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VSE CORP
Form 10-Q
October 30, 2008

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarter Ended September 30, 2008 Commission File Number: 0-3676

VSE CORPORATION
(Exact Name of Registrant as Specified in its Charter)

DELAWARE 54-0649263
(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)

2550 Huntington Avenue 22303-1499 www.vsecorp.com
Alexandria, Virginia (Zip Code) (Webpage)
(Address of Principal Executive Offices)

Registrant's Telephone Number, Including Area Code: (703) 960-4600

Securities registered pursuant to Section 12(b) of the Act:

Title of each class -----	Name of each exchange on which registered -----
Common Stock, par value \$.05 per share	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of

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common stock, as of the latest practicable date:

Number of shares of Common Stock outstanding as of October 30, 2008: 5,081,998.

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VSE Corporation and Subsidiaries

Forward Looking Statements

This report contains statements which, to the extent they are not recitations of historical fact, constitute "forward looking statements" under federal securities laws. All such statements are intended to be subject to the safe harbor protection provided by applicable securities laws. For discussions identifying some important factors that could cause actual VSE Corporation ("VSE," the "Company," "us," or "we") results to differ materially from those anticipated in the forward looking statements contained in this report, see the discussions captioned "Business," "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Notes to Consolidated Financial Statements" contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 filed with the Securities and Exchange Commission (the "SEC") on March 7, 2008.

Readers are cautioned not to place undue reliance on these statements, which reflect management's analysis only as of the date hereof. We undertake no obligation to revise publicly these forward looking statements to reflect events or circumstances that arise after the date hereof. Readers should carefully review the risk factors described in the reports and other documents we file from time to time with the SEC, including this and other Quarterly Reports on Form 10-Q to be filed subsequent to the filing of our Annual Report on Form 10-K and any Current Reports on Form 8-K.

PART I. Financial Information

Item 1. Financial Statements

VSE Corporation and Subsidiaries
Consolidated Financial Statements

Consolidated Balance Sheets

(in thousands except share and per share amounts)

	September 30, 2008 ----	December 31, 2007 ----
	(Unaudited)	
S>		
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,104	\$ 109
Accounts receivable, principally		
U.S. Government, net	175,517	132,389
Deferred tax assets	1,580	1,246
Other current assets	6,890	2,755
	-----	-----
Total current assets	185,091	136,499
Property and equipment, net	19,795	14,920
Deferred tax assets	882	1,888
Intangible assets	11,636	8,034
Goodwill	15,815	5,228
Other assets	6,351	5,202
	-----	-----
Total assets	\$239,570	\$171,771
	=====	=====
Liabilities and Stockholders' Equity		
Current liabilities:		
Bank notes payable	\$ 6,224	\$ 81
Accounts payable	132,596	88,565
Accrued expenses	25,387	22,895
Dividends payable	229	202
	-----	-----
Total current liabilities	164,436	111,743
Deferred compensation	3,832	3,257
Other liabilities	840	395

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Total liabilities	-----	-----
	169,108	115,395
	-----	-----
Commitments and contingencies		
Stockholders' equity:		
Common stock, par value \$.05 per share, authorized 15,000,000 shares; issued and outstanding 5,081,998 and 5,052,512, respectively	254	253
Additional paid-in capital	13,031	11,963
Retained earnings	57,177	44,160
	-----	-----
Total stockholders' equity	70,462	56,376
	-----	-----
Total liabilities and stockholders' equity . .	\$239,570	\$171,771
	=====	=====

The accompanying notes are an integral part of these financial statements.

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VSE Corporation and Subsidiaries
Unaudited Consolidated Financial Statements

Consolidated Statements of Income (Unaudited)

(in thousands except share and per share amounts)

	For the three months ended September 30,		For the nine months ended September 30,	
	2008	2007	2008	2007
	----	----	----	----
Revenues	\$ 306,811	\$ 174,692	\$ 747,222	\$ 455,025
Costs and expenses of contracts	297,330	168,747	723,097	438,899
	-----	-----	-----	-----
Gross profit.	9,481	5,945	24,125	16,126
Selling, general and administrative expenses . .	758	576	1,829	970
Interest income, net	(5)	(161)	(118)	(532)
	-----	-----	-----	-----
Income before income taxes. .	8,728	5,530	22,414	15,688
Provision for income taxes. .	3,419	2,171	8,738	6,053

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	-----	-----	-----	-----
Net income.	\$ 5,309	\$ 3,359	\$ 13,676	\$ 9,635
	=====	=====	=====	=====
Basic earnings per share . .	\$ 1.05	\$ 0.67	\$ 2.70	\$ 1.96
	=====	=====	=====	=====
Basic weighted average shares outstanding	5,075,830	5,024,416	5,066,837	4,922,056
	=====	=====	=====	=====
Diluted earnings per share. .	\$ 1.04	\$ 0.66	\$ 2.68	\$ 1.94
	=====	=====	=====	=====
Diluted weighted average shares outstanding	5,099,794	5,063,279	5,093,715	4,977,371
	=====	=====	=====	=====
Dividends declared per share	\$ 0.045	\$ 0.04	\$ 0.13	\$ 0.115
	=====	=====	=====	=====

The accompanying notes are an integral part of these financial statements.

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VSE Corporation and Subsidiaries
Unaudited Consolidated Financial Statements

Consolidated Statements of Cash Flows (Unaudited)

(in thousands)

For the nine months
ended September 30,
2008 2007
----- -----

Cash flows from operating activities:

Net income \$13,676 \$ 9,635

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Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,813	2,385
Loss on sale of property and equipment	19	1
Deferred taxes	672	(587)
Stock-based compensation	688	228
Change in operating assets and liabilities, net of impact of acquisitions:		
Accounts receivable, net.	(35,728)	(39,931)
Contract inventories	-	4,148
Other current and noncurrent assets	(5,334)	(1,730)
Accounts payable and deferred compensation	41,867	36,686
Accrued expenses	(515)	1,035
Other liabilities	299	193
	-----	-----
Net cash provided by operating activities	19,457	12,063
	-----	-----
Cash flows from investing activities:		
Purchases of property and equipment	(7,225)	(4,867)
Business acquisitions, net of cash acquired	(17,129)	(11,755)
	-----	-----
Net cash used in investing activities	(24,354)	(16,622)
	-----	-----
Cash flows from financing activities:		
Borrowings on bank notes payable	164,173	9,131
Repayments on bank notes payable	(158,030)	(9,131)
Dividends paid	(632)	(539)
Excess tax benefits from share-based payment arrangements	173	2,018
Proceeds from the exercise of stock options	208	1,947
	-----	-----
Net cash provided by financing activities	5,892	3,426
	-----	-----
Net increase (decrease) in cash and cash equivalents . .	995	(1,133)
Cash and cash equivalents at beginning of period	109	8,745
	-----	-----
Cash and cash equivalents at end of period	\$ 1,104	\$ 7,612
	=====	=====

The accompanying notes are an integral part of these financial statements.

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VSE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008

(1) Nature of Business and Basis of Presentation

Our business operations consist primarily of diversified engineering, logistics, management, and technical services performed on a contract basis.

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Substantially all of our contracts are with agencies of the United States Government (the "Government") and other Government prime contractors. Our customers also include non-Government organizations and commercial entities.

Our unincorporated divisions include BAV Division ("BAV"), Communications and Engineering Division ("CED"), Coast Guard Division ("VCG"), Engineering and Logistics Division ("ELD"), Field Support Services Division ("FSS") beginning in June 2007, Fleet Maintenance Division ("FMD"), Management Sciences Division ("MSD"), and Systems Engineering Division ("SED"). Energetics Incorporated ("Energetics"), Integrated Concepts and Research Corporation ("ICRC"), acquired in June 2007, and G&B Solutions, Inc. ("G&B"), acquired in April 2008, are our currently active subsidiaries.

Our accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. For further information refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates affecting the financial statements include accruals for contract disallowance reserves, self-insured health claims and estimated cost to complete on firm fixed-price contracts.

(2) Bank Notes Payable

We have a loan agreement with a bank under which credit is made available to us in the form of revolving loans or letters of credit. The amount of credit available to us under the loan is subject to certain conditions, including a borrowing formula based on our billed receivables. From time to time we may request changes in the amount, maturity date, or other terms and the bank may amend the loan to accommodate our request. The amount of credit available to us as of September 30, 2008 was \$35 million and the maturity date of the loan agreement is May 10, 2010. The loan agreement has collateral requirements that secure our assets, restrictive covenants, a limit on annual dividends, and other affirmative and negative covenants. As of September 30, 2008 we have not been notified by the bank, nor are we aware, of any defaults under the loan agreement.

Under the terms of the loan agreement, we may borrow against the revolving loan at any time and can repay the borrowings at any time without premium or

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penalty. We pay a commitment fee, interest on any revolving loan borrowings at a prime-based rate or an optional LIBOR-based rate, and fees on any letters of credit that are issued. As of September 30, 2008 and December 31, 2007, revolving loan amounts outstanding were approximately \$6.2 million and \$81 thousand, respectively. Interest expense incurred on the loan was approximately \$161 thousand and \$6 thousand for the nine months ended September 30, 2008 and 2007, respectively. There were no letters of credit outstanding in 2008 or 2007.

(3) Stock-based Compensation

Restricted Stock

On April 22, 2008, we awarded 5,831 shares of restricted VSE Stock to an executive. The fair value of this award was \$34.30 per share at the time of the award. Vesting in the stock will occur as follows: 25% of the shares on April 28, 2009, 25% of the shares on April 29, 2010 and 50% of the shares on April 29, 2011. Compensation expense related to this award was approximately \$17 thousand and \$28 thousand for the three and nine-month periods ended September 30, 2008.

On April 22, 2008, we awarded 4,374 shares of restricted VSE Stock to our Executive Chairman under the 2006 Restricted Stock Plan on the occasion of his resignation as our CEO, President and Chief Operating Officer. The fair value of this award was \$34.30 per share. The shares issued vested immediately and cannot be sold, transferred, pledged or assigned before the second anniversary of the grant date. Compensation expense related to this award was approximately \$150 thousand during the second quarter of 2008.

On January 2, 2008, we awarded 3,500 shares of restricted VSE Stock to our non-employee Directors under the 2006 Restricted Stock Plan. The weighted-average grant-date fair value of these restricted stock grants was \$47.92 per share. The shares issued vested immediately and cannot be sold, transferred, pledged or assigned before the second anniversary of the grant date. Compensation expense related to these grants was approximately \$168 thousand during the first quarter of 2008.

On January 2, 2007 and August 15, 2007 we awarded 4,800 shares and 300 shares, respectively, of restricted VSE Stock to our non-employee Directors under the 2006 Restricted Stock Plan. The weighted-average grant-date fair value of these restricted stock grants was \$16.84 per share and \$36.91 per share, respectively. The shares issued vested immediately and cannot be sold, transferred, pledged or assigned before the second anniversary of the grant date. Compensation expense related to these grants was approximately \$11 thousand and \$92 thousand for the three and nine-month periods ended September 30, 2007.

On January 3, 2008 (the "2008 Awards") and January 2, 2007 (the "2007 Awards"), we notified certain employees that they are eligible to receive awards under the 2006 Restricted Stock Plan based on financial performance for the calendar years 2008 and 2007, respectively. Vesting of each award will occur one-third on the date of award and one-third on each of the next two anniversaries of such date of award. The date of award determination is expected to be in March 2009 for the 2008 Awards and the date of award determination for the 2007 Awards was March 3, 2008. On each vesting date, 100% of the vested award will be paid in VSE shares. The number of shares

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issued will be based on the fair market value of our common stock on the vesting date. The earned amount will be expensed ratably over the vesting period of approximately three years.

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VSE CORPORATION AND SUBSIDIARIES
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
 September 30, 2008

The compensation expense related to the 2008 Awards and 2007 Awards for the periods ended September 30, 2008 and 2007 is as follows (in thousands):

	Three Months		Nine Months	
	Ended September 30,		Ended September 30,	
	2008	2007	2008	2007
	----	----	----	----
2008 Awards	\$ 93	\$ -	\$277	\$ -
2007 Awards	69	69	208	208
	----	---	----	----
Total	\$162	\$69	\$485	\$208
	====	===	====	====

On March 3, 2008, the employees eligible for the 2007 Awards received 6,457 shares of common stock. The weighted-average grant-date fair value of these awards was \$30.61 per share.

(4) Earnings Per Share

Basic earnings per share have been computed by dividing net income by the weighted average number of shares of common stock outstanding during each period. Shares issued during the period are weighted for the portion of the period that they were outstanding.

Diluted earnings per share have been computed in a manner consistent with that of basic earnings per share while giving effect to all potentially dilutive common shares that were outstanding during each period. Potentially dilutive common shares represent incremental common shares issuable upon exercise of stock options.

	Three Months		Nine Months	
	Ended September 30,		Ended September 30,	
	2008	2007	2008	2007
	----	----	----	----
Basic weighted average shares outstanding	5,075,830	5,024,416	5,066,837	4,922,056
Dilutive effect of options	23,964	38,863	26,878	55,315
	-----	-----	-----	-----
Diluted weighted average shares outstanding	5,099,794	5,063,279	5,093,715	4,977,371
	=====	=====	=====	=====

During the three and nine-month periods ended September 30, 2008, 15,500 and 16,500 stock options, respectively, were exercised which resulted in an increase to additional paid-in capital of approximately \$361 thousand and \$380 thousand, respectively, net of related income tax benefits.

During the three and nine-month periods ended September 30, 2007, 36,976 and 248,874 stock options, respectively, were exercised which resulted in an increase to additional paid-in capital of approximately \$913 thousand and \$4

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million, respectively, net of related income tax benefits.

(5) Commitments and Contingencies

We have, in the normal course of business, certain claims against us and against other parties. In our opinion, the resolution of these claims will not have a material adverse effect on our results of operations or financial position. However, the results of any legal proceedings cannot be predicted with certainty.

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VSE CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS September 30, 2008

(6) Segment Information

Management of our business operations is conducted under four reportable operating segments: the Federal Group, the International Group, the IT, Energy and Management Consulting Group (formerly the Energy and Environmental Group, renamed in April 2008), and the Infrastructure Group (formerly the Infrastructure and Information Technology Group, renamed in April, 2008). These segments operate under separate management teams and discrete financial information is produced for each segment. The various divisions within the Federal Group and the International Group and the two subsidiaries within the IT, Energy and Management Consulting Group are operating segments as defined by SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," ("SFAS No. 131"), and meet the aggregation of operating segments criteria of SFAS No. 131. We evaluate segment performance based on consolidated revenues and profits or losses from operations before income taxes.

Federal Group - The Federal Group provides engineering, technical, management, integrated logistics support and information technology services to all U.S. military branches and other Government agencies. The Federal Group includes five divisions: CED, ELD, FSS, MSD and SED.

International Group - Our International Group provides engineering, industrial, logistics and foreign military sales services to the U.S. military and other Government agencies. It consists of three divisions: BAV, VCG and FMD.

IT, Energy and Management Consulting Group - The IT, Energy and Management Consulting Group provides technical and consulting services primarily to various civilian Government agencies. This group includes Energetics and, upon acquisition in April 2008, also includes G&B. See footnote 7 for information regarding the acquisition of G&B.

Infrastructure Group - Our Infrastructure Group was created in connection with the June 4, 2007 acquisition of our wholly owned subsidiary, ICRC. ICRC is engaged principally in providing diversified technical and management services to the Government, including transportation infrastructure services, advanced vehicle technology, aerospace services and engineering and information technology.

Our segment information for the three and nine-month periods ended September 30, 2008 and 2007 is as follows (in thousands):

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	Three Months		Nine Months	
	ended September 30,		ended September 30,	
	2008	2007	2008	2007
	----	----	----	----
Revenues:				
Federal Group	\$188,934	\$ 91,619	\$475,400	\$245,414
International Group	55,577	58,795	156,462	174,810
IT, Energy and Management				
Consulting Group	15,853	3,845	33,766	10,698
Infrastructure Group	46,443	20,449	81,581	24,068
Corporate	4	(16)	13	35
	-----	-----	-----	-----
Total revenues	\$306,811	\$174,692	\$747,222	\$455,025
	=====	=====	=====	=====

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VSE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008

	Three Months		Nine Months	
	ended September 30,		ended September 30,	
	2008	2007	2008	2007
	----	----	----	----
Income before income taxes:				
Federal Group	\$ 4,830	\$ 2,815	\$ 13,149	\$ 8,579
International Group	1,005	1,259	4,080	5,002
IT, Energy and Management				
Consulting Group	1,413	429	3,172	1,196
Infrastructure Group	2,011	1,469	3,369	1,636
Corporate/unallocated expenses	(531)	(442)	(1,356)	(725)
	-----	-----	-----	-----
Income before income taxes	\$ 8,728	\$ 5,530	\$ 22,414	\$ 15,688
	=====	=====	=====	=====

Customer Information

Our revenue by customer is as follows (in thousands):

Source of Revenues	Three Months		Nine Months	
	ended September 30,		ended September 30,	
	2008	2007	2008	2007
	----	----	----	----
Army/Army Reserve	\$176,449	\$ 89,035	\$446,413	\$233,061
Navy	52,611	47,575	139,478	147,751
Department of Transportation	42,657	11,619	67,707	12,776
Treasury	13,220	16,381	42,172	38,709
Other	21,874	10,082	51,452	22,728
	-----	-----	-----	-----
Total Revenues	\$306,811	\$174,692	\$747,222	\$455,025
	=====	=====	=====	=====

(7) Acquisitions

G&B Solutions, Inc.

On April 14, 2008, we acquired all of the capital stock of G&B of Reston,

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Virginia. G&B is a diversified information technology and management consulting provider to Government agencies, including the Departments of Homeland Security, Interior, Labor, Agriculture, and Housing and Urban Development, the Pension Benefit Guaranty Corporation, and the National Institutes of Health. G&B's core expertise lies in enterprise architecture development, information assurance/business continuity, program and portfolio management, network IT services and systems design and integration. G&B provides us an opportunity to expand our professional services across a wider range of Government customers.

Cash paid at closing for G&B was approximately \$19.5 million, which includes approximately \$650 thousand of prepaid retention bonuses that will be expensed in the post-acquisition period as the affected employees provide services, less approximately \$600 thousand for certain closing adjustments. We also incurred approximately \$200 thousand of direct acquisition costs consisting of legal, accounting and other fees. Under the terms of the acquisition, we will be required to make additional payments of up to \$4.2 million over the next three years if G&B achieves certain financial performance targets. If earned and paid, such additional purchase price consideration will be recorded as goodwill on the consolidated balance sheet under existing accounting guidance. The results of G&B's operations are included in the accompanying consolidated financial statements beginning as of April 14, 2008.

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VSE CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS September 30, 2008

Of the initial cash purchase price, approximately \$3.8 million was recorded as customer related intangible assets to be amortized over approximately five years. In addition, \$930 thousand was allocated to G&B's tradename, which has an indefinite life, and approximately \$9.8 million was allocated to goodwill. Goodwill and intangible assets with indefinite lives are subject to review for impairment at least annually.

In July 2008, we filed an election under the Internal Revenue Code Section 338(h)(10) to treat the G&B acquisition as a sale of assets for tax purposes. We made a payment to the seller for the seller's incremental tax liability as a result of the election. Tax advantages to us that arise from filing the 338(h)(10) election are expected to exceed the additional payment made to the seller of approximately \$368 thousand. We also incurred approximately \$196 thousand of state income tax liabilities to various states related to the 338(h)(10) election due to G&B's former Subchapter S status. The additional payments were made during the third quarter of 2008 and were recorded as goodwill.

We followed the guidance of SFAS No. 141 "Business Combinations" to record the acquisition of G&B. We recognized the fair value of assets acquired and liabilities assumed as follows (in thousands):

Description	Fair Value
-----	-----
Current assets	\$ 8,835
Property and equipment	173
Intangibles - customer related	3,820
Intangibles - tradename	930
Goodwill	10,441

Total assets acquired	24,199

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Liabilities assumed	(5,182)

Total purchase price	\$19,017
	=====

Integrated Concepts and Research Corporation

On June 4, 2007, we acquired all of the capital stock of ICRC of Alexandria, Virginia. ICRC's core expertise lies in information technology, advance vehicle technology, aerospace, engineering and transportation infrastructure.

We believe that the addition of ICRC will provide us with an opportunity to expand and diversify its business across a number of project areas, including smart vehicles, alternative fuels, large-scale port engineering development and security, and information technology services.

The purchase price for the acquisition of ICRC included an initial cash payment of approximately \$11.8 million and potential additional cash payments of up to approximately \$5.8 million, contingent on meeting certain financial targets during the first six years after the June 2007 acquisition. Additionally, we have filed an election under the Internal Revenue Code Section 338(h)(10) to treat the ICRC acquisition as a sale of assets for tax purposes. An additional \$1.6 million payment was made by us to the seller for the seller's incremental tax liability as a result of the election. Tax advantages to us that arise from filing the 338(h)(10) election are expected to exceed the additional \$1.6 million payment made to the seller. The additional payment was made in April 2008 and recorded as goodwill.

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VSE CORPORATION AND SUBSIDIARIES
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
 September 30, 2008

Of the initial \$11.8 million purchase price, approximately \$7.1 million was recorded as contract related intangible assets to be amortized on a straight line basis over six to eight years; approximately \$1.5 million was recorded as an intangible asset related to ICRC's tradename, which has an indefinite life; and approximately \$2 million was recorded as initial goodwill. Additional goodwill and accrued expenses of approximately \$557 thousand were recorded as of December 31, 2007 for the earn-out payment that was made to the seller as a result of the achievement of the specified earnings target in 2007.

We followed the guidance of SFAS No. 141 to record the acquisition of ICRC. We recognized the fair value of assets acquired and liabilities assumed as follows (in thousands):

Description	Fair Value
-----	-----
Current assets	\$ 6,544
Property and equipment	429
Other assets	27
Intangibles - contract	7,134
Intangibles - tradename	1,500
Goodwill	4,174

Total assets acquired	19,808

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Liabilities assumed	(5,880)

Total purchase price	\$13,928
	=====

The total purchase price includes additional purchase price consideration related to the 2007 earn-out of approximately \$557 thousand and the 338(h)(10) election of approximately \$1.6 million, as described above.

(8) Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141(R), "Business Combinations; a replacement of FASB Statement No. 141," which will become effective for us on January 1, 2009. The new standard will replace existing guidance and significantly change accounting and reporting relative to business combinations in consolidated financial statements, including requirements to recognize acquisition-related transaction and post acquisition restructuring costs in results of operations as incurred. SFAS No. 141(R) will be effective for businesses acquired after the effective date.

On January 1, 2008, we adopted SFAS No. 157, "Fair Value Measurements," which defines fair value, establishes a market-based hierarchy for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value, but does not require any new fair value measurements. The SFAS No. 157 requirements for certain non-financial assets and liabilities have been deferred until the first quarter of 2009 in accordance with Financial Accounting Standards Board Staff Position ("FSP") 157-2. The adoption of SFAS 157 did not have a material impact on our results of operations, financial position or cash flows.

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VSE CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS September 30, 2008

The fair-value hierarchy established in SFAS 157 prioritizes the inputs used in valuation techniques into three levels as follows:

Level 1 - Observable inputs - quoted prices in active markets for identical assets and liabilities;

Level 2 - Observable inputs other than the quoted prices in active markets for identical assets and liabilities - includes quoted prices for similar instruments, quoted prices for identical or similar instruments in inactive markets, and amounts derived from valuation models where all significant inputs are observable in active markets; and

Level 3 - Unobservable inputs - includes amounts derived from valuation models where one or more significant inputs are unobservable and require us to develop relevant assumptions.

Included in other long-term assets as of September 30, 2008 is approximately \$3.7 million of investments we hold in a trust related to a non-qualified

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benefit plan. We determined the fair value of these assets and corresponding liability using the Level 1 methodology. We have an offsetting deferred compensation liability for this plan. As such, we do not have income statement volatility as a result of fluctuations in the value of the plan's investments.

We elected not to adopt the fair value option included in FAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115," which became effective January 1, 2008 for companies electing adoption.

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

Executive Overview

Organization

Our business operations consist primarily of diversified engineering, logistics, management, and technical services performed on a contract basis. Substantially all of our contracts are with agencies of the United States Government (the "Government") and other Government prime contractors.

Our unincorporated divisions include BAV Division ("BAV"), Communications and Engineering Division ("CED"), Coast Guard Division ("VCG"), Engineering and Logistics Division ("ELD"), Field Support Services Division ("FSS") beginning in June 2007, Fleet Maintenance Division ("FMD"), Management Sciences Division ("MSD"), and Systems Engineering Division ("SED"). Energetics Incorporated ("Energetics"), Integrated Concepts and Research Corporation ("ICRC"), acquired in June 2007, and G&B Solutions, Inc. ("G&B"), acquired in April 2008, are our currently active subsidiaries.

Customers and Services

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We provide engineering, design, logistics, management and technical services to the Government, other Government prime contractors, and commercial entities. Our largest customer is the U.S. Department of Defense ("DoD"), including agencies of the U.S. Navy, Army and Air Force.

Operating Segments

We manage our business operations under four reportable operating segments: the Federal Group, the International Group, the IT, Energy and Management Consulting Group (formerly the Energy and Environmental Group, renamed in April 2008), and the Infrastructure Group (formerly the Infrastructure and Information Technology Group, renamed in April 2008).

Federal Group - The Federal Group provides engineering, technical, management, integrated logistics support and information technology services to all U.S. military branches and other Government agencies. This Group includes CED, ELD, FSS, MSD and SED.

CED - CED is dedicated to supporting the Army's Communications and Electronics Command ("CECOM") in the management and execution of the Rapid Response ("R2") Program, which supports clients across DoD and the Government. CED manages execution of tasks involving research and development, technology insertion, systems integration and engineering, hardware/software fabrication and installation, testing and evaluation, studies and analysis, technical data management, logistics support, training and acquisition support. A large portion of our current work on this program is related to the U.S. military involvement in Iraq and Afghanistan, including the Army Equipment Support Program and the Assured Mobility Systems Program.

CED Army Equipment Support Program - Our CED division has a program on its Rapid Response support contract to provide maintenance and logistics services in support of U.S. Army equipment in Iraq and Afghanistan. In February 2008 a new task order with a ceiling value of approximately \$282 million was awarded to continue this program work through February 2009. This program had revenues of approximately \$219 million for the year ended December 31, 2007 and approximately \$245 million for the first three quarters of 2008.

CED Assured Mobility Systems Program - Our CED division has a program on its Rapid Response support contract to provide technical support services in support of U.S. Army PM Assured Mobility Systems and U.S. Army Tank-automotive and Armaments Command ("TACOM"). This program has a current ceiling value of approximately \$271 million and a period of performance that ends in March 2009. This program had revenues of approximately \$28 million for the year

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ended December 31, 2007 and approximately \$61 million for the first nine months of 2008.

ELD - ELD provides full life cycle engineering, logistics, maintenance and refurbishment services to extend and enhance the life of existing equipment. ELD principally supports the U.S. Army, Army Reserve and Army National Guard with core competencies in combat and combat service support system conversions, technical research, sustainment and re-engineering, system integration and configuration management.

FSS - We formed FSS in June 2007 to provide worldwide field maintenance and logistics support services for a wide variety of military vehicles and equipment, including performance of organizational, intermediate and specialized depot-level maintenance. FSS principally supports the U.S. Army and Marine Corps by providing specialized Field Service Representatives ("FSR") and Field Support Teams ("FST") in areas of combat operations and

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austere environments. FSS work includes some field service support on the CED Army Equipment Support program.

MSD - MSD provides services for product and process improvement, supporting a variety of Government and commercial clients. MSD provides training, consulting, and implementation support in the areas of: Enterprise Excellence, Lean Six Sigma, process and product optimization, project management, leadership quality engineering, Integrated Product and Process Development ("IPPD"), and reliability engineering. MSD's services range from individual improvement projects to global organizational change programs.

SED - SED provides comprehensive systems and software engineering, logistics, and prototyping services to DoD. Our services offered through SED principally support U.S. Army, Air Force, and Marine Corps combat and combat support systems. SED's core competencies include: systems technical support, configuration management and life cycle support for wheeled and tracked vehicles and ground support equipment; obsolescence management, service life extension, and technology insertion programs; and technical documentation and data packages. A large portion of our current SED work is related to the U.S. military involvement in southwest Asia.

TBPS Program - Our SED Division performs work on a program providing a protection system, the Tanker Ballistic Protection System, for vehicles deployed by the U.S. Army in Iraq. This program is nearing completion. The total contract ceiling value on this program as of September 30, 2008 was approximately \$96 million, and the remaining available contract ceiling was approximately \$2.7 million.

RCV Maintenance Program - SED was awarded contract coverage on a program to provide maintenance work on U.S. Army Route Clearance Vehicles in Kuwait (the "RCV Maintenance Program") in September 2008. We expect the initial phase of this program to run for two years under contractual coverage of approximately \$194 million.

International Group - The International Group provides engineering, industrial, logistics, and foreign military sales services to the U.S. military and other Government agencies. This Group includes BAV, FMD and VCG.

BAV - Through BAV, we provide assistance to the U.S. Navy in executing its Foreign Military Sales ("FMS") Program for surface ships sold, leased or granted to foreign countries by providing program management, engineering, technical support, logistics services for ship reactivations and transfers and follow-on support. BAV's expertise includes: ship reactivation/transfer, overhaul and maintenance, follow-on technical support, FMS integrated logistics support, engineering and industrial services, training and spare and repair parts support.

FMD - FMD provides global field engineering, logistics, maintenance and information technology services to the U.S. Navy and Air Force, including fleet-wide ship and aircraft support programs. FMD's expertise includes ship repair and modernization, ship systems installations, ordnance engineering and

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logistics, facility operations, war reserve materials management, aircraft sustainment and maintenance automation and IT systems integration. FMD also provides management, maintenance, storage and disposal support for the U.S. Department of Treasury's seized and forfeited general property program.

VCG - VCG provides the U.S. Coast Guard with FMS support and life cycle support for vessels transferred to foreign governments. VCG's core competencies include pre-transfer joint vessel inspections, reactivations,

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crew training, transit assistance, heavy-lift contracting, logistics support, technical support and overseas husbandry.

IT, Energy and Management Consulting Group - The IT, Energy and Management Consulting Group provides technical and consulting services primarily to various civilian Government agencies. This group includes Energetics and, as of April 2008, G&B.

Energetics - Energetics provides technical and management support in areas of nuclear energy, technology research, development, demonstration, and consulting services in the field of energy and environmental management. Energetics' expertise lies in state-of-the-art and advanced technology assessment, technical and economic feasibility analysis, technology transfer, R&D program planning, engineering studies, market assessment, strategic resource management, regulatory analysis, environmental compliance and risk management. Customers include the U.S. Department of Energy, including the Office of Nuclear Energy, Science and Technology; the U.S. Department of Homeland Security, through new contract work won in 2007; and other Government agencies and commercial clients.

G&B - G&B is an established information technology provider to many Government agencies, including the Departments of Homeland Security, Interior, Labor, Agriculture, and Housing and Urban Development, the Pension Benefit Guaranty Corporation, and the National Institutes of Health. G&B's core expertise lies in enterprise architecture development, information assurance/business continuity, program and portfolio management, network IT services and systems design and integration.

We acquired G&B in April 2008. Cash paid at closing for G&B was approximately \$19.5 million, which includes approximately \$650 thousand of prepaid retention bonuses that will be expensed in the post-acquisition period as the affected employees provide services, less approximately \$600 thousand for certain closing adjustments. We also incurred approximately \$200 thousand of direct acquisition costs consisting of legal, accounting and other fees. Under the terms of the acquisition, we will be required to make additional payments of up to \$4.2 million over the next three years if G&B achieves certain financial performance targets.

Infrastructure Group - We formed our Infrastructure Group in the second quarter of 2007, upon acquiring ICRC. We purchased ICRC in June 2007 for an initial cash purchase price of approximately \$11.8 million plus potential additional payments in future years if specified financial targets are achieved. ICRC is engaged principally in providing engineering and transportation infrastructure services.

Port of Anchorage Project - A significant amount of ICRC's revenue and income comes from services performed for the Port of Anchorage in Alaska (the "POA Project"). This intermodal expansion program to provide infrastructure services to the port will significantly expand the size of the port's facilities and allow for larger ships, more dock space, improved cargo flow, improved traffic flow next to the port, more environmentally friendly port operations and other modernization enhancements. Some of the infrastructure services on this project typically cannot be performed during the winter months. The seasonal nature of this work will cause fluctuations in our revenues on this project, with higher revenue levels in summer months and lower revenue levels in winter months. In July 2008, ICRC was awarded a new unrestricted contract to continue work on this program. The contract has an estimated ceiling amount of \$704 million, a three-year base period of

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performance, and four one-year option periods. This project had revenues of

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approximately \$68 million for the first three quarters of 2008.

Concentration of Revenues (in thousands) For the nine months ended September 30,

Source of Revenue	2008	%	2007	%
-----	----	-	----	-
CED Army Equipment Support	\$244,896	33	\$149,356	33
CED Assured Mobility Systems	61,231	8	14,515	3
CED Other	112,747	15	31,929	7
	-----	---	-----	---
Total CED	418,874	56	195,800	43
BAV Egypt	36,879	5	39,380	9
BAV India	55	-	36,765	8
BAV Other	21,821	3	17,869	4
	-----	---	-----	---
Total BAV	58,755	8	94,014	21
Treasury Seized Asset Program	40,760	5	37,675	8
Port of Anchorage Contract	67,700	9	12,708	3
VSE Other	161,133	22	114,828	25
	-----	---	-----	---
Total Revenues	\$747,222	100	\$455,025	100
	=====	===	=====	===

Management Outlook

The growth in our revenues and profits during 2007 and 2008 presents us with both challenges and opportunities. Certain work efforts that have supported our growth in recent years have expired or are due to expire. Large task order awards under the Rapid Response support contract, including the CED Army Equipment Support Program, are due to expire in early 2009. A large majority of the originally proposed work on the TBPS Program has been delivered and this program is due to expire in the near future.

We believe that we are prepared to meet the challenge of replacing the expiring work. Our work in the DoD market remains strong. ELD has expanded its workforce, facilities, capacity to provide services, contractual coverage and funding since its inception, resulting in increases in revenues from these services in 2006, 2007 and the first nine months of 2008. We expect further increases in the remainder of 2008 and in future years. The recent award of the RCV Maintenance program gives us a major new source of work. We continue to seek new task order awards under the Rapid Response support contract. We have also submitted a proposal for a follow-on contract to the current Rapid Response contract. If awarded, the Government could begin issuing new task orders on this follow-on contract beginning in early 2009.

We are augmenting our core base of DoD work by emphasizing growth in our non-DoD services. These efforts have included: 1) a renewed emphasis on marketing our Energetics services that is beginning to show results in 2008, 2) work on the Treasury Seized Property Management program, and, 3) the acquisitions of ICRC in 2007 and G&B in 2008. We expect these efforts that are directed toward the growth of our work in the Federal Civil marketplace to contribute to overall future revenue growth and financial performance.

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Although our current prospects for continued growth in 2009 appear to be favorable, we recognize that 2009 is a federal government transition year and government spending priorities may change in ways that we cannot predict at this time.

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Funded Backlog

Revenues in government contracting businesses depend on contract funding ("Bookings") and funded contract backlog is an indicator of potential future revenues. A summary of our bookings and revenues for the nine month periods ended September 30, 2008 and 2007, and funded contract backlog as of September 30, 2008 and 2007 is as follows:

	(in millions)	
	2008	2007
	----	----
Bookings	\$1,033	\$603
Revenue	\$747	\$455
Funded backlog	\$706	\$478

Approximately \$364 million of the bookings for 2008 were on the CED Army Equipment Support Program and CED Assured Mobility Systems Program. These two programs accounted for approximately \$229 million of the bookings for 2007.

VSE Stock in Employee 401(k) Plan and ESOP Accounts

We decided that employees should have an opportunity to diversify their VSE stock in their 401(k) accounts held in the VSE Corporation Employee ESOP/401(k) Plan (the "Plan") beginning with our 2008 Plan year. In January 2008, employees were notified that they may elect to transfer any portion of their 401(k) accounts that is invested in VSE stock from that investment into another investment alternative under the Plan. This right extends to all of VSE stock held under the 401(k) portion of the Plan. In addition, we have decided to terminate and liquidate the ESOP portion of the VSE Corporation Employee ESOP/401(k) Plan and, as elected by the employees, either distribute VSE stock held in the ESOP accounts to the employees or rollover such VSE Stock into an Individual Retirement Account or employee plan selected by the employee. ESOP shares were distributed to employees in the third quarter of 2008.

Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141(R), "Business Combinations; a replacement of FASB Statement No. 141," which will become effective for us on January 1, 2009. The new standard will replace existing guidance and significantly change accounting and reporting relative to business combinations in consolidated financial statements, including requirements to recognize acquisition-related transaction and post acquisition restructuring costs in results of operations as incurred. SFAS No. 141(R) will be effective for businesses acquired after the effective date.

On January 1, 2008, we adopted SFAS No. 157, "Fair Value Measurements," which defines fair value, establishes a market-based hierarchy for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value, but does not require any new fair value measurements. The SFAS No. 157 requirements for certain non-

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financial assets and liabilities have been deferred until the first quarter of 2009 in accordance with Financial Accounting Standards Board Staff Position ("FSP") 157-2. The adoption of SFAS 157 did not have a material impact on our results of operations, financial position or cash flows.

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Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, which require us to make estimates and assumptions. Please refer to our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 filed with the SEC on March 7, 2008 for a full discussion of our accounting policies.

Revenue by Contract Type

Our revenues by contract type for the nine months ended September 30, 2008 and 2007 were as follows (in thousands):

Contract Type -----	2008		2007	
	Revenues	%	Revenues	%
Cost-type	\$182,689	25	\$159,932	35
Time and materials.	533,345	71	261,889	58
Fixed-price	31,188	4	33,204	7
	-----	---	-----	---
	\$747,222	100	\$455,025	100
	=====	===	=====	===

A significant portion of the time and materials revenues are attributable to revenues from the CED Rapid Response contract. The majority of the revenues on this contract have resulted from the pass through of subcontractor support services that have lower profit margins than the margins on our other contracts.

Results of Operations

We show certain items in the table below, including our consolidated revenues, pre-tax income, and net income, and the changes in these items for the three and nine month periods ended September 30, 2008 and 2007 (in thousands).

Description	Three Months		Nine Months		Change	
	Ended September 30, 2008	2007	Ended September 30, 2008	2007	Three Months	Nine Months
Revenues	\$306,811	\$174,692	\$747,222	\$455,025	\$132,119	\$292,197
Contract costs	297,330	168,747	723,097	438,899	128,583	284,198
	-----	-----	-----	-----	-----	-----
Gross Profit	9,481	5,945	24,125	16,126	3,536	7,999
Selling, general and Administrative Expenses	758	576	1,829	970	182	859
Interest expense (income), net	(5)	(161)	(118)	(532)	156	414

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Income before income taxes	8,728	5,530	22,414	15,688	3,198	6,726
Provision for income taxes	3,419	2,171	8,738	6,053	1,248	2,685
Net Income	\$ 5,309	\$ 3,359	\$ 13,676	\$ 9,635	\$ 1,950	\$ 4,041

Our revenues and contract costs increased by approximately 76% for the three months ended September 30, 2008, as compared to the same period of 2007. Revenues increased by approximately 64% and contract costs increased by approximately 65% for the nine months ended September 30, 2008 as compared to the same period of 2007. The primary reasons for the increases are 1) increased revenues from the Army Equipment Support program and other CED task orders, including the U.S. Army PM Assured Mobility Systems and TACOM support; 2) ICRC is included in our financial results for the full three and nine month periods in 2008 compared to a shorter period in 2007 as a result of the June 2007 acquisition; 3) revenues of G&B from the April 14, 2008 date of acquisition through September 30, 2008; and 4) increases in FMD, ELD, FSS, and Energetics services.

Selling, general and administrative expenses consist primarily of costs and expenses that are not chargeable or reimbursable on our operating unit

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contracts. The increases in these expenses for the three and nine months ended September 30, 2008 as compared to the same periods of 2007 are primarily due to the amortization of intangible assets attributable to the ICRC and G&B acquisitions and to the inclusion of the acquired companies' selling, general and administrative expenses in our results in 2008.

Income before income taxes increased by approximately 58% and 43% for the three and nine month periods ended September 30, 2008 as compared to the same periods of 2007. The increases are primarily due to 1) profits from the growth of revenues on the CED Army Equipment Support program and other CED task orders; 2) the inclusion of ICRC, G&B and FSS in our operating results for the full three and nine month periods of 2008; 3) increased profitability of SED services performed on the TBPS Program; and 4) revenue increases from Energetics services.

Federal Group Results

We show consolidated revenues and income before income taxes and the changes in these items for our Federal Group for the three and nine month periods ended September 30, 2008 and 2007 in the following table (in thousands).

Description	Three Months		Nine Months		Change	
	Ended September 30, 2008	2007	Ended September 30, 2008	2007	Three Months	Nine Months
Revenues	\$188,934	\$91,619	\$475,400	\$245,414	\$97,315	\$229,986
Income before income taxes	\$ 4,830	\$ 2,815	\$ 13,149	\$ 8,579	\$ 2,015	\$ 4,570
Profit percentage	2.6%	3.1%	2.8%	3.5%		

Revenues for our Federal Group increased by approximately 106% and 94% for the three and nine month periods ended September 30, 2008, as compared to the same periods for the prior year. The increases in revenues for 2008 primarily

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resulted from 1) revenues from the CED Army Equipment Support Program work; 2) additional work on other CED task orders, including CED's U.S. Army PM Assured Mobility Systems and TACOM support; 3) increased revenues from ELD's equipment refurbishment services; and 4) revenues from the inclusion of FSS in 2008. The increases in revenues of this segment were offset partially by a decrease in TBPS Program revenues.

Income before income taxes for our Federal Group increased by approximately 72% and 53% for the three and nine month periods ended September 30, 2008, as compared to the same periods for the prior year. The increases are primarily due to 1) the increase in revenues on the CED Army Equipment Support Program work and other CED task orders; 2) increased profitability of SED services performed on the TBPS Program; and, 3) profits from the inclusion of FSS services in our operating results in 2008. These increases in profits were partially offset by a decline in ELD profits resulting from losses on work performed in a new location in the third quarter. These losses are expected to be eliminated as the work performed at this new location becomes more fully developed. Also, a significant amount of the increase in our Federal Group revenues resulted from the CED Army Equipment Support Program work and from other CED task orders that have lower profit margins than our other work, which caused profits as a percentage of revenues to decline as compared to prior year percentages.

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International Group Results

We show consolidated revenues and income before income taxes and the changes in these items for our International Group for the three and nine month periods ended September 30, 2008 and 2007 in the following table (in thousands).

Description	Three Months		Nine Months		Change	
	Ended September 30, 2008	2007	Ended September 30, 2008	2007	Three Months	Nine Months
Revenues	\$55,577	\$58,795	\$156,462	\$174,810	\$ (3,218)	\$ (18,348)
Income before income taxes	\$ 1,005	\$ 1,259	\$ 4,080	\$ 5,002	\$ (254)	\$ (922)
Profit percentage	1.8%	2.1%	2.6%	2.9%		

Revenues for our International Group decreased by approximately 5% and 10% for the three and nine month periods ended September 30, 2008, as compared to the same periods for the prior year. Our BAV division had approximately \$36.8 million of 2007 revenue from a ship transfer to India that was completed in 2007, and there was no similar ship transfer in 2008. This resulted in lower BAV revenues and was the primary reason for the decreases in revenues for the International Group in 2008. Revenue increases from FMD services partially offset the decrease in revenues for this segment.

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Income before income taxes for our International Group decreased by approximately 20% and 18% for the three and nine month periods ended September 30, 2008, as compared to the same periods for the prior year. The decreases resulted primarily from a reduction in the fees earned by BAV due to the lower revenues.

IT, Energy and Management Consulting Group Results

We show consolidated revenues and income before income taxes and the changes in these items for our IT, Energy and Management Consulting Group for the three and nine month periods ended September 30, 2008 and 2007 in the following table (in thousands).

Description	Three Months		Nine Months		Change	
	Ended September 30, 2008	2007	Ended September 30, 2008	2007	Three Months	Nine Months
Revenues	\$15,853	\$3,845	\$33,766	\$10,698	\$12,008	\$23,068
Income before income taxes	\$ 1,413	\$ 429	\$ 3,172	\$ 1,196	\$ 984	\$ 1,976
Profit percentage	8.9%	11.2%	9.4%	11.2%		

For the three and nine month periods ended September 30, 2008, revenues for our IT, Energy and Management Consulting Group increased by approximately 312% and 216%, respectively, and income before income taxes increased by approximately 229% and 165%, respectively, when compared to the same periods for the prior year. Upon our acquisition of G&B in April 2008, G&B became part of this segment. The inclusion of G&B revenues and profits in this segment's results was a major reason for the increases in 2008. Increases in Energetics' revenues and income before income taxes, primarily due to new work performed for the U.S. Department of Homeland Security, also contributed to the increases in this segment for these periods in 2008.

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Infrastructure Group Results

We show consolidated revenues and income before income taxes and the changes in these items for our Infrastructure Group for the three and nine month periods ended September 30, 2008 and 2007 in the following table (in thousands).

Description	Three Months		Nine Months		Change	
	Ended September 30, 2008	2007	Ended September 30, 2008	2007	Three Months	Nine Months
Revenues	\$46,443	\$20,449	\$81,581	\$24,068	\$25,994	\$57,513
Income before income taxes	\$ 2,011	\$ 1,469	\$ 3,369	\$ 1,636	\$ 542	\$ 1,733
Profit percentage	4.3%	7.2%	4.1%	6.8%		

This segment consists of our ICRC subsidiary. Revenues for the three month period ended September 30, 2008 increased by approximately 127%, and income before income taxes increased by approximately 37%, when compared to the same period for the prior year. The primary reason for the increases relates to certain permitting issues associated with the POA Project. In 2007, ICRC work

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on the POA Project was delayed while waiting for receipt of environmental permitting prior to proceeding with the next phase of the project. This permitting was issued in August 2007, but revenues and profits were affected prior to receiving it. ICRC's results for 2008 were not affected by such permitting issues.

Our consolidated results of operations include ICRC revenues and income for the nine month period ended September 30, 2008 whereas our 2007 results include ICRC revenues and income only from the June 4, 2007 acquisition date through September 30, 2007.

Financial Condition

Our financial condition did not change materially in the first three quarters of 2008. The acquisition of G&B resulted in changes to some of our assets and liabilities including increases in bank borrowings, goodwill, and intangible assets.

Liquidity and Capital Resources

Cash Flows

Our cash and cash equivalents increased by approximately \$1 million during the first nine months of 2008 as compared to a decrease of approximately \$1.1 million for the first nine months of 2007. The reason for this difference is that in 2007 we used cash on hand to supplement cash provided by operating activities and financing activities to pay for investing activities whereas in 2008 we funded our investing activities entirely with operating activities and financing activities.

Cash provided by operating activities increased by approximately \$7.4 million in the first nine months of 2008 as compared to the same period of 2007. Approximately \$4 million of this increase was due to the increase in net income, approximately \$3.2 million was due to an increase in depreciation and amortization and other non-cash operating activities, and the remainder was due to changes in the levels of working capital components such as accounts receivable, contract inventories, accounts payable, and accrued expenses that are associated with our contract requirements and billing and collections cycle.

Cash used in investing activities increased by approximately \$7.7 million in the first nine months of 2008 as compared to the same period of 2007. This was due to making a larger business acquisition in 2008 as compared to the

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acquisition made in 2007 and to an increased level of investment in property and equipment in 2008 as compared to 2007.

Cash provided by financing activities increased by approximately \$2.5 million in the first nine months of 2008 as compared to the same period of 2007. This increase was primarily due to an increase in borrowings on our bank loan to help finance our investing activities.

We paid quarterly cash dividends totaling \$.125 per share during the first three quarters of 2008. Pursuant to our bank loan agreement, our payment of cash dividends is subject to annual rate restrictions. We have paid cash dividends each year since 1973.

Liquidity

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Our internal sources of liquidity come mostly from operating activities, specifically from changes in the level of revenues and associated accounts receivable and accounts payable, and from profitability. Significant increases or decreases in revenue and accounts receivable and accounts payable can cause significant increases or decreases in internal liquidity. Our accounts receivable and accounts payable levels can be affected by changes in the level of the work we perform and by the timing of large material purchases and subcontractor efforts used in on our contracts.

From time to time, we may also invest in the acquisition of another company. Our acquisitions of ICRC in 2007 and G&B in 2008 required a significant use of our cash. While there are no firm plans for any specific additional acquisitions at this time, we continue to seek opportunities for growth through acquisitions.

We may also invest in expansion, improvement, and maintenance of our operational and administrative facilities. We invested in the construction of an additional 40,000 square feet of warehouse and shop space at our Ladysmith, Virginia facility. Construction of this additional space was completed in the second quarter of 2008 at a final cost of approximately \$6.2 million. We may make additional investments in operational or administrative facilities in 2008 and in future years.

Our external liquidity consists of a bank loan agreement that provides us with revolving loan financing based on our accounts receivable (see "Notes to Consolidated Financial Statements").

We do not use public debt security financing. Our bank continues to maintain good financial strength ratings from the ratings services and we believe that we are well positioned to obtain financing from other banks if the need should arise. Accordingly, we do not believe that the current turbulence in the financial markets will have an adverse negative impact on our ability to finance our business, financial condition, or results of operations.

Contractual Obligations

Upon the acquisition of G&B in April 2008, we assumed liability for certain additional operating lease commitments. Some of these lease commitments expired on June 30, 2008 when G&B moved some of its offices from McLean, Virginia to Reston, Virginia. After June 30, 2008, G&B had two facility leases for office space for terms of one and six years for an aggregate amount of approximately \$1.7 million.

During 2008, we have signed eight new facility leases for office and warehouse space for various terms for an aggregate amount of approximately \$10.2 million. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 for a summary of our other contractual obligations.

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Inflation and Pricing

Most of our contracts provide for estimates of future labor costs to be escalated for any option periods, while the non-labor costs in our contracts are normally considered reimbursable at cost. Our property and equipment consists principally of computer systems equipment, furniture and fixtures, shop equipment, and land and improvements. We do not expect the overall impact of inflation on replacement costs of our property and equipment to be material

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to our future results of operations or financial condition.

Disclosures About Market Risk

Interest Rates

Our bank loan provides available borrowing to us at variable interest rates. We used a significant amount of cash to pay for our acquisitions of ICRC in June 2007 and G&B in April 2008, causing us to have to borrow on our bank loan beginning in April 2008. The amount borrowed is not large with respect to our cash flows and we believe that we will be able to pay down these bank loan borrowings in a relatively short time frame. Because of this, we do not believe that any adverse movement in interest rates would have a material impact on future earnings or cash flows. If we were to significantly increase our borrowings, future interest rate changes could potentially have a material impact on us.

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VSE CORPORATION AND SUBSIDIARIES

Item 3. Quantitative and Qualitative Disclosures About Market Risks

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See "Disclosures About Market Risk" in Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Item 4. Controls and Procedures

As of the end of the period covered by this report, based on management's evaluation, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d - 15(e) under the Securities Exchange Act of 1934, as amended) our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective in ensuring that information required to be disclosed by us in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There was no change in our internal control over financial reporting during our third quarter of fiscal 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. Other Information

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

VSE did not purchase any of its equity securities during the period covered by this report.

Under the Registrant's bank loan agreement dividends may be paid in an annual aggregate amount of \$.60 per share, provided there is no default under the loan agreement.

Item 6. Exhibits

(a) Exhibits.

Exhibit No.

- 31.1 Section 302 CEO Certification
- 31.2 Section 302 CFO and PAO Certification
- 32.1 Section 906 CEO Certification
- 32.2 Section 906 CFO and PAO Certification

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has omitted all other items contained in "Part II. Other Information" because such other items are not applicable or are not required if the answer is negative or because the information required to be reported therein has been previously reported.

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VSE CORPORATION AND SUBSIDIARIES

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.

VSE CORPORATION

Date: October 30, 2008

/s/ M. A. Gauthier

M. A. Gauthier
President,
Chief Executive Officer and
Chief Operating Officer

Date: October 30, 2008

/s/ T. R. Loftus

T. R. Loftus
Executive Vice President and
Chief Financial Officer
(Principal Accounting Officer)

