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, 2005    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 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 if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [ ]  No [x]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes [ ]  No [x]

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 [ ]

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]

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

Large accelerated filer [ ]  Accelerated filer [ ]  Non-accelerated filer [x]

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

The aggregate market value of outstanding voting stock held by nonaffiliates of the Registrant as of June 30, 2005, was approximately $45.9 million based on the last reported sales price of the Registrant's common stock on the Nasdaq National Market as of that date.

Number of shares of Common Stock outstanding as of March 8, 2006: 2,359,611.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for the Annual Meeting of Stockholders expected to be held on May 2, 2006, 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 Corporation ("VSE" or the "Company" or the "Registrant") results to differ materially from those anticipated in the forward looking statements contained in this filing, 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

VSE was incorporated in Delaware in 1959. The parent company serves as a centralized management and consolidating entity for the business operations conducted by the Company's divisions and wholly owned subsidiary, Energetics Incorporated ("Energetics"). Unincorporated divisions include BAV Division ("BAV"), Communications and Engineering Division ("CED"), Coast Guard Division ("VCG"), Engineering and Logistics Division ("ELD") beginning in 2006, Fleet Maintenance Division ("FMD"), Management Sciences Division ("MSD"), and Systems Engineering Division ("SED").

VSE previously conducted business operations in other subsidiaries and divisions during the past three year period that have been dissolved or became inactive prior to December 31, 2005. These include Human Resource Systems, Inc. ("HRSI"), dissolved in 2004; Telecommunications Technologies Division ("TTD"), discontinued operations in 2004 and Information Assurance Division ("IAD", formerly Value Systems Services Division or "VSS"), inactive as of May 2005. 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, logistics, management, and technical services performed on a contract basis. Substantially all 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.



(b) Financial Information

VSE operations are conducted within a single reporting segment and financial information is presented on a company-wide basis. In 2004, all business operations associated with the Company's TTD division ceased and financial results of TTD are presented as discontinued operations. Financial information for the three years ended December 31, 2005, appears in the "Consolidated Statements of Operations" contained in this Form 10-K.

(c) Description of Business

Services and Products

VSE engineering, logistics, management, and technical services include a broad array of capabilities and resources used in program planning; systems integration support; engineering and technical support for ground weapons; material procurement support; configuration management; computer-aided drafting and design; design and engineering, including prototype development; ship reactivation, transfer support and follow-on technical support; logistics management; design and installation of intelligent conference rooms; training, consulting and implementation support; quality training services for product, process, and management optimization; technology insertion; service life extension; environmental management and support; technology research, development and demonstration programs involving energy conservation and efficiency; advanced technology transfers; technology roadmaps; and feasibility, assessment and development programs.

Typical projects include sustaining engineering support for military vehicles and combat trailers; military equipment refurbishment and modification; military vehicle ballistic protection systems; ship maintenance, repair, overhaul planning and follow-on technical support; logistics management support; machinery condition analysis; specification preparation for ship alterations and repairs; ship force crew training; life cycle support for ships; ship communication systems; energy conservation and advanced technology demonstration projects; technical data package preparation; multimedia, computer LAN, and telecommunications systems; cross-platform technical data, product data and technical manual development and support.

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 may include prime contracts, subcontracts, cooperative arrangements, joint ventures, dedicated ventures, GSA schedules, dedicated cost centers (divisions) and subsidiaries. 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.

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. Other significant customers include the U.S. Army and Army Reserve and the Department of Energy. The Company's customers also include various other government agencies, non-government organizations, and commercial entities.



VSE Revenues by Customer
(Dollars in Thousands)

| | 2005 | | 2004 | | 2003 | |
|---|---|---|---|---|---|---|
| Customer | Revenues | % | Revenues | % | Revenues | % |
| U.S. Navy . . . . . . | $196,363 | 70.1 | $157,433 | 72.9 | $ 93,957 | 70.6 |
| U.S. Army/Army Reserve | 56,019 | 20.0 | 27,384 | 12.7 | 16,374 | 12.3 |
| Department of Energy . | 9,734 | 3.5 | 10,578 | 4.9 | 11,405 | 8.6 |
| U.S. Air Force . . . . | 5,431 | 1.9 | 3,628 | 1.7 | 2,287 | 1.7 |
| U.S. Coast Guard . . . | 5,008 | 1.8 | 8,498 | 3.9 | 4,946 | 3.7 |
| All other government . | 5,795 | 2.1 | 6,535 | 3.0 | 2,408 | 1.8 |
| Commercial and other . | 1,789 | 0.6 | 1,955 | 0.9 | 1,682 | 1.3 |
| Total | $280,139 | 100.0 | $216,011 | 100.0 | $133,059 | 100.0 |

The government's procurement practices in recent years have tended toward the bundling of various work efforts under large comprehensive management contracts ("omnibus"). As a result, the growth opportunities available to the Company have occurred in large, unpredictable increments. The Company has pursued these larger efforts by assembling teams of subcontractors to offer the range of technical competencies required by these omnibus contracts. Typically the use of subcontractors and large material purchases on government contracts does not allow for profit margins that are as high as on work performed by Company personnel. Accordingly, the use of such teaming arrangements may lower the Company's overall profit margins in some years. Although the government's practice of using omnibus contracts is expected to continue, there are indications that the Company will have opportunities to compete for smaller contracts requiring specific areas of expertise in the future. VSE is positioned to pursue these opportunities while continuing to use subcontractor teams to compete for the omnibus contracts. Due to competitive pressures, the Company has also elected to pursue more of its contract work through operating divisions and subsidiaries to focus on particular lines of work or specific customer requirements.

As a result of the bundling trend described above, the Company has some divisions for which revenues are derived predominantly from one major contract effort. Substantially all of BAV's work is performed on a program for the U.S. Navy that accounted for approximately 43%, 52%, and 48% of consolidated revenues in 2005, 2004, and 2003, respectively. This program is currently performed under two contracts. The original ten-year contract was awarded in 1995 with a total contract ceiling of over $1 billion and has been extended to continue work on a major delivery order effort through most of 2006. A follow-on five-year contract with a total ceiling of approximately $544 million was awarded in 2005.

The Company's contracts with the government are typically cost plus fee, time and materials, or fixed-price contracts. Revenues result from work performed on these contracts by the Company's employees and from pass-through of costs for material and work performed by subcontractors. Revenues on cost-type contracts are recorded as contract allowable costs are incurred and fees are earned. Profits on cost-type contracts are equal to the fees that are earned.

The BAV Division contracts have terms that specify award fee payments that are determined by performance and level of contract activity. Award fees under the BAV contracts are made three times during the year, and a contract modification authorizing the award fee payment is issued subsequent to the period in which the work is performed. The Company does not recognize award fee income until the fees are fixed and determinable, generally upon contract notification confirming the award fee. Due to such timing, and to fluctuations in the level of revenues, profits as a percentage of revenues on this contract will fluctuate from period to period.

Revenues for time and materials contracts are recorded on the basis of contract allowable labor hours worked multiplied by the contract defined billing rates, plus the cost of materials used in performance on the contract.



Profits or losses on time and material contracts result from the difference between the cost of services performed and the contract defined billing rates for these services.

Revenue recognition methods on fixed-price contracts will vary depending on the nature of the work and the contract terms. On some fixed-price contracts revenues are recorded as costs are incurred, using the percentage-of-completion method of accounting. Revenues on fixed-price service contracts are recorded as work is performed. Revenues on fixed-price contracts that require delivery of specific items may be recorded based on a price per unit as units are delivered. Profits on fixed-price contracts result from the difference between the incurred costs and the revenue earned.

Backlog

Funded backlog for government contracts represents a measure of the Company's potential future revenues and is defined as the total estimated value of contracts that has been appropriated and funded by the procuring agencies, less the amount of revenues that have already been recognized on such contracts. VSE's funded backlog as of December 31, 2005, increased to approximately $276 million, the highest backlog in the Company's history. Funded backlog as of December 31, 2004 and 2003 was approximately $168 million and $83 million, respectively. The increases in funded backlog during these years are due to increases in funding on the Company's existing programs and the funding received on new programs in 2005. Changes in funded backlog on contracts are sometimes unpredictable due to uncertainties associated with changing program requirements and the ultimate availability of funds. The majority of the Company's funded backlog is expected to be completed within one year.

In addition to the increases in funding on current contracts, there were significant increases in total contract ceiling amounts available for use by the Company resulting from large multiple award, indefinite delivery, indefinite quantity contracts awarded by the U.S. Army and U.S. Navy to the Company in 2004 and 2003. While the award of these contracts has increased the opportunities available to VSE to pursue future work, the amount of future work is not determinable until delivery orders are placed on the contracts. Additionally, these delivery orders must be funded by the procuring agencies before the Company can perform work and begin earning revenues from them.

In December 2005, VSE was awarded a task order on the U.S. Army contract with a base year valued at approximately $139 million, with an additional one-year option period valued at approximately $212 million. The task order is incrementally funded. The initial funding was approximately $31 million, included in the December 31, 2005 funded backlog amount above, with additional funding expected to follow.

Marketing

VSE marketing activities are conducted by its professional staff of engineers, analysts, program managers, contract administrators and other personnel, with these activities centrally coordinated through the Company's Business Development staff. 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 and technical personnel having high levels of education, experience, training and skills. As of February 2006, VSE employed 716 employees. Principal categories of VSE technical personnel include (a) engineers, and technicians in mechanical, electronic, chemical, industrial, energy and environmental services, (b) information technology professionals in computer systems, applications and products, configuration, change and data management disciplines, (c) technical



editors and writers, (d) multimedia and computer design engineers, (e) graphic designers and technicians, and (f) logisticians. 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

The professional and technical services industry in which VSE is engaged is very competitive. There are numerous 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 or may be divisions of much larger organizations, including large manufacturing corporations.

Government agencies have emphasized awarding contracts of the types performed by VSE on a competitive basis as opposed to a sole source or other non-competitive basis. Most of the significant contracts currently 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"). GSA provides a schedule of services at fixed prices which may be ordered outside of the solicitation process. The Company has four GSA schedule contracts for different classes of services, but there is no assurance regarding the level of work which may be obtained by VSE under these contract arrangements. Government budgets, and in particular the budgets of certain government agencies, can also affect competition in VSE's business. A reallocation of government spending priorities or a general decline in government budgets can result in lower levels of potential business for VSE and its competitors, thereby intensifying competition for the remaining business.

It is not possible to predict the extent and range of competition that 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.

The government acquisition policies and procedures often emphasize factors that can present challenges to VSE's efforts to win new business, and may make it difficult for VSE to qualify as a potential bidder. For example, past performance may be used to exclude entrance into new government markets, and multiple-award schedules may result in unequal contract awards between successful contractors.

Available Information

Copies of VSE's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports are filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and are available free of charge through VSE's website www.vsecorp.com as soon as reasonably practicable after the reports are electronically filed with the Securities and Exchange Commission.

ITEM 1A. Risk Factors

VSE's future results may differ materially from past results and from those projected in the forward-looking statements contained in this Form 10-K due to various uncertainties and risks, including but not limited to those set forth below, one-time events and other important factors disclosed previously and from time to time in other filings with the SEC.



Federal procurement directives could result in a loss of work on current programs to set-asides and omnibus contracts.

VSE's business with the government is subject to the risk that one or more of the Company's potential contracts or contract extensions may be awarded by the contracting agency to a small or 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. These risks can potentially have an adverse effect on VSE's revenue growth and profit margins.

Funding uncertainties for federal programs could adversely affect the Company's ability to continue work on its government contracts.

Government contract business is subject to funding delays, terminations, reductions, extensions, and moratoriums caused by political and administrative disagreements within the government. To date, the effect of such negotiations and disagreements on the Company has not been material, but no assurances can be given about such risks with respect to future years.

Global economic conditions and political factors could adversely affect revenues on current programs.

VSE's business is subject to the risks arising from global economic conditions and political factors associated with current and potential customers served through VSE's contracts with the U.S. Government. An economic slowdown in countries served under the BAV Ship Transfer Program could potentially affect sales. Failure by the government of a potential foreign customer to approve and fund acquisition of U.S. Navy ships serviced under this program could affect sales.  BAV sales to Egypt and Taiwan have historically comprised a large percentage of the Company's total sales in any one year. The concentration of a large percentage of work under one or two client countries presents additional risk to the Company.

The current international situation posed by potential terrorist activity and the continuing conflict in the Middle East could potentially increase the political risks for revenues from the BAV Ship Transfer, TBPS, and CED Army Equipment Support Programs. International tensions can also affect work by FMD on U.S. Navy ships when they are deployed outside of U.S. Navy facilities and are unavailable for maintenance work during this time period. Adverse results arising from these global economic and political risks could potentially have a material adverse impact on the Company's results of operations.

VSE is exposed to contractual and financial liabilities in the event that its subcontractors do not perform satisfactorily.

A large percentage of VSE's contract work is performed by subcontractors, which raises certain performance and financial risks to VSE. While subcontractor terms generally specify the terms and performance for which the subcontractor is liable to VSE, in the event of any unsatisfactory performance on the part of subcontractors, the Company still must bear the cost to ensure satisfactory performance on its prime contracts.

As a U.S. Government contractor, VSE is subject to a number of procurement rules and regulations that could expose the Company to potential liabilities or loss of work.

VSE must comply with and is affected by laws and regulations relating to the award, administration and performance of U.S. Government contracts. Government contract laws and regulations affect how the Company does business with its customers and, in some instances, impose added costs on the business. A violation of specific laws and regulations could result in the imposition of fines and penalties or the termination of contracts or debarment from bidding on contracts.

In some instances, these laws and regulations impose terms or rights that are more favorable to the government than those typically available to commercial parties in negotiated transactions. For example, the U.S. Government may terminate any government contracts and, in general, subcontracts, at their convenience, as well as for default based on performance. Upon termination for convenience of a fixed-price type contract, the Company would normally be entitled to receive the purchase price for delivered items, reimbursement for allowable costs for work-in-process and an allowance for profit on the contract or adjustment for loss if completion of performance would have resulted in a loss. Upon termination for convenience of a cost-type contract, the Company would normally be entitled to reimbursement of allowable costs plus a portion of the fee. Such allowable costs would include the cost to terminate agreements with suppliers and subcontractors. The amount of the fee recovered, if any, is related to the portion of the work accomplished prior to termination and is determined by negotiation.

A termination for default could expose the Company to liability and have a material adverse effect on its ability to compete for future contracts and orders. In addition, the U.S. Government could terminate a prime contract under which the Company is a subcontractor, irrespective of the quality of services provided by VSE as a subcontractor.

VSE's business could be adversely affected by a negative audit by the U.S. Government.

U.S. Government agencies, including the Defense Contract Audit Agency and the Department of Labor, routinely audit and investigate government contractors. These agencies review a contractor's performance under its contracts, cost structure and compliance with applicable laws, regulations and standards. The U.S. Government also may review the adequacy of, and a contractor's compliance with, its internal control systems and policies, including the contractor's purchasing, property, estimating, compensation and management information systems. Any costs found to be improperly allocated to a specific contract will not be reimbursed, while such costs already reimbursed must be refunded. If an audit uncovers improper or illegal activities, the Company may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines and suspension or prohibition from doing business with the U.S. Government. In addition, the Company could suffer serious reputational harm if allegations of impropriety were made.

VSE's earnings and margins may vary based on the mix of contracts and programs.

At December 31, 2005, funded backlog included both cost-type and fixed-price contracts. Cost-type contracts generally have lower profit margins than fixed-price contracts. Typically the use of subcontractors and large material purchases on government contracts does not allow for profit margins that are as high as on work performed by Company personnel. Accordingly, the level of work performed on cost-type versus fixed-price contracts and the level of work performed by subcontractors may cause fluctuations in the Company's overall profit margins from year to year or from period to period.

VSE uses estimates in accounting for its programs. Changes in estimates could affect future financial results.

The Company uses estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates affecting the financial statements include the allowance for doubtful accounts and accruals for loss contracts, contract disallowance and self insured health claims, and estimated cost to complete on certain fixed-price contracts.



New accounting standards could result in changes to VSE's methods of quantifying and recording accounting transactions, and could affect financial results and financial position.

Changes to Generally Accepted Accounting Principles in the United States

(GAAP) arise from new and revised standards, interpretations and other guidance issued by the Financial Accounting Standards Board, the SEC, and others. The effects of such changes may include prescribing an accounting method where none had been previously specified, prescribing a single acceptable method of accounting from among several acceptable methods that currently exist, or revoking the acceptability of a current method and replacing it with an entirely different method, among others. Such changes could result in unanticipated effects on results of operations, financial position and other financial measures.

ITEM 1B. Unresolved Staff Comments

None

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, 2008. This building contains approximately 127,000 square feet of engineering, shop, and administrative space. VSE also provides services and products from approximately 16 other U.S. leased facilities located near customer sites to facilitate communications and enhance project performance. These facilities are generally occupied under short-term leases and currently include an aggregate of approximately 173,000 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.

VSE owns and operates an engineering test center in Ladysmith, Virginia, consisting of approximately 45 acres of land and multiple storage and vehicle maintenance buildings totaling approximately 17,000 square feet of space. This property is used by VSE to test military equipment for which VSE provides system technical support or other engineering services; to provide maintenance and refurbishment services for military equipment; and to supplement Alexandria, Virginia, office and shop facilities.

ITEM 3. Legal Proceedings

VSE and its subsidiaries have, in the normal course of business, certain claims against them and against other parties. In the opinion of management, the resolution of these claims will not have a material adverse effect on the Company's results of operations or financial position. However, the results of any legal proceedings cannot be predicted with certainty.

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, 2005.



EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth information concerning the executive officers of the Registrant as of March 8, 2006. Each person named has served as an executive officer of VSE, or has served in a similar executive capacity in VSE, for more than the past five years, except for Mr. Dacus and Mr. Reed.

Mr. Dacus joined VSE in 2001 and previously served as an officer of VSE from 1984 to 1991. From 1991 to 2001, Mr. Dacus served as an officer in four high technology service companies, and his career includes over 30 years experience in managing high technology engineering programs and projects.

Mr. Reed joined VSE in 2005 as Chief Operating Officer of VSE's wholly owned subsidiary Energetics Incorporated, and effective April 1, 2005, he was appointed Energetics' President. Mr. Reed was a founder of Energetics in 1979 and served as an officer of Energetics from 1979 to 2001. He provided senior-level consulting services to government and private clients as a sole proprietor during the period 2001 through 2004. He is a Registered Professional Engineer in Maryland.

The executive officers are appointed 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 |
| --- | --- | --- |
| Thomas G. Dacus . . . . . . . . | 60 | Senior Vice President and Director, Federal Group |
| Donald M. Ervine . . . . . . . | 69 | Chairman and Chief Executive Officer, President and Chief Operating Officer |
| James E. Reed . . . . . . . . . | 57 | President, Energetics Incorporated, and Director, Energy and Environment Group |
| James M. Knowlton . . . . . . . | 63 | Executive Vice President and Director, International Group |
| Thomas R. Loftus . . . . . . . | 50 | Senior Vice President and Chief Financial Officer |
| Craig S. Weber . . . . . . . . | 61 | Executive Vice President, Chief Administrative Officer, and Secretary |



PART II

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

(a) Market Information

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

<TABLE>
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.
<CAPTION>

| Quarter Ended | High | Low | Dividends |
| --- | --- | --- | --- |
| <S> | <C> | <C> | <C> |
| 2004: | | | |
| March 31 . . . . . . . | $19.10 | $12.35 | $.04 |
| June 30 . . . . . . . | 27.00 | 14.62 | .05 |
| September 30 . . . . . | 33.91 | 14.00 | .05 |
| December 31 . . . . . | 33.91 | 22.56 | .05 |
| For the Year | $33.91 | $12.35 | $.19 |
| 2005: | | | |
| March 31 . . . . . . . | $27.49 | $21.09 | $.05 |
| June 30 . . . . . . . | 38.85 | 23.82 | .06 |
| September 30 . . . . . | 40.50 | 30.00 | .00 (see (c) below) |
| December 31 . . . . . | 42.25 | 31.56 | .12 |
| For the Year | $42.25 | $21.09 | $.23 |

</TABLE>

(b) Holders

There were approximately 1,740 stockholders of VSE common stock as of February 1, 2006, consisting of approximately 250 stockholders of record plus the number of beneficial owner proxy sets provided in connection with VSE's Annual Meeting of Stockholders held on May 3, 2005, 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 $.05 per share on March 8, 2005, and $.06 per share on May 3, 2005, October 3, 2005 and December 6, 2005. Pursuant to VSE's bank loan agreement (see Note 8 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.



(d) Equity Compensation Plan Information

The following table provides information about the Company's equity compensation plans as of December 31, 2005:

| Plan Category | Number of Shares to be Issued upon Exercise of Outstanding Options (1) (a) | Weighted Average Exercise Price of Outstanding Options (b) | Number of Shares Remaining Available for Future Issuance Under Equity Compensation Plans (excluding shares reflected in column (a)) (c) |
|---|---|---|---|
| Equity compensation plans approved by stockholders . . . . . | 197,563 | $15.83 | 280,000 |
| Equity compensation plan not approved by stockholders . . . . | - | - | - |
| Total | 197,563 | $15.83 | 280,000 |

(1) Excludes 262,913 shares of issued and outstanding shares of VSE Common Stock (par value $.05 per share) held by the VSE Corporation Employee ESOP/401(k) Plan; these shares may be transferred to Plan participants on retirement, termination of VSE employment, or pursuant to ESOP diversification.



<TABLE>
ITEM 6. Selected Financial Data

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

| <S> | 2005 <C> | 2004 <C> | 2003 <C> | 2002 <C> | 2001 <C> |
|---|---|---|---|---|---|
| Revenues, principally from contracts . . . . . | $280,139 | $216,011 | $133,059 | $128,417 | $103,490 |

| | | | | | |
|---|---|---|---|---|---|
| Income from continuing operations | $ 6,169 | $ 3,445 | $ 2,090 | $ 1,585 | $ 547 |
| (Loss) income from discontinued operations | - | (1) | (79) | (933) | 308 |
| Net income | $ 6,169 | $ 3,444 | $ 2,011 | $ 652 | $ 855 |
| Basic earnings per common share: | | | | | |
| Income from continuing operations | $ 2.66 | $ 1.54 | $ .96 | $ .73 | $ .26 |
| Loss (income) from discontinued operations | - | - | (.04) | (.43) | .14 |
| Net income | $ 2.66 | $ 1.54 | $ .92 | $ .30 | $ .40 |
| Diluted earnings per common share: | | | | | |
| Income from continuing operations | $ 2.58 | $ 1.49 | $ .94 | $ .72 | $ .26 |
| Loss (income) from discontinued operations | - | - | (.04) | (.42) | .14 |
| Net income | 2.58 | $ 1.49 | $ .90 | $ .30 | $ . 40 |
| Working Capital | $ 22,028 | $ 15,748 | $ 13,394 | $ 10,762 | $ 8,807 |
| Total assets | $ 73,866 | $ 60,352 | $ 30,776 | $ 32,075 | $ 33,209 |
| Long-term debt | $ - | $ - | $ - | $ - | $ 351 |
| Stockholders' investment | $ 30,151 | $ 23,043 | $ 19,058 | $ 17,043 | $ 16,475 |
| Cash dividends per common share | $ .23 | $ .19 | $ .16 | $ .16 | $ .16 |

</TABLE>

This consolidated summary of selected financial data should be read in conjunction with Management's Discussion and Analysis of the Financial Condition and Results of Operations included in Item 7 of this Form 10-K and with the Consolidated Financial Statements and related Notes included in Item 8 in this Form 10-K. The historical results set forth in this Item 6 are not necessarily indicative of the results of operations to be expected in the future.



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

### Executive Overview

#### VSE Organization

VSE's business operations consist primarily of services performed by the Company's unincorporated divisions and wholly owned subsidiary. The Company uses multiple operating entities to bid on and perform contract work. The use of an operating structure with multiple entities gives the Company certain competitive advantages and the flexibility to pursue a diverse business base. The term "VSE" or "Company" refers to VSE and its divisions and subsidiaries unless the context indicates operations of the parent company only.

Unincorporated divisions include BAV Division ("BAV"), Communications and Engineering Division ("CED"), Coast Guard Division ("VCG"), Engineering and Logistics Division ("ELD") beginning in 2006, Fleet Maintenance Division ("FMD"), Management Sciences Division ("MSD"), and Systems Engineering Division ("SED"). Energetics Incorporated ("Energetics") is currently VSE's only active subsidiary.

VSE previously conducted business operations in other subsidiaries and divisions during the past three year period that have been dissolved or became inactive prior to December 31, 2005. These include Human Resource Systems, Inc. ("HRSI"), dissolved in 2004; Telecommunications Technologies Division ("TTD"), discontinued operations in 2004 and Information Assurance Division ("IAD", formerly Value Systems Services Division or "VSS"), inactive as of May 2005.

VSE Customers and Services

The Company is engaged principally in providing engineering, design, logistics, management and technical services to the U.S. Government (the "government"), other government prime contractors, and commercial entities. The largest customer for the Company's services is the U.S. Department of Defense ("Defense"), including agencies of the U.S. Navy, Army, and Air Force.

Navy - The majority of VSE's work is performed for the U.S. Navy. BAV is a major provider of logistics, training, and technical assistance in support of the Navy's Foreign Military Sales ("FMS") ship transfer program. FMD supports the Navy by providing a variety of services including ship systems installation efforts, combat systems inspections, ship repair and overhaul availability planning, weapons management, ordnance alterations, and air combat logistics. VCG provides services to the U.S. Coast Guard that are similar to the work performed by BAV for the U.S. Navy and its FMS customers.

Army/Army Reserve - VSE also performs a significant amount of its work for the U.S. Army and U.S. Army Reserve. VSE, through SED and ELD, provides these customers equipment refurbishment services, military vehicle protection systems, engineering and technical support for ground weapons, logistics and training services, material procurement support, and prototype development support for combat vehicles. MSD provides the Army, as well as other government agencies and commercial organizations, with training services in quality systems and product, process, and management optimization. CED provides management oversight and coordinates support efforts for a variety of government work orders on a large Army contract.

Other - Energetics provides the Department of Energy and other government and industry customers with expert consulting services that typically include program planning and analysis, R&D management services, technology assessment and performance metrics, communications and outreach, and conference planning. VSE provides base support and other services to the U.S. Air Force through contract work performed by FMD and SED. The Company has also provided support services to the U.S. Postal Service and U.S. Department of Treasury.



<TABLE>

VSE Revenues by Customer
(Dollars in Thousands)

<CAPTION>

| | 2005 | | 2004 | | 2003 | |
|---|---|---|---|---|---|---|
| Source of Revenue | Revenues | % | Revenues | % | Revenues | % |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Navy | $196,363 | 70.1 | $157,433 | 72.9 | $ 93,957 | 70.6 |
| Army/Army Reserve | 56,019 | 20.0 | 27,384 | 12.7 | 16,374 | 12.3 |
| Other | 27,757 | 9.9 | 31,194 | 14.4 | 22,728 | 17.1 |
| Total Revenues | $280,139 | 100.0 | $216,011 | 100.0 | $133,059 | 100.0 |

</TABLE>

BAV Ship Transfer Program

VSE's BAV Division provides the U.S. Navy with engineering, technical and logistical support services associated with the sale, lease, or transfer of Navy ships to foreign governments. During its life, this program has been the Company's single largest revenue producer. Revenues generated by this program have typically accounted for approximately 40% to 50% of consolidated VSE revenues, and revenues generated by this program accounted for approximately 43% and 52% of consolidated revenues in 2005 and 2004, respectively. The level of revenues and associated profits resulting from fee income generated by this program varies 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 has experienced significant quarterly and annual revenue fluctuations and anticipates that future quarterly and annual revenues will be subject to variation due to changes in the level of activity associated with the Navy's ship transfer program. The transfer of four U.S. Navy ships to Taiwan currently conducted under this program is a major contributor to the Company's revenues in 2005 and 2004.

The original contract associated with this program was a ten-year cost-plus award fee contract awarded in 1995 with a total ceiling value of more than $1 billion. BAV was awarded a second contract in April 2005 to continue work on this program. The new contract is a five-year cost-plus award fee contract with a total ceiling value of approximately $544 million. The Navy began issuing orders on the new contract in the second quarter of 2005 and ceased issuing orders for new work on the original contract at that time. BAV will continue work associated with the transfer of four ships to Taiwan under delivery orders previously issued on the original contract until the work is completed and all four ships are delivered to Taiwan.

Contract terms under both the original and new contracts specify base fee payments and award fee payments to BAV. Base fee payments are determined by level of contract activity and base fee income is recognized each month. Award fee payments are determined by performance and level of contract activity. A contract modification authorizing the award fee payment is issued subsequent to the period in which the work is performed. The Company does not recognize award fee income until the fees are fixed and determinable, generally upon contract notification confirming the award fee. Award fees are made three times during the year. Accordingly, the Company typically has three quarterly reporting periods per year that include the recognition of BAV award fee income and one quarterly reporting period that does not include BAV award fee income. Due to such timing, and to fluctuations in the level of revenues, profits as a percentage of revenues will fluctuate from period to period. In 2005 and 2004, each of the three month periods ended December 31, June 30, and March 31, includes BAV award fee income. The three month periods ended September 30, 2005 and 2004 do not include BAV award fee income.

TBPS Program

In November 2004, VSE's SED Division began work on a program to provide a protection system, the Tanker Ballistic Protection System ("TBPS"), for vehicles deployed by the U.S. Army in Iraq. Under this program, SED applies a Fuel Tank Self-Sealing System and necessary Add-on Armor Panels for Army Fuel



Dispensing Tankers as protection from damage resulting from hostile fire. Testing and preparatory work was conducted in November and December 2004 and delivery of completed vehicle protection systems began in January 2005.

SED has multiple firm fixed price per unit contracts under which it is performing the TBPS Program. Subsequent to award, VSE has received modifications to the contracts to adjust the number of tankers based on Army tanker availability and needs, and the possibility remains that there may be future modifications to these contracts as the Army's needs change. The current funded contract ceiling for the TBPS Program contracts is approximately $78 million as of December 31, 2005. Contractual coverage for work on the TBPS program runs through January 2007 and the Company expects to most likely complete work in early 2007.

The TBPS Program has contributed significantly to VSE revenue growth in 2005. The work performed on this program also significantly increases the amount of fixed price contract work performed by the Company. In general, fixed price contract work carries a higher level of risk and has higher profit margins than work on other contract types. Accordingly, the TBPS program has presented, and is expected to continue to present, VSE's business with the potential for both increased profit margins and increased risks of incurring a loss.

CED Army Equipment Support Program

In December 2005, VSE's CED Division was awarded a task order on its Rapid Response support contract to provide maintenance and logistics services in support of U.S. Army equipment in Iraq and Afghanistan. Services provided under this program include deployed sustainment management, deployed logistics and repairs management, unique system training and curriculum support, resource management, and acquisition and administrative support. Work on this program began in 2006.

The task order for this program is time and materials, with substantially all of the services provided by CED's subcontractor. CED will provide certain program management services. The contract task order has a base year valued at approximately $139 million and an additional one-year option period valued at approximately $212 million. This program is expected to contribute significantly to VSE's revenues in 2006 and 2007, however, profit margins on subcontract work are lower than on work performed by Company personnel.

Government Procurement Policies and Practices

VSE's business is subject to the risks arising from economic conditions and political factors that may impact the budgets and program funding of customers served through VSE's contracts. VSE's revenues have historically been subject to annual fluctuations resulting from changes in the level of Defense spending. Future budgetary and funding decisions by government lawmakers or Defense restructuring efforts could affect the types and level of services provided by VSE to its government customers and could potentially have a material adverse impact on the Company's results of operations or financial condition.

The revenues of the Company depend on its ability to win new contracts and on the amount of work ordered by the government under the Company's existing contracts. The Company's ability to win new contracts is affected by government acquisition policies and procedures, including government procurement practices that in some years have tended toward bundling work efforts under large comprehensive management contracts ("omnibus"). This emphasis on large contracts presents challenges to winning new contract work, including making it more difficult for the Company to qualify as a bidder, increasing the level of competition due to the award of fewer contracts, and forcing the Company into competition with larger businesses that have greater financial resources and larger technical staffs. Competing for these contracts requires the Company to use teams of subcontractors to be able to offer the range of technical competencies needed to do the work. While the use of subcontractors on a large scale basis allows the Company to compete for this work, profit margins on



subcontract work are lower than on work performed by Company personnel, thereby reducing the Company's overall profit margins.

The use of subcontractors on government contracts also raises certain performance and financial risks to VSE in that government prime contractors are responsible for performing to the requirements of the contract and ensuring compliance with U.S. Government regulations relative to the performance by subcontractors.

Other government procurement practices that can affect the Company's revenues are 1) the length of contracts issued, which may vary depending on changes in contracting regulations and other factors; 2) the use of past performance criteria that may preclude entrance into new government markets; and 3) government socioeconomic programs that limit contract work to small, woman, or minority owned businesses. Additional risk factors that could potentially affect the Company's results of operations are the government's right to terminate contracts for convenience, the government's right to not exercise all of the option periods on a contract, and funding delays caused by government political or administrative actions.

Global Economic Conditions and Political Factors

VSE's business is subject to the risks arising from global economic conditions and political factors associated with current and potential customers served through VSE's contracts with the U.S. Government. An economic slowdown in countries served under the BAV Ship Transfer Program could potentially affect sales. Failure by the government of a potential foreign customer to approve and fund acquisition of U.S. Navy ships serviced under this program could affect sales. In any one year, a significant amount of the Company's revenues may result from sales on the BAV Ship Transfer Program to a single foreign government. BAV sales to Egypt have historically comprised a large percentage of the Company's total sales in any one year. Work associated with the transfer of four ships to Taiwan under the BAV Ship Transfer Program during 2004 and 2005 also comprised a large percentage of total sales.

The current international situation posed by potential terrorist activity and the continuing conflict in the Middle East could potentially increase the political risks for revenues from the BAV Ship Transfer, TBPS, and CED Army Equipment Support Programs. International tensions can also affect work by FMD on U.S. Navy ships when they are deployed outside of U.S. Navy facilities and are unavailable for maintenance work during this time period. Adverse results arising from these global economic and political risks could potentially have a material adverse impact on the Company's results of operations.

<TABLE>
Concentration of Revenues From Continuing Operations
(in thousands)
<CAPTION>

| Source of Revenue | 2005 Revenues | % | 2004 Revenues | % | 2003 Revenues | % |
|---|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| BAV Egypt . . . . | $ 52,926 | 18.9 | $ 50,250 | 23.3 | $ 44,190 | 33.2 |
| BAV Taiwan . . . | 63,058 | 22.5 | 56,038 | 25.9 | 12,368 | 9.3 |
| BAV Other . . . . | 5,024 | 1.8 | 6,675 | 3.1 | 7,259 | 5.5 |
| Total BAV | 121,008 | 43.2 | 112,963 | 52.3 | 63,817 | 48.0 |
| TBPS Program | 29,533 | 10.5 | 134 | 0.1 | - | - |
| VSE Other . . . . | 129,598 | 46.3 | 102,914 | 47.6 | 69,242 | 52.0 |
| Total Revenues | $280,139 | 100.0 | $216,011 | 100.0 | $133,059 | 100.0 |

</TABLE>



## Management Outlook

### Another Record Year

VSE again reached historical highs for revenues and profits in 2005. SED's work on the TPBS Program and FMD's continuing work on Navy programs contributed significantly to increased revenues. The Taiwan ship transfer work by BAV also increased revenues and continued to be the Company's single largest work effort. Several of VSE's other divisions also contributed to revenue growth in 2005. Work on the TPBS Program began contributing to VSE's profits, and each of VSE's active business units showed improved profits in 2005. See "Results of Operations" below for a more detailed discussion of 2005 results.

### More Growth Ahead

Subject to the risk elements discussed above, VSE expects to continue to increase revenues and profits in 2006. Reasons for this expectation include:

#### CED Army Equipment Support Program

CED began work on this program in 2006. The program is new work and is expected to increase Company revenues significantly in 2006 and 2007. The contract task order for this program is incrementally funded, with funded backlog of approximately $31 million as of December 31, 2005.

#### TBPS Program

SED began delivery of completed vehicle protection systems on this program in 2005. The program is expected to continue in 2006 with increased levels of production. Funded backlog on the TBPS program was approximately $49 million as of December 31, 2005, as compared to approximately $14 million as of December 31, 2004.

#### Taiwan Ship Transfer

The Taiwan ship transfer effort is expected to continue through mid to late 2006, allowing BAV to maintain revenue levels in 2006 similar to 2005. Funded backlog on the BAV Ship Transfer Program was approximately $115 million as of December 31, 2005, as compared to approximately $71 million as of December 31, 2004.

Other Significant Contracts

VSE has three multiyear, multiple award, indefinite delivery, indefinite quantity contracts that have large nominal ceiling amounts with no funding committed at the time of award. VSE is one of several awardees on each contract. While future VSE revenue from these contracts cannot be predicted with certainty, the award of these contracts provides the Company with the opportunity to compete for work that could contribute to future revenue growth, including new work in 2006. These three contracts are described below.

VSE's CED Division has a multi-year Rapid Response support contract issued by the U.S. Army Communications-Electronics Command (CECOM) that was awarded in January 2003. The contract enhances the Company's revenue producing capabilities by allowing it to provide services through any of VSE's operating entities or through third party subcontractors for various end user government customers. If all options are exercised, this contract has a potential total ceiling of approximately $2.9 billion over an eight-year period. While it is not likely that the full ceiling amount will be realized, this contract has generated revenues for VSE of approximately $37 million and $27 million during 2005 and 2004, respectively. The CED Army Equipment Support Program is expected to add significantly to this contract's and the Company's revenues in 2006. VSE continues to pursue new orders on this contract that present potential revenue opportunities for the future.

VSE's FMD Division has a contract with the U.S. Navy, SeaPort Enhanced, awarded in April 2004, which includes a five-year base period and two five-year



option periods. This contract is a procurement vehicle for the Navy to use for ordering services from a wide range of contractors to support all phases of naval ship and shipboard weapons systems acquisition and life-cycle support. While this award does not guarantee any revenues for VSE, the Company is one of several contractors eligible to bid for services during the life of the contract. To date, FMD has generated only minor amounts of revenue from this contract.

FMD also has a contract, awarded in September 2004, with the U.S. Navy to provide engineering and technical services to support Naval Sea Systems Command maintenance, overhaul, repair, and alteration of systems aboard ships. This contract has a total contract ceiling amount of $1.022 billion over a five-year period if all option periods are exercised. VSE is one of several awardees eligible to share in the potential total contract ceiling amount. Since the date of the contract award, FMD has been awarded delivery orders with ceilings valued at approximately $44 million on this contract, of which approximately $35 million has been funded. Although it is not likely that the full $1.022 billion ceiling amount will be realized, this contract presents potential future revenue opportunities.

Increases in Bookings and Funded Backlog

Revenue increases in government contracting businesses such as that experienced by VSE in 2005 and 2004 are typically preceded by increases in contract funding ("Bookings") and a build-up of funded contract backlog. VSE's Bookings and funded backlog continued to increase in 2005, giving the Company a firm basis for a continuation in revenue growth in 2006.

| (in $ millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Bookings | 390 | 303 | 181 |
| Funded Backlog | 276 | 168 | 83 |
| Revenues | 280 | 216 | 133 |

Longer Term Concerns and Risks

Certain work efforts that have supported VSE's growth in 2004 and 2005 and that are expected to support continued growth in 2006 are due to expire in the future. VSE has received significant contributions to its revenue growth in 2004 from the Taiwan Ship Transfer work and in 2005 from both the Taiwan Ship Transfer work and the TBPS Program work. These two programs and the CED Army Equipment Support Program are expected to be the largest contributors to VSE revenue in 2006. The Taiwan Ship Transfer work is expected to be substantially completed in late 2006. The TBPS program contractual coverage runs through January 2007, and the Company expects to continue work on the program through 2006 and into early 2007. The Company has no indication that there will be any further work ordered on the TBPS program beyond early 2007. The CED Army Equipment Support Program will be performed under a two-year contract task order in 2006 and 2007. The Company does not know of any additional contractual coverage that may be issued to continue VSE's work on this program.

The expected expiration of these programs will present challenges for VSE to sustain the revenue growth that it experienced during 2004 and 2005, and that it expects to experience 2006, in years beyond 2006. VSE is tracking multiple bidding opportunities for new contract work and is also exploring potential acquisition opportunities to mitigate the future loss of revenues associated with the expiration of the Taiwan Ship Transfer, TBPS, and CED Army Equipment Support work.

## Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board issued SFAS 123(R), "Share-Based Payment," which is a revision to SFAS 123. SFAS 123(R) supersedes APB Opinion No. 25 and amends SFAS 95, "Statement of Cash Flows." Generally, the approach in SFAS 123(R) is similar to the approach described in



SFAS 123. However, SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. The Company adopted SFAS 123(R), using the modified prospective method, on January 1, 2006.

If VSE had adopted SFAS 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS 123 as described in the disclosure of pro forma net income and earnings per share. The impact of adopting SFAS 123(R) is expected to be an increase in expenses, net of related tax effects, of approximately $155 thousand in 2006. SFAS 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. The amount of operating cash flows recognized for each of the last three years for such excess tax deductions were approximately $761 thousand, $433 thousand, and $14 thousand for 2005, 2004 and 2003, respectively.

On December 30, 2005, VSE's board of directors (the "Board") directed VSE to discontinue awarding options, both discretionary and nondiscretionary, to purchase VSE common stock ("VSE Stock") under VSE's 2004 Stock Option Plan approved by VSE' stockholders on May 3, 2005 (the "2004 Plan"). The options outstanding under the 2004 Plan as of December 30, 2005, and the options to purchase shares of VSE Stock under VSE's 1998 Stock Option Plan (the "1998 Plan") are not affected by this Board action. The primary reason for the Board's suspension of option awards under the 2004 Plan was the potential impact on VSE's results of operations from the application of SFAS 123 (R) to share-based payments to employees, including stock option awards.

## Critical Accounting Policies

VSE's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, which require VSE to make estimates and assumptions. The Company believes the following critical accounting polices affect our more significant judgments, estimates and assumptions used in the preparation of its consolidated financial statements.

### Revenue Recognition

Substantially all of the Company's services are performed for its customers on a contract basis. The three primary types of contracts used are cost-type contracts, time and materials contracts, and fixed-price contracts. Revenues result from work performed on these contracts by the Company's employees and from pass-through of costs for material and work performed by subcontractors.

Revenues on cost-type contracts are recorded as contract allowable costs are incurred and fees earned. Profits on cost-type contracts are equal to the fees that are earned. The BAV contract terms specify award fee payments that are determined by performance and level of contract activity. Award fees are made three times during the year and a contract modification authorizing the award fee payment is issued subsequent to the period in which the work is performed. The Company does not recognize award fee income until the fees are fixed and determinable, generally upon contract notification confirming the award fee. Due to such timing, and to fluctuations in the level of revenues, profits as a percentage of revenues on this contract will fluctuate from period to period.

Revenues for time and materials contracts are recorded on the basis of contract allowable labor hours worked multiplied by the contract defined billing rates, plus the direct costs and indirect cost burdens associated with materials and subcontract work used in performance on the contract. Profits on time and material contracts result from the difference between the cost of services performed and the contract defined billing rates for these services.



Revenue recognition methods on fixed-price contracts will vary depending on the nature of the work and the contract terms. On certain fixed-price contracts revenues are recorded as costs are incurred, using the percentage-of-completion method of accounting, since these contracts require design, engineering, and manufacturing performed to the customer's specifications. Revenues on fixed-price service contracts are recorded as work is performed. Revenues on fixed-price contracts that require delivery of specific items may be recorded based on a price per unit as units are delivered. Profits on fixed-price contracts result from the difference between the incurred costs and the revenue earned.

Certain direct and incremental contract costs have been deferred and reported as a current asset prior to the recognition of revenue. Such costs are realizable over the life of the contract.

<TABLE>

Revenues by contract type for the three years ended December 31, 2005 were as follows (in thousands):

<CAPTION>

| | 2005 | | 2004 | | 2003 | |
|---|---|---|---|---|---|---|
| Contract Type | Revenues | % | Revenues | % | Revenues | % |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Cost-type . . . . . | $177,567 | 63.4 | $148,043 | 68.5 | $ 93,552 | 70.3 |
| Time and materials. | 60,618 | 21.6 | 31,928 | 14.8 | 24,362 | 18.3 |
| Fixed-price . . . . | 41,954 | 15.0 | 36,040 | 16.7 | 15,145 | 11.4 |
| | $280,139 | 100.0 | $216,011 | 100.0 | $133,059 | 100.0 |

</TABLE>

The Company will occasionally perform work at risk, which is work that is performed prior to the government formalizing funding for such work. Revenue related to work performed at risk is not recognized until it can be reliably estimated and its realization is probable. VSE recognizes this "risk funding" as revenue when the associated costs are incurred or the work is performed. VSE is at risk of loss for any risk funding not received. Revenues recognized in 2005 include approximately $473 thousand for which the Company had not received formalized funding as of December 31, 2005. The Company received funding modifications for approximately $452 thousand of this amount as of February 2006, leaving approximately $21 thousand of 2005 revenues classified as risk funding. VSE believes that it will receive funding for this remaining risk funding revenue.

Long-Lived Assets

In assessing the recoverability of long-lived assets, including goodwill and other intangibles, VSE must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. If these estimates or their related assumptions change in the future, VSE may be required to record impairment charges for these assets not previously recorded.

Goodwill

Goodwill and intangible assets with indefinite lives are subject to a review for impairment at least annually. The Company performs its annual impairment test on September 30. As of December 31, 2005, the Company had approximately $1.1 million of unamortized goodwill associated with its acquisition of Energetics in 1995. The Company has not recognized any reduction to the goodwill due to the impairment rules. If at some time in the future it is determined that impairment has occurred, such impairment could potentially have a material adverse impact on the Company's results of operations or financial condition.

Contingencies

From time to time VSE is subject to proceedings, lawsuits and other claims related to environmental, labor and other matters. VSE is required to assess the likelihood of any adverse judgments or outcomes to these contingencies as well as potential ranges of probable losses and establish



reserves accordingly. The amount of reserves required may change in future periods due to new developments in each matter or changes in approach to a matter such as a change in settlement strategy.

Income Taxes

The carrying value of VSE net deferred tax assets is based on assumptions regarding VSE's ability to generate sufficient future taxable income to utilize these deferred tax assets. If the estimates and related assumptions regarding VSE's future taxable income change in the future, VSE may be required to record valuation allowances against its deferred tax assets, resulting in additional income tax expense.

## Results of Operations

Revenues

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

<TABLE>

Revenues from Operations
(dollars in thousands)

<CAPTION>

| Company or Business Unit | 2005 Revenues | % | 2004 Revenues | % | 2003 Revenues | % |
|---|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| VSE (parent company). . . . . | $ 34 | 0.0 | $ 12 | 0.0 | $ 1,720 | 1.3 |
| BAV . . . . . . . . . . . . . | 121,008 | 43.2 | 112,963 | 52.3 | 63,817 | 48.0 |
| FMD . . . . . . . . . . . . . | 59,800 | 21.3 | 41,711 | 19.3 | 24,406 | 18.4 |
| SED . . . . . . . . . . . . . | 49,001 | 17.5 | 12,762 | 5.9 | 9,750 | 7.3 |
| CED . . . . . . . . . . . . . | 28,564 | 10.2 | 24,615 | 11.4 | 11,743 | 8.8 |
| Energetics . . . . . . . . . | 12,694 | 4.5 | 11,693 | 5.4 | 11,982 | 9.0 |
| VCG . . . . . . . . . . . . . | 4,975 | 1.8 | 7,314 | 3.4 | 4,946 | 3.7 |
| MSD . . . . . . . . . . . . . | 4,063 | 1.5 | 3,300 | 1.5 | 2,261 | 1.7 |
| Business Units Inactive as of December 31, 2005 . | - | - | 1,641 | 0.8 | 2,434 | 1.8 |
| | $280,139 | 100.0 | $216,011 | 100.0 | $133,059 | 100.0 |

</TABLE>

Revenues increased by approximately 30% and 62% for the years ended December 31, 2005 and December 31, 2004, as compared to the respective prior years. The primary reasons for the increases in revenues in 2005 were 1) work attributable to the TBPS program; 2) increased levels of work performed by FMD on its U.S. Navy contracts; 3) an increase in work performed under the BAV Ship

Transfer Program, including revenues associated with the Taiwan ship transfer; 4) an increase in work performed on the CED Rapid Response contract; and 5) increased levels of military equipment refurbishment services performed by SED for the U.S. Army Reserve.

The primary reasons for the increase in revenues in 2004 were 1) an increase in work performed under the BAV contract, including increased revenues associated with the Taiwan ship transfer; 2) the CED Rapid Response contract received work orders that generated revenues throughout the full year in 2004, as compared to the prior year when the contract was awarded in February of 2003 and did not begin to receive any significant amount of work until September; and 3) increased levels of work performed by FMD due in part to the Navy's elevated readiness requirements. Work requirements and revenues also increased in SED, MSD and VCG.



Income from Continuing Operations Before Income Taxes

The following table shows consolidated revenues and income from operations before income taxes, other items of income and expense, and such amounts as a percent of revenues.
<TABLE>

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

| Description | 2005 | % | 2004 | % | 2003 | % |
|---|---|---|---|---|---|---|
| Revenues | $280,139 | 100.0 | $216,011 | 100.0 | $133,059 | 100.0 |
| Costs and expenses | 269,780 | 96.3 | 209,841 | 97.1 | 129,372 | 97.2 |
| Gross profit | 10,359 | 3.7 | 6,170 | 2.9 | 3,687 | 2.8 |
| Selling, general and administrative expenses. | 580 | 0.2 | 636 | 0.3 | 351 | 0.3 |
| Interest(income)expense | (210) | (0.1) | (102) | 0.0 | (69) | (0.1) |
| Income from continuing operations before income taxes | $ 9,989 | 3.6 | $ 5,636 | 2.6 | $ 3,405 | 2.6 |

</TABLE>

VSE's gross profit margin on continuing operations increased in 2005 as compared to 2004 and remained substantially unchanged during 2004 as compared to 2003. Company-wide revenue increases tend to increase the gross margins realized on the Company's fixed price and time and materials contracts due to the ability to spread corporate costs over a larger revenue base. The increase in gross margins in 2005 was primarily attributable to spreading corporate fixed costs over a larger revenue base and an increase in the percentage of work performed on fixed price and time and materials contracts, which have more favorable profit margins than work performed on cost type contracts. The TBPS Program and increased military equipment refurbishment services performed by SED for the U.S. Army Reserve increased both the Company's overall revenue and percentage of fixed price and time and materials contract work, and made the most significant contributions to increased gross margins. Another reason for the improved gross margins is the reduction of operational losses associated with CED in 2005 as compared to 2004 and 2003. Other factors that affect the Company's gross margins include the timing of contract award fees, effective project and cost management, and competitive factors.

Selling, general and administrative expenses consist primarily of costs and expenses that are not chargeable or reimbursable on the Company's operating unit contracts. As a percentage of revenues, these expenses varied little in 2005 and 2004 as compared to the respective prior years.

VSE did not have significant borrowing requirements or interest expense in 2005, 2004, and 2003. The Company's interest income increased in 2005 as compared to 2004 and increased in 2004 as compared to 2003 as profits from operations and resulting cash surpluses were invested.

Discontinued Operations

In July 2004, all business operations associated with the Company's TTD division ceased. Accordingly, prior period consolidated financial statements have been restated to reflect the financial results of TTD as discontinued operations. The revenues, costs and expenses of TTD have been excluded from the respective captions in the Consolidated Statement of Operations. The loss from discontinued operations associated with TTD, net of tax, in the years ended December 31, 2005, 2005, and 2003 was approximately $0, $1 thousand and, $79 thousand, respectively.

Financial Condition
- -------------------

VSE's financial condition remained strong during 2005. The Company's largest assets are its accounts receivable and cash and cash equivalents. The



largest liabilities are its accounts payable and accrued expenses. Accounts receivable increased approximately $3.7 million, accounts payable increased approximately $3.6 million, and accrued expenses increased approximately $4.3 million during 2005 due primarily to the increase in the level of business activity and the associated billings to customers and payments to subcontractors required to perform this work. Cash and cash equivalents increased approximately $12.6 million due to the timing of customer billings and collections, the timing of subcontractor and vendor billings and payments, and to profits. Inventories declined approximately $4.2 million during 2005 as initial quantities of materials and supplies purchased for the TBPS Program were used to complete protection systems for vehicles. The change in total stockholders' investment in this period resulted from earnings and dividend activity and from the exercise of stock options.

Liquidity and Capital Resources
- -------------------------------

Cash Flows

The Company's cash and cash equivalents increased by approximately $12.6 million during 2005. Approximately $15.6 million in net cash was provided by operating activities, approximately $1.6 million was used in investing activities, and approximately $1.4 million was used in financing activities. The difference between cash provided by operating activities of approximately $15.6 million in 2005 as compared to cash used in operating activities of approximately $8.8 million in 2004 is primarily due to differences in the levels of accounts receivable, contract inventories, and accounts payable associated with contract requirements and the associated billing and collections cycle, and to the Company's increase in profits. Investing activities consisted of the purchase of property and equipment. Financing activities consisted of $1.6 million used to repay bank loans, $715 thousand provided by the issuance of common stock to directors and officers associated with the exercise of stock options and directors' fees, and $510 thousand used to pay dividends.

The Company's cash and cash equivalents decreased by approximately $9.7 million during 2004. Approximately $8.8 million in net cash was used in operating activities, investing activities used approximately $2.6 million, and financing activities provided approximately $1.7 million. The difference between cash used in operating activities of approximately $8.8 million in 2004 as compared to cash provided by operating activities of approximately $6.4 million in 2003 is primarily due to increases in accounts receivable and contract inventories associated with contract requirements for significant material and subcontractor usage for which the billing and collections cycle had not been completed. The accounts receivable and contract inventories increases were partially offset by increases in net income and accounts payable and accrued expenses. Investing activities consisted of the purchase of property and equipment. Financing activities consisted of $1.6 million provided by bank loan proceeds, $518 thousand provided by the issuance of common stock to directors and officers associated with the exercise of stock options and directors' fees, and $401 thousand used to pay dividends.

The Company's cash and cash equivalents increased by approximately $5.6

million during 2003. Approximately $6.4 million in net cash was provided by operating activities, investing activities used approximately $720 thousand, and financing activities used approximately $34 thousand. Investing activities consisted of the purchase of property and equipment. Financing activities consisted of $349 thousand used to pay dividends and $315 thousand provided by the issuance of common stock to directors and officers associated with the exercise of stock options and directors' fees.

Quarterly cash dividends were paid at the rate of $.05 per share during the three month periods ended March 31 and June 30, 2005, and at the rate of $.06 per share during the three month periods ended September 30 and December 31, 2005. Pursuant to its bank loan agreement (see Note 8 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.

Liquidity

The Company's internal sources of liquidity result primarily from operating activities, specifically from changes in the level of revenues and associated accounts receivable and accounts payable from period to period, and from profitability. Significant increases or decreases in revenue and accounts receivable and accounts payable can cause significant increases or decreases in internal liquidity.

Accounts receivable arise primarily from billings made by the Company to the government or other government prime contractors for services rendered, and payments received on accounts receivable represent the principal source of cash for the Company. Accounts receivable levels can be affected significantly by the timing of large materials purchases and subcontractor efforts used in performance on the Company's contracts. Accounts receivable levels are also affected by contract retainages, differences between the provisional billing rates authorized by the government compared to the costs actually incurred by the Company, and government delays in processing administrative paperwork for contract funding.

Work on the TBPS program requires the Company to acquire inventories consisting of materials, supplies, and other expenditures for which end units have not yet been completed and accepted. Although these costs are classified as inventories for accounting purposes, they are similar in nature to materials and direct supplies purchased for use in performance on the Company's other contracts in that they are solely and directly attributable to the contract and will be billed to the customer within a relatively short time. All of the inventories are expected to be liquidated, billed, and collected as vehicle protection systems are completed and accepted by the government customer. These materials and direct supplies will not be restocked to maintain any permanent inventory levels.

Accounts payable arise primarily from purchases of subcontractor services and materials used by the Company in the performance of its contract work. Payments made on accounts payable, along with payments made to satisfy employee payroll and payroll associated expenses, make up the principal cash requirements of the Company. Accounts payable levels can be affected by changes in the level of contract work performed by the Company and by the timing of large materials purchases and subcontractor efforts used in performance on the Company's contracts.

Other cash requirements include income tax payments, the acquisition of capital assets for shop, office and computer support, and the payment of cash dividends. From time to time, the Company also invests in the expansion, improvement, and maintenance of its operational and administrative facilities. The Company expects to make approximately $643 thousand in such facilities investments and additional acquisitions of shop equipment in 2006 to support expected increases in the level of military equipment refurbishment efforts.

VSE's external sources of liquidity consist of a revolving bank loan agreement that provides loan financing based on the Company's accounts receivable (See Note 8 of "Notes to Consolidated Financial Statements"). The bank financing complements the internal sources of liquidity by providing increasing levels of borrowing capacity as accounts receivable levels increase.

The bank loan agreement provided loan financing up to a maximum commitment of $15 million as of December 31, 2005. The amount of this commitment is negotiable between the Company and the bank. The Company has determined that the current $15 million commitment amount is adequate to cover known current and future liquidity requirements.

Performance of work under the Company's larger contracts that require significant amounts of subcontractor or material purchases have the potential to cause substantial requirements for working capital; however, management



believes that cash flows from operations and the bank loan commitment are adequate to meet current operating cash requirements.

Contractual Obligations

The following table shows the consolidated contractual obligations for VSE as of December 31, 2005 (in thousands):

<TABLE>
<CAPTION>

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| Contractual Obligations | Total | Less than 1 year | 1-3 years | 4-5 years | After 5 years |
| Operating leases, net of non-cancelable sublease income . . . . . . . . | 6,792 | 2,487 | 4,042 | 263 | - |
| Purchase obligations . . | 451 | 451 | - | - | - |
| Total | $7,243 | $2,938 | $4,042 | $ 263 | $ - |

</TABLE>

Operating lease commitments are primarily for VSE's principal executive and administrative offices and leased facilities for office, shop, and warehouse space located near customer sites. The Company also has some equipment and software leases that are included in these amounts. In January 2006, the Company signed an additional five year facility lease for shop, office and warehouse space to begin in April 2006 for an aggregate amount of $668 thousand.

Purchase obligations consist primarily of contractual commitments associated with construction, improvements and maintenance on VSE facilities, and for the acquisition of office, shop, and computer equipment. The table excludes contractual commitments for materials or subcontractor work purchased to perform U.S. Government contracts. Such commitments for materials and subcontractors are reimbursable when used on the contracts, and generally are also reimbursable in the event a contract is "terminated for convenience" by the U.S. Government pursuant to federal contracting regulations.

## 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 not expected to be significant.

## Disclosures About Market Risk

Interest Rates

VSE's bank loan financing provides available borrowing to the Company at variable interest rates. The Company has not borrowed significant amounts on the loan in recent years. Accordingly, the Company does not believe that any movement in interest rates would have a material impact on future earnings or cash flows. If VSE were to significantly increase borrowings on the current loan arrangement, or enter into other loan arrangements, future interest rate changes could potentially have a material impact.

Foreign Currency

While a significant amount of the Company's business results from the services provided by BAV related to the transfer of ships to foreign governments, the BAV contract payments are made by the U.S. Government in U.S. dollars. Additionally, most funding requirements to support work performed or services purchased in foreign countries are made in U.S. dollars, and the infrequent disbursements that are made in foreign currencies are reimbursable to BAV in post conversion dollars. Foreign currency transactions of other VSE



divisions or subsidiaries are virtually non-existent. Accordingly, the Company does not believe that it is exposed to any material foreign currency.



ITEM 8. Financial Statements and Supplementary Data

Index To Financial Statements

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of VSE Corporation:

We have audited the accompanying consolidated balance sheets of VSE Corporation and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders' investment and cash flows for each of the three years in the period ended December 31, 2005. 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 the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of VSE Corporation and subsidiaries at December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

McLean, Virginia
February 23, 2006



<TABLE>
VSE Corporation and Subsidiaries
Consolidated Balance Sheets

(in thousands, except per share amounts)
<CAPTION>

| | As of December 31, 2005 | As of December 31, 2004 |
|---|---|---|
| <S> | <C> | <C> |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $12,717 | $ 130 |
| Accounts receivable, principally U.S. Government, net | 43,926 | 40,274 |
| Contract inventories | 4,273 | 8,504 |
| Deferred tax assets | 1,033 | 1,077 |
| Other current assets | 2,205 | 1,760 |
| Total current assets | 64,154 | 51,745 |
| Property and equipment, net | 4,583 | 4,310 |
| Deferred tax assets | 682 | 312 |
| Goodwill | 1,054 | 1,054 |
| Other assets | 3,393 | 2,931 |
| Total assets | $73,866 | $60,352 |
| Liabilities and Stockholders' Investment | | |
| Current liabilities: | | |
| Bank notes payable | $ - | $ 1,578 |
| Accounts payable | 29,752 | 26,383 |

| | | |
|---|---|---|
| Accrued expenses | 12,233 | 7,922 |
| Dividends payable | 141 | 114 |
| Total current liabilities | 42,126 | 35,997 |
| Deferred compensation | 1,589 | 1,312 |
| Total liabilities | 43,715 | 37,309 |
| Commitments and contingencies | | |
| Stockholders' investment: | | |
| Common stock, par value $.05 per share, authorized 5,000,000 shares; issued and outstanding 2,359,611 in 2005 and 2,276,688 in 2004 | 118 | 114 |
| Paid-in surplus | 6,348 | 4,879 |
| Deferred stock-based compensation | (1) | (4) |
| Retained earnings | 23,686 | 18,054 |
| Total stockholders' investment | 30,151 | 23,043 |
| Total liabilities and stockholders' investment | $73,866 | $60,352 |

</TABLE>

The accompanying notes are an integral part of these balance sheets.



<TABLE>

VSE Corporation and Subsidiaries

Consolidated Statements of Operations

(in thousands, except share and per share amounts)

<CAPTION>

| For the years ended December 31, | 2005 | 2004 | 2003 |
|---|---|---|---|
| Revenues, principally from contracts | $ 280,139 | $ 216,011 | $ 133,059 |
| Costs and expenses of contracts | 269,780 | 209,841 | 129,372 |
| Gross profit | 10,359 | 6,170 | 3,687 |
| Selling, general and administrative expenses | 580 | 636 | 351 |
| Interest (income) expense, net | (210) | (102) | (69) |
| Income before income taxes | 9,989 | 5,636 | 3,405 |
| Provision for income taxes | 3,820 | 2,191 | 1,315 |
| Income from continuing operations | 6,169 | 3,445 | 2,090 |
| Discontinued operations: | | | |
| Loss from operations before income taxes | - | (2) | (127) |
| Benefit for income taxes | - | (1) | (48) |
| Loss from discontinued operations | - | (1) | (79) |
| Net income | $ 6,169 | $ 3,444 | $ 2,011 |
| Basic earnings per share: | | | |
| Income from continuing operations | $ 2.66 | $ 1.54 | $ 0.96 |
| Loss from discontinued operations | 0.00 | 0.00 | (.04) |
| Net income | $ 2.66 | $ 1.54 | $ 0.92 |
| Basic weighted average shares outstanding | 2,322,736 | 2,231,848 | 2,189,197 |

| | | | |
|---|---|---|---|
| Diluted earnings per share: | | | |
| Income from continuing operations | $ 2.58 | $ 1.49 | $ 0.94 |
| Loss from discontinued operations | 0.00 | 0.00 | (0.04) |
| Net income . . . . . . . . . . . . . . . . | $ 2.58 | $ 1.49 | $ 0.90 |
| Diluted weighted average shares outstanding . . . . . . . . . . . . . . . . | 2,392,027 | 2,309,932 | 2,230,226 |

</TABLE>

The accompanying notes are an integral part of these statements.



<TABLE>
VSE Corporation and Subsidiaries
Consolidated Statements of Stockholders' Investment

(in thousands except per share data)
<CAPTION>

| | Common Stock Shares | Common Stock Amount | Paid-In Surplus | Deferred Stock-based Compensation | Retained Earnings | Total Stockholders' Investment |
|---|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Balance at December 31, 2002 . . . . | 2,186 | $ 109 | $ 3,558 | - | $ 13,376 | $17,043 |
| Net income for the year . . | - | - | - | - | 2,011 | 2,011 |
| Exercised stock options . . | 25 | 1 | 270 | - | - | 271 |
| Tax benefit of options exercised . . . . . . . | - | - | 14 | - | - | 14 |
| Deferred stock-based compensation . . . . . . | - | - | 42 | (42) | - | - |
| Amortization of deferred stock-based compensation. | - | - | - | 25 | - | 25 |
| Issuance of stock . . . . . | 3 | - | 44 | - | - | 44 |
| Dividends declared ($.16) . | - | - | - | - | (350) | (350) |
| Balance at December 31, 2003 | 2,214 | 110 | 3,928 | (17) | 15,037 | 19,058 |
| Net income for the year . . | - | - | - | - | 3,444 | 3,444 |
| Exercised stock options . . | 62 | 4 | 505 | - | - | 509 |
| Tax benefit of options exercised . . . . . . . | - | - | 433 | - | - | 433 |
| Deferred stock-based compensation . . . . . . | - | - | 4 | (4) | - | - |
| Amortization of deferred stock-based compensation. | - | - | - | 17 | - | 17 |
| Issuance of stock . . . . . | 1 | - | 9 | - | - | 9 |
| Dividends declared ($.19) . | - | - | - | - | (427) | (427) |
| Balance at December 31, 2004 | 2,277 | $ 114 | $ 4,879 | $ (4) | $ 18,054 | $23,043 |
| Net income for the year . . | - | - | - | - | 6,169 | 6,169 |
| Exercised stock options . . | 79 | 4 | 587 | - | - | 591 |
| Tax benefit of options exercised . . . . . . . | - | - | 761 | - | - | 761 |
| Deferred stock-based compensation . . . . . . | - | - | (3) | - | - | (3) |
| Amortization of deferred stock-based compensation. | - | - | - | 3 | - | 3 |
| Issuance of stock . . . . . | 4 | - | 124 | - | - | 124 |
| Dividends declared ($.23) . | - | - | - | - | (537) | (537) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Balance at December 31, 2005 | 2,360 | $ 118 | $ 6,348 | $ (1) | $ 23,686 | $30,151 |

</TABLE>

The accompanying notes are an integral part of these statements.



<TABLE>

VSE Corporation and Subsidiaries

Consolidated Statements of Cash Flows

(in thousands)

| <S> For the years ended December 31, | 2005 <C> | 2004 <C> | 2003 <C> |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income | $ 6,169 | $ 3,444 | $ 2,011 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Depreciation and amortization | 1,417 | 1,304 | 1,158 |
| Loss on sale of property and equipment | 1 | - | 7 |
| Deferred taxes | (326) | (273) | 646 |
| Tax benefit of options exercised | 761 | 433 | 14 |
| Amortization of deferred stock-based compensation | - | 17 | 25 |
| Change in operating assets and liabilities: | | | |
| (Increase) decrease in: | | | |
| Accounts receivable, net | (3,652) | (18,439) | (3,913) |
| Contract inventories | 4,231 | (8,504) | - |
| Other current assets and noncurrent assets | (932) | (801) | (246) |
| Increase (decrease) in: | | | |
| Accounts payable and deferred compensation | 3,646 | 12,655 | 5,669 |
| Accrued expenses | 4,311 | 1,332 | 1,016 |
| Net cash provided by (used in) operating activities | 15,626 | (8,832) | 6,387 |
| Cash flows from investing activities: | | | |
| Purchase of property and equipment | (1,666) | (2,576) | (720) |
| Net cash used in investing activities | (1,666) | (2,576) | (720) |
| Cash flows from financing activities: | | | |
| Net proceeds from (repayment of) bank loans | (1,578) | 1,578 | - |
| Dividends paid | (510) | (401) | (349) |
| Proceeds from the exercise of options of common stock | 591 | 508 | 271 |
| Proceeds from issuance of common stock | 124 | 10 | 44 |
| Net cash used in) provided by financing activities | (1,373) | 1,695 | (34) |
| Net increase (decrease) in cash and cash equivalents | 12,587 | (9,713) | 5,633 |
| Cash and cash equivalents at beginning of year | 130 | 9,843 | 4,210 |
| Cash and cash equivalents at end of year | $12,717 | $ 130 | $ 9,843 |

Supplemental cash flow disclosures (in thousands):

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Cash paid during the year for: | | | |
| Interest | $ 2 | $ - | $ - |
| Income taxes | $ 3,153 | $ 2,292 | $ 616 |

</TABLE>

The accompanying notes are an integral part of these statements.

(1) Summary of Significant Accounting Policies

(a) Principles of Consolidation

The consolidated financial statements consist of the operations of the parent company, operations of the Company's unincorporated divisions and wholly owned subsidiary. Energetics Incorporated ("Energetics") is currently VSE's only active subsidiary. Active divisions include BAV Division ("BAV"), Coast Guard Division ("VCG"), Communications and Engineering Division ("CED"), Fleet Maintenance Division ("FMD"), Management Sciences Division ("MSD"), and Systems Engineering Division ("SED").

VSE previously conducted business operations in other subsidiaries and divisions during the past three year period that have been dissolved or became inactive prior to December 31, 2005. These include Human Resource Systems, Inc. ("HRSI"), dissolved in 2004, Telecommunications Technologies Division ("TTD"), discontinued operations in 2004 and Information Assurance Division ("IAD", formerly Value Systems Services Division or "VSS"), inactive as of May 2005.

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 intercompany transactions have been eliminated in consolidation. Certain prior year balances have been reclassified for comparative purposes.

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

VSE operations are conducted within a single reporting segment and financial information is presented on a company-wide basis. The Company's segment includes all of the operations of the Company's subsidiaries and divisions as they have similar operations serving a similar customer base. The Company manages these services as a single segment that is divided into profit centers that are focused on contracts.

(b) Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires 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. Significant estimates affecting the financial statements include the allowance for doubtful accounts and accruals for loss contracts, contract disallowance and self insured health claims, and estimated cost to complete on certain fixed-price contracts.

(c) Accounting for Stock-based Compensation
<TABLE>
In 2005 and prior years, the Company used the disclosure-only provisions of SFAS 123, "Accounting for Stock-Based Compensation," as amended by SFAS 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." Accordingly, the Company accounts for stock-based compensation under Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations, using the intrinsic value method. The following table illustrates the effect on net income and earnings per share if



the Company had applied the fair value recognition provisions of SFAS 123 to all stock-based employee compensation (in thousands, except per share amounts):
<CAPTION>

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |

| | ---- | ---- | ---- |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| Net income, as reported . . . . . . . . | $6,169 | $3,444 | $2,011 |
| Add: Total stock-based employee compensation expense as reported under intrinsic value method (APB No. 25) for all awards, net of related tax effects . . . . . . . . | -- | 9 | 15 |
| Deduct: Total stock-based compensation expense determined under fair value based method (SFAS No. 123) for all awards, net of related tax effects . . | (294) | (126) | (68) |
| | ------ | ------ | ------ |
| Pro forma net income . . . . . . . . . | $5,875 | $3,327 | $1,958 |
| | ====== | ====== | ====== |
| Earnings per share: | | | |
| Basic - as reported . . . . . . . . . | $2.66 | $1.54 | $0.92 |
| Diluted - as reported . . . . . . . . | $2.58 | $1.49 | $0.90 |
| Basic - pro forma . . . . . . . . . . | $2.53 | $1.49 | $0.89 |
| Diluted - pro forma . . . . . . . . . | $2.46 | $1.44 | $0.88 |

</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 calculations for 2005, 2004, and 2003:
<CAPTION>

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| | ---- | ---- | ---- |
| <S> | <C> | <C> | <C> |
| Risk free interest rate . . . . . . . . | 3.28% | 2.47% | 2.18% |
| Dividend yield . . . . . . . . . . . . | 0.79% | 1.30% | 1.48% |
| Expected life . . . . . . . . . . . . . | 3 years | 3 years | 3 years |
| Expected volatility . . . . . . . . . . | 60.50% | 48.30% | 37.30% |

</TABLE>

In December 2004, the Financial Accounting Standards Board issued SFAS 123(R), "Share-Based Payment," which is a revision to SFAS 123. SFAS 123(R) supersedes APB Opinion No. 25 and amends SFAS 95, "Statement of Cash Flows." Generally, the approach in SFAS 123(R) is similar to the approach described in SFAS 123. However, SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. The Company will adopt SFAS 123(R), using the modified prospective method, on January 1, 2006.

On December 30, 2005, the board of directors of VSE Corporation (the "Board") directed VSE to discontinue, until and unless the Board determined otherwise, awarding options, both discretionary and nondiscretionary, to purchase VSE common stock ("VSE Stock") under VSE's 2004 Stock Option Plan approved by VSE' stockholders on May 3, 2005 (the "2004 Plan"). The options outstanding under the 2004 Plan, as of December 30, 2005, are not affected by this Board action. In addition, the options to purchase shares of VSE Stock under VSE's 1998 Stock Option Plan (the "1998 Plan") are not affected by this Board action.

The primary reason for the Board's suspension of option awards under the 2004 Plan was the potential impact on VSE's results of operations from the application of SFAS 123 (R) to share-based payments to employees, including stock option awards.



Had VSE adopted SFAS 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS 123 as described in the disclosure of pro forma net income and earnings per share above. The impact of adopting SFAS 123(R) is expected to be an increase in expenses, net of related tax effects, of approximately $155 thousand in 2006. SFAS 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. While the Company cannot estimate what those amounts will be in the future because they depend on, among other things, when employees exercise stock options, the amount of operating cash flows recognized for each of the last three years of the period ending December 31, 2005 for such excess tax deductions were approximately $761 thousand, $433 thousand, and $14 thousand for 2005, 2004 and 2003, respectively.

(d) Earnings Per Share

Basic earnings per share have been computed by dividing net income by the weighted average number of shares of common stock outstanding during each period. Shares issued during the period and shares reacquired during the period are weighted for the portion of the period that they were outstanding. Diluted earnings per share have been computed in a manner consistent with that of basic earnings per share while giving effect to all potentially dilutive common shares that were outstanding during each period. Potentially dilutive common shares include incremental common shares issuable upon exercise of stock options.

| | Years Ended December 31, 2005 | 2004 | 2003 |
|---|---|---|---|
| Basic weighted average common shares outstanding | 2,322,736 | 2,231,848 | 2,189,197 |
| Dilutive effect of options | 69,291 | 78,084 | 41,029 |
| Diluted weighted average common shares outstanding | 2,392,027 | 2,309,932 | 2,230,226 |

(e) Cash and Cash Equivalents

Cash and cash equivalents reported by the Company consist of cash balances in the Company's bank accounts and short term temporary invested balances netted by checks issued on the Company's bank accounts that have not yet been presented to the bank for collection. The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

(f) Contract Inventories

Contract inventories consist of materials purchased, advances to suppliers, and other expenditures arising from and solely and directly attributable to contract requirements. The cost of such contract inventories is expected to be billed to the customer within a relatively short time. These materials and direct supplies are purchased to satisfy contract requirements and are not restocked to maintain any permanent contract inventory levels.

Raw material contract inventories consist of advances to suppliers for materials for use in contract requirements for which work has not yet begun and are stated at cost. Work in process contract inventories consist of amounts for materials, supplies and other expenditures for which work has been performed but for which the end unit has not yet been completed and accepted. Work in process contract inventory is stated at cost plus applicable indirect cost burdens, including general and administrative costs. Pursuant to contract provisions, agencies of the U.S. Government and certain other customers have title to or a security interest in inventories related to such contracts as a result of



advances, performance based payments and progress payments. Such advances and payments are reflected as an offset against the related inventory balances.

(g) Property and Equipment

Property and equipment are stated at cost. Depreciation of computer systems equipment is provided principally by the double-declining method over periods of two to four years. Depreciation of furniture and fixtures is provided principally by the straight-line method over approximately nine years.

Depreciation of other equipment is provided principally by the double-declining method over periods of three to ten years. Depreciation of buildings and land improvements is provided principally by the straight-line method over periods of approximately twenty to thirty years. Amortization of leasehold improvements is provided by the straight-line method over the lesser of their useful life or the remaining term of the lease.

(h) 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, including assets of the deferred compensation plan and debt, approximate book value.

Contracts with the U.S. Government either as a prime or subcontractor, primarily with the U.S. Department of Defense, accounted for approximately 99% of revenues for each of the years ending December 31, 2005, 2004, and 2003. The BAV contract accounted for approximately 43%, 52% and 48% of consolidated revenues during 2005, 2004 and 2003, respectively.

(i) Contract Revenues

Substantially all of the Company's revenues result from contract services performed for the U.S. Government or for contractors engaged in work for the government under a variety of contracts. Revenue is considered earned when persuasive evidence of an arrangement exists, services have been rendered, the price is fixed and determinable and collectibility is reasonably assured.

Revenues on cost-type contracts are recorded as contract allowable costs are incurred and fees earned. Profits on cost-type contracts are equal to the fees that are earned. The BAV contract terms specify award fee payments that are determined by performance and level of contract activity. Award fees are made three times during the year and a contract modification authorizing the award fee payment is issued subsequent to the period in which the work is performed. The Company does not recognize award fee income until the fees are fixed and determinable, generally upon contract notification confirming the award fee. Due to such timing, and to fluctuations in the level of revenues, profits as a percentage of revenues on this contract will fluctuate from period to period.

Revenues for time and materials contracts are recorded on the basis of contract allowable labor hours worked multiplied by the contract defined billing rates, plus the direct costs and indirect cost burdens associated with materials and subcontract work used in performance on the contract. Profits on time and material contracts result from the difference between the cost of services performed and the contract defined billing rates for these services.

Revenue recognition methods on fixed-price contracts will vary depending on the nature of the work and the contract terms. On certain fixed-price contracts revenues are recorded as costs are incurred, using the percentage-of-completion method of accounting, since these contracts require design, engineering, and manufacturing performed to the customer's specifications. Revenues on fixed-price service contracts are recorded as work is performed.



Revenues on fixed-price contracts that require delivery of specific items may be recorded based on a price per unit as units are delivered. Profits on fixed-price contracts result from the difference between the incurred costs and the revenue earned.

Revenue related to work performed on contracts at risk, which is work performed at the customer's request prior to the government formalizing funding, is not recognized as income until it can be reliably estimated and its realization is probable. The Company provides for anticipated losses on contracts, based on total contract revenue compared to total contract costs, by a charge to income during the period in which losses are first identified. Contract costs include direct and indirect costs, including general and administrative costs, which are considered costs and expenses of contracts.

Certain direct and incremental contract costs have been deferred and reported as a current asset prior to the recognition of revenue. Such costs are amortized over the life of the contract.

A substantial portion of 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 2002 and prior years and these completed audits have not resulted in material adjustments to the Company's results of operations or financial position. While the Company maintains reserves to cover the risk of potential future audit adjustments based primarily on the results of prior audits, there can be no assurances that the audits of the indirect cost rates for 2005, 2004 and 2003 will not result in material adjustments to the Company's results of operations or financial position.

The Company establishes allowances for collection of doubtful accounts. The Company assesses the adequacy of these reserves by considering general factors, such as the length of time individual receivables are past due and historical collection experience. The Company believes that the established valuation allowances are adequate.

(j) Deferred Compensation Plans

Deferred compensation plan expense for the years ended December 31, 2005, 2004, and 2003 was $421 thousand, $240, and $0 thousand, respectively.

Included in other assets are assets of the deferred compensation plans which include debt and equity securities recorded at fair value. The fair value of the deferred compensation plan assets was approximately $1.6 million and $1.3 million as of December 31, 2005, and 2004, respectively. Because plan participants are at risk for market value changes in these assets, the liability to plan participants fluctuates with the asset values.

(k) Impairment of Long-Lived Assets

Long-lived assets includes property and equipment to be held and used. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount should be addressed pursuant to SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," ("SFAS No. 144"). The criteria for determining impairment for such long-lived assets to be held and used is determined by comparing the carrying value of these long-lived assets to management's best estimate of future undiscounted cash flows expected to result from the use of the assets. The Company believes that no impairment existed under SFAS No. 144 as of December 31, 2005.

(l) Income Taxes

Income taxes are accounted for under the asset and liability method in accordance with FASB Statement No. 109, "Accounting for Income Taxes." Under the asset and liability method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. This method also requires the recognition of future



tax benefits such as net operating loss carryforwards, to the extent that realization of such benefits is more likely than not. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The carrying value of VSE net deferred tax assets is based on assumptions regarding VSE's ability to generate sufficient future taxable income to utilize these deferred tax assets. If the estimates and related assumptions regarding VSE's future taxable income change in the future, VSE may be required to record valuation allowances against its deferred tax assets, resulting in additional income tax expense. Management believes that the deferred tax assets will be realized through future taxable income and, therefore, no valuation allowance is required.

(m) Discontinued Operations

In July 2004, all business operations associated with the Company's TTD division ceased. Accordingly, prior period consolidated financial statements have been restated to reflect the financial results of TTD as discontinued operations. The revenues, costs and expenses of TTD have been excluded from the respective captions in the Consolidated Statement of Operations. The revenues from discontinued operations associated with TTD in the years ended December 31, 2004 and 2003 were approximately $9 thousand and $1.4 million, respectively. The loss from discontinued operations associated with TTD, net of tax, in the years ended December 31, 2004 and 2003 was approximately $1 thousand and $79 thousand, respectively. Approximately $6 thousand net current liabilities comprised primarily of payables and approximately $5 thousand net current assets comprised primarily of receivables, related to TTD, were included in the December 31, 2005 and December 31, 2004 balance sheets, respectively.

(n) Goodwill

SFAS No. 142 does not permit amortization of goodwill, but requires a review for impairment at least annually, or more frequently if an asset might be impaired, using a fair-value based approach. See Note 7 of the Company's consolidated financial statements for further discussion.

(2) Accounts Receivable

<TABLE>

The components of accounts receivable as of December 31, 2005 and 2004, were as follows (in thousands):

<CAPTION>

| | 2005 | 2004 |
|---|---|---|
| <S> | <C> | <C> |
| Billed .................... | $14,218 | $15,777 |
| Unbilled: | | |
| Government retainage ............ | 65 | 35 |
| Subcontract retainage ............ | 4,160 | 4,700 |
| Other (principally December work billed in January) ................. | 25,539 | 19,814 |
| Less-Allowance for doubtful accounts ..... | (56) | (52) |
| Total accounts receivable, net | $43,926 | $40,274 |

</TABLE>

Unbilled subcontract retainage includes amounts withheld from payments to subcontractors.

The "Unbilled: Other" includes certain costs for work performed at risk but which the Company believes will be funded by the government. Amounts not presently funded included in "Unbilled: Other" were $21 thousand and $56 thousand as of December 31, 2005, and 2004, respectively.



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

<TABLE>

The following table summarizes activity in the allowance for doubtful accounts (in thousands):

<CAPTION>

| Allowance for Doubtful Accounts | Balance at Beginning of Period | Additions Charged to Costs and Expenses | Deductions(1) | Balance at End of Period |
|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> |
| For the year ended December 31, 2005 ......... | $52 | $22 | $26 | $56 |
| For the year ended December 31, 2004 ......... | 77 | 35 | 10 | 52 |
| For the year ended December 31, 2003 ......... | 99 | 87 | 65 | 77 |

(1) Write-offs and settlements
</TABLE>

(3) Other Current Assets

Other current assets consisted of the following as of December 31, 2005 and 2004 (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Prepaid materials | $ 392 | $ 88 |
| Prepaid rent expense | 345 | 208 |
| Travel advances | 299 | 271 |
| Federal and state tax receivable | 171 | 401 |
| Prepaid software license | 164 | 95 |
| Deferred contract costs | 106 | - |
| Other | 728 | 697 |
| Total other current assets | $2,205 | $1,760 |

(4) Contract Inventories

The components of contract inventories as of December 31, 2005 and 2004 were as follows (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Raw material | $ - | $4,783 |
| Work in process | 9,965 | 3,721 |
| | 9,965 | 8,504 |
| Less: Progress payments and customer advances received | (5,692) | - |
| Total contract inventories | $4,273 | $8,504 |

Inventories at December 31, 2005 and 2004 consisted of materials purchased, advances to suppliers, and other expenditures for use in a contract to modify and apply a protective system, the Tanker Ballistic Protection System ("TBPS"), to military vehicles for the U.S. Army. This contract was awarded to VSE in November 2004.

Although these costs are classified as inventories for accounting purposes, they are similar in nature to materials and direct supplies purchased for use in performance on the Company's other contracts in that they are solely and directly attributable to the contract and will be billed to the customer within a relatively short time. These materials and direct supplies will not be restocked to maintain any permanent inventory levels. Contract inventories are relieved when units are delivered and revenue is recognized.



Raw materials inventories consist of advances to suppliers for materials for use on this contract but on which work has not yet begun. Work in process inventories consist of amounts for materials, supplies and other expenditures for which work has been performed but for which the end unit has not yet been completed and accepted. Work in process inventories at December 31, 2005 and 2004 included applicable indirect cost burdens, including general and administrative costs totaling approximately $1.3 million and $442 thousand, respectively. Indirect cost burdens, including general and administrative costs charged to cost of sales from inventories for the years ended December 31, 2005 and 2004 totaled $3.4 million and $0, respectively.

(5) Other Assets
<TABLE>
Other assets consisted of the following as of December 31, 2005 and 2004 (in thousands):
<CAPTION>

| | 2005 | 2004 |
|---|---|---|
| Cash surrender value of life insurance | $ 1,432 | $ 1,347 |
| Deferred compensation | 1,589 | 1,312 |
| Other assets | 372 | 272 |
| Total other assets | $ 3,393 | $ 2,931 |

</TABLE>

(6) Property and Equipment

<TABLE>

Property and equipment (recorded at cost) consisted of the following as of December 31, 2005 and 2004(in thousands):

<CAPTION>

| | 2005 | 2004 |
|---|---|---|
| Computer systems equipment | $ 4,591 | $ 4,360 |
| Furniture, fixtures, equipment and other | 3,168 | 2,877 |
| Leasehold improvements | 2,799 | 2,607 |
| Buildings | 1,259 | 1,050 |
| Land and land improvements | 385 | 385 |
| | 12,202 | 11,279 |
| Less accumulated depreciation and amortization | (7,619) | (6,969) |
| Total property and equipment | $ 4,583 | $ 4,310 |

</TABLE>

Depreciation and amortization expense for property and equipment was approximately $1.4 million for 2005, $1.3 million for 2004 and approximately $1.2 million for 2003.

(7) Goodwill and Intangible Assets

As part of the August 29, 1995, acquisition of Energetics, the Company recorded approximately $1.7 million of goodwill. Between 1995 and 2001, VSE amortized the goodwill by the straight-line method using a fifteen year life. In accordance with SFAS No. 142, VSE stopped amortizing the goodwill in January 2002, but continues to review it at least annually, or more frequently, if this asset might be impaired, to determine if impairment has occurred. Approximately $1.1 million of unamortized goodwill remains on the books as of December 31, 2005.

(8) Debt

VSE has a loan agreement with a bank under which credit is made available to the Company in the form of revolving loan amounts or letters of credit. The amount of credit available to the Company is $15 million, subject to certain conditions, including a borrowing formula based on billed receivables. The expiration date of the loan agreement is May 31, 2007. From time to time the bank and the Company may negotiate an amendment to the loan to increase or



decrease the amount of available credit or to change the expiration date to a later date.

The loan agreement contains terms whereby the Company may borrow against the revolving loan and has the option at any time and from time to time to prepay such borrowings in whole or in part without premium or penalty. There are collateral requirements by which Company assets secure amounts outstanding, restrictive covenants that include minimum tangible net worth and profitability requirements, a limit on annual dividends, and other affirmative and negative covenants. As of December 31, 2005 the Company has not been notified by the bank, nor is the Company aware of any non-compliance with any of the bank loan covenants.

The Company pays a fixed annual commitment fee of $20 thousand, interest on any revolving loan borrowings at a prime-based rate or an optional LIBOR-based rate, and fees on any letters of credit that are issued. As of December 31, 2005, there were no revolving loan amounts outstanding and one letter of credit for approximately $192 thousand. Amounts outstanding under this loan agreement as of December 31, 2004 were approximately $1.6 million in revolving loan borrowings and no letters of credit. Interest expense incurred for revolving loan amounts borrowed was approximately $1 thousand for each year in 2005 and 2004. There was no borrowing and no interest expense for 2003.

(9) Accrued Expenses

The components of accrued expenses as of December 31, 2005 and 2004, were as follows (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Accrued bonus | $ 4,040 | $1,856 |
| Accrued vacation | 1,951 | 1,661 |
| Accrued salaries | 1,745 | 1,432 |
| Billed amounts in excess of revenue recognition | 1,618 | 470 |
| Estimated contract disallowances | 499 | 467 |
| Accrued pension and 401(k) contributions | 446 | 468 |
| Accrued deferred compensation | 419 | 156 |
| Estimated future losses on contracts | 320 | 480 |
| Accrued workers compensation | 214 | - |
| Other accrued expenses | 981 | 932 |
| Total accrued expenses | $12,233 | $7,922 |

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

VSE has an ESOP/401(k) plan that allows employees meeting certain age and service requirements to contribute a portion of their salary to certain investment trusts. Under the terms of the plan, 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 6% of the employee pay deferred. The Company expense associated with this plan for 2005, 2004, and 2003 was $578 thousand, $415 thousand, and $262 thousand, respectively.

Prior to April 1, 1999, the Company made contributions under this plan into an ESOP 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. Subsequent to April 1, 1999, the ESOP contributions were discontinued and replaced by employer 401(k) contributions. The ESOP/401(k) plan held 262,913 shares and 281,933 shares of VSE stock as of December 31, 2005 and 2004, respectively. Such shares receive dividend payments and are included in the weighted average shares for earnings per share calculations.



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 2005, 2004, and 2003 was $420 thousand, $443 thousand, and $429 thousand, respectively.

(11) Stock Option Plans

On December 30, 2005, the board of directors of VSE Corporation (the "Board") directed VSE to discontinue, until and unless the Board determined otherwise, awarding options, both discretionary and nondiscretionary, to purchase VSE common stock ("VSE Stock") under VSE's 2004 Stock Option Plan approved by VSE' stockholders on May 3, 2005 (the "2004 Plan"). The options outstanding under the 2004 Plan, as of December 30, 2005, are not affected by this Board action. In addition, the options to purchase shares of VSE Stock under VSE's 1998 Stock Option Plan (the "1998 Plan") are not affected by this Board action.

The primary reason for the Board's suspension of option awards under the 2004 Plan was the potential impact on VSE's results of operations from the application of SFAS 123 (R) to share-based payments to employees, including stock option awards.

(a) 2004 Stock Option Plan

As of December 31, 2005, options issued under the 2004 Plan for up to 68,250 shares of VSE Common Stock, par value $.05 per share ("shares" or "VSE Stock") remain outstanding. Each option granted under the 2004 Plan was issued at the fair market value of VSE shares on the date of grant. Each option vests 25% on date of award and 25% on each anniversary date thereafter, becoming 100% vested as of the third anniversary date of award. The 2004 Plan will terminate on the earliest of May 1, 2014, or the date on which all options issued under the 2004 Plan have been exercised, expire, or have been terminated.

(b) 1998 Stock Option Plan

As of December 31, 2005, options issued under the 1998 Plan for up to 129,313 shares remain outstanding. The 1998 Plan will terminate on the earliest of May 6, 2008, or the date on which all options issued under the 1998 Plan have been exercised, expire, or have been terminated.

<TABLE>

Information with respect to stock options is as follows:

<CAPTION>

| <S> | 2005 <C> | Weighted Average Exercise Price <C> | 2004 <C> | Weighted Average Exercise Price <C> | 2003 <C> | Weighted Average Exercise Price <C> |
|---|---|---|---|---|---|---|
| Number of shares under stock options: | | | | | | |
| Outstanding at beginning of year . . . . . . . . | 211,625 | $ 9.51 | 212,250 | $ 8.07 | 185,000 | $ 7.66 |
| Granted . . . . . . . . | 70,000 | 25.17 | 65,500 | 12.82 | 68,750 | 10.85 |
| Exercised . . . . . . . | (79,312) | 7.45 | (62,125) | 8.19 | (24,875) | 10.89 |
| Forfeited . . . . . . . | (4,750) | - | - | - | (4,625) | 10.18 |
| Terminations . . . . . . | - | - | (4,000) | 8.03 | (12,000) | 10.93 |
| Outstanding at end of year | 197,563 | $15.83 | 211,625 | $ 9.51 | 212,250 | $ 8.07 |
| Exercisable at end of year . . . . . . . . | 146,438 | $13.93 | 161,938 | $ 8.70 | 127,250 | $ 7.45 |
| Weighted average remaining contractual life . . . | 3 years | | 2 years | | 1 year | |
| Weighted average fair value of options granted | $4.70 | | $2.76 | | $2.80 | |

</TABLE>



<TABLE>

The following table summarizes the range of exercise prices for options outstanding at December 31, 2005:

<CAPTION>

| | Outstanding Options | | | Exercisable Options | |
|---|---|---|---|---|---|
| Range of Exercise Prices <S> | Number of Shares <C> | Weighted Average Contractual Life (in years) <C> | Weighted Average Exercise Price <C> | Number of Shares <C> | Weighted Average Exercise Price <C> |
| $6.62 . . . . . . . . . | 24,750 | 1 | $ 6.62 | 24,750 | $ 6.62 |
| $10.73 . . . . . . . . . | 45,438 | 2 | 10.73 | 45,438 | 10.73 |
| $12.82 . . . . . . . . . | 59,125 | 3 | 12.82 | 43,000 | 12.82 |
| $25.17 . . . . . . . . . | 68,250 | 4 | 25.17 | 33,250 | 25.17 |

| | | | | | |
|---|---|---|---|---|---|
| Total | 197,563 | 3 | $15.83 | 146,438 | $13.93 |
| | ======= | = | ====== | ======= | ====== |

</TABLE>

The Company accounts for stock-based employee compensation using the intrinsic value method prescribed in APB Opinion No. 25 and related interpretations. The total stock-based employee compensation expense, net of tax effects, as of December 31, 2005 and 2004, was approximately $0 thousand and $9 thousand, respectively.

(12) Income Taxes

<TABLE>

The Company files consolidated federal income tax returns with all of its subsidiaries. The components of the provision for income taxes from continuing operations for the years ended December 31, 2005, 2004, and 2003 are as follows (in thousands):

<CAPTION>

| <S> | 2005 <C> | 2004 <C> | 2003 <C> |
|---|---|---|---|
| Current | | | |
| Federal . . . . . . . . . . . . . . . . . . | $3,475 | $1,989 | $ 796 |
| State . . . . . . . . . . . . . . . . . . . | 671 | 475 | 244 |
| | 4,146 | 2,464 | 1,040 |
| Deferred | | | |
| Federal . . . . . . . . . . . . . . . . . . | (288) | (202) | 275 |
| State . . . . . . . . . . . . . . . . . . | (38) | (71) | - |
| | (326) | (273) | 275 |
| Provision for income taxes . . . . . . . . . . | $3,820 | $2,191 | $1,315 |
| | ====== | ====== | ====== |

</TABLE>

<TABLE>

The benefit for income taxes from discontinued operations for the years ended December 31, 2005, 2004 and 2003 are as follows (in thousands):

<CAPTION>

| <S> | 2005 <C> | 2004 <C> | 2003 <C> |
|---|---|---|---|
| Current . . . . . . . . . . . . . . . . . . . | $ - | $ (1) | $(419) |
| Deferred . . . . . . . . . . . . . . . . . . . | - | - | 371 |
| Total income tax benefit | $ - | $ (1) | $ (48) |
| | ===== | ===== | ===== |

</TABLE>

<TABLE>

The differences between the amount of tax computed at the federal statutory rate of 34% and the provision for income taxes for 2005, 2004, and 2003 are as follows (in thousands):

<CAPTION>

| <S> | 2005 <C> | 2004 <C> | 2003 <C> |
|---|---|---|---|
| Tax at statutory federal income tax rate at 34% . . . . . . . . . . . . . . | $3,396 | $1,916 | $1,158 |
| Increases (decreases) in tax resulting from: | | | |
| State taxes, net of federal tax benefit . . | 417 | 266 | 160 |
| Permanent differences, net . . . . . . . . | 6 | 9 | (6) |
| Other, net . . . . . . . . . . . . . . . . | 1 | - | 3 |
| Provision for income taxes . . . . . . . . . . | $3,820 | $2,191 | $1,315 |
| | ====== | ====== | ====== |

</TABLE>



<TABLE>

The Company's deferred tax assets (liabilities) as of December 31, 2005 and 2004 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> | 2005 <C> | 2004 <C> |
|---|---|---|
| Current deferred tax assets | $1,247 | $1,173 |
| Current deferred tax liabilities | (214) | (96) |
| Net current deferred tax assets | 1,033 | 1,077 |
| Noncurrent deferred tax assets | 1,480 | 1,109 |
| Noncurrent deferred tax liabilities | (798) | (797) |
| Net noncurrent deferred tax assets | 682 | 312 |
| Net deferred tax assets | $1,715 | $1,389 |

</TABLE>
<TABLE>

The tax effect of temporary differences representing deferred tax assets and liabilities as of December 31, 2005 and 2004, are as follows (in thousands):

<CAPTION>

| <S> | 2005 <C> | 2004 <C> |
|---|---|---|
| Deferred compensation and accrued paid leave | $1,558 | $1,221 |
| Reserve for contract and other disallowances | 198 | 165 |
| Reserve for future losses | 126 | 186 |
| Accrued expenses | 101 | 75 |
| Accelerated depreciation | 65 | (133) |
| Reserve for doubtful accounts | 16 | 32 |
| Retainages not taxed until billed | (7) | (9) |
| Deferred revenues | (180) | (50) |
| Intangible assets | (185) | (139) |
| Other | 23 | 41 |
| Net deferred tax assets | $1,715 | $1,389 |

</TABLE>

(13) Commitments and Contingencies

(a) Leases and other commitments

<TABLE>

The Company and its subsidiaries have various non-cancelable operating leases for facilities, equipment, and software with terms between two and ten years. Rent expense is recognized on a straight-line basis for rent agreements having escalating rent. Payments on these leases for 2005, 2004, and 2003 were:

<CAPTION>

| | (in thousands) | | |
|---|---|---|---|
| <S> | Payments on Leases <C> | Sublease Income <C> | Net Expense <C> |
| 2005 | $3,733 | $ 922 | $2,811 |
| 2004 | 3,692 | 566 | 3,126 |
| 2003 | 3,289 | 637 | 2,652 |

</TABLE>
<TABLE>

Future minimum annual non-cancelable commitments as of December 31, 2005 are as follows:

<CAPTION>

| | (in thousands) | | |
|---|---|---|---|
| <S> | Payments on Leases <C> | Sublease Income <C> | Net Expense <C> |
| 2006 | $ 3,396 | $ 909 | $2,487 |
| 2007 | 2,919 | 910 | 2,009 |
| 2008 | 1,876 | 390 | 1,486 |
| 2009 | 642 | 95 | 547 |
| 2010 | 263 | - | 263 |
| Thereafter | - | - | - |

| | | | |
|---|---|---|---|
| Total | $ 9,096 | $2,304 | $6,792 |

</TABLE>



(b) Contingencies

VSE and its subsidiaries have, in the normal course of business, certain claims against them and against other parties. In the opinion of management, the resolution of these claims will not have a material adverse effect on the Company's results of operations or financial position. However, the results of any legal proceedings cannot be predicted with certainty.



(14) Selected Quarterly Data (Unaudited)

<TABLE>

The following table shows selected quarterly data for 2005 and 2004, in thousands, except earnings per share:

<CAPTION>

| | 2005 Quarters | | | |
|---|---|---|---|---|
| | 1st | 2nd | 3rd | 4th |
| <S> | <C> | <C> | <C> | <C> |
| Revenues . . . . . . . . . . . . . . . . | $65,919 | $72,682 | $76,600 | $64,938 |
| Gross profit . . . . . . . . . . . . . . | $ 2,164 | $ 2,966 | $ 2,717 | $ 2,512 |
| Income from continuing operations . . . | $ 1,304 | $ 1,765 | $ 1,587 | $ 1,513 |
| Loss from discontinued operations . . . | - | - | - | - |
| Net income . . . . . . . . . . . . . . . | $ 1,304 | $ 1,765 | $ 1,587 | $ 1,513 |
| Basic earnings per share: | | | | |
| Income from continuing operations . . . | $ .57 | $ .76 | $ .68 | $ .64 |
| Loss from discontinued operations . . . | - | - | - | - |
| Net income per share . . . . . . . . . . | $ .57 | $ .76 | $ .68 | $ .64 |
| Weighted average shares outstanding . . | 2,279 | 2,311 | 2,348 | 2,351 |
| Diluted earnings per share: | | | | |
| Income from continuing operations . . . | $ .55 | $ .74 | $ .66 | $ .63 |
| Loss from discontinued operations . . . | - | - | - | - |
| Net income per share . . . . . . . . . . | $ .55 | $ .74 | $ .66 | $ .63 |
| Weighted average shares outstanding . . | 2,354 | 2,377 | 2,417 | 2,419 |

| | 2004 Quarters | | | |
|---|---|---|---|---|
| | 1st | 2nd | 3rd | 4th |

| | | | | |
|---|---|---|---|---|
| Revenues | $42,609 | $54,037 | $62,223 | $57,142 |
| Gross profit | $ 1,147 | $ 1,613 | $ 1,604 | $ 1,806 |
| Income from continuing operations | $ 708 | $ 855 | $ 885 | $ 997 |
| Loss from discontinued operations | - | (1) | - | - |
| Net income | $ 708 | $ 854 | $ 885 | $ 997 |
| Basic earnings per share: | | | | |
| Income from continuing operations | $ .32 | $ .38 | $ .40 | $ .44 |
| Loss from discontinued operations | - | - | - | - |
| Net income per share | $ .32 | $ .38 | $ .40 | $ .44 |
| Weighted average shares outstanding | 2,216 | 2,222 | 2,225 | 2,264 |
| Diluted earnings per share: | | | | |
| Income from continuing operations | $ .31 | $ .37 | $ .38 | $ .43 |
| Loss from discontinued operations | - | - | - | - |
| Net income per share | $ .31 | $ .37 | $ .38 | $ .43 |
| Weighted average shares outstanding | 2,287 | 2,306 | 2,301 | 2,346 |

</TABLE>



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

None.

ITEM 9A. Controls and Procedures

As of the end of the period covered by this report, based on our management's evaluation, with the participation of VSE's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d - 15(e) under the Securities Exchange Act of 1934, as amended) our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective in ensuring that information required to be disclosed by us in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There was no change in our internal control over financial reporting during our fourth quarter of fiscal 2005 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. Other Information

None.

PART III

Except as otherwise indicated below, the information required by Items 10, 11, 12, 13 and 14 of Part III of Form 10-K has been omitted in reliance of General Instruction G(3) and is incorporated herein by reference to the Company's definitive proxy statement relating to its Annual Meeting of Stockholders scheduled for May 2, 2006 (the "Proxy Statement") to be filed with the SEC, except as otherwise indicated below:

ITEM 10. Directors and Executive Officers of the Registrant

The information required by this Item is incorporated by reference to the Proxy Statement.

ITEM 11. Executive Compensation

The information required by this Item is incorporated by reference to the Proxy Statement except for the text thereof under the captions "Compensation Committee Report" and "Performance Graph."

ITEM 12. Security Ownership of Certain Beneficial Owners and Management

Except for the "Equity Compensation Plan Information" disclosed in Item 5(d) above, the information required by this Item is incorporated by reference to the Proxy Statement.

ITEM 13. Certain Relationships and Related Transactions

The information required by this Item is incorporated by reference to the Proxy Statement.



ITEM 14. Principal Accountant Fees and Services

The information required by this Item is incorporated by reference to the Proxy Statement.

PART IV

ITEM 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

1. Financial Statements

The consolidated financial statements are listed under Item 8 of this report.

2. 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, notes to the consolidated financial statements, or supplementary financial information.

3. Exhibits

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

4. Reports on Form 8-K

On January 6, 2006, the Registrant filed a Current Report on Form 8-K to report that on December 30, 2005, the Registrant's board of directors (the "Board") directed VSE Corporation to discontinue, until and unless the Board determined otherwise, awarding options, both discretionary and nondiscretionary, to purchase VSE common stock under VSE's 2004 Stock Option Plan approved by VSE's stockholders on May 3, 2004.

On November 3, 2005, the Registrant filed a Current Report on Form 8-K to report Amended and Restated By-Laws of VSE Corporation, as of November 1, 2005.

On October 31, 2005, the Registrant filed a Current Report on Form 8-K to announce the financial results of the third quarter 2005.

## 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 7, 2006 By: /s/ D. M. Ervine
---------------------------
D. M. Ervine
Chairman, President,
Chief Executive Officer and
Chief Operating Officer

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

| Name | Title | Date |
|---|---|---|
| /s/ Donald M. Ervine<br>- ----------------------------<br>Donald M. Ervine | Chairman, President,<br>Chief Executive Officer,<br>Chief Operating Officer | March 7, 2006 |
| /s/ Craig S. Weber<br>- ----------------------------<br>Craig S. Weber | Executive Vice President,<br>Chief Administrative<br>Officer, Secretary | March 7, 2006 |
| /s/ Thomas R. Loftus<br>- ----------------------------<br>Thomas R. Loftus | Senior Vice President and<br>Chief Financial Officer<br>Principal Financial and<br>Accounting Officer) | March 7, 2006 |
| /s/ Clifford M. Kendall<br>- ----------------------------<br>Clifford M. Kendall | Director | March 7, 2006 |
| /s/ Calvin S. Koonce<br>- ----------------------------<br>Calvin S. Koonce | Director | March 7, 2006 |
| /s/ James F. Lafond<br>- ----------------------------<br>James F. Lafond | Director | March 7, 2006 |
| /s/ David M. Osnos<br>- ----------------------------<br>David M. Osnos | Director | March 7, 2006 |
| /s/ Jimmy D. Ross<br>- ----------------------------<br>Jimmy D. Ross | Director | March 7, 2006 |
| /s/ Bonnie K. Wachtel<br>- ----------------------------<br>Bonnie K. Wachtel | Director | March 7, 2006 |



## 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<br>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 November 1, 2005 *

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 December 10, 1997, by and between VSE Corporation and Craig S. Weber (Exhibit VIII to form 10-K dated March 7, 2001) *
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 to Form 10-K dated March 15, 2000) *
Employment Agreement dated as of March 10, 2004, By and between VSE Corporation and Thomas G. Dacus (Exhibit 10.1 to form 10-Q dated April 28, 2004) *
Employment Agreement dated as of July 1, 2004, By and between VSE Corporation and Thomas R. Loftus (Exhibit 10.1 to form 10-Q dated July 30, 2004) *
VSE Corporation Deferred Supplemental Compensation Plan effective January 1, 1994 as amended by the Board through March 9, 2004 (Exhibit 10.2 to Form 10-Q dated April 28, 2004) *
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) *



EXHIBIT INDEX

| Reference No. per Item 601 of Regulation S-K | Description of Exhibit | Exhibit No. in this Form 10-K |
|---|---|---|
| | 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) | * |
| | VSE Corporation 2004 Stock Option Plan (Appendix B to Registrant's definitive proxy statement for the Annual Meeting of Stockholders held on May 3, 2004) | * |
| | VSE Corporation 2004 Non-employee Directors Stock Plan (Appendix C to Registrant's definitive proxy statement for the Annual Meeting of Stockholders held on | |

| | | |
|---|---|---|
| | May 3, 2004) | * |
| 12 | Statements re computation of ratios | Not Applicable |
| 13 | Annual report to security holders, Form 10-Q or selected quarterly data | Exhibit 13 |
| 16 | Letter re change in certifying accountant | Not Applicable |
| 18 | Letter re change in accounting principles | Not Applicable |
| 21 | Subsidiaries of the Registrant | Exhibit 21 |
| 22 | Published report regarding matters submitted to vote of security holders | Not Applicable |
| 23.1 | Consent of independent registered public accounting firm | Exhibit 23.1 |
| 24 | Power of attorney | Not Applicable |
| 31.1 | Section 302 CEO Certification | Exhibit 31.1 |
| 31.2 | Section 302 CFO and PAO Certification | Exhibit 31.2 |
| 32.1 | Section 906 CEO Certification | Exhibit 32.1 |
| 32.2 | Section 906 CFO and PAO Certification | Exhibit 32.2 |
| 99 | Audit Committee Charter (as adopted by the Board Of Directors of VSE Corporation on March 9, 2004 (Appendix A to Registrant's definitive proxy Statement for the Annual Meeting of Stockholders held on May 3, 2004 | * |

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

Exhibit 21

SUBSIDIARIES OF THE REGISTRANT

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

| | Jurisdiction of Organization |
|---|---|
| Energetics Incorporated | Maryland |
| VSE Services International, Inc. | Delaware |

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements (Form S-8 File Numbers 333-15307 pertaining to the Employee ESOP/401(k) Plan, 333-15311 pertaining to the 1996 Stock Option Plan, 333-92427 pertaining to the 1998 Non-employee Directors Stock Plan and 1998 Stock Option Plan, 333-109561 pertaining to the 1998 Stock Option Plan, and 333-115218 pertaining to the 2004 Stock Option Plan and 2004 Non-employee Directors Stock Plan and Form S-3 File Number 333-15309 pertaining to the Non-employee Directors Stock Plan,) of VSE Corporation of our report dated February 23, 2006, with respect to the consolidated financial statements of VSE Corporation and subsidiaries included in this Annual Report (Form 10-K) for the year ended December 31, 2005.

/s/ Ernst & Young LLP

McLean, Virginia
March 7, 2006

Exhibit 31.1

CERTIFICATION PURSUANT TO
RULE 13A-14 OF THE SECURITIES EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, D. M. Ervine, Chairman, President, Chief Executive Officer and Chief Operating Officer of the Company, certify that:

1. I have reviewed this annual report on Form 10-K of VSE Corporation (the "Registrant");

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this annual report;

4. The Registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Registrant and we have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

(b) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this annual report based on such evaluation; and

(c) disclosed in this annual report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the Registrant's auditors and the audit committee of Registrant's Board of Directors (or persons performing the equivalent function):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: March 8, 2006 /s/ D. M. Ervine

D. M. Ervine
Chairman, President,
Chief Executive Officer and
Chief Operating Officer

Exhibit 31.2

CERTIFICATION PURSUANT TO
RULE 13A-14 OF THE SECURITIES EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, T. R. Loftus, Senior Vice President and Chief Financial Officer of the Company, certify that:

1. I have reviewed this annual report on Form 10-K of VSE Corporation (the "Registrant");

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this annual report;

4. The Registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Registrant and we have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

(b) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this annual report based on such evaluation; and

(c) disclosed in this annual report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the Registrant's auditors and the audit committee of Registrant's Board of Directors (or persons performing the equivalent function):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: March 8, 2006 /s/ T. R. Loftus

____________________________

T. R. Loftus
Senior Vice President and

Chief Financial Officer
(Principal Accounting Officer)

Exhibit 32.1

CERTIFICATION PURSUANT TO
SECTION 1350, CHAPTER 63 OF TITLE 18, UNITED STATES CODE,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned, as Chairman, President, Chief Executive Officer and Chief Operating Officer of VSE Corporation (the "Company"), does hereby certify that to the best of the undersigned's knowledge:

1) the Company's Annual Report on Form 10-K for the year ending December 31, 2005 (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2) the information contained in the Company's Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: March 8, 2006 /s/ D. M. Ervine

D. M. Ervine
Chairman, President,
Chief Executive Officer and
Chief Operating Officer

Exhibit 32.2

CERTIFICATION PURSUANT TO
SECTION 1350, CHAPTER 63 OF TITLE 18, UNITED STATES CODE,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned, as Senior Vice President and Chief Financial Officer of VSE Corporation (the "Company"), does hereby certify that to the best of the undersigned's knowledge:

1) the Company's Annual Report on Form 10-K for the year ending December 31, 2005 (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2) the information contained in the Company's Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: March 8, 2006 /s/ T. R. Loftus

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