more detail in the Company's Form 10-K for the fiscal year ended January 31, 2018 under the caption "Risk Factors".

The Company's forward-looking statements represent its judgment only on the dates such statements were made. By making any forward-looking statements, the Company assumes no duty to update them to reflect new, changed or unanticipated events or circumstances.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company is subject to interest rate risk related to its seasonal borrowings used to finance additional inventory and receivables. Rising interest rates may adversely affect the Company's results of operations and cash flows related to its variable-rate bank borrowings under its credit line with PNC. Accordingly, a 100-basis point upward fluctuation in PNC's base rate would have caused the Company to incur additional interest charges of approximately \$114,000 and \$175,000 for the three months and six months ended July 31, 2018, respectively. The Company would have benefited from a similar interest savings if the base rate were to have fluctuated downward by a like amount.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including its Principal Executive Officer along with its Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934 ("Exchange Act") as of July 31, 2018. Based upon the foregoing, the Company's Principal Executive Officer along with the Company's Principal Financial Officer concluded that the Company's disclosure controls and procedures as of such date were effective to ensure that the information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to Company management, including its Principal Executive Officer and Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, Company management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Changes in Internal Control Over Financial Reporting

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including its Principal Executive Officer along with its Principal Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures. Based upon the foregoing, the Company's Principal Executive Officer along with the Company's Principal Financial Officer concluded that the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective as of the end of the period covered by this Quarterly Report on Form 10-Q. There have been no changes in the Company's internal control over financial reporting during the fiscal quarter covered by this quarterly report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

PART II — Other Information

Virco Mfg. Corporation

Item 1. Legal Proceedings

The Company is a party to various legal actions arising in the ordinary course of business which, in the opinion of the Company, are not material in that management either expects that the Company will be successful on the merits of the pending cases or that any liabilities resulting from such cases will be substantially covered by insurance. While it is impossible to estimate with certainty the ultimate legal and financial liability with respect to these actions, management believes that the aggregate amount of such liabilities will not be material to the results of operations, financial position, or cash flows of the Company.

Item 1A. Risk Factors

You should carefully consider and evaluate the information in this Quarterly Report and the risk factors set forth under the caption “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended January 31, 2018 (the “Form 10-K”), which was filed with the SEC on April 27, 2018. The risk factors associated with our business have not materially changed compared to the risk factors disclosed in the Form 10-K.

Item 2. Unregistered Sales of Equity Securities, Use of Proceeds and Issuer Purchases of Equity Securities
None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit 31.1 — Certification of Robert A. Virtue, Chief Executive Officer, pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.

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

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

Exhibit 101.INS — XBRL Instance Document.

Exhibit 101.SCH — XBRL Taxonomy Extension Schema Document.

Exhibit 101.CAL — XBRL Taxonomy Extension Calculation Linkbase Document.

Exhibit 101.LAB — XBRL Taxonomy Extension Label Linkbase Document.

Exhibit 101.PRE — XBRL Taxonomy Extension Presentation Linkbase Document.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

VIRCO MFG. CORPORATION

Date: September 14, 2018 By: /s/ Robert E. Dose

Robert E. Dose

Vice President — Finance

(Principal Financial Officer)