SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended December 31, 1999    Commission File Number: 0-3676

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

| | |
|---|---|
| DELAWARE | 54-0649263 |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |
| 2550 Huntington Avenue<br>Alexandria, Virginia | 22303-1499 |
| (Address of Principal Executive Offices) | (Zip Code) |

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

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

Common Stock, par value $.05 per share
(Title of Class)

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 [x]    No [ ]

Aggregate market value of voting stock held by nonaffiliates of the registrant as of March 1, 2000, was approximately $7 Million.

Number of shares of Common Stock outstanding as of March 1, 2000: 2,122,289.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for the Annual Meeting of Stockholders expected to be held on May 4, 2000, are incorporated by reference into Part III of this report.

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Forward Looking Statements

This filing 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 results to differ materially from those anticipated in the forward looking statements contained in this statement, see VSE's "Narrative Description of Business", "Management's Discussion and Analysis" and "Notes to Consolidated Financial Statements". Readers are cautioned not to place undue reliance on these forward looking statements, which reflect management's analysis only as of the date hereof. The company undertakes no obligation to publicly revise these forward looking statements to reflect events or circumstances that arise after the date hereof. Readers should carefully review the risk factors described in other documents the company files from time to time with the Securities and Exchange Commission, including the Quarterly Reports on Form 10-Q to be filed by the company subsequent to this Annual Report on Form 10-K and any Current Reports on Form 8-K filed by the company.

Part I

ITEM 1. Business

(a) General Development of Business

VSE Corporation ("VSE" or the "company") was established and incorporated in Delaware January 1959. The company's business operations consist of the operations of the parent company, operations of the company's wholly owned subsidiaries and operations of the company's divisions. Wholly owned subsidiaries include Energetics Incorporated ("Energetics"), Human Resource Systems, Inc. ("HRSI"), Ship Remediation and Recycling, Inc. ("SRR", formerly VSE Services Corporation) and VSE Services International Inc. ("VSI"). The company sold its CMstat Corporation subsidiary in May 1999. Unincorporated divisions include BAV Division ("BAV"), Fleet Maintenance Division ("Fleet Maintenance"), Ordnance Division ("Ordnance"), VSE IT Services Division ("IT Services"), and Value Systems Services Division ("VSS"). The term "VSE" or "company" means VSE and its subsidiaries and divisions unless the context indicates operations of the parent company only.

The company's business operations consist primarily of diversified engineering, technical, and management services, performed on a contract basis. A large majority of the company's contracts are with agencies of the United States Government (the "government") and other government prime contractors. The company's customers also include non-government organizations and commercial entities.

VSE seeks to provide its customers with competitive, cost effective solutions to specific problems. These problems generally require a detailed technical knowledge of materials, processes, functional characteristics, information systems, technology and products, and an in-depth understanding of the basic requirements for effective systems and equipment. Customers are



generally billed for a specified level-of-effort incurred in performing a project or providing a service or, less frequently, for installed products, systems and maintenance charges.

(b) Financial Information About Industry Segments

Financial information about industry segments for the three years ended December 31, 1999, appears in Note 10 (Segment Information) of "Notes to Consolidated Financial Statements" contained in this Form 10-K.

(c) Narrative Description of Business

During the three years ended December 31, 1999, the company operated in two business segments. The engineering, logistics, management and technical services segment ("ELMTS") includes the operations of the parent company and all of the subsidiaries and divisions except CMstat. The software products and services segment ("SPS") was comprised of the operations of CMstat prior to the sale of CMstat in May 1999. The company has not had any operations in SPS since May 1999.

Services and Products

Engineering, Logistics, Management and Technical Services Segment

VSE engineering, technical, management and information technology services include a broad array of capabilities and resources used in program planning; design and engineering, including prototype development; ship reactivation and transfer support; logistics management; ship maintenance, repair, overhaul planning and follow-on technical support; ship dismantlement and recycling services; office automation systems and support; training; technology research, development and demonstration programs involving energy conservation and efficiency, advanced technology transfers, and feasibility, assessment and development programs.

Typical engineering and technical services projects include sustaining engineering support for military vehicles, combat trailers, bridging systems and amphibious transport; ocean engineering and mooring systems; depot repair operations; logistics management support for military aircraft; machinery condition analysis; specification preparation for ship alterations and repairs; ship force crew training; ship dismantlement and ship sales; energy conservation and advanced technology demonstration projects; and technical data package preparation.

VSE information technology services and products include cross-platform technical data, product data and configuration management (CM/PDM) support, bar coding and inventory application, and database management and control.

Contracts

Depending on solicitation requirements and other factors, VSE offers its professional and technical services and products through various



competitive contract arrangements and business units which are responsive to customer requirements and which may also provide an opportunity for diversification. Such arrangements include prime contracts, subcontracts, cooperative arrangements, joint ventures, dedicated ventures, dedicated cost centers (divisions) and subsidiaries.

Substantially all of the company's revenues are derived from contract services performed for the government. The U.S. Navy is VSE's largest single customer, and most of the company's operating divisions and subsidiaries derive a majority or all of their work from the Navy. Other significant customers include: the U.S. Army, served by VSE (parent company); the U.S. Postal Service, served by VSE (parent company) and by HRSI; and the Department of Energy, which comprises the majority of Energetics' work. The company's customers also include various other government agencies, non-government organizations, and commercial entities.

<TABLE>

VSE Revenues by Customer
(Dollars in Thousands)

<CAPTION>

| Customer | 1999 Revenues | % | 1998 Revenues | % | 1997 Revenues | % |
|---|---|---|---|---|---|---|
| U.S. Navy | $109,993 | 69.9 | $128,773 | 72.7 | $105,103 | 68.9 |
| U.S. Army | 19,468 | 12.4 | 19,577 | 11.1 | 19,423 | 12.7 |
| All other government | 27,558 | 17.5 | 27,991 | 15.8 | 25,804 | 16.9 |
| Commercial | 380 | 0.2 | 754 | 0.4 | 2,220 | 1.5 |
| Total | $157,399 | 100.0 | $177,095 | 100.0 | $152,550 | 100.0 |

</TABLE>

The government's procurement practices in recent years have tended toward the bundling of various work efforts under large comprehensive ("omnibus") management contracts. As a result, the growth opportunities available to the company will probably continue to occur in large unpredictable increments. The company has elected to pursue these larger efforts by assembling teams of subcontractors and forming joint venture partnerships to offer the range of technical competencies required by these omnibus contracts. The company has also elected to pursue more of its contract work through its operating divisions and subsidiaries to focus on particular lines of work or specific customer bases.

As a result of the bundling trend described above, the company has several divisions for which revenues are derived predominantly from one major contract effort. During 1999, the company's six largest contracts accounted for approximately 80% of total revenues. The company's largest contract, performed by BAV, is with the U.S. Navy and accounted for more than 50% of consolidated revenues in 1999 and 1998. This contract is a ten year contract awarded in 1995, and it has the potential to generate total revenues of over one billion dollars from 1995 through 2005. Other major contracts include U.S. Navy contracts performed by VSE (parent company), VSS, and Ordnance divisions, and a U.S. Postal Service contract and a U.S. Army contract performed by VSE (parent company). The VSS contract and the U.S. Postal Service contract are expected to be re-bid in 2000, and the company is actively pursuing the continuance of this work.

The company's contracts with the government are typically performed under cost plus fee, time and materials, or fixed price contracts. Under cost



plus fee contracts, the customer reimburses the company for its allowable costs and pays a fee as determined by the contract terms. Under time and materials contracts, the customer pays the company contract specific hourly rates for labor services and reimburses the company for the cost of materials. Under fixed price contracts, the customer pays a contract specific price for services or products. Some of the contracts permit the contracting agency to issue delivery orders or task orders in an expeditious manner to satisfy relatively short-term requirements for engineering and technical services. The services ordered pursuant to such arrangements are normally performed and completed within one year. During 1999, the company provided services to the government and other customers under approximately 210 contracts and approximately 795 delivery orders or task orders.

## Backlog

During 1999 and 1998, VSE was awarded contracts having potential ceiling values of approximately $115 million and $124 million, respectively.

VSE's funded backlog of contract work as of December 31, 1999, 1998 and 1997 was approximately $108 million, $122 million and $110 million, respectively. Funded backlog is defined as orders for services that have not been fully rendered and for which funding has been provided either at the time of award or thereafter. Substantially all the funded backlog is expected to be completed within one year.

The excess of unfulfilled contract estimates over the incremental funding authorized represents an unfunded backlog. Based on the total estimated value of contracts actually awarded, the company's potential revenues for work remaining to be performed under existing contracts (both funded and unfunded backlog) was approximately $946 million, $1 billion and $1.2 billion, as of December 31, 1999, 1998 and 1997, respectively. The company has no reasonable basis on which to determine when or if such unfunded backlog will be funded. Because of uncertainties associated with changing program requirements and the ultimate availability of funds, VSE believes that measurements of unfunded backlog are of limited use in evaluating future workload.

As of December 31, 1999, VSE had proposals pending for engineering services contracts covering approximately $618 million in services for the Department of Defense or other government agencies or prime contractors. If these contracts are awarded to VSE, resulting ordering periods could extend through 2005. There is no assurance that VSE will be the successful bidder for any of these contracts. Additionally, there can be no assurance that contracts awarded will result in revenues to VSE because (a) contract awards may be rescinded as a result of the government's bid protest procedures, (b) contracts may not be funded at the nominal amounts cited in competitive bid announcements and (c) contracts when funded may be terminated at the convenience of the government.

## Marketing

VSE marketing activities are conducted by its professional staff of engineers, analysts, program managers, contract administrators and other personnel. Information concerning new programs and requirements becomes



available in the course of contract performance, through formal and informal briefings, from participation in professional organizations, and from literature published by the government, trade associations, professional organizations and commercial entities.

## Personnel

VSE services are provided by a staff of professional, scientific, medical and technical personnel having high levels of education, experience, training and skills. As of February 2000, VSE employed approximately 900 employees, including approximately 150 part-time personnel.

Principal categories of VSE personnel include (a) engineers, scientists and technicians in mechanical, electrical, electronic, chemical, industrial, energy and environmental services, marine and ocean engineering disciplines, (b) information technology professionals in computer systems, applications and products, configuration, change and data management disciplines, (c) technical editors and writers, (d) graphic designers and technicians and (e) health care service personnel. The expertise required by VSE customers also frequently includes knowledge of government administrative procedures. Many VSE employees have had experience as government employees or have served in the U.S. armed forces. The company considers its relationships with employees to be excellent.

## Competition and Risks

Competition. The professional and technical services industry in which VSE is engaged is very competitive. There are a substantial number of other organizations, including large, diversified firms with greater financial resources and larger technical staffs, which are capable of providing essentially the same services as those offered by VSE. Such companies may be publicly owned or privately held and may be divisions of much larger organizations including large manufacturing corporations. Competition in the government contract business has intensified in recent years due to declining government budgets.

Government agencies have placed an increased emphasis on awarding contracts of the types performed by VSE on a competitive basis as opposed to a non-competitive basis. All significant contracts currently being performed by VSE were either initially awarded on a competitive basis or have been renewed at least once on a competitive basis. Government agencies also order work through contracts awarded by the General Services Administration ("GSA") which provide a schedule of services at fixed prices which may be ordered outside of the solicitation process. The company has been awarded three separate GSA schedule contracts for various classes of services, but there is no assurance regarding the level of work under these contract arrangements.

It is not possible to predict the extent and range of competition which VSE will encounter as a result of changing economic or competitive conditions, customer requirements, or technological developments. VSE believes the principal competitive factors for the professional and technical services business in which it is engaged are technical and financial



qualifications, quality and innovation of services and products, past performance and low price.

Risks. Since 1993, the government has initiated a series of changes designed to improve and streamline its acquisition policies and procedures. Such changes include an emphasis on very large contracts, which may make it more difficult for VSE to qualify as a potential bidder; past performance, which may be used to exclude entrance into new government markets; and multiple-award schedules, which may result in unequal contract awards between successful contractors.

VSE's business with the government is subject to the risk that one or more of its potential contracts or contract extensions may be awarded by the contracting agency to a "small and disadvantaged" or minority-owned business pursuant to "set-aside" programs administered by the Small Business Administration or may be bundled into omnibus contracts for very large businesses. In addition, government contract business is subject to funding delays, extensions, and moratoriums caused by political and administrative disagreements such as occurred during the 1996 U.S. Government budget negotiations. To date, the effect of such negotiations and disagreements on the company has not been material; however, no assurances can be given about such risks with respect to future years.

Government contracts are subject to termination at the government's convenience, which means that the government may terminate the contract at any time, without cause. If a government contract is terminated for convenience, the contractor is generally reimbursed for its allowable costs to the date of termination and is paid a proportionate amount of the stipulated profit or fee for the work actually performed. VSE has not suffered any material losses or disruptions of its business due to government terminations for convenience.

VSE's business is subject to the risks arising from global economic conditions associated with potential foreign customers served through the company's contracts with the U.S. Government. For example, economic slowdowns in certain countries served under the BAV contract could potentially affect BAV sales. In addition, the company's subsidiary VSE Services International, Inc. is also expected to serve foreign customers on a direct sales basis and may be subject to such economic slowdowns.

ITEM 2. Properties

VSE's principal executive and administrative offices are located in a five story building in Alexandria, Virginia, leased by VSE through April 30, 2003. This building contains approximately 108,000 square feet of engineering, shop, and administrative space. VSE also provides services and products from approximately 11 U.S. branch offices located at or near customer sites to facilitate communications and enhance project performance. Branch offices are generally occupied under short term leases and currently include an aggregate of approximately 195,000 square feet of office and warehouse space. VSE employees often provide services at customer facilities, limiting VSE's requirement for additional space. BAV provides services from several locations outside of the United States (generally at foreign shipyards); these services are often of short duration based on "tiger team" or "as-ordered" requirements.



VSE owns and operates an engineering test center in Ladysmith, Virginia, consisting of approximately 44 acres of land and an improved storage and vehicle maintenance facility. This facility has been used by VSE to test military and commercial equipment for which VSE provides system technical support or other engineering services and to supplement Alexandria, Virginia, office and shop facilities.

ITEM 3. Legal Proceedings

Litigation

None.

ITEM 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of stockholders, through the solicitation of proxies or otherwise, during the three month period ended December 31, 1999.



EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth information concerning the executive officers of the Registrant as of March 15, 2000.

The executive officers are chosen annually to serve until the first meeting of the Board of Directors following the next annual meeting of stockholders and until their successors are elected and have qualified, or until death, resignation or removal, whichever is sooner.

| Name | Age | Position with Registrant |
|---|---|---|
| William R. Albertolli | 57 | Senior Vice President and President, VSS Division |
| Byron S. Bartholomew | 72 | Executive Vice President, Business Development |
| Donald M. Ervine | 63 | Chairman and Chief Executive Officer |
| James M. Knowlton | 57 | President and Chief Operating |

Officer, President and
General Manager, BAV Division

| Name | Age | Position |
|---|---|---|
| Jayne M. Tuohig | 53 | Senior Vice President and General Manager, Postal Service Program Center |
| Paul A. Vander Myde | 63 | Senior Vice President, Corporate Affairs |
| Craig S. Weber | 55 | Senior Vice President, Chief Financial Officer and Corporate Secretary |



PART II

ITEM 5. Market for Registrant's Common Stock and Related Stockholder Matters

(a) Market Information

The company's common stock ($.05 par value) is traded in the Nasdaq National Market System, trading symbol: VSEC, Newspaper listing: VSE.

The following table sets forth the range of high and low sales price information on VSE common stock for each quarter and annually during the last two years based on information reported by the Nasdaq National Market System.

<TABLE>
<CAPTION>

| Quarter Ended | High | Low | Dividends |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| 1998: | | | |
| March 31 | $ 9.70 | $8.125 | $.036 |
| June 30 | 10.50 | 8.00 | .036 |
| September 30 | 9.50 | 7.75 | .036 |
| December 31 | 13.00 | 5.75 | .036 |
| For the Year | $13.00 | $5.75 | $.144 |
| 1999: | | | |
| March 31 | $11.75 | $8.25 | $.036 |
| June 30 | 11.00 | 6.75 | .036 |
| September 30 | 10.50 | 8.125 | .036 |
| December 31 | 9.875 | 7.125 | .036 |
| For the Year | $11.75 | $6.75 | $.144 |

</TABLE>

(b) Holders

There were approximately 1,200 stockholders of VSE common stock as of March 1, 2000, consisting of about 300 stockholders of record plus the number of beneficial owner proxy sets provided in connection with VSE's 1999 Annual Meeting of Stockholders to (a) brokers, banks, and nominees and (b) participants in the VSE Corporation Employee ESOP/401(k) Plan.

(c) Dividends

Cash dividends were declared at the rate of $.144 per share during 1999 and 1998. Pursuant to its bank loan agreement (see Note 4 of "Notes to Consolidated Financial Statements"), the payment of cash dividends by VSE is subject to annual rate restrictions. VSE has paid cash dividends each year since 1973.

<TABLE>

ITEM 6.    Selected Financial Data

(In thousands, except per share data)
<CAPTION>

| | 1999 | 1998 | 1997 | 1996 | 1995(A) |
|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> |
| Revenues, principally from contracts . . . . . | $157,399 | $177,095 | $152,550 | $115,616 | $72,378 |
| Income (loss) from continuing operations . . . | $ 1,534 | $ 1,595 | $ (1,447) | $ 1,946 | $ 1,738 |
| (Loss) from discontinued operations . . . . . | - | - | - | (25) | (92) |
| Loss on disposal of discontinued operations . . . . . . . . . . . . . . . . . | - | - | - | (179) | - |
| Net income (loss) . . . . . . . . . . . . | $ 1,534 | $ 1,595 | $ (1,447) | $ 1,742 | $ 1,646 |
| Basic earnings per common share: | | | | | |
| Income (loss) from continuing operations . . | $ .73 | $ .75 | $ (.68) | $ .89 | $ .80 |
| (Loss) from discontinued operations . . . . | - | - | - | (.09) | (.04) |
| Net income (loss) . . . . . . . . . . . . | $ .73 | $ .75 | $ (.68) | $ .80 | $ .76 |
| Diluted earnings per common share: | | | | | |
| Income (loss) from continuing operations . . | $ .73 | $ .75 | $ (.68) | $ .88 | $ .80 |
| (Loss) from discontinued operations . . . . | - | - | - | (.09) | (.04) |
| Net income (loss) . . . . . . . . . . . . | .73 | $ .75 | $ (.68) | $ .79 | $ .76 |
| Working Capital . . . . . . . . . . . . . . . | $ 7,078 | $ 5,801 | $ 6,258 | $ 9,839 | $ 9,535 |
| Total assets . . . . . . . . . . . . . . . . . | $ 31,250 | $ 47,248 | $ 43,413 | $ 49,353 | $29,108 |
| Long-term debt . . . . . . . . . . . . . . . . | $ - | $ 1,503 | $ 3,444 | $ 5,384 | $ 4,514 |
| Stockholders' investment . . . . . . . . . . . | $ 15,145 | $ 13,852 | $ 12,481 | $ 14,595 | $13,553 |
| Cash dividends per common share . . . . . . . | $ .144 | $ .144 | $ .144 | $ .138 | $ .13 |

</TABLE>

Per share amounts have been adjusted to reflect stock splits effected in 1996 and 1997.

(A) The increase in revenues in 1996 as compared to 1995 are attributed to the award of the BAV contract and the acquisitions of Energetics Incorporated and CMstat Incorporated.

This consolidated summary of selected financial data should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this Annual Report.



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

VSE and its subsidiaries and divisions have two reportable segments: the engineering, logistics, management and technical services segment ("ELMTS") and the software products and services segment ("SPS"). The term "VSE" or "company" means VSE and its subsidiaries and divisions unless the context indicates operations of the parent company only.

The ELMTS business operations consist of the operations of the parent company, operations of the company's wholly owned subsidiaries and operations of the company's divisions. Wholly owned subsidiaries in this segment include Energetics Incorporated ("Energetics"), Human Resource Systems, Inc.

("HRSI"), Ship Remediation and Recycling, Inc. ("SRR", formerly VSE Services Corporation) and VSE Services International Inc ("VSI") incorporated in August 1999. Unincorporated divisions in this segment include BAV Division ("BAV"), Fleet Maintenance Division ("Fleet Maintenance") formed in June 1999, Ordnance Division ("Ordnance"), VSE IT Services Division ("IT Services"), formed in January 1999, and Value Systems Services Division ("VSS").

The SPS business operations include sales of developed software products and the services related to the installation and use of the software. This is the primary business of VSE's former subsidiary CMstat Corporation ("CMstat"), sold in May 1999. (See "Divestiture" below).

The company is engaged principally in providing engineering, software development, testing and management services to the U.S. Government (the "government"). Intercompany sales are principally at cost and have been eliminated from the consolidated financial statements.



Results of Operations

Revenues

The following table shows the revenues from operations of VSE and subsidiaries and such revenues as a percent of total revenues:

<TABLE>

Revenues from Operations
(dollars in thousands)

<CAPTION>

| Company or Business Unit | 1999 Revenues | % | 1998 Revenues | % | 1997 Revenues | % |
|---|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> | |
| ELMTS Segment: | | | | | | |
| VSE (parent company). . . . . | $ 44,301 | 28.0 | $ 51,993 | 28.9 | $ 50,040 | 32.2 |
| BAV . . . . . . . . . . . . . | 78,791 | 49.8 | 93,564 | 52.0 | 75,296 | 48.3 |
| Energetics . . . . . . . . . | 11,604 | 7.3 | 11,984 | 6.6 | 11,598 | 7.4 |
| VSS . . . . . . . . . . . . . | 10,271 | 6.5 | 10,182 | 5.6 | 9,179 | 5.9 |
| Ordnance . . . . . . . . . . | 6,115 | 3.9 | 1,531 | 0.8 | 0 | 0.0 |
| HRSI . . . . . . . . . . . . | 5,770 | 3.6 | 7,841 | 4.4 | 6,437 | 4.1 |
| Fleet Maintenance . . . . . . | 273 | 0.2 | - | 0.0 | - | 0.0 |
| IT Services . . . . . . . . . | 268 | 0.1 | - | 0.0 | - | 0.0 |
| VSI . . . . . . . . . . . . . | 6 | 0.0 | - | 0.0 | - | 0.0 |
| | $157,399 | 99.4 | $177,095 | 98.3 | $152,550 | 97.9 |
| SPS Segment: | | | | | | |
| CMstat . . . . . . . . . . . | $ 902 | 0.6 | $ 3,138 | 1.7 | $ 3,313 | 2.1 |

</TABLE>

The consolidated statements of operations have been restated and include the revenues and income from the SPS segment on the "Loss on CMstat operations" line.

Engineering, Logistics, Management and Technical Services Segment

The largest customer for the ELMTS segment is the U.S. Department of Defense ("Defense"), including agencies of the U.S. Army, Navy and Air Force. VSE's ELMTS segment revenues have historically been subject to annual fluctuations resulting from changes in the level of Defense spending. Accordingly, there can be no assurance that future reductions in Defense spending will not have a material adverse impact on the company's results of operations or financial position.

Substantially all of the company's revenues from this segment depend on the award of new contracts, on current contracts not being terminated for the convenience of the government, and on the exercise of option periods and the satisfaction of incremental funding requirements on current contracts. In

1999, 1998 and 1997, the company did not experience any terminations of contracts for the convenience of the government nor any non-exercise of option periods on current contracts which were material to the company's results of operations or financial position.



During 1998 and 1999, the Ordnance and Fleet Maintenance divisions bid on contract work that had been traditionally performed by VSE. This enabled the company to use an operating structure that was better suited to perform certain types of contract work. In prior years, the company has utilized this strategy to win contracts and generate new revenue in the BAV and VSS divisions. The company anticipates that it will continue this strategy to better service the needs of its customers. As the use of operating divisions to bid and win new contracts increases, the company expects that the revenue of VSE (the parent company) will be further reduced in the future as parent company contracts are replaced by operating division contracts. Management believes that the use of operating divisions to perform future work and the associated improvements in servicing customers will better position the consolidated entity for future revenue growth.

BAV Contract. Since August 1995, VSE's BAV Division has had a contract with the U.S. Navy to provide engineering, technical and logistical support services associated with the sale, lease or transfer of Navy ships to foreign governments. This contract has the potential, if all options are exercised, to generate revenues in excess of one billion dollars over a ten year period from 1995 through 2005. The contract accounted for approximately 50% and 52% of consolidated revenues from operations during 1999 and 1998, respectively. The level of revenues generated by this contract will vary depending on a number of factors including the timing of ship transfers and associated support services ordered by foreign governments and economic conditions of potential customers worldwide. The company experienced significant quarterly and annual revenue fluctuations from 1997 through 1999 and anticipates that future revenues will be subject to significant variations primarily due to this contract.

New Business. The company has been successful in bidding and winning new types of work in the ELMTS segment. IT Services was formed in January 1999 to bid and perform on work issued through the government's GSA schedule. This division was awarded a second purchase agreement in October 1999 to support the U.S. Navy's Engineering Investigations (EI) safety program related to naval aircraft and aircraft systems and subsystems.

VSI was formed in August 1999 to expand VSE's international presence and perform services for foreign government and commercial customers similar to the services VSE has traditionally provided in the United States. VSI received its first work order in September 1999.

SRR is a participant in a joint venture that was awarded a contract associated with a new program to dismantle and recycle retired U.S. Navy ships. Work on this contract began in January 2000.

Each of these three new business units is engaged in bidding on and performing work that could potentially increase the future revenues of the company.

Software Products and Services Segment

The company sold its CMstat subsidiary in May 1999. (See "Divestiture" below). The revenues and pretax losses of this segment for 1999 include the activity of CMstat through May 21, 1999, and the pretax loss includes a loss on the sale of CMstat. Accordingly, year to year comparisons of revenue and



income for this segment are not meaningful. As a result of the sale of CMstat, the company will no longer have any active business operations in the software products and services segment. The company's 1999 operating results for the SPS segment are therefore not a good indicator of future quarterly results.

Income from Operations Before Income Taxes

The following table shows consolidated revenues and income from operations before income taxes of VSE segments, other items of income and expense, and such amounts as a percent of segment revenues.

<TABLE>
Income (Loss) from Operations Before Income Taxes
(dollars in thousands)
<CAPTION>

| Description | 1999 | % | 1998 | % | 1997 | % |
|---|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| ELMTS Segment: | | | | | | |
| Revenues . . . . . . . | $157,399 | 100.0 | $177,095 | 100.0 | $152,550 | 100.0 |
| Costs and expenses . . | 152,705 | 97.0 | 171,629 | 96.9 | 148,412 | 97.3 |
| Gross profit . . . . . | 4,694 | 3.0 | 5,466 | 3.1 | 4,138 | 2.7 |
| Selling, general and administrative expenses | 684 | 0.4 | 592 | 0.3 | 159 | 0.1 |
| Interest expense . . . | 132 | 0.1 | 45 | 0.1 | 130 | 0.1 |
| Income from operations before income taxes . . . . . . . | $ 3,878 | 2.5 | $ 4,829 | 2.7 | $ 3,849 | 2.5 |
| SPS Segment: | | | | | | |
| Revenues . . . . . . . | $ 902 | 100.0 | $ 3,138 | 100.0 | $ 3,313 | 100.0 |
| Costs and expenses . . | 1,072 | 118.9 | 4,607 | 146.8 | 8,178 | 246.9 |
| Gross loss . . . . . . | (170) | (18.9) | (1,469) | (46.8) | (4,865) | (146.9) |
| Selling, general and administrative expenses | 82 | 9.1 | 178 | 5.7 | 691 | 20.9 |
| Loss on disposition of CMstat | 1,098 | 121.7 | - | 0.0 | - | 0.0 |
| Interest expense . . . | 128 | 14.2 | 496 | 15.8 | 376 | 11.3 |
| Loss from operations before income taxes . . . . . . . | $ (1,478) | (163.9) | $ (2,143) | (68.3) | $ (5,932) | (179.1) |

</TABLE>

Engineering, Logistics, Management and Technical Services Segment

Costs and expenses of operations, as a percentage of ELMTS segment revenues, were fairly stable during 1999, 1998 and 1997. The small percentage differences between 1999, 1998 and 1997 are due to a combination of factors, some of which are offsetting, including (a) differences between



costs incurred and costs billable (whether they may be billed based on contract provisions), (b) the effects of increases or decreases in facility and equipment lease renewals, fringe benefit programs and similar period expenses, (c) costs associated with contract start-up and termination phases, (d) narrower profit margins on new work due to increased competition, (e) increased labor costs reflecting a more competitive marketplace for attracting and retaining our employees, (f) the establishment and reversal of reserves for potential contract disallowances due to the timing of government audits on costs incurred, g) the amount of work performed on certain contracts as a percentage of total revenues, (h) the timing of contract award fees and (i) effective project and cost management.

Selling, general and administrative expenses as a percentage of segment revenues increased slightly in 1999 as compared to 1998 and in 1998 as compared to 1997. Selling, general and administrative expenses will vary from year to year due to various types of nonreimbursable costs, including costs associated with the start up of new divisions or subsidiaries, costs of discontinued operations and unrecoverable contract costs.

Interest expense as a percentage of segment revenues increased slightly in 1999 as compared to 1998 due primarily to an increase in average levels of bank debt resulting from the sale of CMstat. Interest expense as a percentage of segment revenues decreased approximately 0.1% in 1998 as compared to 1997 due primarily to the application of earnings to reduce the bank debt of this segment and to the improved cash collection cycles on government contracts.

## Divestiture

On May 22, 1999, VSE sold its wholly owned subsidiary CMstat. Under the terms of the transaction, VSE sold all of the outstanding capital stock of CMstat to an officer of CMstat in exchange for a promissory note for which principal is payable in installments from September 1, 1999 through May 20, 2006. The transaction resulted in a pretax loss of approximately $1.1 million. An additional pretax loss from CMstat operations prior to the sale date of approximately $400 thousand was incurred in 1999.

The sale of CMstat is a divestiture for legal and tax purposes. For accounting purposes, the sale is not afforded discontinued operations treatment under Staff Accounting Bulletin No. 30 "Accounting for Divestiture of a Subsidiary or Other Business Operation"("SAB No. 30") since the sale did not transfer the risks of ownership because the sales price is primarily dependent on the buyer's ability to repay the promissory note.

The company sustained significant losses on CMstat operations during 1999, 1998 and 1997. Management believes that the divestiture of CMstat will allow the company to focus on its core business lines and improve profitability in the future.

## Liquidity and Capital Resources

### Cash Flows

The company's level of net cash and cash equivalents did not change significantly during 1999. Approximately $4.2 million in net cash provided by



operations was used for financing activities of approximately $3.1 million and for investing activities of approximately $1.1 million. Significant financing activities included decreases in bank loan borrowings and the current portion of long-term debt of approximately $1.5 million and $1.3 million, respectively. Significant investing activities included approximately $1.2 million associated with the purchase of property and equipment, primarily computer equipment. Cash flows provided by operating activities increased in 1999 as compared to 1998 due primarily to changes in the levels of accounts receivable and accounts payable in 1999 resulting from a decrease in revenues on the BAV contract as compared with the previous year.

A net increase in cash and cash equivalents of approximately $34 thousand during 1998 resulted from approximately $2.9 million provided by operations, approximately $1.4 million used in financing activities, and approximately $1.5 million used in investing activities. Significant financing activities included a decrease in bank loan borrowings of approximately $1.9 million. Significant investing activities included approximately $1.5 million associated primarily with the purchase of computer equipment. Cash flows provided by operating activities decreased in 1998 as compared to 1997 due primarily to an increase in the level of accounts receivable in 1998 resulting from the increased revenues in 1998 as compared with a significant decrease in accounts receivable in 1997 due to collections of accounts receivable on the BAV contract. The decrease in cash flows provided by operating activities due to changes in the level of accounts receivable was offset slightly by cash provided by the increase in net income and the increase in accounts payable.

A net decrease in cash and cash equivalents of approximately $399 thousand during 1997 resulted from approximately $3.5 million provided by operations, approximately $2 million used in financing activities, and approximately $1.8 million used in investing activities. Significant financing activities included a decrease in bank loan borrowings of $1.9 million. Significant investing activities included approximately $1.8 million associated with the purchase of property and equipment.

The company's principal requirements for cash are to finance the costs of operations pending the collection of accounts receivable, to acquire capital assets including leaseholds for office and computer support and to pay cash dividends. Performance of work under the BAV contract has the potential to cause substantial requirements for cash; however, management believes that the cash flows from future operations and the bank revolving loan commitment are adequate to meet current operating cash requirements.

Working Capital

VSE's requirements for working capital are affected significantly by its revenues and accounts receivable, which are primarily derived from billings made by the company to the government or other government prime contractors for services rendered. Such accounts receivable generally do not present liquidity or collection problems. Working capital is also affected by (a) contract retainages, (b) start-up and termination costs associated with new or completed contracts, (c) capital equipment requirements, (d) differences between the provisional billing rates authorized by the government compared to the costs actually incurred by the company and (e) profitability.



Government contracts generally require VSE to pay for material and subcontract costs included in VSE's contract billings prior to receiving payment for such costs from the government. However, such contracts generally provide for progress payments on a monthly or semimonthly basis, thereby reducing requirements for working capital.

Dividends

Cash dividends were declared at the rate of $.144 per share during 1999, 1998, and 1997. Pursuant to its bank loan agreement (see Note 4 of "Notes to Consolidated Financial Statements"), the payment of cash dividends by VSE is subject to annual rate restrictions. VSE has paid cash dividends each year since 1973.

ESOP Advances

Prior to December 1998 the company made advances to the ESOP trust totaling $792 thousand in connection with distributions made to terminated participants. In December 1998, the company and the ESOP entered into an agreement in which the ESOP repaid the advances. Under the terms of the agreement, the company purchased 72,000 shares of VSE stock from the ESOP at market price and the ESOP simultaneously returned the proceeds of $792,000 from the stock sale to the company as repayment of the advances.

Inflation and Pricing

Most of the contracts performed by VSE provide for estimates of future labor costs to be escalated for any option periods provided by the contracts, while the non-labor costs included in such contracts are normally considered reimbursable at cost. VSE property and equipment consists principally of computer systems equipment and furniture and fixtures. The overall impact of inflation on replacement costs of such property and equipment is expected to be insignificant.

Global Economic Conditions

VSE's business is subject to the risks arising from global economic conditions associated with potential foreign customers served through VSE's contracts with the U.S. Government. For example, an economic slowdown in countries served under the BAV contract could potentially affect BAV sales. Management is unable to predict what, if any, impact such conditions may have on the company's financial position or results of operations.

Year 2000

Overview. The company is not currently aware of any Year 2000 issues that have affected its business. During 1999, the company completed a detailed assessment of all its information technology and non-information technology hardware and software with regard to the Year 2000 issue, with special emphasis on mission critical systems. Prior to December 31, 1999, information and non-information technology hardware and software were



inventoried and those not Year 2000 ready were identified, remediated (i.e., corrected or replaced) and tested to ensure that they would, in fact, operate as desired according to Year 2000 requirements. It is possible that the company's computerized systems could be affected in the future by the Year 2000 issue. The company will continue to monitor its mission critical computer applications throughout the year 2000 to ensure that any latent Year 2000 matters that may arise are addressed promptly.

Costs. Costs incurred to date for Year 2000 readiness efforts have been minimal and are included as part of the company's ongoing administrative costs and have not been separately identified. The company continues to upgrade and improve its information technology systems as part of its normal effort to maintain a competitive edge. As these upgrades and improvements are made, the company is ensuring that all are Year 2000 ready. Therefore, the majority of costs incurred for computer systems that ensure Year 2000 readiness are expenditures that are made in the normal course of business. Total property and equipment expenditures for 1999 and 1998, including expenditures for computers and computer systems, were approximately $1.2 million and $1.5 million, respectively. Accordingly, management believes that the incremental costs of addressing the Year 2000 readiness issue have not materially affected the company's consolidated financial position, liquidity, or results of operations through December 31, 1999 and will not materially affect them through 2000.

Impact on Operations. The company did not materially alter its spending patterns for information technology as a result of the Year 2000 issue. The company has not experienced any material revenue fluctuations due to increases or decreases in customer purchasing activity related to the Year 2000 issue during late 1999 or early 2000 and does not expect to experience such fluctuations. The company has not experienced and does not expect to experience any significant returns of products or services purchased in 1999 by customers in preparation for Year 2000. Accordingly, the company does not anticipate that the Year 2000 issue will materially impact its results of operations in 2000 as compared to 1999.

Risks. The full range of potential risks associated with the Year 2000 issue will continue to be monitored. Potential risks include obligations related to contract performance on current and past contracts, the reliance on infrastructure services to conduct the company's business operations, and the possibility of liquidity issues caused by payment problems with VSE's banks or government customers. Although management believes that the risks associated with internal issues regarding the Year 2000 problem will be minimal, the risks associated with external issues are difficult to predict. If these external issues cause massive failures to systems upon which the company is reliant, the results could materially affect the company's consolidated financial position, liquidity, or results of operations.

Market Risk

The Company does not use derivative instruments to alter the interest characteristics of its debt instruments. The aggregate fair value of the company's financial instruments approximates the carrying value at December 31, 1999.



ITEM 8. Financial Statements and Supplementary Data

Index To Financial Statements





Report of Independent Public Accountants

To the Stockholders of VSE Corporation:

We have audited the accompanying consolidated balance sheets of VSE Corporation (a Delaware corporation) and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of operations, stockholders' investment and cash flows for the three years ended December 31, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of VSE Corporation as of December 31, 1999 and 1998, and the results of its operations and its cash flows for the three years ended December 31, 1999, in conformity with accounting principles generally accepted in the United States.

ARTHUR ANDERSEN LLP

Vienna, Virginia
March 3, 2000



<TABLE>

Consolidated Balance Sheets As of December 31,

- ---------------------------------------------------------------------------

(in thousands, except share amounts)

<CAPTION>

<S> <C> <C>

| | 1999 | 1998 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $ 62 | $ 49 |
| Accounts receivable, principally U.S. Government, net | 19,361 | 34,105 |
| Deferred tax assets | 927 | 403 |
| Other current assets | 974 | 1,266 |
| Total current assets | 21,324 | 35,823 |
| Property and equipment, net | 4,377 | 4,480 |
| Deferred tax assets | 728 | 703 |
| Intangible assets, net | 1,267 | 2,836 |
| Note receivable from business transferred | 665 | - |
| Net assets of business transferred under contractual arrangement | - | 629 |
| Other assets | 2,889 | 2,777 |
| Total assets | $31,250 | $47,248 |
| Liabilities and Stockholders' Investment | | |
| Current liabilities: | | |
| Current portion of long-term debt | $ - | $ 1,333 |
| Accounts payable | 8,193 | 15,930 |
| Accrued expenses | 5,977 | 5,935 |
| Dividends payable | 76 | 77 |
| Net liabilities of business transferred under contractual arrangement | - | 6,747 |
| Total current liabilities | 14,246 | 30,022 |
| Long-term debt | - | 1,503 |
| Deferred compensation | 1,859 | 1,871 |
| Total liabilities | 16,105 | 33,396 |
| Commitments and contingencies | | |
| Stockholders' investment: | | |
| Common stock, par value $.05 per share, authorized 5,000,000 shares; issued 2,194,289 in 1999 and 2,186,905 in 1998 | 110 | 109 |
| Paid-in surplus | 3,894 | 3,832 |
| Retained earnings | 11,933 | 10,703 |
| Treasury stock, at cost (72,000 shares) | (792) | (792) |
| Total stockholders' investment | 15,145 | 13,852 |
| Total liabilities and stockholders' investment | $31,250 | $47,248 |

</TABLE>

See accompanying notes



<TABLE>

Consolidated Statements of Operations For the years ended December 31,

- ---------------------------------------------------------------------------

(in thousands, except share amounts)

<CAPTION>

<S> <C> <C> <C>

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Revenues, principally from contracts | $ 157,399 | $ 177,095 | $ 152,550 |
| Costs and expenses of contracts | 152,684 | 171,510 | 148,020 |
| Gross profit | 4,715 | 5,585 | 4,530 |

| | | | |
|---|---|---|---|
| Selling, general and administrative expenses | 684 | 592 | 159 |
| Loss on CMstat operations . . . . . . . . . | 401 | 2,262 | 6,324 |
| Loss on disposition of CMstat . . . . . . . | 1,098 | - | - |
| Interest expense . . . . . . . . . . . . . . | 132 | 45 | 130 |
| | --------- | --------- | --------- |
| Income (loss) before income taxes . . . . . | 2,400 | 2,686 | (2,083) |
| Provision (benefit) for income taxes . . . . | 866 | 1,091 | (636) |
| | --------- | --------- | --------- |
| Net income (loss) . . . . . . . . . . . . . | $ 1,534 | $ 1,595 | $ (1,447) |
| | ========= | ========= | ========= |
| Basic earnings per share: | | | |
| Net income (loss) . . . . . . . . . . . . . | $ 0.73 | $ 0.75 | $ (0.68) |
| | ========= | ========= | ========= |
| Basic weighted average shares outstanding | 2,115,569 | 2,126,151 | 2,123,544 |
| | ========= | ========= | ========= |
| Diluted earnings per share: | | | |
| Net income (loss) . . . . . . . . . . . . . | $ 0.73 | $ 0.75 | $ (0.68) |
| | ========= | ========= | ========= |
| Diluted weighted average shares outstanding | 2,115,569 | 2,126,151 | 2,123,544 |
| | ========= | ========= | ========= |

</TABLE>

See accompanying notes



<TABLE>

Consolidated Statements of Stockholders' Investment

(in thousands)

<CAPTION>

| | Common Stock Shares | Common Stock Amount | Paid-In Surplus | Retained Earnings | Treasury Stock | ESOP Obligation | Unrealized Loss on Available-for-Sale Securities |
|---|---|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> | <C> |
| Balance at December 31, 1996 | 3,908 | $ 195 | $ 8,241 | $ 22,840 | $ (16,285) | $ (350) | $ (46) |
| Net loss for the year | -- | -- | -- | (1,447) | -- | -- | -- |
| Purchase of Treasury Stock | -- | -- | -- | -- | (70) | -- | -- |
| ESOP Obligation | -- | -- | -- | -- | -- | (330) | -- |
| Realized loss on marketable securities | -- | -- | -- | -- | -- | -- | 46 |
| Retirement of Treasury Stock | (2,176) | (109) | (4,588) | (11,658) | 16,355 | -- | -- |
| Stock split effected in the form of a 5-for-4 stock dividend | 433 | 22 | (22) | -- | -- | -- | -- |
| Dividends declared ($.144) | -- | -- | -- | (313) | -- | -- | -- |
| | ------ | ----- | ------- | -------- | --------- | ------ | ----- |
| Balance at December 31, 1997 | 2,165 | 108 | 3,631 | 9,422 | -- | (680) | -- |
| Net income for the year | -- | -- | -- | 1,595 | -- | -- | -- |
| ESOP Obligation | -- | -- | -- | -- | -- | (112) | -- |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Purchase of Treasury Stock | -- | -- | -- | -- | (792) | 792 | -- |
| Issuance of stock | 22 | 1 | 201 | -- | -- | -- | -- |
| Dividends declared ($.144) | -- | -- | -- | (314) | -- | -- | -- |
| | ------ | ----- | ------- | -------- | --------- | ------ | ----- |
| Balance at December 31, 1998 | 2,187 | 109 | 3,832 | 10,703 | (792) | -- | -- |
| Net income for the year | -- | -- | -- | 1,534 | -- | -- | -- |
| Issuance of stock | 7 | 1 | 62 | -- | -- | -- | -- |
| Dividends declared ($.144) | -- | -- | -- | (304) | -- | -- | -- |
| | ------ | ----- | ------- | -------- | --------- | ------ | ----- |
| Balance at December 31, 1999 | 2,194 | $ 110 | $ 3,894 | $ 11,933 | $ (792) | $ -- | $ -- |
| | ====== | ===== | ======= | ======== | ========= | ====== | ===== |

</TABLE>

See accompanying notes

25

<TABLE>

Consolidated Statements of Cash Flows For the years ended December 31,

- ----------------------------------------------------------------------------------------------

(in thousands)

<CAPTION>

| <S> | 1999 <C> | 1998 <C> | 1997 <C> |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income (loss) . . . . . . . . . . . . . . . . . . . . . . . | $ 1,534 | $ 1,595 | $(1,447) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | | |
| Depreciation and amortization . . . . . . . . . . . . . . . | 1,947 | 1,603 | 1,622 |
| Loss on disposition of CMstat . . . . . . . . . . . . . . . | 1,098 | - | - |
| (Gain) loss on sale of property and equipment . . . . . . . | (124) | 5 | 47 |
| Deferred compensation plan expense . . . . . . . . . . . . | 29 | 140 | 6 |
| Net (payments of) proceeds from deferred compensation . . . | (45) | 188 | 242 |
| Change in Deferred taxes . . . . . . . . . . . . . . . . . | (549) | 317 | (733) |
| Change in operating assets and liabilities: | | | |
| (Increase) decrease in: | | | |
| Accounts receivable . . . . . . . . . . . . . . . . . . . | 14,652 | (3,817) | 4,983 |
| Other current assets and noncurrent assets . . . . . . . . | 1,569 | (509) | 80 |
| Increase (decrease) in: | | | |
| Accounts payable . . . . . . . . . . . . . . . . . . . . . | (7,733) | 1,999 | (5,819) |
| Accrued expenses . . . . . . . . . . . . . . . . . . . . . | 42 | 9 | 522 |
| Net Liabilities of business transferred under contractual arrangements . . . . . . . . . . . . . . . . | (8,205) | 1,421 | 3,968 |
| | ------- | ------- | ------- |
| Net cash provided by operating activities | 4,215 | 2,951 | 3,471 |
| | ------- | ------- | ------- |
| Cash flows from investing activities: | | | |
| Purchase of property and equipment, (net of proceeds from dispositions) . . . . . . . . . . . . . | (1,199) | (1,530) | (1,818) |
| Proceeds from note receivable from business transferred . . . . | 74 | - | - |
| | ------- | ------- | ------- |
| Net cash used in investing activities | (1,125) | (1,530) | (1,818) |
| | ------- | ------- | ------- |
| Cash flows from financing activities: | | | |
| Net payments of bank loan . . . . . . . . . . . . . . . . . . | (1,503) | (1,941) | (1,940) |
| Current portion of long-term debt . . . . . . . . . . . . . . | (1,333) | 778 | 555 |
| Cash dividends paid . . . . . . . . . . . . . . . . . . . . . | (304) | (314) | (313) |
| Repayment from (advance to)ESOP . . . . . . . . . . . . . . . | - | 680 | (330) |
| Purchase of Treasury stock . . . . . . . . . . . . . . . . . | - | (792) | (70) |
| Realized loss on marketable securities . . . . . . . . . . . . | - | - | 46 |
| Issuance of common stock . . . . . . . . . . . . . . . . . . | 63 | 202 | - |
| | ------- | ------- | ------- |
| Net cash used in financing activities | (3,077) | (1,387) | (2,052) |
| | ------- | ------- | ------- |

| | | | |
|---|---|---|---|
| Net increase (decrease) in cash and cash equivalents | 13 | 34 | (399) |
| Cash and cash equivalents at beginning of year | 49 | 15 | 414 |
| Cash and cash equivalents at end of year | $ 62 | $ 49 | $ 15 |

</TABLE>
<TABLE>
Supplemental disclosures of cash flow information for the three years ended December 31, are presented below (in thousands):
<CAPTION>

| <S> | 1999 <C> | 1998 <C> | 1997 <C> |
|---|---|---|---|
| Cash paid during the year for: | | | |
| Interest | $ 321 | $ 537 | $ 568 |
| Income taxes | $ 1,261 | $ 903 | $ 319 |
| Noncash investing and financing activities: | | | |
| Note receivable from business transferred | $ 800 | $ - | $ - |

</TABLE>

See accompanying notes



VSE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include two segments: the engineering, logistics, management, and technical services ("ELMTS") segment and the software products and services ("SPS") segment. ELMTS business operations consist of the operations of the parent company, operations of the company's wholly owned subsidiaries, and operations of the company's divisions. Wholly owned subsidiaries in this segment include Energetics Incorporated ("Energetics"), Human Resource Systems, Inc. ("HRSI"), Ship Remediation and Recycling, Inc. ("SRR", formerly VSE Services Corporation), and VSE Services International, Inc. ("VSI"). Unincorporated divisions in this segment include BAV Division ("BAV"), Fleet Maintenance Division ("Fleet Maintenance"), Ordnance Division ("Ordnance"), VSE IT Services Division ("IT Services"), and Value Systems Services Division ("VSS"). This segment is engaged principally in providing engineering, testing, management and information technology services to the U.S. Government (the "government") and other government prime contractors. The SPS segment business operations consist of the operations of wholly owned subsidiary CMstat, sold in May 1999 (see note 10), which was engaged principally in software development and sales of software products and services primarily to government prime contractors.

The term "VSE" or "company" means VSE and its subsidiaries and divisions unless the context indicates operations of the parent company only. Intercompany sales are principally at cost. All significant intercompany transactions have been eliminated in consolidation. Certain prior year balances have been reclassified for comparative purposes.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management 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.

Stockholders' Investment and Earnings Per Share

At December 31, 1999, options to purchase 149,023 shares, 38,063 shares, 36,563 shares and 55,438 shares of common stock at $10.91, $13.04, $9.42 and $10.93 per share, respectively, were outstanding. There was no dilutive impact on reported earnings per share for 1999, 1998 and 1997.



Cash and Cash Equivalents

The company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

The company has classified all debt and equity securities as available-for-sale. Available-for-sale securities are carried at fair value with unrealized gains and losses, net of tax, reported as a component of stockholders' investment. Realized gains and losses are included in other income. Available-for-sale debt securities as of December 31, 1999 and December 31, 1998 consisted of overnight money market accounts of $1.7 million and $3.3 million, respectively, secured by Government agency securities. The estimated fair value of these securities approximated cost, and the amount of gross unrealized gains and losses was not significant.

Concentration of Credit Risk/Fair Value of Financial Instruments

Financial instruments that potentially subject the company to concentration of credit risk consist primarily of cash, cash equivalents and trade accounts receivable. The company believes that concentrations of credit risk with respect to trade accounts receivable are limited as they are primarily Government receivables. The company believes that the fair market value of all financial instruments approximates book value.

Contract Revenues

Substantially all of the company's revenues result from contract services performed for the Government or for contractors engaged in work for the Government under a variety of contracts. Revenues on cost-type contracts are recorded on the basis of recoverable costs incurred and fees earned.

Revenues on fixed price contracts are recorded as services are performed, using the percentage-of-completion method of accounting, primarily based on contract costs incurred to date compared with total estimated costs at completion. Revenues on time and material contracts are recorded on the basis of hours delivered plus other allowable direct costs as incurred.

Potential revenue related to work performed at risk is not recognized either as income or as an offset against a potential loss until it can be reliably estimated and its realization is probable. The company provides for anticipated losses on contracts by a charge to income during the period in which losses are first identified.

A substantial portion of the contract and administrative costs is subject to audit by the Defense Contract Audit Agency. The company's indirect cost rates have been audited and approved for 1997 and prior years, with the exception of VSS which has been audited and approved through 1996. In the opinion of management, the audits of the indirect cost rates for 1999, 1998 and the VSS 1997 audit will not result in material adjustments, if any, to the company's results of operations or financial position.



Property and Equipment

<TABLE>

Property and equipment (valued at cost) consisted of the following (in thousands):

<CAPTION>

| <S> | 1999 <C> | 1998 <C> |
|---|---|---|
| Computer systems equipment . . . . . . . . . . . . . | $ 7,916 | $ 7,215 |
| Furniture, fixtures, equipment and other . . . . . . | 4,736 | 4,688 |

| | | |
|---|---|---|
| Leasehold improvements | 1,608 | 1,395 |
| Buildings | 302 | 381 |
| Land and land improvements | 385 | 385 |
| | 14,947 | 14,064 |
| Less accumulated depreciation | (10,570) | (9,584) |
| | $ 4,377 | $ 4,480 |

</TABLE>

Depreciation and amortization expense for property and equipment was approximately $1.8 million for 1999, $1.3 million for 1998 and $1.2 million for 1997. Depreciation of computer systems equipment is provided principally by the double-declining method over periods of four to six years. Depreciation of furniture and fixtures is provided principally by the straight-line method over approximately nine years. Depreciation of all other property and equipment is provided principally by the double-declining method over periods of three to twenty years. Depreciation of buildings and land improvements is provided principally by the straight-line method over approximately thirty years.

Note Receivable

As discussed in footnote 10, as part of the sale of CMstat, VSE received a seven year, $800,000 promissory note with an effective interest rate of 8%. As of December 31, 1999 this note had a balance of $756,630. Approximately $92 thousand of this balance has been appropriately classified as short term and included as a component of accounts receivable.

Deferred Compensation Plans

Deferred compensation plan expense for the years ended December 31, 1999, 1998 and 1997 was approximately $29 thousand, $140 thousand and $6 thousand, respectively.

Included in other assets are assets of the deferred compensation plans which include equity securities recorded at fair value. The fair value of these securities was approximately $1.8 million as of December 31, 1999 and 1998. Because plan participants are at risk for market value changes in these assets, the liability to plan participants fluctuates with the asset values.



Impairment Review

The company performs a periodic review of certain assets to determine if impairment has occurred. If impaired, the company writes down the asset to its fair market value.

(2) Goodwill

As part of the August 29, 1995 acquisition of Energetics, the company recorded approximately $1.7 million of goodwill in connection with this acquisition, including approximately $200 thousand of additional goodwill due to contingency requirements established in the purchase agreement. Goodwill is being amortized by the straight-line method over fifteen years, and approximately $1.3 million of unamortized goodwill remains on the books as of December 31, 1999.

(3) Accounts Receivable

<TABLE>

The components of accounts receivable as of December 31, 1999 and 1998, were as follows (in thousands):

<CAPTION>

| | 1999 | 1998 |
|---|---|---|
| <S> | <C> | <C> |

| | | |
|---|---|---|
| Billed .................... | $ 7,967 | $10,402 |
| Unbilled: | | |
| Retainages ................. | 71 | 100 |
| Other (principally December work billed in January) .................. | 11,400 | 16,407 |
| Receivable from CMstat ............ | - | 7,281 |
| Less-Allowance for doubtful accounts ..... | (77) | (85) |
| | ------- | ------- |
| Total accounts receivable | $19,361 | $34,105 |
| | ======= | ======= |

</TABLE>

The "Unbilled: Other" included in accounts receivable are reported net of an allowance for contract disallowances of approximately $422 thousand as of December 31, 1999 and approximately $333 thousand as of December 31, 1998. "Unbilled: Other" also includes certain costs which are not reimbursable under current contracts, but which the company believes will be reimbursable on execution of contract documentation or amendments increasing funding. Amounts not presently reimbursable included in "Unbilled: Other" were approximately $287 thousand and $485 thousand as of December 31, 1999, and 1998, respectively.

Contracts with the Government, primarily with the U.S. Department of Defense, accounted for more than 95% of revenues in all years presented. These contracts were primarily for engineering services. A contract awarded in 1995 with the U.S. Navy accounted for approximately 50% and 52% of such revenues in 1999 and 1998, respectively.

The company generally expects to collect all accounts receivable other than retainages within one year.



(4) Debt

Long-term debt as of December 31, 1998 was as follows (in thousands):

| | 1998 |
|---|---|
| | ---- |
| Bank loan borrowings and commitments ....... | $ 2,836 |
| Less portion due within one year ......... | (1,333) |
| | ------- |
| | $ 1,503 |
| | ======= |

VSE has a loan agreement with a syndicate of banks that includes a revolving loan and a term loan and contains certain financial covenants. Under the revolving loan portion of the agreement, VSE can borrow up to $30 million, subject to a borrowing formula based on billed receivables. Interest is charged at a prime-based rate or an optional LIBOR-based rate. Commitment fees are charged on the unused portion of the revolving loan commitment. The termination date of the revolving loan is May 31, 2001. The original principal amount of the term loan was $4 million and the term of the loan was four years. During September 1999, VSE repaid the principal amount in full, and the term loan portion of the loan agreement no longer exists. Repayment of the term loan did not cause any changes in the terms related to the revolving loan portion of the agreement. The loan agreement contains collateral requirements by which company assets secure amounts outstanding, restrictive covenants that include minimum tangible net worth and cash flow coverage ratio requirements, a limit on annual dividends, and limits on investments and loans to certain affiliates.

Due to losses incurred by VSE's CMstat subsidiary, the company was not in compliance with certain original loan covenants during 1999 and 1998. The company's banks amended the loan agreement in these years to restate certain terms and conditions of the loan, including the covenants with which the company was not compliant. The company was in compliance during 1999 and 1998 with all covenants of the loan agreement as amended.

(5) Accrued Expenses

<TABLE>

The components of accrued expenses as of December 31, 1999 and 1998, were as

follows (in thousands):
<CAPTION>

| <S> | 1999 <C> | 1998 <C> |
|---|---|---|
| Accrued salaries | $1,766 | $1,791 |
| Accrued vacation | 1,619 | 1,659 |
| Estimated future losses on fixed-price and time and material contracts | 583 | 350 |
| Other accrued expenses | 2,009 | 2,135 |
| Total accrued expenses | $5,977 | $5,935 |

</TABLE>

(6) ESOP/401(k) Plan and Profit Sharing Plan

VSE established an ESOP/401(k) plan in 1984. Under the provisions of the ESOP, VSE and certain of its operating entities made contributions into a trust which purchased VSE stock on behalf of employees who met certain age and service requirements and were employed at the end of the plan year.



Contributions at the rate of up to 2% of eligible employee compensation were permitted at the discretion of the VSE board of directors and were allocated, subject to a vesting schedule, on a pro rata basis on eligible employee compensation. The 401(k) segment of the plan allows employees meeting certain age and service requirements to contribute a portion of their salary to certain investment trusts. As of April 1, 1999, the ESOP portion was discontinued and replaced by a plan provision whereby employer 401(k) contributions are made on behalf of the eligible employee participants based on the employees' 401(k) payroll deferrals. The employer contribution is equal to 50% of the employee deferral on the first 5% of the employee pay deferred. The company expense associated with this plan for 1999, 1998, and 1997 was approximately $333 thousand, $359 thousand, and $236 thousand, respectively.

The ESOP/401(k) plan held 582,761 shares and 688,522 shares of VSE stock as of December 31, 1999 and 1998, respectively, which receive dividend payments and are included in the weighted average shares for earnings per share calculations.

During 1998 and 1997, the company advanced the ESOP trust $112 thousand and $330 thousand, respectively, in connection with distributions made to terminated participants. The advances were payable to the company when the funds became available. The unallocated shares of the company's common stock related to these transactions are not included in the weighted average shares for earnings per share calculations. On December 31, 1998 the ESOP trust sold shares to the company and repaid the advances. These shares were accounted for as treasury stock.

Energetics maintains a profit sharing plan for employees. All employees who have completed two years of service are members of the profit sharing plan. At its discretion, Energetics may make contributions to the plan. The plan expense for 1999, 1998, and 1997 was approximately $312 thousand, $443 thousand, and $420 thousand, respectively.

(7) Stock Option Plans

1996 and 1998 Stock Option Plans
<TABLE>
The company accounts for the VSE Corporation 1996 Stock Option Plan (the "1996 Plan") and the 1998 Stock Option Plan (the "1998 Plan") pursuant to APB Opinion No. 25, "Accounting for Stock Issued to Employees," under which no compensation cost has been recognized because the exercise price of the stock options equals the market price of the underlying stock on the date of grant. Had compensation costs for the 1996 Plan and 1998 Plan been determined based on SFAS No. 123, "Accounting for Stock-Based Compensation," the company's net income and earnings per share would have been as follows (in thousands, except per share amounts):
<CAPTION>

| | | 1999 | 1998 | 1997 |
|---|---|---|---|---|
| Net income (loss): | As reported | $ 1,534 | $1,595 | $(1,447) |
| | Pro forma | $ 1,463 | $1,542 | $(1,569) |
| Earnings per share: | As reported | $ 0.73 | $ 0.75 | $ (0.68) |
| | Pro forma | $ 0.69 | $ 0.73 | $ (0.74) |

</TABLE>



Under the 1996 Plan, the company may grant options for and sell up to an aggregate of 273,698 shares of the common stock of the company. Through December 31, 1999 the company has granted options for 267,725 shares of common stock priced at 100% of the fair value of the stock at the time of the grant of the option. The maximum term of the options granted is five years. The vesting period is three years and allows for 25% vesting immediately upon date of the grant and an additional 25% on each successive anniversary date thereafter. Vesting may be accelerated for shares granted to certain individuals as determined by the Board of Directors. The 1996 Plan will terminate on the earliest of February 5, 2006, or the date on which all options under the 1996 plan have been exercised or terminated.

Under the 1998 Plan, the company may grant options for and sell up to an aggregate of 343,750 shares of common stock. Of the shares available for grant, 15,625 shares may be granted to non-employee directors of VSE, and 328,125 shares may be granted to executive officers and key employees. Through December 31, 1999 the company has granted options for 69,750 shares of common stock priced at 100% of the fair value of the stock at the time of the grant of the option. The vesting period is three years and allows for 25% vesting immediately upon date of the grant and an additional 25% on each successive anniversary date thereafter. The 1998 Plan will terminate on the earliest of May 6, 2008, or the date on which all options under the 1998 Plan have been exercised or terminated.

<TABLE>

Information with respect to stock options is as follows:

<CAPTION>

| | 1999 | Weighted Average Exercise Price | 1998 | Weighted Average Exercise Price | 1997 | Weighted Average Exercise Price |
|---|---|---|---|---|---|---|
| Number of shares under stock options: | | | | | | |
| Outstanding at beginning of year | 234,273 | $10.95 | 205,283 | $11.38 | 160,707 | $10.91 |
| Granted | 69,750 | 10.93 | 47,000 | 9.42 | 56,500 | 13.04 |
| Exercised | (313) | 9.42 | 0 | 0.00 | 0 | 0.00 |
| Forfeited | (24,625) | 10.32 | (18,010) | 11.80 | (11,924) | 12.83 |
| Outstanding at end of year | 279,085 | $11.01 | 234,273 | $10.95 | 205,283 | $11.38 |
| Exercisable at end of year | 213,585 | $11.02 | 142,642 | $11.07 | 91,203 | $11.18 |
| Weighted average remaining contractual life | 6 years | | 7 years | | 8 years | |
| Weighted average fair value of options granted | $2.36 | | $2.14 | | $3.05 | |

</TABLE>



<TABLE>

The fair value of the options is estimated on the date of grant using the Black-Scholes option pricing model. The following assumptions were used in the pricing calculation for 1999, 1998 and 1997:
<CAPTION>

| <S> | 1999 <C> | 1998 <C> | 1997 <C> |
|---|---|---|---|
| Risk free interest rate | 4.57% | 5.47% | 6.03% |
| Dividend yield | 2.00% | 2.00% | 2.00% |
| Expected life | 3 years | 3 years | 3 years |
| Expected volatility | 29.00% | 29.00% | 29.00% |

</TABLE>

(8) Income Taxes
<TABLE>
The company files consolidated federal income tax returns with all of its subsidiaries. The components of the provision (benefit) for income taxes for the years ended December 31, 1999, 1998 and 1997 are as follows (in thousands):
<CAPTION>

| <S> | 1999 <C> | 1998 <C> | 1997 <C> |
|---|---|---|---|
| Current | | | |
| Federal | $1,145 | $ 574 | $ 460 |
| State | 270 | 197 | 231 |
| | 1,415 | 771 | 691 |
| Deferred | | | |
| Federal | (432) | 249 | (1,103) |
| State | (117) | 71 | (224) |
| | (549) | 320 | (1,327) |
| Provision (benefit) for income taxes | $ 866 | $ 1,091 | $ (636) |

</TABLE>
<TABLE>
The differences between the amount of tax computed at the federal statutory rate of 34% and the provision for income taxes for 1999, 1998 and 1997 are as follows (in thousands):
<CAPTION>

| <S> | 1999 <C> | 1998 <C> | 1997 <C> |
|---|---|---|---|
| Tax at statutory federal income tax rate at 34% | $ 816 | $ 913 | $ (708) |
| Increases (decreases) in tax resulting from: | | | |
| State taxes, net of federal tax benefit | 98 | 179 | 39 |
| Permanent differences for tax | (68) | 38 | 33 |
| Other, net | 20 | (39) | - |
| Provision (benefit) for income taxes | $ 866 | $ 1,091 | $ (636) |

</TABLE>



<TABLE>
The company's deferred tax assets (liabilities) as of December 31, 1999 and 1998, which represent the tax effects of temporary differences between tax and financial accounting bases of assets and liabilities and are measured using presently enacted tax rates, are as follows (in thousands):
<CAPTION>

| <S> | 1999 <C> | 1998 <C> |
|---|---|---|
| Current deferred tax assets | $ 1,334 | $ 1,234 |
| Current deferred tax liabilities | (407) | (831) |
| Net current deferred tax assets | 927 | 403 |
| Noncurrent deferred tax assets | 1,031 | 1,010 |

| | | |
|---|---|---|
| Noncurrent deferred tax liabilities | (253) | (257) |
| Valuation allowance | (50) | (50) |
| Net noncurrent deferred tax assets | 728 | 703 |
| Net deferred tax assets | $ 1,655 | $ 1,106 |

</TABLE>

A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. The company has established such a valuation allowance for the deferred tax asset associated with certain real property because of the uncertainty that the deferred tax asset will be fully realized.

<TABLE>
The tax effect of temporary differences representing deferred tax assets and liabilities as of December 31, 1999 and 1998, are as follows (in thousands):
<CAPTION>

| <S> | 1999 <C> | 1998 <C> |
|---|---|---|
| Deferred compensation | $ 1,377 | $ 1,400 |
| Accrued expenses | 263 | 267 |
| Accelerated depreciation | 6 | (28) |
| Other | 229 | 182 |
| Allowance for contract and other disallowances | 163 | 129 |
| Bad debt expense | 32 | 35 |
| Retainages not taxed until billed. | (68) | (389) |
| Deferred revenues | (338) | (440) |
| Intangible assets | 41 | - |
| | 1,705 | 1,156 |
| Valuation allowance | (50) | (50) |
| Net deferred tax assets | $ 1,655 | $ 1,106 |

</TABLE>

(9) Commitments and Contingencies

Leases

The principal facilities of the company and its subsidiaries are generally rented under noncancelable operating leases for periods of one to ten years. The company and its subsidiaries also lease furniture and equipment generally under noncancelable operating leases for periods of one to five years. Rent expense for 1999, 1998 and 1997 was approximately $1.9 million, $2.1 million, and $2.7 million, respectively, which was net of sublease income of approximately $686 thousand, $464 thousand and $318 thousand, respectively. The future minimum annual rental required under leases having remaining noncancelable lease terms in excess of one year, net of noncancelable sublease income, will approximate $1.1 million in 2000, 2001 and 2002, and $716 thousand in 2003 and $519 thousand in 2004 and $1.8 million thereafter.



Litigation

The company and its subsidiaries have, in the normal course of business, certain claims against them and against other parties. The company is not aware of any present claims which would have a material adverse effect on the company's results of operations or financial position.

(10) Segment Information

Prior to May 21, 1999, VSE had two reportable segments: the engineering, logistics, management, and technical services segment ("ELMTS"), which provides diversified engineering, technical and management services principally to agencies of the United States Government and to other government prime contractors; and the software products and services segment

("SPS"), which provided application software and services related to the installation of the software to primarily commercial customers.  As discussed below, the SPS segment was sold on May 21, 1999.

The accounting policies are the same as those described in the summary of significant accounting policies for each segment. VSE's reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. The software products and services segment was acquired as a unit, and the management had been maintained separately since the acquisition.

<TABLE>

The following table presents revenues and other financial information by business segment for the years 1999, 1998, and 1997, in thousands:
<CAPTION>

| 1999 | ELMTS | SPS | Subtotal | Effect of Disposition(A) | Consolidated |
|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> |
| Revenues | $157,399 | $ 902 | $158,301 | $(902) | $157,399 |
| Interest expense | 132 | 128 | 260 | (128) | 132 |
| Depreciation and amortization | 1,947 | 105 | 2,052 | (105) | 1,947 |
| Loss on disposition of CMstat | - | (1,098) | (1,098) | - | (1,098) |
| Operating income (loss) | 3,878 | (1,478) | 2,400 | - | 2,400 |
| Expenditures for capital assets | 1,847 | 25 | 1,872 | 25 | 1,897 |
| Assets | 31,250 | - | 31,250 | - | 31,250 |



| 1998 | ELMTS | SPS | Subtotal | Effect of Disposition(A) | Consolidated |
|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> |
| Revenues | $177,095 | $3,138 | $180,233 | $(3,138) | $177,095 |
| Interest expense | 45 | 496 | 541 | (496) | 45 |
| Depreciation and amortization | 1,603 | 251 | 1,854 | (251) | 1,603 |
| Operating income (loss) | 4,829 | (2,143) | 2,686 | - | 2,686 |
| Expenditures for capital assets | 1,538 | 55 | 1,593 | (55) | 1,538 |
| Assets | 38,515 | 2,223 | 40,738 | 6,510 | 47,248 |

| 1997 | ELMTS | SPS | Subtotal | Effect of Disposition(A) | Consolidated |
|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> |
| Revenues | $152,550 | $3,313 | $155,863 | $(3,313) | $152,550 |
| Interest expense | 130 | 376 | 506 | (376) | 130 |
| Depreciation and amortization | 1,622 | 2,465 | 4,087 | (2,465) | 1,622 |
| Operating income (loss) | 3,849 | (5,932) | (2,083) | - | (2,083) |
| Expenditures for capital assets | 1,826 | 974 | 2,800 | (974) | 1,826 |
| Assets | 35,551 | 2,498 | 38,049 | 5,364 | 43,413 |

(A)  See below regarding the divestiture of the SPS segment.
</TABLE>

Divestiture

On May 21, 1999, the company sold all of its interests in the SPS segment. This entailed selling its CMstat subsidiary for an $800 thousand promissory note.  The  sale is a divestiture for legal and tax purposes.  For accounting purposes, the sale is not afforded discontinued operations treatment under

Staff Accounting Bulletin No. 30 "Accounting for Divestiture of a Subsidiary or Other Business Operation"("SAB No. 30") since the sale did not transfer the risks of ownership because the sales price is primarily dependent on the buyer's ability to repay the promissory note.

As prescribed by SAB No. 30, the revenues, costs and expenses, assets and liabilities and cash flows for the SPS segment have been excluded from the respective captions in the Consolidated Statements of Operations, Balance Sheets, Cash Flows and related footnotes.

As such, the results of operations for the SPS segment are reflected as a single line item "Loss on CMstat operations" in the Consolidated Statements of Operations for each year presented. Additionally, a $1,098 thousand loss from the disposal of CMstat was recognized for the year ended December 31, 1999. The assets and liabilities are presented in the Consolidated Balance Sheets as "Net assets of business transferred under contractual arrangement" and "Net liabilities of business transferred under contractual arrangement", respectively.



ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

There have been no changes in the company's independent public accountants or disagreements with such accountants on accounting principles or practices or financial statement disclosures.



# PART III

ITEM 10. Directors and Executive Officers of the Registrant

Information with respect to Directors of the company is incorporated by reference from the registrant's definitive proxy statement for its annual meeting of stockholders to be filed not later than 120 days after December 31, 1999, with the Securities and Exchange Commission pursuant to Regulation 14A (the "Proxy Statement"). Certain information relating to Executive Officers of the company appears on page 10 of this Form 10-K Annual Report.

ITEM 11. Executive Compensation

Information with respect to this item is incorporated by reference from the Proxy Statement.

ITEM 12. Security Ownership of Certain Beneficial Owners and Management

Information with respect to this item is incorporated by reference from the Proxy Statement.

ITEM 13. Certain Relationships and Related Transactions

Information with respect to this item is incorporated by reference from the Proxy Statement.



PART IV

ITEM 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) Exhibits

See "Exhibit Index" hereinafter contained and incorporated by reference.

(b) Supplemental Financial Statement Schedule

Schedules not included herein have been omitted because of the absence of conditions under which they are required or because the required information, where material, is shown in the consolidated financial statements, financial notes, or supplementary financial information.

(c) Reports on Form 8-K

None.



SIGNATURES

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

VSE CORPORATION

Date: March 15, 2000 By: /s/ C. S. Weber

------------------------
C. S. Weber, Senior Vice
President and Chief Financial
Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on March 14, 2000, by the following persons on behalf of the Registrant and in the capacities indicated.

(a) Principal Executive Officers:

/s/ D. M. Ervine
--------------------------------------------------------------
D. M. Ervine, Chairman of the Board and Chief Executive Officer

/s/ J. M. Knowlton
--------------------------------------------------------------
J. M. Knowlton, President and Chief Operating Officer

| (b) Principal Financial Officer: | (c) Principal Accounting Officer: |
|---|---|
| /s/ C. S. Weber | /s/ T. R. Loftus |
| C. S. Weber, Senior Vice President and Chief Financial Officer | T. R. Loftus, Vice President and Comptroller |

(b) Directors:

| | |
|---|---|
| /s/ D. M. Ervine | /s/ D. M. Osnos |
| D. M. Ervine | D. M. Osnos |
| /s/ R. J. Kelly | /s/ J. D. Ross |
| R. J. Kelly | J. D. Ross |
| /s/ C. S. Koonce | /s/ B. K. Wachtel |
| C. S. Koonce | B. K. Wachtel |
| /s/ J. M. Knowlton | |
| J. M. Knowlton | |



EXHIBIT INDEX

| Reference No. per Item 601 of Regulation S-K | Description of Exhibit | Exhibit No. in this Form 10-K |
|---|---|---|
| 2 | Plan of acquisition, reorganization, arrangement, liquidation or succession | |
| | Exchange Agreement dated as of March 25, 1992, amended as of September 1, 1992, by and between VSE Corporation and JBT Holding Corp., et al. (Exhibit A to Exhibit 1, Proxy Statement, filed on Form 8-K on November 2, 1992) | * |
| 3 | Articles of incorporation and by-laws | |
| | Restated Certificate of Incorporation of VSE Corporation dated as of February 6, 1996 | * |
| | By-Laws of VSE Corporation as amended through July 14, 1998 (Exhibit V to Form 10-K dated March 18, 1999) | * |
| 4 | Instruments defining the rights of security holders, including indentures | |
| | Specimen Stock Certificate as of May 19, 1983 (Exhibit 4 to Registration Statement No. 2-83255 dated April 22, 1983 on Form S-2) | * |
| 9 | Voting trust agreement | Not Applicable |

10 Material contracts

| | |
|---|---|
| Employment Agreement entered into as of October 21, 1998, by and between VSE Corporation and Donald M. Ervine (Exhibit VI to Form 10-K dated March 18, 1999) | * |
| Employment Agreement entered into as of January 15, 1999, by and between VSE Corporation and Energetics, Incorporated and Robert J. Kelly (Exhibit VII to Form 10-K dated March 18, 1999) | * |
| Employment Agreement entered into as of June 3, 1999, by and between VSE Corporation and James M. Knowlton | Exhibit V |
| VSE Corporation Deferred Supplemental Compensation Plan effective January 1, 1994 (Exhibit III to Form 10-K dated March 23, 1995) | * |
| Stock Purchase Agreement dated August 29, 1995 by and between VSE Corporation and the shareholders of Energetics Incorporated (Exhibit 2 to Form 8-K dated September 13, 1995 and Amendment 1 on Form 8-K/A dated November 9, 1995) | * |
| VSE Corporation 1996 Stock Option Plan (Appendix A to Registrant's definitive proxy statement dated April 3, 1996) | |
| VSE Corporation 1998 Stock Option Plan (Appendix A to Registrant's definitive proxy statement for the Annual Meeting of Stockholders held on May 6, 1998) | |
| VSE Corporation 1998 Non-employee Directors Stock Plan (Appendix B to Registrant's definitive proxy statement for the Annual Meeting of Stockholders held on May 6, 1998) | |



EXHIBIT INDEX

| Reference No. per Item 601 of Regulation S-K | Description of Exhibit | Exhibit No. in this Form 10-K |
|---|---|---|
| 12 | Statements re computation of ratios | Not Applicable |
| 13 | Annual report to security holders, Form 10-Q or quarterly report to security holders | Exhibit II |
| 16 | Letter re change in certifying accountant | Not Applicable |
| 18 | Letter re change in accounting principles | Not Applicable |
| 21 | Subsidiaries of the registrant | Exhibit I |
| 22 | Published report regarding matters submitted to vote of security holders | Not Applicable |
| 23 | Consents of experts and counsel | Exhibit IV |
| 24 | Power of attorney | Not Applicable |
| 27 | Financial Data Schedule | Exhibit III |
| 99 | Additional exhibits | Not Applicable |

*Document has been filed as indicated and is incorporated by reference herein.

EXHIBIT I

SUBSIDIARIES OF THE REGISTRANT

The following is a listing of the subsidiaries of the Registrant:

| | Jurisdiction of Organization |
|---|---|
| Energetics Incorporated | Maryland |
| Human Resource Systems, Inc. | Delaware |
| Ship Remediation and Recycling, Inc. | Delaware |
| VSE Services International, Inc. | Delaware |

EXHIBIT V

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT is made and entered into as of 3 June 1999, by and between VSE Corporation, a Delaware corporation ("Employer"), and James M. Knowlton ("Employee");

WHEREAS, Employee currently is employed by Employer as president and chief operating officer;

WHEREAS, Employee has rendered many years of good and valuable service to the Employer and has contributed greatly to Employer' s growth and success;

WHEREAS, the parties desire to update the Employment Agreement dated 10 December 1997 to reflect Employee's current position and responsibilities;

WHEREAS, Employer wishes to induce Employee to remain in Employer's employ to prevent the significant loss which Employer would incur if Employee were to leave and to enter the employment of a competitor;

WHEREAS, in the current business climate of takeovers and acquisitions, Employee may be concerned about the continuation of his employment and his status and responsibilities if a Change in Control (as defined below) occurs, and Employer is concerned that Employee may be approached by others with employment opportunities;

WHEREAS, Employer desires to ensure that, if a Change in Control appears possible, Employee will be in a secure position from which to objectively engage in any potential deliberations or negotiations respecting such Change in Control without fear of any direct or implied threat to employment, status and responsibilities; and

WHEREAS, Employee desires to have the foregoing assurances;

NOW, THEREFORE, in consideration of the mutual promises contained herein, and for other good and valuable consideration, the adequacy of which is hereby acknowledged, Employer and Employee, each intending to be legally bound, agree as follows:

1. Term. The term of Employee's employment hereunder shall commence on the date hereof and shall continue until January 1, 2001, except as otherwise provided in Section 7. If the term of Employee's employment hereunder shall have continued until January 1, 2001, thereafter, such term of Employee's employment hereunder shall be deemed to be renewed automatically, on the same terms and conditions contained herein, for successive periods of one year each, unless and until Employee, at least 90 days prior to the expiration of the original term or any such extended term, shall give written notice to the Employer of intent not to renew the term of Employee's employment hereunder. All references herein to the "Term" refer to the original term of Employee's employment hereunder and all extensions thereof.



2. Duties

(a) Offices

During the Term, Employee shall serve as Employer's president and chief operating officer, and the Board shall renominate Employee as a director of Employer, reappoint Employee as Employer's president and chief operating officer, and Employee shall perform the duties of those positions, as assigned to him by the chairman. Employer agrees that Employee will be assigned only duties of the type, nature and dignity normally assigned to the chief operating officer of a corporation of the size, stature and nature of Employer. During the Term, Employee shall have, at a minimum, the same perquisites of office as he had on the date hereof, and he shall report to the chairman and chief executive officer.

(b) Full-Time Basis

During the Term, Employee shall devote, on a full-time basis, his services, skills and abilities to his employment hereunder, excepting periods of vacation, illness or Disability (as defined below), and excepting any pursuits which do not materially interfere with duties hereunder or present a conflict of interest with the interests of Employer or of any subsidiary thereof ("Subsidiary").

3. Compensation

(a) Salary

During the Term, as compensation for services rendered by Employee hereunder, Employer shall pay to Employee a base salary at the rate of not less than his current annual rate, payable in installments in accordance with Employer's policy governing salary payments to senior officers generally ("Base Salary"). Effective January 1 of every year during the Term, Employee's compensation, including Base Salary, will be subject to the Board's review, provided that, the Base Salary shall not be less than the current annual rate.

(b) Performance Bonus

Except as otherwise provided in Section 7, in addition to the Base Salary, Employee shall be eligible for an annual performance bonus as determined by the Board or its Compensation Committee ("Performance Bonus"). Any Performance Bonus payable pursuant to this Section 3(b) shall be paid within 30 days after the end of the fiscal period to which such Performance Bonus relates.



(c) Other Compensation Plans or Arrangements

During the Term, Employee shall also be eligible to participate in all other currently existing or subsequently implemented compensation or benefit plans or arrangements available generally to other officers or senior officers of Employer, including Employer's "Deferred Supplemental Compensation Plan," ESOP/401(k), and any stock grant, stock option, stock purchase or similar stock plans or arrangements.

(d) Tax Withholdings

Employer shall withhold from Employee's compensation hereunder and pay over to the appropriate governmental agencies all payroll taxes, including income, social security, and unemployment compensation taxes, required by the federal, state and local governments with jurisdiction over Employer.

4. Benefits. During the Term, Employee shall be entitled to such comparable fringe benefits and perquisites as may be provided to any or all of Employer's senior officers pursuant to policies established from time to time by the Board. These fringe benefits and perquisites shall include holidays, group health insurance, short-term and long-term disability insurance, and life insurance, vehicle allowances, and supplemental executive health care benefits. Also, during the Term, Employee shall be entitled to 30 days paid leave per annum and to accrue unused leave from year to year and to be reimbursed for the costs of physical examinations up to $1,000 per annum.

5. Expenses and Other Perquisites. Employer shall reimburse Employee for all reasonable and proper business expenses incurred by him during the Term in the performance of his duties hereunder, in accordance with Employer's customary practices for senior officers, and provided such business expenses are reasonably documented. Also, during the Term, Employer shall continue to provide Employee with an office and suitable office fixtures, telephone services, and secretarial assistance of a nature appropriate to Employee's position and status.

6. Exclusive Services, Confidential Information, Business Opportunities and Non-Solicitation

(a) Exclusive Services

(i) During the Term, Employee shall at all times devote his full-time attention, energies, efforts and skills to Employer's business and shall not, directly or indirectly, engage in any other business activity, whether or not for profit, gain or other pecuniary advantages, without the Board's written consent provided that such prior consent shall not be required with respect to (1) business interests that neither compete with Employer or any Subsidiaries nor interfere with Employee's duties and obligations hereunder, and (2) Employee's charitable, eleemosynary, philanthropic or professional association activities.



(ii) During the Term, Employee shall not, without the Board's prior written consent, directly or indirectly, either as an officer, director, employee, agent, advisor, consultant, principal, stockholder, partner, owner or in any other capacity, on Employee's own behalf or otherwise, in any way engage in, represent, be connected with or have a financial interest in, any business which is, or to his knowledge, is about to become, engaged in the business of providing engineering, management, energy or environmental services to the United States Government or any department, agency, or instrumentality thereof or any state or local governmental agency or to any person, corporation or other entity (collectively a "Person") with which Employer or any Subsidiary is currently or has previously done business or any subsequent line of business developed by Employee or any Subsidiary during the term. Notwithstanding the foregoing, Employee shall be permitted to own passive investments in publicly held companies provided that such investments do not exceed five percent of any such company's outstanding equity.

(b) Confidential Information

During the Term and for the first 24 consecutive months after the termination of the Term, Employee shall not disclose or use, directly or indirectly, any Confidential Information (as defined below). For the purposes of this Agreement, "Confidential Information" shall mean all information disclosed to Employee, or known by him as a consequence of or through his employment with Employer or any Subsidiary, where such information is not generally known in the trade or industry or was regarded or treated as confidential by Employer or any Subsidiary, and where such information refers or relates in any manner whatsoever to the business activities, processes, services or products of Employer or its Subsidiaries. Confidential Information shall include business and development plans (whether contemplated, initiated or completed), information with respect to the development of technical and management services, business contacts, methods of operation, results of analysis, business forecasts, financial data, costs, revenues, and similar information. Upon termination of Term, Employee shall immediately return to Employer all of property of Employer or any Subsidiary and Confidential Information which is in tangible form, and all copies thereof.

(c) Business Opportunities

(i) During the Term, Employee shall promptly disclose to Employer each business opportunity of a type which, based upon its prospects and relationship to the existing businesses of Employer or any Subsidiary, Employer or any Subsidiary might reasonably consider pursuing.



Upon termination of the Term, regardless of the circumstances thereof, Employer shall have the exclusive right to participate in or undertake any such opportunity on its own behalf without any involvement of Employee.

(ii) During the Term, Employee shall refrain from engaging in any activity, practice or act which conflicts with, or has the potential to conflict with, the interests of Employer or its Subsidiaries, and he shall avoid any acts or omissions which are disloyal to, or competitive with Employer or its Subsidiaries.

(d) Non-Solicitation of Employees

During the Term and for the first 24 consecutive months after termination of the Term, Employee shall not, except in the course of duties hereunder, directly or indirectly, induce or attempt to induce or otherwise counsel, advise, ask or encourage any person to leave the employ of Employer or any Subsidiary, or solicit or offer employment to any person who was employed by Employer or any Subsidiary at any time during the twelve-month period preceding the solicitation or offer.

(e) Covenant Not To Compete

(i) If Employee voluntarily terminates the Term, or if Employer terminates the Term for Cause (as defined below), Employee shall not, during the first 24 consecutive months following such termination, engage in competition with Employer or any Subsidiary, or solicit, from any person or entity who purchased any then existing product or service from Employer or any Subsidiary during his employment hereunder, the purchase of any then existing product or service in competition with then existing products or services of Employer or any Subsidiary.

(ii) For purposes of this Agreement, Employee shall be deemed to engage in competition with Employer if he shall directly or indirectly, either individually or as a stockholder, director, officer, partner, consultant, owner, employee, agent, or in any other capacity, consult with or otherwise assist any person or entity engaged in providing technical and management services to any person or entity which Employer or any Subsidiary, during the Term, has developed or is working to develop. Notwithstanding anything herein to the contrary, if Employer is in material breach of this Agreement, the provisions of this Section 6 shall not apply.

(f) Employee Acknowledgment

Employee hereby agrees and acknowledges that the restrictions imposed upon by the provisions of this Section 6 are fair and reasonable considering the



nature of Employer's business, and are reasonably required for Employer's protection.

(g) Invalidity

If a court of competent jurisdiction or an arbitrator shall declare any provision or restriction contained in this Section 6 as unenforceable or void, the provisions of this Section 6 shall remain in full force and effect to the extent not so declared to be unenforceable or void, and the court may modify the invalid provision to make it enforceable to the maximum extent permitted by law.

(h) Specific Performance

Employee agrees that if Employee breaches any of the provisions of this Section 6, the remedies available at law to Employer would be inadequate and in lieu thereof, or in addition thereto, Employer shall be entitled to appropriate equitable remedies, including specific performance and injunctive relief. Employee agrees not to enter into any agreement, either written or oral, which may conflict with this Agreement, and Employee authorizes Employer to make known the terms of Sections 6 and 7 hereof to any Person, including future employers of Employee.

7. Termination

(a) By Employer

(i) Termination for Cause

Employer may for Cause (as defined below) terminate the Term at any time by written notice to Employee. For purposes of this Agreement, the term "Cause" shall mean any one or more of the following: (1) conduct by Employee which is materially illegal or fraudulent or contrary to Company policy; (2) the breach or violation by Employee of any of the material provisions of this Agreement, provided that Employee must first be given notice by the Chairman or the Board of the alleged breach or violation and 30 days to cure said alleged breach or violation; (3) Employee's use of illegal drugs or abuse of alcohol or authorized drugs which impairs Employee's ability to perform duties hereunder, provided that Employee must be given notice by the Chairman or the Board of such impairment and 60 days to cure the impairment; (4) Employee's knowing and willful neglect of duties or negligence in the performance of duties which materially affects Employer's or any Subsidiary's business, provided that Employee must first be given notice by the Chairman or the Board of such alleged neglect or negligence and 30 days to cure said alleged neglect or negligence. If a termination occurs pursuant to clause (1) above, the date on which the Term is terminated (the "Termination Date") shall be the



date Employee receives notice of termination and, if a termination occurs pursuant to clauses (2), (3) or (4) above, the Termination Date shall be the date on which the specified cure period expires. In any event, as of the Termination Date (in the absence of satisfying the alleged breach or violation within the applicable cure period), Employee shall be relieved of all duties hereunder and Employee shall not be entitled to the accrual or provision of any compensation or benefit, after the Termination Date but Employee shall be entitled to the provision of all compensation and other benefits that shall have accrued as of the Termination Date, including Base Salary, Performance Bonuses, paid leave benefits, Deferred Compensation Units, Deferred Supplemental Compensation to the extent permitted by the plans, and reimbursement of incurred business expenses.

(ii) Termination Without Cause

Employer may, in its sole discretion, without Cause, terminate the Term at any time by providing Employee with (a) 60 days' prior notice thereof and (b) on or prior to the Termination Date, a lump sum severance compensation payment equal to one (1) times the total amount of Employee's Base Salary payable hereunder, based upon the amount in effect as of the effective Termination Date. In such event, Employee shall not be entitled to the accrual or provision of any other compensation or benefit after the Termination Date other than (a) the medical and hospitalization benefits for the first 18 months after the Termination Date or longer if permitted under Employer's policies and procedures; (b) the provision of all compensation and other benefits that shall have accrued as of the Termination Date, including Base Salary, Performance Bonus, paid leave benefits, Deferred Compensation Units, Deferred Supplemental Compensation and reimbursements of incurred expenses; and (c) all stock options or similar rights to acquire capital stock granted by Employer to Employee shall automatically become vested and exercisable in whole or in part.

(b) Death or Disability

The Term shall be terminated immediately and automatically upon Employee's death or "Disability." The term "Disability" shall mean Employee's inability to perform all of the essential functions of his position hereunder for a period of 26 consecutive weeks or for an aggregate of 150 work days during any 12-month period by reason of illness, accident or any other physical or mental incapacity, as may be permitted by applicable law. Employee's capability to continue performance of Employee's duties hereunder shall be determined by a panel composed of two independent medical doctors appointed by the Board and one appointed by the Employee or designated representative. If the panel is unable to reach a decision, the matter will be referred to arbitration in accordance with Section 8. In the event of Employee's



death or Disability for any period of six consecutive months, Employee (or designated beneficiary) will be paid his Base Salary then in effect for one full year following the date of death or disability.

(c) By Employee

(i) Employee may, in his sole discretion, without cause, terminate the Term at any time upon 60 days' written notice to Employer. If Employee exercises such termination right, Employer may, at its option, at any time after receiving such notice from Employee, relieve Employee of all duties and terminate the Term at any time prior to the expiration of said notice period. If the Term is terminated by Employee or Employer pursuant to this Section 7(c)(i), Employee shall not be entitled to any further Base Salary or the accrual or provision of any compensation or benefits after the Termination Date, except standard medical and hospitalization benefits in accordance with Employer's policy.

(ii) If, during the Term, a Change of Control (as defined below) occurs, Employee may, in his sole discretion, terminate the Term upon 30 days' notice to Employer. If Employee exercises such termination right, Employer may, at its option, at any time after receiving such notice from Employee, relieve Employee of all duties hereunder and terminate the Term at any time prior to the expiration of said notice period. If this Agreement is terminated by Employee or Employer pursuant to this Section 7(c)(ii), Employee shall be entitled to (a) payment on or prior to the Termination Date of a lump sum severance compensation payment equal to two (2) times the total amount of Employee's Base Salary payable hereunder, based on the amount in effect as of the Termination Date; (b) continue the medical and hospitalization benefits in accordance with Employer's policy and to payment of all compensation and other benefits that shall have accrued as of the Termination Date, as described in Section 7(a)(ii)(l); and (c) to the automatic vesting and exercisability in whole or in part of all stock options or similar rights to acquire capital stock granted by Employer to Employee; provided that Employee shall not be entitled, after the Termination Date to the accrual or provision of any other compensation payable hereunder, including the Performance Bonus.

(d) Change of Control

For purposes of this Section 7, a "Change of Control" shall be deemed to have occurred upon the happening of any of the following events:

(i) any "person," including a "group," as such terms as defined in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended, and the rules promulgated thereunder (collectively the "Exchange Act"), other than a trustee or other fiduciary holding voting securities of

Employer ("Voting Securities") under any Employer-sponsored benefit plan, becomes the beneficial owner, as defined under the Exchange Act, directly or indirectly, whether by purchase or acquisition or agreement to act in concert or otherwise, of 30% or more of the outstanding Voting Securities;

(ii) a cash tender or exchange offer is completed for such amount of Voting Securities which, together with the Voting Securities then beneficially owned, directly or indirectly, by the offeror (and affiliates thereof) constitutes 40% or more of the outstanding Voting Securities;

(iii) except in the case of a merger or consolidation in which (a) Employer is the surviving corporation and (b) the holders of Voting Securities immediately prior to such merger or consolidation beneficially own, directly or indirectly, more than 50% of the outstanding Voting Securities immediately after such merger or consolidation (there being excluded from the number of Voting Securities held by such holders, but not from the outstanding Voting Securities, any Voting Securities received by affiliates of the other constituent corporation(s) in the merger or consolidation in exchange for stock of such other corporation), Employer's shareholders approve an agreement to merge, consolidate, liquidate, or sell all or substantially all of Employer's assets; or

(iv) two or more directors are elected to the Board without having previously been nominated and approved by the members of the Board incumbent on the day immediately preceding such election. For purposes of this Section 7, "affiliate" of a person or another entity shall mean a person or other entity that directly or indirectly controls, is controlled by, or is under common control with the person or other entity specified.

(e) No Duty to Mitigate

If Employee is entitled to the compensation and other benefits provided under Sections 7(a)(ii) or (c)(ii), Employee shall have no obligation to seek employment to mitigate damages hereunder.

8. Arbitration. Whenever a dispute arises between the parties concerning this Agreement or any of the obligations hereunder, or Employee's employment generally, Employer and Employee shall use their best efforts to resolve the dispute by mutual agreement. If any dispute cannot be resolved by Employer and Employee, it shall be submitted to arbitration to the exclusion of all other avenues of relief and adjudicated pursuant to the American Arbitration Association's Rules for Employment Dispute Resolution then in effect. The decision of the arbitrator must be in writing and shall be final and binding on the parties, and judgment may be entered on the arbitrator's award in any court having jurisdiction thereof. The arbitrator's authority in granting relief to Employee shall be limited to an award of



compensation, benefits and unreimbursed expenses as described in Sections 3, 4, and 5 above, and to the release of Employee from the provisions of Section 6 and the arbitrator shall have no authority to award other types of damages or relief to Employee, including consequential or punitive damages. The arbitrator Shall also have no authority to award consequential or punitive damages to Employer for violations of this Agreement by Employee. The expenses of the arbitration shall be borne by the losing party to the arbitration and the prevailing party shall be entitled to recover from the losing party all of its own costs and attorneys' fees with respect to the arbitration. Nothing in this Section 8 shall be construed to derogate Employer's rights to seek legal and equitable relief in a court of competent jurisdiction as contemplated by Section 6(h).

9. Non-Waiver. It is understood and agreed that one party's failure at any time to require the performance by the other party of any of the terms, provisions, covenants or conditions hereof shall in no way affect the first party's right thereafter to enforce the same, nor shall the waiver by either party of the breach of any term, provision, covenant or condition hereof be taken or held to be a waiver of any succeeding breach.

10. Severability. If any provision of this Agreement conflicts with the law under which this Agreement is to be construed, or if any such provision is held invalid or unenforceable by a court of competent jurisdiction or any arbitrator, such provision shall be deleted from this Agreement and the Agreement shall be construed to give full effect to the remaining provision thereof.

11. Survivability. Unless otherwise provided herein, upon termination of the Term, the provisions of Sections 6(b), (d) and (e) shall nevertheless remain in full force and effect.

12. Governing Law. This Agreement shall be interpreted, construed and governed according to the laws of the Commonwealth of Virginia, without regard to the conflict of law provisions thereof.

13. Construction. The paragraph headings and captions contained in this Agreement are for convenience only and shall not be construed to define, limit or affect the scope or meaning of the provisions hereof. All references herein to Sections shall be deemed to refer to Sections of this Agreement.

14. Entire Agreement. This Agreement contains and represents the entire agreement of Employer and Employee and supersedes all prior agreements, representations or understandings, oral or written, express or implied with respect to the subject matter hereof. This Agreement may not be modified or amended in any way unless in a writing signed by each of Employer and Employee. No representation, promise or inducement has been made by either Employer or Employee that is not embodied in this Agreement, and neither Employer nor Employee shall be bound by or liable for any alleged representation, promise or inducement not specifically set forth herein.

15. Assignability. Neither this Agreement nor any rights or obligations of Employer or Employee hereunder may be assigned by



Employer or Employee without the other party's prior written consent. Subject to the foregoing, this Agreement shall be binding upon and inure to the benefit of Employer and Employee and their heirs, successors and assigns.

16. Notices. All notices required or permitted hereunder shall be in writing and shall be deemed properly given if delivered personally or sent by certified or registered mail, postage prepaid, return receipt requested, or sent by telegram, telex, telecopy or similar form of telecommunication, and shall be deemed to have been given when received. Any such notice or communication shall be addressed: (a) if to Employer, to Chief

Executive Officer, c/o VSE Corporation, 2550 Huntington Avenue, Alexandria, Virginia 22303-1499 or (b) if to Employee, to the last known home address on file with Employer, or to such other address as Employer or Employee shall have furnished to the other in writing.

IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement, to be effective as of the day and year first above written.

VSE CORPORATION
a Delaware corporation

Date: 3 June 1999 By: Signature on File

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D. M. Ervine
Chairman and Chief
Executive Officer

Date: 3 June 1999 By: Signature on File

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J. M. Knowlton

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EXHIBIT IV

VSE CORPORATION
CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation by reference in this Form 10-K of our report dated March 3, 2000 included in Registration Statement File Numbers 333-15307, 333-15309, 333-15311 and 333-92427.

ARTHUR ANDERSEN LLP

Vienna, Virginia
March 15, 2000

EXHIBIT V

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT is made and entered into as of 3 June 1999, by and between VSE Corporation, a Delaware corporation ("Employer"), and James M. Knowlton ("Employee");

WHEREAS, Employee currently is employed by Employer as president and chief operating officer;

WHEREAS, Employee has rendered many years of good and valuable service to the Employer and has contributed greatly to Employer' s growth and success;

WHEREAS, the parties desire to update the Employment Agreement dated 10 December 1997 to reflect Employee's current position and responsibilities;

WHEREAS, Employer wishes to induce Employee to remain in Employer's employ to prevent the significant loss which Employer would incur if Employee were to leave and to enter the employment of a competitor;

WHEREAS, in the current business climate of takeovers and acquisitions, Employee may be concerned about the continuation of his employment and his status and responsibilities if a Change in Control (as defined below) occurs, and Employer is concerned that Employee may be approached by others with employment opportunities;

WHEREAS, Employer desires to ensure that, if a Change in Control appears possible, Employee will be in a secure position from which to objectively engage in any potential deliberations or negotiations respecting such Change in Control without fear of any direct or implied threat to employment, status and responsibilities; and

WHEREAS, Employee desires to have the foregoing assurances;

NOW, THEREFORE, in consideration of the mutual promises contained herein, and for other good and valuable consideration, the adequacy of which is hereby acknowledged, Employer and Employee, each intending to be legally bound, agree as follows:

1. Term. The term of Employee's employment hereunder shall commence on the date hereof and shall continue until January 1, 2001, except as otherwise provided in Section 7. If the term of Employee's employment hereunder shall have continued until January 1, 2001, thereafter, such term of Employee's employment hereunder shall be deemed to be renewed automatically, on the same terms and conditions contained herein, for successive periods of one year each, unless and until Employee, at least 90 days prior to the expiration of the original term or any such extended term, shall give written notice to the Employer of intent not to renew the term of Employee's employment hereunder. All references herein to the "Term" refer to the original term of Employee's employment hereunder and all extensions thereof.



2. Duties

(a) Offices

During the Term, Employee shall serve as Employer's president and chief operating officer, and the Board shall renominate Employee as a director of Employer, reappoint Employee as Employer's president and chief operating officer, and Employee shall perform the duties of those positions, as assigned to him by the chairman. Employer agrees that Employee will be assigned only duties of the type, nature and dignity normally assigned to the chief operating officer of a corporation of the size, stature and nature of Employer. During the Term, Employee shall have, at a minimum, the same perquisites of office as he had on the date hereof, and he shall report to the chairman and chief executive officer.

(b) Full-Time Basis

During the Term, Employee shall devote, on a full-time basis, his services, skills and abilities to his employment hereunder, excepting periods of vacation, illness or Disability (as defined below), and excepting any pursuits which do not materially interfere with duties hereunder or present a conflict of interest with the interests of Employer or of any subsidiary thereof ("Subsidiary").

3. Compensation

(a) Salary

During the Term, as compensation for services rendered by Employee hereunder, Employer shall pay to Employee a base salary at the rate of not less than his current annual rate, payable in installments in accordance with Employer's policy governing salary payments to senior officers generally ("Base Salary"). Effective January 1 of every year during the Term, Employee's compensation, including Base Salary, will be subject to the Board's review, provided that, the Base Salary shall not be less than the current annual rate.

(b) Performance Bonus

Except as otherwise provided in Section 7, in addition to the Base Salary, Employee shall be eligible for an annual performance bonus as determined by the Board or its Compensation Committee ("Performance Bonus"). Any Performance Bonus payable pursuant to this Section 3(b) shall be paid within 30 days after the end of the fiscal period to which such Performance Bonus relates.



(c) Other Compensation Plans or Arrangements

During the Term, Employee shall also be eligible to participate in all other currently existing or subsequently implemented compensation or benefit plans or arrangements available generally to other officers or senior officers of Employer, including Employer's "Deferred Supplemental Compensation Plan," ESOP/401(k), and any stock grant, stock option, stock purchase or similar stock plans or arrangements.

(d) Tax Withholdings

Employer shall withhold from Employee's compensation hereunder and pay over to the appropriate governmental agencies all payroll taxes, including income, social security, and unemployment compensation taxes, required by the federal, state and local governments with jurisdiction over Employer.

4. Benefits. During the Term, Employee shall be entitled to such comparable fringe benefits and perquisites as may be provided to any or all of Employer's senior officers pursuant to policies established from time to time by the Board. These fringe benefits and perquisites shall include holidays, group health insurance, short-term and long-term disability insurance, and life insurance, vehicle allowances, and supplemental executive health care benefits. Also, during the Term, Employee shall be entitled to 30 days paid leave per annum and to accrue unused leave from year to year and to be reimbursed for the costs of physical examinations up to $1,000 per annum.

5. Expenses and Other Perquisites. Employer shall reimburse Employee for all reasonable and proper business expenses incurred by him during the Term in the performance of his duties hereunder, in accordance with Employer's customary practices for senior officers, and provided such business expenses are reasonably documented. Also, during the Term, Employer shall continue to provide Employee with an office and suitable office fixtures, telephone services, and secretarial assistance of a nature appropriate to Employee's position and status.

6. Exclusive Services, Confidential Information, Business Opportunities and Non-Solicitation

(a) Exclusive Services

(i) During the Term, Employee shall at all times devote his full-time attention, energies, efforts and skills to Employer's business and shall not, directly or indirectly, engage in any other business activity, whether or not for profit, gain or other pecuniary advantages, without the Board's written consent provided that such prior consent shall not be required with respect to (1) business interests that neither compete with Employer or any Subsidiaries nor interfere with Employee's duties and obligations hereunder, and (2) Employee's charitable, eleemosynary, philanthropic or professional association activities.



(ii) During the Term, Employee shall not, without the Board's prior written consent, directly or indirectly, either as an officer, director, employee, agent, advisor, consultant, principal, stockholder, partner, owner or in any other capacity, on Employee's own behalf or otherwise, in any way engage in, represent, be connected with or have a financial interest in, any business which is, or to his knowledge, is about to become, engaged in the business of providing engineering, management, energy or environmental services to the United States Government or any department, agency, or instrumentality thereof or any state or local governmental agency or to any person, corporation or other entity (collectively a "Person") with which Employer or any Subsidiary is currently or has previously done business or any subsequent line of business developed by Employee or any Subsidiary during the term. Notwithstanding the foregoing, Employee shall be permitted to own passive investments in publicly held companies provided that such investments do not exceed five percent of any such company's outstanding equity.

(b) Confidential Information

During the Term and for the first 24 consecutive months after the termination of the Term, Employee shall not disclose or use, directly or indirectly, any Confidential Information (as defined below). For the purposes of this Agreement, "Confidential Information" shall mean all information disclosed to Employee, or known by him as a consequence of or through his employment with Employer or any Subsidiary, where such information is not generally known in the trade or industry or was regarded or treated as confidential by Employer or any Subsidiary, and where such information refers or relates in any manner whatsoever to the business activities, processes, services or products of Employer or its Subsidiaries. Confidential Information shall include business and development plans (whether contemplated, initiated or completed), information with respect to the development of technical and management services, business contacts, methods of operation, results of analysis, business forecasts, financial data, costs, revenues, and similar information. Upon termination of Term, Employee shall immediately return to Employer all of property of Employer or any Subsidiary and Confidential Information which is in tangible form, and all copies thereof.

(c) Business Opportunities

(i) During the Term, Employee shall promptly disclose to Employer each business opportunity of a type which, based upon its prospects and relationship to the existing businesses of Employer or any Subsidiary, Employer or any Subsidiary might reasonably consider pursuing.



Upon termination of the Term, regardless of the circumstances thereof, Employer shall have the exclusive right to participate in or undertake any such opportunity on its own behalf without any involvement of Employee.

(ii) During the Term, Employee shall refrain from engaging in any activity, practice or act which conflicts with, or has the potential to conflict with, the interests of Employer or its Subsidiaries, and he shall avoid any acts or omissions which are disloyal to, or competitive with Employer or its Subsidiaries.

(d) Non-Solicitation of Employees

During the Term and for the first 24 consecutive months after termination of the Term, Employee shall not, except in the course of duties hereunder, directly or indirectly, induce or attempt to induce or otherwise counsel, advise, ask or encourage any person to leave the employ of Employer or any Subsidiary, or solicit or offer employment to any person who was employed by Employer or any Subsidiary at any time during the twelve-month period preceding the solicitation or offer.

(e) Covenant Not To Compete

(i) If Employee voluntarily terminates the Term, or if Employer terminates the Term for Cause (as defined below), Employee shall not, during the first 24 consecutive months following such termination, engage in competition with Employer or any Subsidiary, or solicit, from any person or entity who purchased any then existing product or service from Employer or any Subsidiary during his employment hereunder, the purchase of any then existing product or service in competition with then existing products or services of Employer or any Subsidiary.

(ii) For purposes of this Agreement, Employee shall be deemed to engage in competition with Employer if he shall directly or indirectly, either individually or as a stockholder, director, officer, partner, consultant, owner, employee, agent, or in any other capacity, consult with or otherwise assist any person or entity engaged in providing technical and management services to any person or entity which Employer or any Subsidiary, during the Term, has developed or is working to develop. Notwithstanding anything herein to the contrary, if Employer is in material breach of this Agreement, the provisions of this Section 6 shall not apply.

(f) Employee Acknowledgment

Employee hereby agrees and acknowledges that the restrictions imposed upon by the provisions of this Section 6 are fair and reasonable considering the



nature of Employer's business, and are reasonably required for Employer's protection.

(g) Invalidity

If a court of competent jurisdiction or an arbitrator shall declare any provision or restriction contained in this Section 6 as unenforceable or void, the provisions of this Section 6 shall remain in full force and effect to the extent not so declared to be unenforceable or void, and the court may modify the invalid provision to make it enforceable to the maximum extent permitted by law.

(h) Specific Performance

Employee agrees that if Employee breaches any of the provisions of this Section 6, the remedies available at law to Employer would be inadequate and in lieu thereof, or in addition thereto, Employer shall be entitled to appropriate equitable remedies, including specific performance and injunctive relief. Employee agrees not to enter into any agreement, either written or oral, which may conflict with this Agreement, and Employee authorizes Employer to make known the terms of Sections 6 and 7 hereof to any Person, including future employers of Employee.

7. Termination

(a) By Employer

(i) Termination for Cause

Employer may for Cause (as defined below) terminate the Term at any time by written notice to Employee. For purposes of this Agreement, the term "Cause" shall mean any one or more of the following: (1) conduct by Employee which is materially illegal or fraudulent or contrary to Company policy; (2) the breach or violation by Employee of any of the material provisions of this Agreement, provided that Employee must first be given notice by the Chairman or the Board of the alleged breach or violation and 30 days to cure said alleged breach or violation; (3) Employee's use of illegal drugs or abuse of alcohol or authorized drugs which impairs Employee's ability to perform duties hereunder, provided that Employee must be given notice by the Chairman or the Board of such impairment and 60 days to cure the impairment; (4) Employee's knowing and willful neglect of duties or negligence in the performance of duties which materially affects Employer's or any Subsidiary's business, provided that Employee must first be given notice by the Chairman or the Board of such alleged neglect or negligence and 30 days to cure said alleged neglect or negligence. If a termination occurs pursuant to clause (1) above, the date on which the Term is terminated (the "Termination Date") shall be the



date Employee receives notice of termination and, if a termination occurs pursuant to clauses (2), (3) or (4) above, the Termination Date shall be the date on which the specified cure period expires. In any event, as of the Termination Date (in the absence of satisfying the alleged breach or violation within the applicable cure period), Employee shall be relieved of all duties hereunder and Employee shall not be entitled to the accrual or provision of any compensation or benefit, after the Termination Date but Employee shall be entitled to the provision of all compensation and other benefits that shall have accrued as of the Termination Date, including Base Salary, Performance Bonuses, paid leave benefits, Deferred Compensation Units, Deferred Supplemental Compensation to the extent permitted by the plans, and reimbursement of incurred business expenses.

(ii) Termination Without Cause

Employer may, in its sole discretion, without Cause, terminate the Term at any time by providing Employee with (a) 60 days' prior notice thereof and (b) on or prior to the Termination Date, a lump sum severance compensation payment equal to one (1) times the total amount of Employee's Base Salary payable hereunder, based upon the amount in effect as of the effective Termination Date. In such event, Employee shall not be entitled to the accrual or provision of any other compensation or benefit after the Termination Date other than (a) the medical and hospitalization benefits for the first 18 months after the Termination Date or longer if permitted under Employer's policies and procedures; (b) the provision of all compensation and other benefits that shall have accrued as of the Termination Date, including Base Salary, Performance Bonus, paid leave benefits, Deferred Compensation Units, Deferred Supplemental Compensation and reimbursements of incurred expenses; and (c) all stock options or similar rights to acquire capital stock granted by Employer to Employee shall automatically become vested and exercisable in whole or in part.

(b) Death or Disability

The Term shall be terminated immediately and automatically upon Employee's death or "Disability." The term "Disability" shall mean Employee's inability to perform all of the essential functions of his position hereunder for a period of 26 consecutive weeks or for an aggregate of 150 work days during any 12-month period by reason of illness, accident or any other physical or mental incapacity, as may be permitted by applicable law. Employee's capability to continue performance of Employee's duties hereunder shall be determined by a panel composed of two independent medical doctors appointed by the Board and one appointed by the Employee or designated representative. If the panel is unable to reach a decision, the matter will be referred to arbitration in accordance with Section 8. In the event of Employee's



death or Disability for any period of six consecutive months, Employee (or designated beneficiary) will be paid his Base Salary then in effect for one full year following the date of death or disability.

(c) By Employee

(i) Employee may, in his sole discretion, without cause, terminate the Term at any time upon 60 days' written notice to Employer. If Employee exercises such termination right, Employer may, at its option, at any time after receiving such notice from Employee, relieve Employee of all duties and terminate the Term at any time prior to the expiration of said notice period. If the Term is terminated by Employee or Employer pursuant to this Section 7(c)(i), Employee shall not be entitled to any further Base Salary or the accrual or provision of any compensation or benefits after the Termination Date, except standard medical and hospitalization benefits in accordance with Employer's policy.

(ii) If, during the Term, a Change of Control (as defined below) occurs, Employee may, in his sole discretion, terminate the Term upon 30 days' notice to Employer. If Employee exercises such termination right, Employer may, at its option, at any time after receiving such notice from Employee, relieve Employee of all duties hereunder and terminate the Term at any time prior to the expiration of said notice period. If this Agreement is terminated by Employee or Employer pursuant to this Section 7(c)(ii), Employee shall be entitled to (a) payment on or prior to the Termination Date of a lump sum severance compensation payment equal to two (2) times the total amount of Employee's Base Salary payable hereunder, based on the amount in effect as of the Termination Date; (b) continue the medical and hospitalization benefits in accordance with Employer's policy and to payment of all compensation and other benefits that shall have accrued as of the Termination Date, as described in Section 7(a)(ii)(l); and (c) to the automatic vesting and exercisability in whole or in part of all stock options or similar rights to acquire capital stock granted by Employer to Employee; provided that Employee shall not be entitled, after the Termination Date to the accrual or provision of any other compensation payable hereunder, including the Performance Bonus.

(d) Change of Control

For purposes of this Section 7, a "Change of Control" shall be deemed to have occurred upon the happening of any of the following events:

(i) any "person," including a "group," as such terms as defined in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended, and the rules promulgated thereunder (collectively the "Exchange Act"), other than a trustee or other fiduciary holding voting securities of

Employer ("Voting Securities") under any Employer-sponsored benefit plan, becomes the beneficial owner, as defined under the Exchange Act, directly or indirectly, whether by purchase or acquisition or agreement to act in concert or otherwise, of 30% or more of the outstanding Voting Securities;

(ii) a cash tender or exchange offer is completed for such amount of Voting Securities which, together with the Voting Securities then beneficially owned, directly or indirectly, by the offeror (and affiliates thereof) constitutes 40% or more of the outstanding Voting Securities;

(iii) except in the case of a merger or consolidation in which (a) Employer is the surviving corporation and (b) the holders of Voting Securities immediately prior to such merger or consolidation beneficially own, directly or indirectly, more than 50% of the outstanding Voting Securities immediately after such merger or consolidation (there being excluded from the number of Voting Securities held by such holders, but not from the outstanding Voting Securities, any Voting Securities received by affiliates of the other constituent corporation(s) in the merger or consolidation in exchange for stock of such other corporation), Employer's shareholders approve an agreement to merge, consolidate, liquidate, or sell all or substantially all of Employer's assets; or

(iv) two or more directors are elected to the Board without having previously been nominated and approved by the members of the Board incumbent on the day immediately preceding such election. For purposes of this Section 7, "affiliate" of a person or another entity shall mean a person or other entity that directly or indirectly controls, is controlled by, or is under common control with the person or other entity specified.

(e) No Duty to Mitigate

If Employee is entitled to the compensation and other benefits provided under Sections 7(a)(ii) or (c)(ii), Employee shall have no obligation to seek employment to mitigate damages hereunder.

8. Arbitration. Whenever a dispute arises between the parties concerning this Agreement or any of the obligations hereunder, or Employee's employment generally, Employer and Employee shall use their best efforts to resolve the dispute by mutual agreement. If any dispute cannot be resolved by Employer and Employee, it shall be submitted to arbitration to the exclusion of all other avenues of relief and adjudicated pursuant to the American Arbitration Association's Rules for Employment Dispute Resolution then in effect. The decision of the arbitrator must be in writing and shall be final and binding on the parties, and judgment may be entered on the arbitrator's award in any court having jurisdiction thereof. The arbitrator's authority in granting relief to Employee shall be limited to an award of



compensation, benefits and unreimbursed expenses as described in Sections 3, 4, and 5 above, and to the release of Employee from the provisions of Section 6 and the arbitrator shall have no authority to award other types of damages or relief to Employee, including consequential or punitive damages. The arbitrator Shall also have no authority to award consequential or punitive damages to Employer for violations of this Agreement by Employee. The expenses of the arbitration shall be borne by the losing party to the arbitration and the prevailing party shall be entitled to recover from the losing party all of its own costs and attorneys' fees with respect to the arbitration. Nothing in this Section 8 shall be construed to derogate Employer's rights to seek legal and equitable relief in a court of competent jurisdiction as contemplated by Section 6(h).

9. Non-Waiver. It is understood and agreed that one party's failure at any time to require the performance by the other party of any of the terms, provisions, covenants or conditions hereof shall in no way affect the first party's right thereafter to enforce the same, nor shall the waiver by either party of the breach of any term, provision, covenant or condition hereof be taken or held to be a waiver of any succeeding breach.

10. Severability. If any provision of this Agreement conflicts with the law under which this Agreement is to be construed, or if any such provision is held invalid or unenforceable by a court of competent jurisdiction or any arbitrator, such provision shall be deleted from this Agreement and the Agreement shall be construed to give full effect to the remaining provision thereof.

11. Survivability. Unless otherwise provided herein, upon termination of the Term, the provisions of Sections 6(b), (d) and (e) shall nevertheless remain in full force and effect.

12. Governing Law. This Agreement shall be interpreted, construed and governed according to the laws of the Commonwealth of Virginia, without regard to the conflict of law provisions thereof.

13. Construction. The paragraph headings and captions contained in this Agreement are for convenience only and shall not be construed to define, limit or affect the scope or meaning of the provisions hereof. All references herein to Sections shall be deemed to refer to Sections of this Agreement.

14. Entire Agreement. This Agreement contains and represents the entire agreement of Employer and Employee and supersedes all prior agreements, representations or understandings, oral or written, express or implied with respect to the subject matter hereof. This Agreement may not be modified or amended in any way unless in a writing signed by each of Employer and Employee. No representation, promise or inducement has been made by either Employer or Employee that is not embodied in this Agreement, and neither Employer nor Employee shall be bound by or liable for any alleged representation, promise or inducement not specifically set forth herein.

15. Assignability. Neither this Agreement nor any rights or obligations of Employer or Employee hereunder may be assigned by



Employer or Employee without the other party's prior written consent. Subject to the foregoing, this Agreement shall be binding upon and inure to the benefit of Employer and Employee and their heirs, successors and assigns.

16. Notices. All notices required or permitted hereunder shall be in writing and shall be deemed properly given if delivered personally or sent by certified or registered mail, postage prepaid, return receipt requested, or sent by telegram, telex, telecopy or similar form of telecommunication, and shall be deemed to have been given when received. Any such notice or communication shall be addressed: (a) if to Employer, to Chief

Executive Officer, c/o VSE Corporation, 2550 Huntington Avenue, Alexandria, Virginia 22303-1499 or (b) if to Employee, to the last known home address on file with Employer, or to such other address as Employer or Employee shall have furnished to the other in writing.

IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement, to be effective as of the day and year first above written.

VSE CORPORATION
a Delaware corporation

Date: 3 June 1999 By: Signature on File

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D. M. Ervine
Chairman and Chief
Executive Officer

Date: 3 June 1999 By: Signature on File

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J. M. Knowlton