

Total current assets	27,748	18,816
Property and equipment, net	4,568	4,355
Intangible assets, net	3,493	3,874
Other assets	1,987	1,650
Net property, equipment, and other noncurrent assets of discontinued operations	0	243
Total assets	\$37,796	\$28,938
Liabilities and Stockholders' Investment		
Current liabilities:		
Accounts payable and other current liabilities	\$ 7,811	\$ 3,097
Accrued expenses	6,377	5,684
Dividends payable	78	74
Total current liabilities	14,266	8,855
Long-term debt	7,616	4,992
Deferred tax liabilities	98	411
Deferred compensation	1,280	1,127
Total liabilities	23,260	15,385
Commitments and contingencies		
Stockholders' investment:		
Common stock, par value \$.05 per share, authorized 5,000,000 shares; issued 3,908,088 shares in 1996 and 1,954,044 in 1995	195	98
Paid-in surplus	8,241	8,338
Retained earnings	22,385	21,402
Treasury stock, at cost (2,169,754 shares in 1996 and 1,084,877 in 1995)	(16,285)	(16,285)
Total stockholders' investment	14,536	13,553
Total liabilities and stockholders' investment	\$37,796	\$28,938

</TABLE>

-1-

<TABLE>

VSE Corporation and Subsidiaries
Consolidated Financial Statements (Unaudited)

Consolidated Statements of Income For the three and nine months ended

(in thousands, except per share amounts)

<CAPTION>

	September 30,			
	1996		1995	
	Three Months	Nine Months	Three Months	Nine Months
Revenues, principally from contracts	\$ 29,664	\$ 73,778	\$ 20,892	\$ 53,702
Costs and expenses of contracts	28,772	70,894	19,373	51,023
Gross profit	892	2,884	1,519	2,679
Selling, general and administrative expenses	331	490	657	542
Interest expense	108	347	15	27

<S>

<C> <C> <C> <C>

Pretax income from continuing operations	453	2,047	847	2,110
Provision for income taxes	(25)	634	339	811
Income from continuing operations	478	1,413	508	1,299
Discontinued operations, net of tax:				
Loss from operations (net of tax benefit of \$0 and \$14 in 1996, \$19 and \$45 in 1995)	0	(25)	(49)	(129)
Loss on disposal (net of tax benefit of \$118).	0	(179)	0	0
Net income	\$ 478	\$ 1,209	\$ 459	\$ 1,170

Earnings per common share, based on weighted average shares outstanding:

Income from continuing operations	\$.27	\$.81	\$.29	\$.75
Loss from discontinued operations	0	(.12)	(.02)	(.07)
Net income	\$.27	\$.69	\$.27	\$.68

Weighted average shares outstanding 1,738,334 1,738,334 1,738,334 1,731,134

</TABLE>

<TABLE>

VSE Corporation and Subsidiaries
Consolidated Financial Statements (Unaudited)

Consolidated Statements of Stockholders' Investment

(in thousands)
<CAPTION>

	Common Stock Shares	Paid-In Amount	Retained Surplus	Retained Earnings	Treasury Stock
Balance at December 31, 1994	1,948	\$ 97	\$8,247	\$20,042	\$(16,285)
Net income for the year	--	--	1,646	--	--
Dividends declared (\$.325)	--	--	(286)	--	--
Issuance of stock	6	1	91	--	--
Balance at December 31, 1995	1,954	98	8,338	21,402	(16,285)
Net income for the period	--	--	1,209	--	--
Dividends declared (\$.1275)	--	--	(226)	--	--
Stock split effected in the form of a 100% stock dividend	1,954	97	(97)	--	--
Balance at September 30, 1996	3,908	\$195	\$8,241	\$22,385	\$(16,285)

</TABLE>

-3-

<TABLE>

VSE Corporation and Subsidiaries
Consolidated Financial Statements (Unaudited)

Consolidated Statements of Cash Flows For the nine months ended September 30,

(in thousands)

<CAPTION>

	1996	1995
	<C>	<C>
Cash flows from operating activities:		
Net income	\$ 1,209	\$ 1,170
Adjustments to reconcile net income to net cash provided by (used in) continuing operating activities:		
Depreciation and amortization	1,017	1,938
Discontinued operations	204	129
Deferred compensation plan expense	171	94
Change in assets and liabilities, net of discontinued operations		
(Increase) decrease in:		
Accounts receivable	(8,585)	(6,383)
Other current assets and noncurrent assets	(839)	351
Deferred tax assets, net	(451)	640
Increase (decrease) in:		
Accounts payable and other current liabilities	4,697	1,417
Accrued expenses	693	1,660
Net cash used in continuing operating activities	(1,884)	1,016
Net cash used in discontinued operating activities	(25)	(129)
Net cash (used in) provided by operating activities	(1,909)	887
Cash flows from investing activities:		
Purchase of property and equipment, (net of dispositions)	(1,230)	(2,503)
Acquisition of CMstat	0	(970)
Acquisition of Energetics	0	(3,660)
Issuance of treasury stock	0	91
Net proceeds from sale of Schmoldt Engineering	100	0
Change in net assets of discontinued operations	439	129
Net cash used in investing activities	(691)	(6,913)
Cash flows from financing activities:		
Net proceeds from revolving term loan	2,624	3,651
Cash dividends paid	(222)	(207)
Net cash provided by financing activities	2,402	3,444
Net decrease in cash and cash equivalents	(198)	(2,582)
Cash and cash equivalents at beginning of period	601	3,096
Cash and cash equivalents at end of period	\$ 403	\$ 514

</TABLE>

-4-

VSE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine month period ended September 30, 1996 are not necessarily indicative of the results that may be expected for the year ending December 31, 1996. For further information refer to the consolidated financial statements and footnotes thereto included in the VSE Corporation annual report on Form 10-K for the year ended December 31, 1995.

Stockholder's Investment

Stockholder's Investment and Earnings Per Share

On April 17, 1996, VSE announced a two for one stock split in the form of a 100% stock dividend payable to stockholders of record as of May 15, 1996. The stock dividend was made on May 22, 1996. All share and per share amounts have been adjusted to give retroactive effect to the increased number of common shares outstanding due to the stock split.

Stock Option Plan

In February 1996, the company's Stock Option Plan (the "Plan") was adopted by the Board of Directors and approved by the company's stockholders on May 4, 1996. Under the plan, stock options may be granted for up to an aggregate of 218,958 shares of the common stock of the company. The maximum term of the options granted is five years. The option price is equal to the fair market value per share of common stock on the date of grant. The vesting period is three years and allows for 25% vesting immediately upon date of the grant and an additional 25% on each successive anniversary date after the grant date. Vesting may be accelerated for shares granted to certain individuals as determined by the Board of Directors.

As of September 30, 1996, options covering 131,380 shares were granted, of which 32,845 shares were exercisable at fair market value of \$13.64 per share.

FAS 123

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("FAS 123"). The expense recognition provision encouraged by FAS 123 would require fair-value based financial accounting to recognize compensation expense for employee stock compensation plans. The company has determined that

data. The company has not yet determined the impact of these pro forma adjustments.

Discontinued Operation

On February 7, 1996, VSE sold its wholly owned subsidiary Schmoldt Engineering Services Company ("Schmoldt Engineering"). Under the terms of the transaction, VSE sold all of the outstanding capital stock of Schmoldt Engineering to certain officers of Schmoldt Engineering in exchange for \$100 thousand in cash and a \$300 thousand promissory note for which principal and interest is payable in monthly installments between March 1, 1996 and September 1, 2001. The transaction resulted in a pretax loss of approximately \$293 thousand to VSE which was recorded in the first quarter.

The consolidated financial statements of the company have been reclassified to report separately the net assets and operating results of the discontinued operations. Financial results for periods prior to the dates of discontinuance have been restated to reflect continuing operations.

-6-

VSE CORPORATION AND SUBSIDIARIES Management Discussion and Analysis

<TABLE>

The following table sets forth certain items, including consolidated revenues, pretax income, and net income, and the amount of changes of such items for the three and nine month periods ended September 30, 1996 and 1995 (in thousands).

<CAPTION>

	1996 Compared to					
	Three Months		Nine Months		1995	
	Ended September 30 1996	Ended September 30 1995	Ended September 30 1996	Ended September 30 1995	Three Months	Nine Months
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Revenues, principally from contracts . .	\$29,664	\$20,892	\$73,778	\$53,702	\$ 8,772	\$20,076
Pretax income from continuing opera- tions	\$ 453	\$ 847	\$ 2,047	\$ 2,110	\$ (394)	\$ (63)
Provision for income taxes . . .	(25)	339	634	811	(364)	(177)
Income from continu- ing operations . .	478	508	1,413	1,299	(30)	114
Loss from discontinu- ed operations, net of taxes	0	(49)	(204)	(129)	49	(75)
Net income	\$ 478	\$ 459	\$ 1,209	\$ 1,170	\$ 19	\$ 39

</TABLE>

RESULTS OF OPERATIONS

The discussion and analysis which follows is intended to assist in understanding and evaluating the results of continuing operations, financial condition, and certain other matters of VSE Corporation and its wholly owned subsidiaries ("VSE" or the "company"), CMstat Corporation ("CMstat"), acquired in May 1995, Energetics Incorporated ("Energetics"), acquired in August 1995, Human Resource Systems, Inc. ("HRSI"), and Value Systems Services Division ("VSS") and BAV Division ("BAV"), unincorporated divisions of VSE. The company is engaged principally in providing engineering, software development, testing, and management services to the U. S. Government (the "government"). Two other VSE subsidiaries, VSE Corona, Inc. ("VCI") and VSE Services Corporation ("VSES"), have generally been inactive after 1992. Intercompany sales are principally at

cost and have been eliminated from the consolidated financial statements.

Revenues from continuing operations for the three and nine month periods ending September 30, 1996 increased by approximately 42% and 37%, respectively, compared to the same periods of 1995. The increase in revenues is primarily due to the new work performed by BAV in 1996 (see the discussion about the "BAV Contract" below) and to the inclusion of full nine month revenues of CMstat and Energetics in 1996. The increase in revenues was partially offset by the loss of one of VSE's major contracts. (See the discussion about "VSE Navy Contract" below).

Income from continuing operations for the nine month period ended September 30, 1996 increased by approximately 9%, compared to the same period ended September 30, 1995. The increase was primarily attributable to the inclusion of nine month income from BAV, CMstat and Energetics in 1996 and the recording of a

-7-

VSE CORPORATION AND SUBSIDIARIES

Management Discussion and Analysis

deferred tax asset from the acquisition of CMstat. The increase was partially offset by the reduced profits associated with the loss of the VSE Navy Contract.

Net income for the nine month period ended September 30, 1996 increased by approximately 3% compared to the same period ended September 30, 1995. The increase was primarily attributable to the inclusion of nine month income from BAV, CMstat and Energetics in 1996 and the recording of a deferred tax asset from the acquisition of CMstat. The increase was partially offset by the reduced profits associated with the loss of the VSE Navy Contract and the loss from discontinued operations.

Income from continuing operations for the three month period ended September 30, 1996 decreased slightly by approximately 6%, compared to the same period ended September 30, 1995. The decrease was due primarily to the timing of profits associated with various contracts. Decreased profits from the VSE Navy Contract were offset by increases in other new contracts, as well as the recording of a deferred tax asset due to the acquisition of CMstat.

Net income for the three month period ended September 30, 1996 increased by approximately 4% compared to the same period ended September 30, 1995. The increase was due to the elimination of losses from the discontinued operations in 1995, as well as the recording of a deferred tax asset from the acquisition of CMstat.

The largest customer for the services rendered by the company is the U. S. Department of Defense ("Defense"), including agencies of the U. S. Army, Navy, and Air Force. The Defense budget has been restrained by the federal budget deficit in recent years, resulting in increased competition for contracts for the services performed by VSE. There can be no assurance that future reductions in the Defense budget will not have a materially adverse impact on the company's results of operations or financial position.

Substantially all of the company's revenues from operations depend on the award of new contracts, on current contracts not being terminated for the convenience of the government, and on the exercise of option periods and the satisfaction of incremental funding requirements on current contracts. In 1996 and 1995 the company did not experience any termination of contracts for the convenience of the government or any non-exercise of option periods on current contracts which were material to the company's results of operations or financial position.

BAV Contract. In August 1995, VSE's BAV Division was awarded a contract with the U. S. Navy to provide engineering, technical and logistical support services associated with the sale, lease, or transfer of Navy ships to foreign governments. BAV began work on the contract in September 1995. Work on this contract accounted for approximately 23% of total revenues for the nine month period ended September 30, 1996. This contract has the potential, if all options are exercised, to generate revenues in excess of one billion dollars over a ten year period from 1995 through 2005.

VSE Navy Contract. VSE had a contract with the U. S. Navy which accounted for approximately 18% of total revenues for the nine month period ended September 30, 1995. The Navy combined the work performed under this contract with other related work under a new contract, and VSE was not the successful bidder for the new contract. Substantially all work on the contract ended in September 1995.

-8-

VSE CORPORATION AND SUBSIDIARIES

Management Discussion and Analysis

Discontinued Operation

On February 7, 1996, VSE sold its wholly owned subsidiary Schmoldt Engineering Services Company ("Schmoldt Engineering"). Under the terms of the transaction, VSE sold all of the outstanding capital stock of Schmoldt Engineering to certain officers of Schmoldt Engineering in exchange for \$100 thousand cash and a \$300 thousand promissory note for which principal and interest are payable in monthly installments between March 1, 1996 and September 1, 2001. The transaction resulted in a pretax loss of approximately \$293 thousand to VSE during the first quarter of 1996.

Liquidity and Capital Resources

A net decrease in cash and cash equivalents of approximately \$200 thousand during the nine month period ended September 30, 1996 resulted from approximately \$2.4 million provided by financing activities, approximately \$1.9 million used in operating activities and approximately \$700 thousand used in investing activities. Significant financing activities included borrowing on the company's revolving term loan, including commitments for checks outstanding, of approximately \$2.6 million. Significant investing activities included approximately \$1.2 million net cash used to purchase property and equipment, which was partially offset by approximately \$100 thousand cash and \$400 thousand change in net assets provided by the divestiture of Schmoldt Engineering. Cash flows from operating activities declined by approximately \$2.8 million as compared to the same period of 1995 primarily due to the additional accounts receivable associated with the increasing level of work on the BAV Contract in 1996.

A net decrease in cash and cash equivalents of approximately \$2.6 million during the nine month period ended September 30, 1995, resulted from approximately \$6.9 million used in investing activities, approximately \$3.4 million in cash provided by financing activities and approximately \$900 thousand provided by operating activities. Significant investing activities included approximately \$3.7 million associated with the acquisition of Energetics, \$1 million associated with the acquisition of CMstat and approximately \$2.5 million used to purchase property and equipment. Significant financing activities included borrowing on the company's revolving term loan, including commitments for checks outstanding, of approximately \$3.6 million.

The company's principal requirements for cash are to finance the costs of operations pending the collection of accounts receivable, to acquire capital assets for office and computer support, and to pay cash dividends. Performance of work under the BAV contract is expected to substantially increase the company's requirements for cash, however, management believes that the cash flows from operations and the bank loan commitment are adequate to meet current operating cash requirements.

VSE's requirements for working capital are affected significantly by its revenues and accounts receivable, which are primarily from billings made by the company to the government or other government prime contractors for services rendered. Such accounts receivable generally do not present liquidity or collection problems. Working capital requirements are also affected by (a) contract retainages, (b) start-up and termination costs associated with new or

-9-

Management Discussion and Analysis

completed contracts, (c) capital equipment requirements, and (d) differences between the provisional billing rates authorized by the government and billable costs actually incurred by the company.

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

Quarterly cash dividends at the rate of \$.0425 per share were declared during the three month periods ended March 31, June 30, and September 30, 1996. Pursuant to its bank loan agreement, the payment of cash dividends by VSE is subject to a maximum annual rate. VSE has paid cash dividends since 1973.

Inflation and Pricing Policy

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 impact of inflation on replacement costs of such property and equipment is expected to be insignificant.

-10-

VSE CORPORATION AND SUBSIDIARIES

PART II. Other Information

Item 5. Other Information.

On October 18, 1996, the Registrant filed a Form 11-K containing audited financial statements for the VSE Corporation Employee ESOP/401(k) Plan for the plan years ended December 27, 1995 and 1994.

On October 31, 1996, the Registrant filed a Form S-3 covering the potential sale of up to 200,000 shares of VSE Common Stock (\$.05 par value) to meet employee benefit plan obligations under the VSE Corporation Employee ESOP/401(k) Plan.

On October 31, 1996, the Registrant filed a Form S-8 covering up to 218,996 new shares of VSE Common Stock (\$.05 par value) which may be issued on exercise of option agreements under the VSE Corporation 1996 Stock Option Plan.

On October 31, 1996, the Registrant filed a Form S-8 covering up to 100,000 shares of VSE Common Stock (\$.05 par value) owned by the VSE Corporation Employee ESOP/401(k) Plan.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits.

(11) Statement regarding computation of per share earnings. Reference is made to the "Consolidated Statements of Income" included in Part I of this Form 10-Q on the computation of per share earnings.

(b) Reports on Form 8-K.

No current reports on Form 8-K were filed by the Registrant during the three month period ended September 30, 1996.

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

-11-

VSE CORPORATION AND SUBSIDIARIES

SIGNATURES

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

VSE CORPORATION

/s/ C. S. WEBER

Date: November 14, 1996

C. S. Weber, Senior Vice President,
Secretary and Treasurer
(Principal Financial Officer)

/s/ T. J. CORRIDON

Date: November 14, 1996

T. J. Corridon, Senior Vice President
and Comptroller
(Principal Accounting Officer)

The financial information included in this report reflects all known adjustments normally determined or settled at year-end which are, in the opinion of management, necessary to a fair statement of the results for the interim periods. The accompanying notes to consolidated financial statements are an integral part of this report.

-12-

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