

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, 1998 Commission File Number: 0-3676

VSE CORPORATION

(Exact Name of Registrant as Specified in its Charter)

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

2550 Huntington Avenue  
Alexandria, Virginia 22303-1499  
(Address of Principal Executive Offices) (Zip Code)

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

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

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

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

Aggregate market value of voting stock held by nonaffiliates of the registrant as of March 1, 1999, was approximately \$21 Million.

Number of shares of Common Stock outstanding as of March 1, 1999: 2,114,905.

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

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Registrant's 1998 Annual Report for the year ended December 31, 1998, are incorporated into Parts I and II of this report.
2. Portions of the Registrant's Proxy Statement for the Annual Meeting of Stockholders expected to be held on May 6, 1999, are incorporated by reference into Part III of this report.

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PART I

ITEM 1. Business

Refer to the discussions captioned "Letter to Stockholders", "VSE Operations" and "Description of Business" in VSE Corporation's ("VSE" or the "Registrant") 1998 Annual Report which is incorporated herein by reference.

ITEM 2. Properties

Refer to the discussion captioned "Description of Business" in VSE's 1998 Annual Report which is incorporated herein by reference.

ITEM 3. Legal Proceedings

Refer to Note 9 (Commitments and Contingencies - Litigation) of the "Notes to Consolidated Financial Statements" in VSE's 1998 Annual Report which is

incorporated herein by reference.

#### ITEM 4. Submission of Matters to a Vote of Stockholders

Not applicable.

### PART II

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

Refer to discussion captioned "VSE Common Stock" in VSE's 1998 Annual Report which is incorporated herein by reference.

#### ITEM 6. Selected Financial Data

Refer to table captioned "Financial Highlights" in VSE's 1998 Annual Report which is incorporated herein by reference.

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

Refer to discussion captioned "Management Discussion and Analysis" in VSE's 1998 Annual Report which is incorporated herein by reference.

#### ITEM 7A. Quantitative and Qualitative Disclosures about Market Risk

Refer to discussion captioned "Management Discussion and Analysis" in VSE's 1998 Annual Report which is incorporated herein by reference.

#### ITEM 8. Financial Statements and Supplementary Data

Refer to sections captioned "Consolidated Financial Statements" and "Notes to Consolidated Financial Statements" in VSE's 1998 Annual Report which is incorporated herein by reference.

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

Not applicable.

### PART III

#### ITEM 10. Directors and Executive Officers of the Registrant

Information with respect to VSE Directors is incorporated by reference to VSE's definitive proxy statement for its annual meeting of stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A (the "Proxy Statement") not later than 120 days after December 31, 1998. The executive officers are chosen annually at the board of directors meeting next following the annual meeting of stockholders and serve until their successors have been duly elected and qualified, or until resignation or removal. Also refer to section captioned "Executive Officers" in VSE's 1998 Annual Report which is incorporated herein by reference.

#### ITEM 11. Executive Compensation

Information with respect to this item is incorporated by reference from the Proxy Statement discussions captioned "Certain Relationships and Related Transactions," "Compensation Committee Report," "Summary Compensation Table," "Option Grants in Last Fiscal Year," and "Aggregate Options Exercised in Last Fiscal Year and Fiscal Year-End Option Values."

#### ITEM 12. Security Ownership of Certain Beneficial Owners and Management

Information with respect to this item is incorporated by reference to the discussion captioned "Security Ownership of Certain Beneficial Owners and Management" in the Proxy Statement.

ITEM 13. Certain Relationships and Related Transactions

Information with respect to this item is incorporated by reference to the discussion captioned "Certain Relationships and Related Transactions" in Item No. 1 (Election of Directors) in the Proxy Statement.

PART IV

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

(a) The following documents are filed as part of this report:

1. Financial statements from VSE's 1998 Annual Report which is incorporated herein by reference:

Report of Independent Public Accountants  
In section captioned "Consolidated Financial Statements":

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Consolidated Balance Sheets as of December 31, 1998 and 1997  
Consolidated Statements of Income for the Years Ended  
December 31, 1998, 1997, and 1996  
Consolidated Statements of Stockholders' Investment for the  
Years Ended December 31, 1998, 1997, and 1996  
Consolidated Statements of Cash Flows for the Years Ended  
December 31, 1998, 1997, and 1996  
Notes to Consolidated Financial Statements

2. Financial Statement schedules required to be filed by Item 8 of this Form:

None.

3. Exhibits:

Information with respect to exhibits is contained at page E-1  
Exhibit Index.

(b) Reports on Form 8-K:

None.

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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 18, 1999 By: /s/ C. S. Weber

\_\_\_\_\_  
C. S. Weber, Senior Vice President  
and Corporate Secretary

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on March 17, 1999, by the following persons on behalf of the Registrant and in the capacities indicated.

(a) Principal Executive Officers:

/s/ D. M. Ervine

\_\_\_\_\_  
D. M. Ervine, Chairman of the Board and Chief Executive Officer

/s/ J. M. Knowlton

\_\_\_\_\_  
J.M. Knowlton, President and Chief Operating Officer

(b) Principal Financial Officer:           (c) Principal Accounting Officer:

/s/ T.J. Corridon

/s/ T. R. Loftus

\_\_\_\_\_  
T.J. Corridon, Senior Vice President and Chief Financial Officer

\_\_\_\_\_  
T. R. Loftus, Vice President and Comptroller

(d) Directors:

/s/ D. M. Ervine

/s/ J. M. Marchello

\_\_\_\_\_  
D. M. Ervine

\_\_\_\_\_  
J. M. Marchello

/s/ R. J. Kelly

/s/ D. M. Osnos

\_\_\_\_\_  
R. J. Kelly

\_\_\_\_\_  
D. M. Osnos

/s/ C. S. Koonce

/s/ J. D. Ross

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C. S. Koonce

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J. D. Ross

/s/ J. M. Knowlton

/s/ B. K. Wachtel

\_\_\_\_\_  
J. M. Knowlton

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B. K. Wachtel

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EXHIBIT INDEX

Reference No. per Item 601 of Regulation S-K	Description of Exhibit	Exhibit No. in this Form 10-K
2	Plan of acquisition, reorganization, arrangement, liquidation or succession Exchange Agreement dated as of March 25, 1992, amended as of September 1, 1992, by and between VSE Corporation and JBT Holding Corp., et al. (Exhibit A to Exhibit 1, Proxy Statement, filed on Form 8-K on November 2, 1992)	*
3	Articles of incorporation and by-laws Restated Certificate of Incorporation of VSE Corporation dated as of February 6, 1996 By-Laws of VSE Corporation as amended through July 14, 1998	Exhibit V *
4	Instruments defining the rights of security holders, including indentures Specimen Stock Certificate as of May 19, 1983 (Exhibit 4 to Registration Statement No. 2-83255 dated April 22, 1983 on Form S-2)	*
9	Voting trust agreement	Not Applicable
10	Material contracts Employment Agreement entered into as of October 21, 1998, by and between VSE Corporation and Donald M. Ervine	Exhibit VI
	Employment Agreement entered into as of January 15,	

1999, by and between VSE Corporation and  
Energetics, Incorporated and Robert J. Kelly Exhibit VII  
Employment Agreement entered into as of January 15,  
1997, by and between VSE Corporation and  
James M. Knowlton Exhibit VIII  
VSE Corporation Deferred Supplemental Compensation  
Plan effective January 1, 1994 (Exhibit III to  
Form 10-K dated March 23, 1995) \*

Stock Purchase Agreement dated August 29, 1995 by  
and between VSE Corporation and the shareholders  
of Energetics Incorporated (Exhibit 2 to Form 8-K  
dated September 13, 1995 and Amendment 1 on Form  
8-K/A dated November 9, 1995) \*

VSE Corporation 1996 Stock Option Plan (Appendix A to  
Registrant's definitive proxy statement dated  
April 3, 1996)

VSE Corporation 1998 Stock Option Plan (Appendix A to  
Registrant's definitive proxy statement for the Annual  
Meeting of Stockholders held on May 6, 1998)

VSE Corporation 1998 Non-employee Directors Stock Plan  
(Appendix B to Registrant's definitive proxy statement  
for the Annual Meeting of Stockholders held on May 6, 1998)

12 Statements re computation of ratios Not Applicable

13 Annual report to security holders, Form 10-Q  
or quarterly report to security holders Exhibit II

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EXHIBIT INDEX

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

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

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EXHIBIT I

SUBSIDIARIES OF THE REGISTRANT

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

	Jurisdiction of Organization
CMstat Corporation	Delaware
Energetics Incorporated	Maryland
Human Resource Systems, Inc.	Delaware
Ship Remediation and Recycling, Inc.	Delaware

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Exhibit II

QUALITY SOLUTIONS FOR THE 21st CENTURY

1998 Annual Report

"VSE - Our systems  
help people succeed"

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## Corporate Profile

VSE Corporation is a professional services company established in 1959. VSE provides diversified engineering, development, testing, maintenance and management services and products to maintain and modernize equipment and systems, principally to agencies of the U.S. Government and to other prime contractors. The company's subsidiaries and divisions include BAV, CMstat Corporation, Energetics Incorporated, Human Resource Systems, Inc., Ordnance, Ship Remediation and Recycling, Inc. (formerly VSE Services Corporation), Value Systems Services (VSS), and from July 1990 through February 6, 1996, Schmoltdt Engineering Services Company. The company provides products and services to customers from more than 20 locations across the United States.

## Annual Meeting of Stockholders

VSE's Annual Meeting of Stockholders is expected to be held on May 6, 1999, at 10:00 a.m., at the Hilton Alexandria Hotel at Mark Center, 5000 Seminary Road, Alexandria, Virginia 22311.

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## ISO 9001 VSE's Quality Policy

VSE's policy is to provide products and services of the highest quality to meet the needs, expectations, and requirements of its customers, on time, and at a fair price. VSE's management is committed to the pursuit of quality performance in all its enterprises. This commitment is reflected in the Company's mission statement and is our quality objectives.

## VSE's Mission Statement

"VSE..Our systems help people succeed."

VSE Corporation helps organizations succeed through the effective use of people, systems, and technology. In helping others succeed, we increase shareholder value by capturing new work, delighting our customers, increasing our technical competence, and building great industry teammates. Our reputation for success, and our quality management system, are based on honesty and integrity in everything we do; on communications, on teamwork and leadership; and on an enduring commitment to help our customers, employees, and teaming partners succeed with cost effective solutions, continuous learning, and process improvement.

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## Financial Highlights

### Selected Financial Data

(In thousands, except per share data)

<TABLE>

<CAPTION>

	1998	1997	1996	1995	1994
<S>	<C>	<C>	<C>	<C>	<C>
Revenues, principally from contracts . . . . .	\$180,233	\$155,863	\$120,087	\$73,790	\$63,682
Income (loss) from continuing operations . . . . .	\$ 1,595	\$ (1,447)	\$ 1,946	\$ 1,738	\$ 1,547
(Loss) income from discontinued operations . . . . .	0	0	(25)	(92)	6

Loss on disposal of discontinued operations .....	0	0	(179)	0	0
Net income (loss) .....	\$ 1,595	\$ (1,447)	\$ 1,742	\$ 1,646	\$ 1,553

Basic earnings per common share:

Income (loss) from continuing operations ..	\$ .75	\$ (.68)	\$ .89	\$ .80	\$ .72
(Loss) from discontinued operations ....	0	0	(.09)	(.04)	0
Net income (loss) .....	\$ .75	\$ (.68)	\$ .80	\$ .76	\$ .72

Diluted earnings per common share:

Income (loss) from continuing operations ..	\$ .75	\$ (.68)	\$ .88	\$ .80	\$ .72
(Loss) from discontinued operations ....	0	0	(.09)	(.04)	0
Net income (loss) .....	.75	(\$ .68)	.79	.76	.72

Total assets .....	\$ 40,737	\$ 38,048	\$ 48,341	\$ 28,938	\$ 21,063
Long-term debt .....	\$ 5,370	\$ 7,108	\$ 12,651	\$ 4,992	\$ 0
Stockholders' investment .....	\$ 13,850	\$ 12,481	\$ 14,595	\$ 13,553	\$ 12,101
Cash dividends per common share .....	\$ .144	\$ .144	\$ .138	\$ .13	\$ .122

</TABLE>

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

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

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Letter to Stockholders

Fellow Stockholders:

VSE achieved impressive levels of growth in 1998, our 40th year. Record revenues, a return to profitability, important contract wins, an increase in bidding opportunities, and a strong emphasis on providing a solid foundation for future growth have VSE positioned well for the future.

For the year, consolidated annual revenues increased by \$24 million or 15% to \$180 million. Consolidated net income was approximately \$1.6 million or \$.75 per share. Led by BAV, the engineering, logistics, management and technical services segment revenues increased by \$25 million or 16% to \$177 million and this segment's net income increased by \$0.5 million or 17% to \$3.0 million or \$1.42 a share. All of our other companies or business units comprising this segment increased their revenue from last year. Annual revenues for the software products and services segment decreased by \$200 thousand or 6%. We made substantial progress in reducing the net losses of this segment from \$4.0 million to \$1.4 million in 1998. While this is positive, we are still committed to eliminating the losses incurred by our software products and services segment. We have restructured the management of the company and we have reduced its size wherever we can while still retaining quality product and service capability. We continue to keep all of our options open and continue our efforts to return CMstat to profitability.

Building and Strengthening VSE

When I look back on 1998, I think it will best be remembered as a pivotal time of building and strengthening VSE. Some of the accomplishments of 1998 are



critical toward positioning VSE for continued success and competition in the federal government marketplace for many years to come. While measured in annual increments in this annual report, these changes are fundamental and I am hopeful they will provide a continued return on our investment for many years to come.

VSE distinguished itself among professional engineering service providers by achieving ISO 9001 registration. This investment will be a discriminator in all of our proposals that few competitors can offer. I also firmly believe that this framework will instill the discipline to focus VSE on quality products and customer satisfaction. I expect the quality system we put in place in 1998 will enhance our financial results in 1999 and future years.

Our other major emphasis in 1998 was to upgrade our Information Technology infrastructure to enable us to take advantage of the state-of-the-art tools that are available for companies like ours. I am a firm believer that through automation, we can provide increased levels of services at lower overall costs and thereby keep VSE cost competitive in the eyes of our customers. In 1998, we established a wide area network connecting the principal offices of our Sea Warfare, Land Warfare and Air Warfare divisions as well as all of our administrative functions. We updated our entire

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Letter to Stockholders

telephone, voice, and data systems, and we installed a video conferencing facility in our Alexandria, Virginia location. We added similar capabilities in several other VSE offices to minimize travel between our facilities. Additionally, we installed a new training facility equipped with the latest in computer hardware and software.

Strengthening our people has been a further initiative in 1998. We established a training office, a training facility, and formal training plans as part of our ISO 9001 process. We are investing in our people. The response from our employees has been tremendous. We believe that continued training is a win-win for VSE, our employees, and our customers.

Business Development

The government marketplace, which VSE serves, continues to be very large. We have experienced an upturn in bidding opportunities, and we had some key wins in 1998 that fit in well with our strategic objectives. We wanted to offer our professional services to more federal government customers, and the award of a GSA Federal Supply Contract to VSE and subsidiaries for information technology services in February of 1999 enables us to do this. This contract makes it fast and easy for customers to get to us, and I am optimistic that we will see increased revenues in this market. We have initiatives underway for two additional GSA contracts.

Another strategic VSE objective is to capitalize on a DOD budget trend of spending more dollars on information technology programs. We are providing higher technical services in areas such as military systems integration, upgrading circuitry in fielded Army devices, inventing new power generation solutions for fielded communications systems, and integrating advanced technology insertion on military vehicles and ships to modernize and extend their service lives. We continue to see opportunities to offer services that help our customers achieve better solutions at lower costs.

Personnel Resources

VSE is, above all, a services company. The strength of our management and the quality of our services depend on the experience, education, training, and motivation of VSE employees and managers, beginning with our Board of Directors. Several important milestones for VSE directors were reached in 1998 and early 1999.

In September 1998, we celebrated David Osnos' 30 years of service on VSE's Board of Directors. In February 1999, VSE's Board appointed Jim Knowlton as VSE

President and Chief Operating Officer, and a member of the Board, replacing Dick McFarland who retired after ten years of valuable service to VSE during his "second career."

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Letter to Stockholders

1999 and Beyond

In the business description which follows you will see how VSE is responding to a changing business environment. You will see the building and strengthening in each VSE business unit. You will read about our continued progress toward providing high tech solutions. We believe in our mission statement: "Our systems help people succeed," and we are executing on every level. You will see in our management discussion and analysis our approach to the Year 2000 issue. We have a focused effort, and all indications are that we as a company will be ready to do business as usual in the year 2000. Our goals are the same as they have always been, to continue to grow the company and to increase shareholder value. We remain committed to doing just that.

In our 40th Anniversary Annual Report, we've emphasized "innovation through experience," which is our way of saying that VSE brings its customers the proven experience to perform and the talent and energy to innovate solutions that work better and cost less.

As I like to do every year, I acknowledge the very valuable support and contribution made by our industry teaming partners, suppliers, bankers, directors, and stockholders. VSE needs the effort of everyone to succeed. Your support is very important, and I welcome your comments and suggestions for improvement at any time.

D. M. Ervine  
Chairman and CEO

March 17, 1999

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## V S E O P E R A T I O N S

Engineering, Logistics, Management and Technical Services Segment

VSE Land Warfare Group

Throughout 1998, VSE's Land Warfare Group demonstrated the versatility of its engineering support solutions for Army, Marine Corps, and Defense Logistics Agency customers. After redesigning and successfully fabricating three prototype Direction Finding Systems last year, the group produced 135 units this year to replace initial production models in Army organizations worldwide. The success of these initial production models resulted in a production contract for 95 units. Soldiers continually give high marks to the operational effectiveness and readiness of the redesigned models. The redesigned systems effort has been identified as the only success story in the Army's Modernization to Spares Program, a program designed to encourage cost reduction through engineering solutions.

The group remains an integral part of the Army Reserves' dynamic "out of the box" approach to modernize, sustain, and improve aging combat service support systems. The Glider Kit pilot program is an excellent example of VSE's partnering efforts with the Army Reserve. VSE provides technical expertise,

research and development, and analyses of equipment and systems resulting in cost avoidance and improved reliability and durability. The Glider Kit conversion process uses the engine and rear tandem axles from an existing Army vehicle and combines them with an upgraded cab with air conditioning, electronics, automatic transmission, and new chassis, front axles, and tires. Additional advancements include an anti-lock brake system (ABS) and the capability to accept the next generation global positioning systems (GPS). VSE, through the Office of the Chief, Army Reserve, maintained both an engineering and logistics presence, throughout the program, moving it continuously from its infancy to full-scale production and fielding. The conversion transforms an aging, unreliable, maintenance-intensive vehicle into a technologically proven, mission-ready asset. The result is essentially a new vehicle closely resembling the existing newer version of the vehicle but costing approximately 50 percent less. The culmination of VSE's efforts over three years was witnessed at the initial fielding ceremony for the M915A4 Glider at Fort McCoy, Wisconsin, on October 10, 1998.

Since October 1998, members of the VSE Team have supported the integrated logistics support management assessment for the 7th Army Reserve Command in Germany. We are developing strategies that will improve equipment maintenance through implementation of proven business and operational practices, achieving mission efficiency and combat readiness. In addition, plans are in development to export these methods to the 9th Regional Support Command in Hawaii. We will continue to maintain and build on our outstanding relationship with the Army Reserve as partners in innovation.

Our talented and dedicated employees continue to investigate cost avoidance measures that will be valuable to our Army, Marine Corps, and Defense Logistics Agency customers. We have submitted several large proposals that could result in expanded business opportunities - opportunities to further demonstrate our cost-effective advantage to our clients in 1999 and beyond.

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VSE Sea Warfare Group

During 1998, VSE's Sea Warfare Group continued to provide single-source engineering solutions to the U.S. Navy, other defense customers, and with our industry partners such as commercial shipyards. Sea Warfare Group customers include the Naval Facilities Engineering Service Center, Naval Sea Shipbuilding Support Office, and the Naval Air Command, and the Supervisor of Shipbuilding at Portsmouth, Virginia. The group was awarded another subcontract to support the Fleet Technical Support Center Atlantic, adding combat systems assessment to the list of services that we provide to our customers.

Our reputation for fleet maintenance and modernization support has enabled us to put together teams with other industry leaders to respond to even larger and more complex government fleet support acquisitions. Our personnel continue to provide high quality "turn-key" support, including scheduling, project management, material identification, procurement and control, shipping and expediting, installation, repair and maintenance, testing, system assessment, documentation, provisioning, and training. Major contracts in 1998 included installation of new, complex radar systems and air traffic control on seven aircraft carriers on the East and West Coasts, and at the land based test site at Wallops Island, Virginia. Our marine engineering personnel also accomplished the first installation of the upgraded combined engagement capability systems onboard the aircraft carrier USS KENNEDY and the first complete IT-21 compliant installation of the integrated ships information system, which was installed onboard the aircraft carrier USS THEODORE ROOSEVELT.

Our Ocean Systems personnel continued providing engineering and construction support for the Naval Facilities Engineering Service Center. In 1998, major projects included the installation of heavy weather hurricane and typhoon ship moorings in Hawaii, Texas and Puerto Rico. Ocean Systems personnel also provided facility design support for the new Navy Inactive Ship Facility in Newport, Rhode Island which included pier fendering, fire, water, electrical and communications systems. The project included design and modifications to the inactive aircraft carriers Saratoga and Forrestal, and the battleship Iowa. It also included the supervision of berthing operations for these vessels. Significant pier overhaul and refurbishment was accomplished in Port Hadlock, Washington. Our Ocean Systems personnel managed the cutting, removal, and replacement of sixteen 110-foot long octagonal concrete support piles, which

was successfully accomplished without disruption to ongoing pier activities.

#### Postal Service Program Center

For over 22 years, VSE has expanded its capabilities and commitment to meet the strategic technology objectives of the U.S. Postal Service ("USPS"). VSE employees are proud of their contributions to the success of USPS initiatives and innovations.

VSE's Postal Service Program Center continued to build its professional services operations and partnering capabilities in 1998 by supporting USPS Engineering, Merrifield, Virginia. In 1998, we strengthened our technical engineering staff with focus on unique customer requirements, team building, and commitment to excellence.

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Our professional staff offers diverse technical engineering services to design, modernize, test and logistically support automated electro-mechanical mail processing and delivery equipment and systems. VSE also provides services to support new automated processes and solutions for USPS configuration management, inventory control, and equipment maintenance programs utilizing CMstat systems. VSE professionals support significant USPS programs to develop state-of-the-art stamp manufacturing standards and materials qualifications with growing emphasis on environmentally benign stamp products.

VSE engineers and technicians sustain many important U. S. Postal Service programs involving next generation automation enhancements to meet USPS business, customer service and organizational productivity goals. Working with evolving technologies, reengineering processes, and equipment to achieve a fully automated mail processing and material handling environment, VSE engineers support the integration of current systems with technology advancements for development of the integrated processing facility initiative, deployments of tray management and robotics equipment systems, as well as implementation of mail equipment transport projects. VSE employees also support USPS innovations such as the development of state-of-the-art printed circuit boards, delivery confirmation initiatives, alternative fuel utilization for USPS vehicle programs, web site development, and database integration for research and marketing programs.

As our USPS customers advance in the development and implementation of new systems and technology, the VSE Postal Service Program Center team of professionals will continue providing technical excellence to ensure best value for the USPS.

#### VSE Air Warfare Group

During 1998 VSE consolidated all of its Aviation Engineering and Logistics Services into the Air Warfare Group (AWG), thereby establishing a corporate competency to serve the Aviation Business Sector. The main operational unit of the AWG is the Value Systems Services (VSS) Division.

VSS continues to serve our Navy customers through the Naval Air Systems Command (NAVAIR) Logistics Support Omnibus contract.

In 1998, VSS completed the move to Patuxent River, Maryland, to accommodate NAVAIR's relocation. In our new Southern Maryland facility, VSS employs over 100 engineers and logisticians who assist the supportability requirements of most aircraft and missile system programs.

Additionally, in 1998 VSS was awarded a contract with the Navy's Outsourcing Support Office. Via this contract, VSS provides analytical and cost estimation services in support of the Navy's A-76 outsourcing initiatives. VSS has completed the management studies for both the Naval Shipyard in Portsmouth, Virginia, and the Navy Surface Warfare Center, Indian Head Division in Indian Head, Maryland. This contract has the potential for revenue growth as the Navy increases its outsourcing efforts in support of decreased budgetary outlays.

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VSS continues to support the U.S. Special Operations Command in Tampa, Florida, via a subcontract with an industry partner. Under this contract, VSS provides technical and logistics services to the Air Force component of the Joint Command.

Another of Air Warfare Group's Air Force customers is the Warner Robins Air Logistics Center in Georgia. We provide engineering, logistics, and computer-based support to the airborne weapons programs at Warner Robins.

VSS has made significant progress in meeting our corporate objective of providing innovative solutions to our customers. During 1998, VSS was awarded tasking in support of the Continuous Acquisition Life Cycle Support (CALC) and the Automated Maintenance Environment (AME) initiatives. These initiatives consist of the deployment of an advanced maintenance schedule and diagnostic system that will significantly improve the cost effectiveness of the F/A-18 Aircraft Logistics Support. In connection with the CALC/AME initiatives VSS has entered into a partnership with the Maryland Department of Economic Development to train engineering personnel in advanced software and network systems.

VSS is also supporting the Naval Supply Systems Command by providing baseline development of a Serial Number Tracking (SNT) integrated system. SNT incorporates Automatic Information Technology and Contact Memory Buttons into an object oriented tracking system. SNT will be the 21st century replacement for bar-coding and component related paper documentation.

VSS is proud to be a member of the Joint Strike Fighter (JSF) team. JSF is a joint services, future replacement multi-role fighter. As part of this tasking, VSS provides supportability and affordability analysis and makes recommendations for improvement of system reliability and maintainability.

We are confident that our current involvement in these "Information Age" initiatives will provide opportunities for continued growth in the years ahead.

#### BAV Division

The BAV Division continued to expand its business base and generated record revenues in 1998 exceeding \$93 million. During the year, BAV and its team of subcontractors facilitated the reactivation and transfer of eight inactive ex-U.S. Navy ships to the navies of Egypt, Thailand, and Turkey. In addition, follow-on technical support and logistic services were provided to Taiwan, Egypt, Thailand, Greece, Germany, Saudi Arabia, and Italy. BAV has institutionalized all its processes under the ISO 9001 quality standard and continues to provide engineering services on a competitive "Best Value" basis. We have been zealous about providing services that exceed the expectations of our foreign customers and the BAV team's reputation has grown.

BAV has sought and executed a number of strategic partnerships that have supported new business opportunities. We have developed alliances with both national and international companies. These partnering relationships have enabled us to provide engineering services such as support of the Turkish Navy to retrofit five ex-U.S. Navy FFG 7 Class ships with the Aircraft Integrated Secure and Traverse (ASIST) system, a state-of-the-art helicopter recovery and

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handling system. We are also pursuing a long-term business relationship with the U.S. Coast Guard ("USCG") to facilitate USCG foreign military sales ship transfers. The USCG has recognized the benefits and value of the BAV Team methodology for their FMS program support.

BAV has sought to build a common marketing approach with the entire range of U.S. Navy Security Assistance Organizations and is also exploring the requirements for Direct Commercial Sales opportunities. BAV is continuing to increase its international presence and participated in industry trade shows and expositions in 1998 that included EURONAVAL (Paris, France), EXPONAVAL (Valparaiso, Chile), and DEFENDORY (Athens, Greece). Our Washington, D.C. location helps to keep local embassies informed of BAV's broad array of services and lifecycle support.

Human Resource Systems, Inc.

Human Resource Systems, Inc. (HRSI), a subsidiary of VSE, provides professional employer services to Government clients in a variety of technical disciplines, including engineering, architecture, real estate, information technology, and health care. Most HRSI employees work at customer facilities nationwide under contractual arrangements lasting up to five years.

With HRSI's continued growth during 1998, HRSI took a number of strategic steps to strengthen the organization and reinforce the quality of service delivery. HRSI expanded nationwide support of its technical services division by establishing a program management office in Louisville, Kentucky, in addition to corporate offices in Alexandria and Chesapeake, Virginia. HRSI has been engaged in an on-going process to update its policies and procedures in keeping with the needs of our clients. HRSI completed a number of strategic staff additions to keep pace with corporate growth and business expansion. HRSI increased its Internet capabilities to augment recruitment, communications, and new business development. Operating in tandem with VSE, HRSI plans to deploy many of its practices via the Internet during 1999 to strengthen our presence with customers and employees.

HRSI's growth and reputation are predicated on delivering exceptional client service, helping clients succeed and answer new challenges appropriately and efficiently. For example, during 1998 HRSI was selected by the U.S. Navy to provide special emergency health care staffing services at the National Naval Medical Center in Bethesda, Maryland, to replace critical military staff deployed to a hospital ship. HRSI also continued to expand its range of technical services offered and the locations where services are provided to meet client technical needs and budgetary requirements.

In keeping with the HRSI's strategic plan, HRSI has vigorously pursued new work within our dominant business lines. HRSI has several bids outstanding and in process. Toward this end, HRSI has expanded its role as a business partner with other leading firms that share HRSI's commitment to quality and professionalism. HRSI's strategic alliances should lead to increased growth in the years ahead.

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Energetics Incorporated

Energetics Incorporated ("Energetics"), a VSE subsidiary, is a full-service consulting company specializing in energy and environmental issues. Founded in 1979, Energetics provides technical and managerial support to the U.S. Department of Energy (DOE) as well as other clients in the public and private sectors. Projects have ranged across the energy and environmental spectrums, from management support to analyses of advanced technological research and development. As a testament to the quality of work, many of Energetics' clients have contracted continuously with Energetics for over a decade because of key Energetics people. Energetics' experienced staff of more than 100 engineers and other professionals concentrate on three areas vital to the future well-being of the nation and world:

- \* Energy Supply
- \* Energy Conservation
- \* Environmental Management

Energy Supply

Energetics assists the government and utility companies in planning and implementing innovative programs to improve the production and delivery of electricity to consumers. Several of the staff are recognized internationally for their knowledge of battery energy-storage technologies, hydrogen systems, clean coal technologies, superconductivity, electromagnetic fields, and utility deregulation.

Energy Conservation

Energetics provides advanced technical solutions to reduce energy use, prevent pollution, and save costs. In addition to conducting numerous technical, economic, and policy studies, the staff helps clients identify energy-efficient

technologies and alternative fuels for use in buildings, industries, and transportation systems, including emerging technologies that offer state-of-the-art options and performance.

#### Environmental Management

Energetics assists clients with regulatory analysis, environmental regulatory compliance, and restoration support. The environmental staff has comprehensive knowledge and understanding of all applicable statutes and regulations. With the recent interest in global climate change, Energetics has significantly increased its support to associated activities at DOE. Recent focus is on reducing greenhouse-gas emissions from industrial operations. Energetics has studied and analyzed the most energy-intensive industries, and recently completed an evaluation of carbon dioxide emissions from eight industrial sectors. This effort directly supports the DOE's role on the President's Climate Change Task Force.

Energetics moved into newly renovated office spaces in the latter part of 1998. In addition, a state-of-the-art telephone system and local area network were installed. These improvements assure greater connectivity with clients and make the working environment much more efficient and hospitable.

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The future for energy and environmental work is bright and Energetics has charted a course for long term growth, involving

- - improved marketing strategy to provide additional services to existing clients and to expand into other markets;
- - continued training of the workforce;
- - continuous improvement of quality in services and products.

#### Software Products and Services Segment

##### CMstat

CMstat provides "best in class" systems and software solutions which enable clients to manage technically complex, rapidly changing products and processes that have become increasingly central to the current economy.

CMstat strengthened its business in 1998 with the development of re-usable methods to integrate the Configuration Management ("CM") system with other critical applications used in the engineering and product management arena. In addition, CMstat introduced a new web-based product that provides large numbers of users across the enterprise with easy, cost-effective access to detailed product data captured and managed within the CM process. These developments allow customers to maintain control of product content and documentation across their entire enterprise, as well as among their suppliers and customers, and at every stage of the product life cycle.

CMstat continues to develop object-based and web-based technologies. CMstat is building new applications that support complex manufacturing and technical asset management and the integration of product design, manufacturing, and maintenance tasks and applications. Quickly deployed, easily learned applications, that control the flow of current product specification and design data across the entire supply chain, will become essential as all facets of the product cycle are distributed among various enterprises and locations. CMstat is building these applications now, working in partnership with customers who are "pushing the envelope" in managing the supply and support chain for complex products.

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#### VSE Quality Strategy - ISO 9001 Registration

VSE has achieved another milestone in its commitment to deliver to its customers

products and services of superior quality: Registration of its quality management system to ISO 9001 by an internationally recognized third party registrar, Lloyd's Register Quality Assurance. Completing a rigorous company-wide internal process improvement effort, the attainment of ISO 9001 registration is an acknowledgement of VSE's continuing commitment to quality and to our dedication to continuous improvement of our business processes.

Quentin Conroy, VSE's Director of Quality and ISO 9001 Management Representative, reported the achievement of ISO 9001 registration is certainly a mark of accomplishment setting VSE apart from many other engineering services companies doing business with the U.S. Government. "Don Ervine, VSE's Chairman and CEO, initiated our first formal quality program in 1988," said Mr. Conroy. "At that time, we focused principally on the Department of Defense TQM (Total Quality Management) initiative. We have worked to incorporate continuous process improvement into our procedures throughout the company. With the ISO 9001 system of requirements, we have an even stronger set of standards, and we have a structure that automatically integrates quality into everything we do. We have prepared ourselves to move forward into the 21st century with emphasis on quality."

"The importance of implementing a quality system like ISO 9001 cannot be overemphasized," said Jim Knowlton, VSE's President and COO. "Throughout the company, we work in teams to improve quality and increase operating efficiency. An effective quality management system begins and ends with a heightened awareness of our customers' needs, expectations, and requirements. Our job is to satisfy the customer, and delivering value and quality products and services to the customer is our goal. ISO 9001 is an important tool in helping us guide these efforts."

#### VSE Quality Strategy II - Information Technology

In 1998, VSE continued the process of strengthening its computer and information technology capabilities by focusing on and drawing together the vital tools needed to compete in the 21st century. Concurrently, we implemented a plan to re-engineer and update our core equipment, including telecommunications, by installing new local area network (LAN), wide area network (WAN), and video teleconferencing to improve rapid internal and external communications. These advancements benefit all VSE and allow us to offer these advanced technology capabilities to our customers. We have developed a dynamic, proactive program for keeping current with the advancements in computer technology and refreshing our capabilities and expertise on an evolving basis, maintaining a competitive advantage in the future.

Our efforts over the past year have involved the development and implementation of new and updated systems taking advantage of innovations in desktop, relational database, Internet, telecommunication, network, and programming technologies. Our systems have contributed appreciably to the success of our customers by providing IT solutions and tools that have enabled them to enhance the management of information associated with business, finance, and technical issues. We have actively pursued the resolution of

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Year 2000 (Y2K) challenges, both for internal and external operations, leveraging the information gained into the basis for our IT asset management program. This gives our customers confidence that their systems that work today will work well beyond the year 2000.

Along with updating our information technology capabilities, we have embarked upon enterprise-wide business development efforts. Our efforts include receiving a General Services Administration Information Technology contract that will allow us to provide information technology services and software to many federal government agencies. We regard this opportunity as a business area that can provide significant growth opportunities as we capitalize on our investments in updated computer and information technology. Areas of new business opportunities include Y2K solutions, LAN/WAN implementations, desktop support, networking and telecommunications, web-page design, and systems planning, architecture, design, and implementations. We will build upon our existing broad capabilities and expertise in providing professional information



technology products and services for VSE and our clients to meet the challenges that will face us in this important growth area into the 21st century.

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## Description of Business

### Introduction

VSE Corporation ("VSE") is a Delaware corporation established in 1959. During 1998, VSE and its subsidiaries and divisions operated in two segments: the engineering, logistics, management and technical services segment and the software products and services segment. The term "VSE" or "company" means VSE and its subsidiaries and divisions unless the context indicates operations of the parent company only.

Since incorporation, VSE has provided diversified engineering, technical, and management services, principally to agencies of the United States Government (the "government") and to other government prime contractors.

\* Engineering, logistics, management and technical services including information technology services are provided by VSE and by each of its subsidiaries and divisions including BAV Division, Energetics Incorporated, Human Resource Systems, Inc., Ordnance Division, Value Systems Services Division, and Ship Remediation and Recycling, Inc.

\* Software products and services are the primary business of VSE's subsidiary, CMstat Corporation ("CMstat").

The engineering, logistics, management and technical services segment accounted for 98.3%, 97.9%, 96.3%, and the software products and services segment accounted for 1.7%, 2.1%, 3.7% of VSE's consolidated revenues from continuing operations in 1998, 1997, and 1996, respectively.

### Services and Products

#### Engineering, Logistics, Management and Technical Services Segment

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

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

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### Description of Business

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

#### Software Products and Services Segment

Through its subsidiary, CMstat, VSE markets a series of proprietary products (the CMstat System) used in configuration, workflow, and change management applications across a variety of functions including design and engineering, prototype, manufacturing, purchasing, and support and maintenance.

#### Marketing

VSE marketing activities are conducted by its professional staff of engineers, analysts, program managers, contract administrators, and other personnel. Information concerning new programs and requirements becomes available in the course of contract performance, through formal and informal briefings, from participation in professional organizations, and from literature published by the government, trade associations, professional organizations, and commercial entities.

#### Contracts

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. Billing for services is generally accomplished by billing customers for a specified level-of-effort incurred in performing a project or providing a service or for installed products, systems, and maintenance charges.

Depending on solicitation requirements and other factors, VSE offers its professional and technical services and products through various competitive contract arrangements and business units which are responsive to customer requirements and which may also provide an opportunity for diversification. Such arrangements include prime contracts, subcontracts, cooperative arrangements, joint ventures, dedicated ventures, dedicated cost centers, separate profit centers (divisions), and subsidiaries.

During 1998, VSE's six largest contracts accounted for approximately 80% of total revenues, and one such contract with the U.S. Navy accounted for more than 52% of such revenues. The contract was awarded in 1995 and included a base year and nine option year periods which expire in July 2005. See "Results of Operations - Revenues" in "Management Discussion and Analysis" for further discussion of this contract.

The following table shows the revenues of VSE and its subsidiaries and divisions by customer or agency:

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Description of Business

<TABLE>

VSE Revenues by Customer or Agency  
(Dollars in thousands)

<CAPTION>

Group or Agency	1998		1997		1996	
	Revenues	%	Revenues	%	Revenues	%
U.S. Navy	\$131,911	73.2%	\$108,416	69.5%	\$ 75,232	62.6%
U.S. Army	19,577	10.9	19,423	12.5	18,880	15.7
All other government	27,991	15.5	25,804	16.6	23,836	19.8
Commercial	754	0.4	2,220	1.4	2,139	1.4
<b>Total</b>	<b>\$180,233</b>	<b>100.0%</b>	<b>\$155,863</b>	<b>100.0%</b>	<b>\$120,087</b>	<b>100.0%</b>

</TABLE>

During 1998, VSE provided services to the government and other prime contractors under approximately 235 contracts, some of which are of an indefinite delivery/indefinite quantity ("ID/IQ") ordering nature. ID/IQ 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 ID/IQ arrangements are normally performed and completed within a one year period. During 1998, VSE provided services under approximately 1,220 such delivery orders or task orders.

VSE has expanded its engineering services customer base to non-defense clients, such as the U.S. Postal Service and the U.S. Department of Energy.

Human Resource Systems, Inc. ("HRSI") competes for certain technical and consulting service work. Through this subsidiary, VSE provides technical personnel and health care professionals and technicians to work on-site at customer facilities at the direction of customer management. In 1996, an HRSI joint venture was awarded a five-year, \$60 million contract to provide nursing and allied services for a regional naval medical center.

Value Systems Services was awarded a contract in 1994 to provide logistic support services for Naval aircraft, helicopters, and airborne weapons systems. This contract has the potential to generate revenues to VSE of about \$77 million over a five-year period ending in 1999.

In 1991, VSE formed VSE Services Corporation ("VSES") as a subsidiary to compete for certain contracts. VSES has been inactive since 1992. In 1999, VSES changed its name to Ship Remediation and Recycling, Inc.

In 1995, VSE made two acquisitions to expand and diversify its business base:

\* In May 1995, VSE acquired CMstat Corporation, an information technology company located in San Diego, California. CMstat is a leading supplier of commercial (off-the-shelf) software products and technology to manage engineering, product, and configuration management data.

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#### Description of Business

\* In August 1995, VSE acquired Energetics Incorporated, an energy management and environmental technology company located in Columbia, Maryland. Energetics provides technical and management services for advanced technology programs, primarily for the Department of Energy and other government and commercial clients.

In 1995, VSE formed the BAV Division to compete for an engineering, technical and support services contract for U.S. Navy ships to be sold, leased, or otherwise transferred to foreign governments. BAV was awarded this contract in August 1995. This contract accounted for 52% of VSE's revenues in 1998 and has the potential to generate total revenues of over \$1 billion depending on delivery order requirements and option periods exercised through the year 2005.

In 1996, a VSE joint venture was awarded an approximately \$12 million fixed-price production contract to produce more than 100 common bridge transporter systems for the U.S. Army. VSE is expected to receive approximately one-half of the total program value. This contract is expected to be substantially completed in 1999.

In 1998, VSE formed the Ordnance Division to provide engineering support services in the field of energy and associated systems support.

Schmoltdt Engineering Services Company, which was acquired by VSE in 1990, was divested in February 1996.

VSE Corona, Inc., which was formed by VSE to perform on a specific contract awarded in 1987, was dissolved in 1997.

#### Personnel

VSE services are provided by a staff of professional, scientific, medical, and technical personnel having high levels of education, experience,

training, and skills. As of February 1999, VSE employed approximately 1,300 employees, including approximately 300 part-time personnel.

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

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Description of Business

Facilities

VSE's principal executive and administrative offices are located in a five story building in Alexandria, Virginia, leased by VSE through the year 2003. This building contains approximately 108,000 square feet of engineering, shop, and administrative space. VSE also provides services and products from approximately 20 U.S. branch offices located at or near customer sites to facilitate communications and enhance project performance. Branch offices are generally occupied under short term leases and currently include an aggregate of approximately 195,000 square feet of office and warehouse space. VSE employees often provide services at customer facilities, limiting VSE's requirement for additional space. BAV provides services from several locations outside of the United States (generally at foreign shipyards); these services are often of short duration based on "tiger team" or "as-ordered" requirements.

VSE owns and operates an engineering test center in Ladysmith, Virginia, consisting of approximately 44 acres of land and an improved storage and vehicle maintenance facility. This facility has been used by VSE to test military and commercial equipment for which VSE provides system technical support or other engineering services and to supplement Alexandria, Virginia, shop facilities. Current engineering test center projects include the construction of certain ocean engineering contract deliverable items such as ship camels, pier fenders, and plate anchor drive followers.

Backlog

As of December 31, 1998, VSE had proposals pending for engineering services contracts covering approximately \$239 million in services for the Department of Defense or other government agencies or prime contractors. If these contracts are awarded to VSE, resulting ordering periods could extend through 2004. However, there is no assurance that VSE will be the successful bidder for any of these contracts. Moreover, there can be no assurance that contract awards, if any, will all result in revenues to VSE because (a) contract awards may be rescinded as a result of the government's bid protest procedures, (b) contracts may not be funded at the nominal amounts cited in competitive bid announcements, and (c) contracts when funded may be terminated at the convenience of the government.

During 1998 and 1997, VSE was awarded contracts having potential ceiling values of approximately \$124 million and \$120 million, respectively.

VSE's funded backlog of work as of December 31, 1998, 1997, and 1996 was approximately \$122 million, \$110 million and \$120 million, respectively. "Funded" backlog is defined as orders for services that have not been fully rendered and for which funding has been provided either at the time of award or thereafter. Substantially all of the funded backlog is expected to be completed within one year.

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#### Description of Business

The excess of unfulfilled contract estimates over the incremental funding authorized represents an "unfunded" backlog. Based on the total estimated value of contracts actually awarded, the potential revenues for work remaining to be performed under existing contracts (both funded and unfunded backlog) was approximately \$1 billion, \$1.2 billion, and \$1.3 billion, as of December 31, 1998, 1997 and 1996, respectively. VSE has no reasonable basis on which to determine when or if such unfunded backlog may be funded. Because of uncertainties associated with changing program requirements and the ultimate availability of funds, VSE believes that measurements of unfunded backlog are of limited use in evaluating future workload.

#### Competition and Risks

**Competition.** The professional and technical services industry in which VSE is engaged is very competitive. There are a substantial number of other organizations, including large, diversified firms with greater financial resources and larger technical staffs, which are capable of rendering essentially the same services as those offered by VSE. Such companies may be publicly owned or privately held and may be divisions of much larger organizations including large manufacturing corporations.

The government's own "in-house" capabilities are also, in effect, competitors of VSE (including the government's own nonprofit federally funded research and development centers) because government employees often perform many of the services that might otherwise be performed by VSE.

It is not possible to predict the extent and range of competition which VSE will encounter as a result of changing economic or competitive conditions, customer requirements, or technological developments. Competition in the government contract business has intensified since 1987 due to declining government budgets, and such markets are often dominated by one or a few "niche" companies. 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.

Since 1993, the government has initiated a series of changes designed to improve and streamline its acquisition policies and procedures. Such changes include an emphasis on very large contracts, which may reduce the potential number of qualified bidders; past performance, which may be used to exclude entrance into new government markets; multiple-award schedules, which may result in unequal contract awards between successful contractors; and best value contract awards, which reduce the advantages of price competition. The net effect of all such changes on future VSE revenues is unknown.

**Risks.** Sales of key business process or enterprise-wide computer software, such as the software sold by CMstat, are subject to a lengthy sales cycle which may exceed one year in some instances. The length of the sales cycle increases marketing costs, increases the risk of product obsolescence, makes it difficult to predict the timing and amount of revenues, and may result in large negative cash flows and operating losses pending the final

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#### Description of Business

results of such sales efforts. The company's engineering and technical services are typically provided under cost-plus-fee, time and materials or fixed-price contracts. Under cost-plus-fee contracts, the customer reimburses VSE for its allowable costs permitted by regulations and pays a fee based on negotiated terms. Under time and materials contracts, the customer pays VSE at fixed hourly rates for direct labor costs and the related overhead and profit, and reimburses VSE for the cost of materials without profit. Under fixed-price

contracts, the customer pays an agreed price for services or products. Under fixed-price contracts and time-and-materials contracts, VSE bears the risk that increased or unexpected costs may reduce its profit or cause it to sustain a loss. To the extent VSE incurs actual costs below anticipated costs on these contracts, VSE realizes greater profit margins.

Government agencies have placed an increased emphasis on awarding contracts of the types performed by VSE on a competitive basis as opposed to a non-competitive basis. All significant contracts currently being performed by VSE were either initially awarded on a competitive basis or have been renewed at least once on a competitive basis. Countering this trend are contracts awarded by the General Services Administration which provide a schedule of services at fixed prices which may be ordered by potential customers essentially outside of the solicitation process. In some cases, these contracting methods may pose substantial risks to traditional VSE business development efforts. While VSE has been awarded a GSA schedule contract in 1999, there is no assurance that VSE will be successful in obtaining work under this contract arrangement.

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

VSE's business is subject to the risks arising from global economic conditions associated with potential foreign customers served through VSE's contracts with the U.S. Government. For example, the reported economic slowdown of certain countries located in Southeast Asia could potentially affect BAV sales.

Government contracts are subject to termination at the government's convenience, which means that the government may terminate the contract at any time, without cause. However, during VSE's 40-year history the aggregate amount of such government terminations for convenience has not been material. If a government contract is terminated for convenience, generally VSE is reimbursed for its allowable costs to the date of termination and is paid a proportionate amount of the stipulated profit or fee for the work actually performed.

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## Management Discussion and Analysis

The discussion and analysis which follows is intended to assist in understanding and evaluating the results of operations, financial condition, and certain other matters of VSE Corporation and its wholly owned subsidiaries ("VSE" or the "company"), including CMstat Corporation ("CMstat"), Energetics Incorporated ("Energetics"), Human Resource Systems, Inc. ("HRSI"), Ship Remediation and Recycling, Inc. ("SRR") (formerly VSE Services Corporation, ("VSES")), and Value Systems Services ("VSS"), BAV and Ordnance, 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"). SRR has generally been inactive since 1992. Intercompany sales are principally at cost and have been eliminated from the consolidated financial statements.

### Results of Operations

#### Revenues

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

<TABLE>

Revenues from Continuing Operations  
(dollars in thousands)

<CAPTION>

Company or Business Unit	1998		1997		1996	
	Revenues	%	Revenues	%	Revenues	%
-----						
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Engineering, Logistics, Management and Technical Services Segment:						
VSE (parent only) . . . . .	\$ 52,089	28.9	\$ 50,126	32.2	\$ 47,404	39.5
BAV . . . . .	93,564	52.0	75,296	48.3	45,399	37.8
Energetics . . . . .	11,984	6.6	11,598	7.4	11,286	9.4
VSS . . . . .	10,182	5.6	9,179	5.9	8,798	7.3
HRSI . . . . .	7,841	4.4	6,437	4.1	2,729	
Ordnanace . . . . .	1,531	0.8	0	0.0	0	2.3
	-----		-----		-----	
	177,191	98.3	152,636	97.9	115,616	96.3
Software Products and Services Segment:						
CMstat . . . . .	3,042	1.7	3,227	2.1	4,471	3.7
-----						
Total revenues . . . . .	\$180,233	100.0	\$155,863	100.0	\$120,087	100.0
=====						

</TABLE>

Engineering, Logistics, Management and Technical Services Segment

The largest customer for the engineering, logistics, management and technical services rendered by the company is the U.S. Department of Defense ("Defense"), including agencies of the U.S. Army, Navy, and Air Force. VSE's engineering services revenues have historically been subject to year to year fluctuations resulting from changes in the level of Defense spending. Defense

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Management Discussion and Analysis

spending has been reduced in recent years, and there can be no assurance that future reductions in Defense spending will not have a material adverse impact on the company's results of operations or financial position.

Substantially all of the company's revenues from this segment depend on the award of new contracts, on current contracts not being terminated for the convenience of the government, and on the exercise of option periods and the satisfaction of incremental funding requirements on current contracts. In 1998, 1997 and 1996, the company did not experience any termination of contracts for the convenience of the government nor any non-exercise of option periods on current contracts which were material to the company's results of operations or financial position. The increases in revenues between periods is driven primarily by the increased level of activity on the BAV contract.

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. This contract has the potential, if all options are exercised, to generate revenues in excess of one billion dollars over a ten year period from 1995 through 2005. The contract accounted for approximately 52% and 48% of consolidated revenues from continuing operations during 1998 and 1997, respectively. The level of revenues generated by this contract will vary depending on a number of factors including the timing of ship transfers and associated support services ordered by foreign governments and economic conditions of potential customers worldwide. The company experienced significant quarterly revenue fluctuations in 1998 and anticipates that future quarterly revenues will be subject to significant variations primarily due to this contract.

## Software Products and Services Segment

Revenues from the software products and services segment decreased approximately 6% to \$3 million in 1998 compared to 1997, and approximately 28% to \$3.2 million in 1997 compared to 1996. The revenues of this segment depend upon a number of factors including the demand for its products, the size and timing of specific sales, the delay or deferral of customer implementations, the level of product and price competition that it encounters, the length of its sales cycles, and the timing of new product introductions and product enhancements by CMstat and its competitors.

The profitability of this segment is dependent upon CMstat's sales. While management believes that CMstat will generate sufficient revenues to keep pace with its cost structure in 1999, failure to do so could adversely affect the company's results of operations.

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## Management Discussion and Analysis

### Income from Continuing Operations Before Income Taxes

The following table shows consolidated revenues and income from continuing operations before income taxes of VSE segments, other items of income and expense, and such amounts as a percent of segment revenues. Engineering, logistics, management and technical services segment revenues were 98.3%, 97.9% and 96.3% of total revenues for 1998, 1997 and 1996, respectively. Software products and services segment revenues made up the remaining revenues.

<TABLE>

Income (Loss) from Continuing Operations Before Income Taxes  
(dollars in thousands)

<CAPTION>

Description	1998	%	1997	%	1996	%
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Engineering, Logistics, Management And Technical Services Segment:						
Revenues . . . . .	\$177,191	100.0%	\$152,636	100.0%	\$115,616	100.0%
Costs and expenses . .	171,605	96.8	147,649	96.7	111,852	96.7
Gross profit . . . . .	5,586	3.2	4,987	3.3	3,764	3.3
Selling, general and administrative expenses	592	0.3	617	0.4	507	0.4
Interest expense . . .	45	0.0	130	0.1	314	0.3
Income from continuing operations before income taxes . . . . .	\$ 4,949	2.9%	\$ 4,240	2.8%	\$ 2,943	2.6%
Software Products and Services Segment:						
Revenues . . . . .	\$ 3,042	100.0%	\$ 3,227	100.0%	\$ 4,471	100.0%
Costs and expenses . .	4,631	152.2	8,941	277.1	4,138	92.6
Gross (loss) profit . .	(1,589)	(52.2)	(5,714)	(177.1)	333	7.4
Selling, general and administrative expenses	178	5.9	233	7.2	165	3.7
Interest expense . . .	496	16.3	376	11.6	149	3.3
(Loss)income from continuing operations before income taxes . . . . .	\$ (2,263)	(74.4)	\$ (6,323)	(195.9)%	\$ 19	0.4%



</TABLE>

Engineering, Logistics, Management and Technical Services Segment

Costs and expenses of operations, as a percentage of segment revenues, increased by approximately 0.1% in 1998 as compared to 1997. Costs and expenses of operations, as a percentage of segment revenues, were unchanged during 1997 as compared to 1996. The percentage differences between 1998,

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Management Discussion and Analysis

1997 and 1996 are due to a combination of factors, some of which are offsetting, including (a) differences between costs incurred and costs billable (whether they may be billed based on contract provisions), (b) the effects of increases or decreases in facility and equipment lease renewals, fringe benefit programs, and similar period expenses, (c) costs associated with contract start-up and termination phases, (d) narrower profit margins on new work due to increased competition, (e) increased labor costs reflecting a more competitive marketplace for attracting and retaining our employees, (f) the establishment and reversal of reserves for potential contract disallowances due to the timing of government audits on costs incurred, (g) the amount of work performed on certain contracts as a percentage of total revenues, (h) the timing of contract award fees, and (i) effective project and cost management.

Selling, general and administrative expenses as a percentage of segment revenues decreased slightly, 0.1%, in 1998 as compared to 1997 primarily due to the increased revenue base. Selling, general and administrative expenses as a percentage of segment revenues remained constant in 1997 as compared to 1996.

Interest expense as a percentage of segment revenues decreased approximately 0.1% in 1998 as compared to 1997 and approximately 0.2% in 1997 as compared to 1996 due primarily to the application of earnings to reduce the bank debt of this segment and to the improved cash collection cycles on government contracts.

Software Products and Services Segment

Costs and expenses of operations, as a percentage of segment revenues, decreased approximately 125% for 1998 as compared to 1997 due primarily to cost reduction efforts implemented by company management to bring costs to a level consistent with anticipated revenues.

Costs and expenses of operations, as a percentage of segment revenues, increased approximately 185% for 1997 as compared to 1996 due to the failure to consummate several large contracts, higher operating costs incurred in anticipation of such prospective contracts, the writedown of approximately \$725 thousand in leasehold improvements associated with the sublease of CMstat's former headquarters space, and the amortization of approximately \$1.4 million of previously capitalized software development costs.

CMstat's business continues to consist of large contracts with long sales cycles. Cost reduction efforts have been implemented to reduce CMstat's operating cost levels and management believes that future CMstat sales will return to a level commensurate with operating expenses.

Selling, general and administrative expenses, as a percentage of segment revenues, decreased approximately 1.3% during 1998 as compared to 1997. This decrease is primarily due to cost reduction efforts implemented by company management.

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Management Discussion and Analysis

Selling, general and administrative expenses, as a percentage of segment revenues, increased approximately 3.5% during 1997 as compared to 1996. This increase was primarily due to increased marketing expenses.

Interest expense, as a percentage of segment revenues, increased approximately 4.7% in 1998 as compared to 1997 and approximately 8.3% in 1997 as compared to 1996 due primarily to the cost of financing the CMstat operating loss.

The company expects that this segment will experience significant fluctuations in quarterly operating results due largely to the nature of CMstat's business. CMstat's future operating results will depend upon a number of factors, including the demand for its products, the size and timing of specific sales, the delay or deferral of customer implementations, the level of product and price competition that it encounters, the length of its sales cycles, the timing of new product introductions and product enhancements by CMstat and its competitors, the mix of products and services sold, the activities of and acquisitions by its competitors, and its ability to develop and market new products and control costs. CMstat's operating results could also be affected by general economic conditions. In addition, the decision to license and implement an enterprise-level business software system is usually discretionary, involves a significant commitment of customer resources and is subject to delays, budget cycles and to the internal authorization procedures of CMstat's customers. The loss or delay of individual orders could have a significant impact on CMstat's operating results, particularly on a quarterly basis. Furthermore, while CMstat's revenue from license fees is difficult to predict because of the length and variability of CMstat's sales cycles, CMstat's operating expenses are based on anticipated revenue trends. Because a high percentage of these expenses are relatively fixed, a delay in the recognition of revenue from a limited number of license transactions could cause significant variations in operating results from quarter to quarter. To the extent such expenses precede, or are not subsequently followed by, anticipated revenue, the company's operating results could be materially and adversely affected.

CMstat derives substantially greater profit margins from license fees than from service revenues or from sales of third-party equipment and software. The mix of revenues among these three components can fluctuate materially from quarter to quarter, and such fluctuations can have a significant effect on margins. Should lower margin service revenues or revenues from sales of third-party equipment and software increase in the future as a percentage of the company's total revenues, CMstat's margins and income from operations could be adversely affected.

As a result of these and other factors, the company's operating results for any quarter are subject to significant variation, and the company believes that period-to-period comparisons of its operating results are not necessarily meaningful and should not be relied upon as indications of future performance. The company's 1998 quarterly operating results are not a good indicator of future quarterly results.

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Management Discussion and Analysis

Acquisitions and Divestitures

On February 7, 1996, VSE sold its wholly owned subsidiary 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 cash and a promissory note for which principal is payable in installments from January 1, 1997 through September 1, 2001. The transaction resulted in a pretax loss of approximately \$300 thousand.

Liquidity and Capital Resources

Cash Flows

A net increase in cash and cash equivalents of approximately \$30 thousand during 1998 resulted from approximately \$3.4 million provided by operations, approximately \$1.8 million used in financing activities, and approximately \$1.6 million used in investing activities. Significant financing activities included a decrease in bank loan borrowings of approximately \$1.7 million net of commitments for checks outstanding at year end of approximately \$3.9 million. Significant investing activities included approximately \$1.6 million associated primarily with the purchase of computer equipment. Cash flows provided by operating activities decreased in 1998 as compared to 1997 due primarily to an increase in the level of accounts receivable in 1998 that was commensurate with the increased revenues in 1998 as compared with a significant decrease in accounts receivable in 1997 due to collections of accounts receivable on the BAV contract. The decrease in cash flows provided by operating activities due to changes in the level of accounts receivable was offset slightly by cash provided by the increase in net income and the increase in accounts payable.

A net decrease in cash and cash equivalents of approximately \$440 thousand during 1997 resulted from approximately \$8.1 million provided by operations, approximately \$2.7 million used in investing activities, and approximately \$5.8 million used in financing activities. Significant investing activities included approximately \$2.2 million associated with the purchase of property and equipment. Significant financing activities included a decrease in bank loan borrowings of \$5.5 million, net of commitments for checks outstanding at year end of approximately \$3.0 million. Cash flows provided by operating activities increased in 1997 as compared to 1996 due primarily to decreases in accounts receivable by reason of collections of accounts receivable on the BAV contract.

A net decrease in cash and cash equivalents of approximately \$150 thousand during 1996 resulted from approximately \$7 million provided by financing activities, approximately \$4.4 million used in operating activities, and approximately \$2.7 million used in investing activities. Significant financing activities included increased borrowing on the company's revolving term loan, including commitments for checks outstanding at year end, of

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#### Management Discussion and Analysis

approximately \$7.7 million. Significant investing activities included approximately \$3.3 million associated with the purchase of property and equipment, including the new office facilities and equipment for CMstat and the capitalization of software development costs by CMstat.

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

#### Working Capital

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

Government contracts generally require VSE to pay for material and subcontract costs included in VSE's contract billings prior to receiving payment for such costs from the government. However, such contracts generally provide

for progress payments on a monthly or semimonthly basis, thereby reducing requirements for working capital.

## Dividends

Cash dividends were declared at the rate of \$.144 per share during 1998, \$.144 per share during 1997, and \$.138 per share during 1996. Pursuant to its bank loan agreement (see Note 4 of "Notes to Consolidated Financial Statements"), the payment of cash dividends by VSE is subject to annual rate restrictions. VSE has paid cash dividends each year since 1973.

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## Management Discussion and Analysis

### ESOP Advances

During 1998, 1997 and 1996, the company advanced the ESOP trust \$112 thousand, \$330 thousand and \$350 thousand, respectively, in connection with distributions made to terminated participants. In December 1998, the company and the ESOP entered into an agreement in which the ESOP repaid the advances. Under the terms of the agreement, the company purchased 72,000 shares of VSE stock from the ESOP at market price and the ESOP simultaneously returned the proceeds of \$792,000 from the stock sale to the company as repayment of the advances.

### Inflation and Pricing

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

### Global Economic Conditions

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

### Year 2000

Overview. The "Year 2000" problem, or the inability of many computerized systems to properly recognize a date in the year 2000, could potentially affect the company's ability to perform many common business functions. The company recognizes the impact that this could have on its operating and financial results and has implemented a Year 2000 Action Plan ("Y2K Plan") to address the issue. The Y2K Plan includes: 1) Assignment of compliance responsibilities to operating managers, staff directors, information technology staff, contract administration and procurement staff, and the Comptroller. Additionally, the company has assigned a Senior Vice President to serve as the Y2K Coordinator, with responsibility for ensuring development and implementation of the Y2K Plan; 2) Development of a Y2K Communications System to ensure proper information dissemination and reporting with regard to Year 2000 compliance efforts; and 3) Development and implementation of a Year 2000 Compliance Program ("Y2K Program").

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**State of Readiness.** Ongoing assessments of the impact of the Year 2000 issue on systems and operations have been formalized into the Y2K Program. The Y2K Program includes phases for awareness, inventory and assessment, correction and renovation (including validation and testing and implementation), and contingency planning.

**Awareness.** Managers have been informed about the nature of the Year 2000 problem and what the company is doing to address it. This includes: distribution of reference materials and lists of vendor certified Year 2000 compliant hardware, equipment, and software; selection of contact points for each location and organization for Year 2000 compliance issues; and assignment of responsibility for ensuring that operations are not disrupted or are only minimally affected. At this time, all of the company's initially identified efforts associated with the awareness phase have been completed. Additional awareness efforts, if any, will be made as they become known.

**Inventory and Assessment.** Identification is made of all "Mission Critical" actions or functions and of all hardware, equipment, software, and embedded systems used to conduct the "Mission Critical" actions or functions. "Mission Critical" is defined as an action or function that must happen in order to serve a customer or line of business comprising more than 10% of the revenue base or pre-tax profit of an organization within the company. This phase includes: 1) Developing inventory listings of all hardware, equipment, software, embedded systems, operating systems, custom user applications, and contract obligations having a Year 2000 impact; 2) Analyzing and developing corrective actions for each of the items on the inventory listings; 3) Procuring programs and tools to provide compliance for the items on the inventory listings; and 4) Surveying manufacturers and vendors to obtain certification of their products as Year 2000 compliant. The inventory and assessment phase is approximately 80% complete. Analysis of the items on the inventory listing has been done primarily using internally administered programs supplied by independent outside sources. Approximately 90% of the items on the inventory listing have been found to be Year 2000 compliant.

**Correction and Renovation.** The items identified in the inventory and assessment phase are redesigned, repaired, converted, or replaced, as necessary, to ensure Year 2000 compliance. Corrections and renovations are documented and this documentation is distributed to the affected managers and staff. Testing plans are developed and validation and testing occurs. Risk analysis is conducted and contingency planning issues are identified. The correction and renovation phase is in process and is expected to be completed prior to December of 1999.

**Costs.** Costs incurred to date for Year 2000 compliance efforts have been minimal and are included as part of the company's ongoing administrative costs and have not been separately identified. The company continues to upgrade and improve its information technology systems as part of its normal effort to maintain a competitive edge. As these upgrades and improvements are made, the company is ensuring that all are Year 2000 compliant. Therefore, the majority of costs incurred for computer systems that ensure Year 2000 compliance are

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Management Discussion and Analysis

expenditures that are made in the normal course of business. Total property and equipment expenditures for 1998, including expenditures for computers and computer systems, were approximately \$1.6 million. Expenditures for 1999 are expected to remain at about the same level. Accordingly, management believes that the incremental costs of addressing the Year 2000 compliance issue will not materially affect the company's consolidated financial position, liquidity, or results of operations through December 31, 1999.

**Risks.** The full range of potential risks associated with the Year 2000 issue is under review. Potential risks include obligations related to contract performance on current and past contracts, the reliance on infrastructure

services to conduct the company's business operations, and the possibility of liquidity issues caused by payment problems with VSE's banks or government customers. Although management believes that the risks associated with internal issues regarding the Year 2000 problem will be minimal, the risks associated with external issues are difficult to predict. If these external issues cause massive failures to systems upon which the company is reliant, the results could materially affect the company's consolidated financial position, liquidity, or results of operations.

Contingency Plans. The Y2K Plan calls for the development of contingency plans. VSE currently has extra borrowing capacity under its bank loan agreement and intends to maintain this extra borrowing capacity beyond the year 2000 to provide funding in the event of government customer payment problems. Contingency plans related to contract performance obligations and to business operation infrastructure services will be developed prior to December of 1999.

#### Market Risk

The Company does not use derivative instruments to alter the interest characteristics of its debt instruments. The aggregate fair value of the company's financial instruments approximates the carrying value at December 31, 1998.

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#### Executive Officers

William R. Albertoli, 56  
Senior Vice President and  
President, VSS Division

Byron S. Bartholomew, 71  
Executive Vice President,  
Business Development

Thomas J. Corridon, 41  
Senior Vice President,  
Chief Financial Officer and  
Treasurer

Donald M. Ervine, 62  
Chairman and  
Chief Executive Officer

James M. Knowlton, 56  
President and  
Chief Operating Officer,  
President and General Manager,  
BAV Division

Thomas L. Prather, Jr., 58  
Senior Vice President and  
General Manager,  
Land Warfare Group

Mark A. Robin, 45  
Senior Vice President,  
Human Resources and President,  
Human Resource Systems, Inc.

Jayne M. Tuohig, 52  
Senior Vice President and  
General Manager,  
Postal Service Program Center

Paul A. Vander Myde, 62  
Senior Vice President,  
Corporate Affairs

Craig S. Weber, 54  
Senior Vice President and  
Corporate Secretary

#### VSE COMMON STOCK

VSE common stock (par value \$.05 per share) is traded in the Nasdaq National Market System, trading symbol: VSEC  
Newspaper listing: VSE.

The following table sets forth the range of high and low sales price information on VSE common stock for each quarter and annually during the last two years based on information reported by the Nasdaq National Market System and adjusted for the five-for-four stock split in 1997.

<TABLE>  
<CAPTION>

Quarter	High	Low	Dividends
<S>	<C>	<C>	<C>
1997:			
March 31 . . .	\$13.80	\$11.60	\$.036
June 30 . . .	11.80	8.00	.036
September 30 .	10.70	9.60	.036
December 31 .	10.20	9.60	.036
For the year	\$13.80	\$ 8.00	\$.144

1998:			
March 31 . . .	\$ 9.70	\$ 8.125	\$.036
June 30 . . .	10.50	8.00	.036
September 30 .	9.50	7.75	.036
December 31 .	13.00	5.75	.036
For the year	\$13.00	\$ 5.75	\$.144

</TABLE>

There were approximately 1,400 stockholders of VSE common stock as of March 1, 1999, consisting of about 300 stockholders of record plus the number of beneficial owner proxy sets provided in connection with VSE's 1998 Annual Meeting of Stockholders to (a) brokers, banks, and nominees and (b) participants in the VSE Corporation Employee ESOP/401(k) Plan.

VSE has a loan agreement with a bank which permits, subject to absence of any event of default, the payment of cash dividends subject to annual rate restrictions. See Note 4 (Debt) of "Notes to Consolidated Financial Statements" included elsewhere in this Annual Report.

To the Stockholders of VSE Corporation:

We have audited the accompanying consolidated balance sheets of VSE Corporation (a Delaware corporation) as of December 31, 1998 and 1997, and the related consolidated statements of income, stockholders' investment and cash flows for the years ended December 31, 1998, 1997, and 1996. 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 generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of VSE Corporation as of December 31, 1998 and 1997, and the results of its operations and its cash flows for the years ended December 31, 1998, 1997 and 1996, in conformity with generally accepted accounting principles.

/s/ ARTHUR ANDERSEN LLP

ARTHUR ANDERSEN LLP

Washington, D.C.,  
March 5, 1999

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Consolidated Financial Statements

<TABLE>

-----  
Consolidated Balance Sheets As of December 31,  
-----

(in thousands, except share amounts)

<CAPTION>

	1998	1997
	-----	-----
<S>	<C>	<C>
Assets		
Current assets:		
Cash and cash equivalents . . . . .	\$ 49	\$ 15
Accounts receivable, principally		
U.S. Government, net . . . . .	27,574	24,650
Deferred tax assets . . . . .	422	899
Other current assets . . . . .	1,266	1,322
	-----	-----
Total current assets . . . . .	29,311	26,886
	-----	-----
Property and equipment, net . . . . .	5,089	5,034
Deferred tax assets . . . . .	449	309
Intangible assets, net . . . . .	2,836	3,117
Other assets . . . . .	3,052	2,702
	-----	-----
Total assets . . . . .	\$40,737	\$38,048
	=====	=====

Liabilities and Stockholders' Investment

Current liabilities:

Current portion of long-term debt . . . . .	\$ 1,333	\$ 555
Accounts payable and other current liabilities . . . . .	11,846	10,184
Accrued expenses . . . . .	6,388	6,152
Dividends payable . . . . .	79	78



Total current liabilities	19,646	16,969
Long-term debt	5,370	7,108
Deferred compensation	1,871	1,490
Total liabilities	26,887	25,567

Commitments and contingencies (Note 9)

Stockholders' investment:

Common stock, par value \$.05 per share, authorized 5,000,000 shares; issued 2,186,905 in 1998 and 2,165,405 in 1997	109	108
Paid-in surplus	3,832	3,631
Retained earnings	10,701	9,422
ESOP obligation	0	(680)
Treasury stock, at cost (72,000 shares in 1998)	(792)	0
Total stockholders' investment	13,850	12,481
Total liabilities and stockholders' investment	\$40,737	\$38,048

</TABLE>

See accompanying notes

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Consolidated Financial Statements  
<TABLE>

Consolidated Statements of Income For the years ended December 31,

(in thousands, except share amounts)

<CAPTION>

	1998	1997	1996
Revenues, principally from contracts	\$ 180,233	\$ 155,863	\$ 120,087
Costs and expenses of contracts	176,236	156,590	115,990
Gross profit (loss)	3,997	(727)	4,097
Selling, general and administrative expenses	770	850	672
Interest expense	541	506	463
Income (loss) from continuing operations before income taxes	2,686	(2,083)	2,962
Provision (benefit) for income taxes	1,091	(636)	1,016
Income (loss) from continuing operations	1,595	(1,447)	1,946
Discontinued operations, net of tax:			
Loss from operations (net of tax benefit of \$14)	0	0	(25)
Loss on disposal (net of tax benefit of \$118)	0	0	(179)
Net income (loss)	\$ 1,595	\$ (1,447)	\$ 1,742

Basic earnings per share:

Income (loss) from continuing operations	\$ 0.75	\$ (0.68)	\$ 0.89
Loss from discontinued operations	0.00	0.00	(0.09)
Net income (loss)	\$ 0.75	\$ (0.68)	\$ 0.80

Diluted earnings per share:

Income (loss) from continuing operations . . . . .	\$ 0.75	\$ (0.68)	\$ 0.88
Loss from discontinued operations . . . . .	0.00	0.00	(0.09)
	-----		
Net income (loss) . . . . .	\$ 0.75	\$ (0.68)	\$ 0.79
	=====		
Basic weighted average shares outstanding	2,126,151	2,123,544	2,164,505
	=====		

</TABLE>

See accompanying notes

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PAGE  
Consolidated Financial Statements

<TABLE>

-----  
Consolidated Statements of Stockholders' Investment  
-----

(in thousands)

<CAPTION>

	Common Shares	Stock Amount	Paid-In Surplus	Retained Earnings	Treasury Stock	Unrealized Loss on ESOP Obligation	Available-for- Sale Securities
	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Balance at							
December 31, 1995	1,954	\$ 98	\$ 8,338	\$ 21,402	\$(16,285)	\$ 0	\$ 0
Net income for							
the year	--	--	1,742	--	--	--	--
ESOP obligation	--	--	--	--	(350)	--	--
Stock split							
effectuated in the							
form of a 2-for-1							
stock dividend	1,954	97	(97)	--	--	--	--
Unrealized loss							
on marketable							
securities	--	--	--	--	--	(46)	--
Dividends							
declared (\$ .138)	--	--	(304)	--	--	--	--
	-----						
Balance at							
December 31, 1996	3,908	195	8,241	22,840	(16,285)	(350)	(46)
Net loss for							
the year	--	--	(1,447)	--	--	--	--
Purchase of Treasury							
Stock	--	--	--	(70)	--	--	--
ESOP Obligation	--	--	--	--	(330)	--	--
Realized loss on							
marketable							
securities	--	--	--	--	--	46	--
Retirement of							
Treasury Stock	(2,176)	(109)	(4,588)	(11,658)	16,355	--	--
Stock split							
effectuated in the							
form of a 5-for-4							
stock dividend	433	22	(22)	--	--	--	--
Dividends							
declared (\$ .144)	--	--	(313)	--	--	--	--
	-----						
Balance at							
December 31, 1997	2,165	108	3,631	9,422	--	(680)	--
Net income for							
the year	--	--	1,595	--	--	--	--
ESOP Obligation	--	--	--	--	(112)	--	--
Purchase of Treasury							
Stock	--	--	--	(792)	792	--	--
Issuance of stock	22	1	201	--	--	--	--

Dividends  
declared (\$.144)    --    --    --    (316)    --    --    --

Balance at  
December 31, 1998    2,187    \$ 109    \$ 3,832    \$ 10,701    \$ (792)    \$ 0    \$ 0

</TABLE>

See accompanying notes

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Consolidated Financial Statements  
<TABLE>

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

(in thousands)

<CAPTION>

	1998	1997	1996
	-----	-----	-----
<S>	<C>	<C>	<C>
Cash flows from operating activities:			
Net income (loss) .....	\$ 1,595	\$(1,447)	\$ 1,742
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization .....	1,853	2,667	1,344
Amortization of capitalized software development costs ..	0	1,420	147
Discontinued operations .....	0	0	204
Loss on sale of property and equipment .....	5	47	13
Deferred compensation plan expense .....	140	6	141
Change in assets and liabilities, net of discontinued operations (Increase) decrease in:			
Accounts receivable .....	(2,924)	9,057	(17,634)
Other current assets and noncurrent assets .....	(350)	157	(1,255)
Deferred taxes .....	337	(1,327)	518
Increase (decrease) in:			
Current portion of long-term debt .....	778	555	0
Accounts payable and other current liabilities .....	1,715	(3,324)	10,271
Accrued expenses .....	236	311	157
Net cash provided by (used in) continuing operating activities .....	3,385	8,122	(4,352)
Net cash used in discontinued operating activities .....	0	0	(25)
	-----	-----	-----
Net cash provided by (used in) operating activities	3,385	8,122	(4,377)
	-----	-----	-----
Cash flows from investing activities:			
Purchase of property and equipment, (net of proceeds from dispositions) .....	(1,576)	(2,229)	(2,465)
Capitalized software development costs .....	0	(491)	(795)
Net proceeds from sale of Schmoltd Engineering .....	0	0	100
Change in net assets of discontinued operations .....	0	0	440
	-----	-----	-----
Net cash used in investing activities	(1,576)	(2,720)	(2,720)
	-----	-----	-----
Cash flows from financing activities:			
Net (payments of) proceeds from bank loan .....	(1,738)	(5,543)	7,659
Cash dividends paid .....	(315)	(313)	(300)
Net proceeds from (payments of) deferred compensation .....	188	370	(14)
Advance to ESOP .....	680	(330)	(350)
Purchase of Treasury stock .....	(792)	(70)	0
Realized (unrealized) loss on marketable securities .....	0	46	(46)
Issuance of common stock .....	202	0	0
	-----	-----	-----
Net cash (used in) provided by financing activities	(1,775)	(5,840)	6,949
	-----	-----	-----
Net increase (decrease) in cash and cash equivalents .....	34	(438)	(148)

Cash and cash equivalents at beginning of year. . . . .	15	453	601
	-----		
Cash and cash equivalents at end of year. . . . .	\$ 49	\$ 15	\$ 453
	=====		

</TABLE>

See accompanying notes

PAGE  
Notes to Consolidated Financial Statements

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(1) Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include two segments: the engineering, logistics, management, and technical services segment and the software products and services segment. The engineering, logistics, management, and technical services segment is comprised of VSE Corporation and its wholly-owned subsidiaries ("VSE" or the "company"), Energetics Incorporated ("Energetics"), and Human Resource Systems, Inc. ("HRSI"), and the unincorporated divisions of VSE, Value Systems Services ("VSS"), BAV and Ordnance. This segment is engaged principally in providing engineering, testing, management and information technology services to the U. S. Government (the "government"). The Ship Remediation and Recycling, Inc. ("SRR") subsidiary (formerly VSE Services Corporation ("VSES")), has generally been inactive after 1992. The software products and services segment is comprised of VSE's wholly-owned subsidiary CMstat and is engaged principally in software development and sales of software products and services to primarily government prime contractors. Intercompany sales are principally at cost. All significant intercompany transactions have been eliminated in consolidation. Certain prior year balances have been reclassified for comparative purposes.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Accounting Pronouncements

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS No. 131"). SFAS No. 131 requires a public company to report financial and descriptive information about its reportable operating segments. SFAS No. 131 also establishes standards for related disclosures about products and services, geographic areas, and major customers. The company adopted the provisions of the standard in its 1997 annual report.

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS No. 130"). SFAS No. 130 requires a company to report comprehensive income and its components in financial statements. The company adopted the provisions of the standard during the first quarter of 1998. There were no differences between comprehensive income and historical net income reported by the company.

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In February 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 128 "Earnings Per Share" ("SFAS No. 128") which supersedes Accounting Principles Board Opinion No. 15. SFAS No. 128

specifies the computation, presentation, and disclosure requirements for earnings per share ("EPS") for entities with publicly held common stock. The objective of SFAS No. 128 is to make the U.S. standard for computing EPS more compatible with international EPS computations. SFAS No. 128 has been adopted in these financial statements. Refer to "Stockholders' Investment and Earnings Per Share" below for the discussion of EPS.

#### Stockholders' Investment and Earnings Per Share

On December 10, 1997, VSE announced a five-for-four stock split in the form of a stock dividend payable to stockholders of record as of the close of business on December 31, 1997. The stock dividend was distributed on January 7, 1998. 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.

At December 31, 1998, options to purchase 149,023 shares, 38,250 shares and 47,000 shares of common stock at \$10.91, \$13.04, and \$9.42 per share, respectively, were outstanding. There was no dilutive impact on reported earnings per share for 1998 and 1997. The computation for earnings per share from continuing operations for the year ended December 31, 1996 is as follows:

<TABLE>

<CAPTION>

	Net Income from Continuing Operations	Weighted Average Shares	Per-Share Amount
	(in thousands)		
<S>	<C>	<C>	<C>
Basic EPS	\$1,946	2,164,504	\$ 0.89
Assumed Exercise of Options		0	33,747
Diluted EPS	\$1,946	2,198,251	\$ 0.88

</TABLE>

#### Discontinued Operations

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 is payable in monthly installments from January 1, 1997 through September 1, 2001. The transaction resulted in a pretax loss of approximately \$300 thousand to VSE which was recorded in the first quarter of 1996.

The company's consolidated financial statements for 1996 report separately the net assets and operating results of Schmoldt Engineering as discontinued operations pursuant to the provisions of Accounting Principles Board Opinion

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("APB") No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." Schmoldt Engineering operated in the oil and gas pipeline services business, providing its services to commercial customers. The net losses of these operations from January 1, 1996 to February 7, 1996, are included in the consolidated statements of income under "Discontinued operations, net of tax: Losses from operations." Revenue from such operations was \$66 thousand for the period ended February 7, 1996.

#### Cash and Cash Equivalents

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

The company has classified all debt and equity securities as available-for-sale. Available-for-sale securities are carried at fair value with unrealized gains and losses, net of tax, reported as a component of stockholders' investment.

Realized gains and losses are included in other income. Available-for-sale debt securities as of December 31, 1998 and December 31, 1997 consisted of overnight money market accounts of \$3.3 million and \$3.5 million, respectively, secured by U.S. Government agency securities. The estimated fair value of these securities approximated cost, and the amount of gross unrealized gains and losses was not significant. Additionally, the company held available-for-sale marketable securities as of December 31, 1996 with a fair value of \$20 thousand consisting of publicly traded stock. The unrealized loss on these securities as of December 31, 1996 of \$46 thousand is presented as a separate component of stockholders' investment. These securities were sold in December 1997 at a realized loss of \$53 thousand.

#### 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 U.S. Government receivables. The company believes that the fair market value of all financial instruments approximates book value.

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#### Consolidated Statements of Cash Flows

<TABLE>

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

<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
Interest payments . . . . .	\$ 537	\$ 568	\$ 447
Income tax payments . . . . .	903	319	590

</TABLE>

#### 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 U.S. Government under a variety of contracts. Revenues on cost-type contracts are recorded on the basis of recoverable costs incurred and fees earned.

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

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

A substantial portion of the contract and administrative costs is subject to audit by the Defense Contract Audit Agency. In 1996, the company's indirect cost rates were audited and approved for years 1995, 1994, and 1993 with no material changes. This resulted in a reduction of previously established reserves of \$1,044 thousand for contract and audit disallowances related to those years. All audit years prior to 1996 have now been approved. In the opinion of management, the audits of the indirect cost rates for 1998, 1997, and 1996 will not result in material adjustments, if any, to the company's results of operations or financial position.

The company's software revenues result from sales of software licenses and post contract customer support. Revenue from the sale of licenses is recognized upon delivery of the software. Revenue from the support is recognized ratably over the period to which the support agreement relates.

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Property and Equipment

<TABLE>

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

<CAPTION>

	1998	1997
	-----	-----
<S>	<C>	<C>
Computer systems equipment . . . . .	\$ 8,247	\$ 8,262
Furniture, fixtures, equipment, and other . . . . .	4,845	5,043
Leasehold improvements . . . . .	2,278	2,295
Buildings . . . . .	381	381
Land and land improvements . . . . .	385	385
	-----	-----
	16,136	16,366
Less accumulated depreciation . . . . .	(11,047)	(11,332)
	-----	-----
	\$ 5,089	\$ 5,034
	=====	=====

</TABLE>

Depreciation and amortization expense for property and equipment was approximately \$1.5 million for 1998, \$2.3 million for 1997 and \$1.3 million for 1996. Depreciation of computer systems equipment is provided principally by the double-declining method over periods of four to six years. Depreciation of furniture and fixtures is provided principally by the straight-line method over approximately nine years. Depreciation of all other property and equipment is provided principally by the double-declining method over periods of three to twenty years. Depreciation of buildings and land improvements is provided principally by the straight-line method over approximately thirty years.

In March of 1998, the company entered into a sublease agreement for approximately 20,000 square feet formerly occupied by CMstat. Leasehold improvements of approximately \$725 thousand, which will not be recovered by future sublease payments, were fully written down in 1997.

Capitalized Software Development Costs

The company capitalizes certain computer software development costs, primarily associated with CMstat, upon the establishment of technological feasibility. Costs capitalized include labor and associated fringe benefits. These costs are amortized utilizing the straight-line method generally over a period of two years. Accumulated amortization was approximately \$1.5 million as of December 31, 1998 and 1997. Amortization expense for 1998, 1997, and 1996 was approximately \$0, \$1.4 million and \$147 thousand, respectively.

The company performs a quarterly review of the recoverability of such capitalized software costs. At the time a determination is made that capitalized amounts are not recoverable based on the estimated cash flows to be generated from the applicable software, any remaining capitalized amounts are written off. In 1997, approximately \$890 thousand of previously capitalized software development costs were written down completely. No additional software development costs were capitalized in 1998.

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Nonoperating Net Income

Nonoperating net income included in selling, general and administrative

expenses, primarily interest income, was approximately \$39 thousand, \$46 thousand, and \$32 thousand for the years ended December 31, 1998, 1997, and 1996, respectively.

#### Deferred Compensation Plans

Deferred compensation plan expense for the years ended December 31, 1998, 1997, and 1996 was approximately \$140 thousand, \$6 thousand and \$141 thousand, respectively.

Included in other assets are assets of the deferred compensation plans which include equity securities recorded at fair value. The fair value of these securities was approximately \$1,775 thousand and \$1,564 thousand as of December 31, 1998 and 1997, respectively. Because plan participants are at risk for market value changes in these assets, the liability to plan participants fluctuates with the asset values.

#### (2) Acquisitions

On May 31, 1995 the company acquired all of the outstanding stock of CMstat, a leading developer and supplier of commercial off-the-shelf configuration and product data management solutions, for approximately \$970 thousand in cash. The acquisition was accounted for by the purchase method of accounting. The results of CMstat's operations since May 31, 1995 are included in these consolidated financial statements. The company recorded approximately \$1.2 million of identifiable intangible assets, \$800 thousand of deferred taxes related to the identifiable intangible assets and \$400 thousand of goodwill. Goodwill related to this transaction and identifiable intangible assets are being amortized by the straight-line method generally over a period of ten years.

On August 29, 1995 the company acquired all of the outstanding stock of Energetics for approximately \$3.7 million. Energetics assists government and industry in conducting effective technology programs, primarily in the fields of energy use and the environment. The acquisition was accounted for by the purchase method of accounting. The results of Energetics' operations since August 29, 1995 are included in these consolidated financial statements. The company has recorded approximately \$1.5 million of goodwill and \$100 thousand of identifiable intangible assets in connection with this acquisition. Goodwill is being amortized by the straight-line method over fifteen years. Identifiable intangible assets were amortized over one year.

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#### (3) Accounts Receivable

<TABLE>

The components of accounts receivable as of December 31, 1998 and 1997, were as follows (in thousands):

<CAPTION>

	1998	1997
	-----	-----
<S>	<C>	<C>
Billed .....	\$ 11,045	\$ 12,369
Unbilled:		
Retainages .....	133	126
Other (principally December work billed in January) .....	16,481	12,295
Less-Allowance for doubtful accounts .....	(85)	(140)
	-----	-----
Total accounts receivable	\$ 27,574	\$ 24,650
	=====	=====

</TABLE>

The "Unbilled: Other" included in accounts receivable are reported net of an allowance for contract disallowances of approximately \$333 thousand as of December 31, 1998 and approximately \$279 thousand as of December 31, 1997. "Unbilled: Other" also includes certain costs which are not reimbursable under current contracts, but which the company believes will be reimbursable on



execution of contract documentation or amendments increasing funding. Amounts not presently reimbursable included in "Unbilled: Other" were approximately \$485 thousand and \$102 thousand as of December 31, 1998, and 1997, respectively.

Contracts with the U.S. Government, primarily with the U.S. Department of Defense, accounted for more than 95% of revenues in all years presented. These contracts were performed primarily in the engineering services industry. A contract awarded in 1995 with the U.S. Navy accounted for approximately 52% and 48% of such revenues in 1998 and 1997, respectively.

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

(4) Debt

<TABLE>

Long-term debt as of December 31, 1998 and 1997 was as follows (in thousands):

<CAPTION>

	1998	1997
	-----	-----
<S>	<C>	<C>
Bank loan borrowings and commitments . . . . .	\$ 6,703	\$ 7,663
Less portion due within one year . . . . .	(1,333)	(555)
	-----	-----
	\$ 5,370	\$ 7,108
	=====	=====

</TABLE>

VSE has a loan agreement with a syndicate of banks that includes a revolving loan and a term loan and contains certain financial covenants. Under the revolving loan portion of the agreement, VSE can borrow up to \$30 million, subject to a borrowing formula based on billed receivables. Interest is charged at a prime-based rate or an optional LIBOR-based rate. Commitment fees are charged on the unused portion of the revolving loan commitment. The termination date of the revolving loan is May 31, 2000. The original principal amount of the term loan was \$4 million and the term of the loan was four

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years. There were no principal payments due during the first 12 months of the loan. Monthly principal payments of approximately \$111 thousand are due in 36 installments beginning August 1998 through July 2001. Interest on the term loan is charged at a LIBOR-based rate 1% higher than the LIBOR-based rate charged on the revolving loan. The loan agreement contains collateral requirements by which company assets secure amounts outstanding, restrictive covenants that include minimum tangible net worth and cash flow coverage ratio requirements, a limit on annual dividends, and limits on investments and loans to certain affiliates.

Due to losses incurred by VSE's CMstat subsidiary, the company was not in compliance with certain original loan covenants during 1998 and 1997. The loan agreement was amended in July 1997 and again in September 1998 to restate certain terms and conditions of the loan, including the covenants with which the company was not compliant. The company was in compliance during 1998 and 1997 with all covenants of the loan agreement as amended through September 1998.

Included in long-term debt at December 31, 1998 and December 31, 1997 are bank loan principal amounts of approximately \$2.8 million and \$4 million, respectively, and commitments for checks outstanding of approximately \$3.9 and \$3.7 million, respectively.

(5) Accrued Expenses

<TABLE>

The components of accrued expenses as of December 31, 1998 and 1997, were as follows (in thousands):

<CAPTION>

	1998	1997
	-----	-----
<S>	<C>	<C>
Accrued salaries . . . . .	\$ 1,791	\$ 1,700
Accrued vacation . . . . .	1,692	1,595

Estimated future losses on fixed-price and time and material contracts . . . . .	350	257
Other accrued expenses . . . . .	2,555	2,600
	-----	-----
Total accrued expenses	\$ 6,388	\$ 6,152
	=====	=====

</TABLE>

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

VSE established an ESOP/401(k) plan in 1984. Under the provisions of the ESOP, the company and certain of its subsidiaries make contributions into a trust which purchases VSE stock on behalf of employees who meet certain age and service requirements and are employed at the end of the plan year. Contributions at the rate of up to 2% of eligible employee compensation may be made at the discretion of the board of directors. Contributions are allocated, subject to a vesting schedule, pro rata based on eligible employee compensation. The plan expense for VSE and certain of its subsidiaries for 1998, 1997, and 1996, was approximately \$359 thousand, \$236 thousand, and \$328 thousand, respectively.

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The ESOP/401(k) plan held 688,522 shares and 816,211 shares of VSE stock as of December 31, 1998 and 1997, respectively, which receive dividend payments and are included in the weighted average shares for earnings per share calculations.

During 1998, 1997 and 1996, the company advanced the ESOP trust \$112 thousand, \$330 thousand, and \$350 thousand, respectively, in connection with distributions made to terminated participants. The advances were payable to the company when the funds became available. On December 31, 1998 the ESOP trust sold shares to the Company and repaid the advances. The unallocated shares of the company's common stock related to these transactions are not included in the weighted average shares for earnings per share calculations.

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 1998, 1997, and 1996 was approximately \$443 thousand, \$420 thousand, and \$460 thousand, respectively.

(7) Stock Option Plans

1996 Stock Option Plan

<TABLE>

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

<CAPTION>

	1998	1997	1996
	-----	-----	-----
<S>	<C>	<C>	<C>
Net income (loss):	As reported	\$ 1,595	\$(1,447) \$1,742
	Pro forma	1,542	(1,569) 1,643
		=====	=====
Earnings per share:	As reported	\$ 0.75	\$(0.68) \$ 0.79
	Pro forma	0.73	(0.74) 0.75
		=====	=====

</TABLE>

Under the 1996 Plan, the company may grant options for and sell up to an aggregate of 273,698 shares of the common stock of the company. Through

December 31, 1998 the company has granted options for 267,725 shares of common stock priced at 100% of the fair value of the stock at the time of the grant of the option. The maximum term of the options granted is five years. The vesting period is three years and allows for 25% vesting immediately upon date of the grant and an additional 25% on each successive anniversary date

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thereafter. Vesting may be accelerated for shares granted to certain individuals as determined by the Board of Directors. The 1996 Plan will terminate on the earliest of January 1, 2007, or the date on which all options under the 1996 plan have been exercised or terminated.

<TABLE>

Information with respect to stock options is as follows:

<CAPTION>

	Weighted Average Exercise 1998		Weighted Average Exercise 1997		Weighted Average Exercise 1996	
	Price		Price		Price	
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Number of shares under stock options:						
Outstanding at beginning of year	205,283	\$11.38	160,707	\$10.91	0	\$ 0
Granted	47,000	9.42	56,500	13.04	164,225	10.91
Forfeited	(18,010)	11.80	(11,924)	12.83	(3,518)	10.91
Outstanding at end of year	234,273	\$10.95	205,283	\$11.38	160,707	\$10.91
Exercisable at end of year	142,642	\$11.07	91,203	\$11.18	41,056	\$10.91
Weighted average fair value of options granted	\$2.14		\$3.05		\$2.43	

</TABLE>

<TABLE>

The fair value of the options is estimated on the date of grant using the Black-Scholes option pricing model. The following assumptions were used in the pricing calculation for 1998, 1997 and 1996:

<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
Risk free interest rate	5.47%	6.03%	5.14%
Dividend yield	2.00%	2.00%	2.00%
Expected life	3 years	3 years	3 years
Expected volatility	29.00%	29.00%	29.00%

</TABLE>

#### 1998 Stock Option Plan

In May of 1998, the VSE shareholders approved the VSE Corporation 1998 Stock Option Plan (the "1998 Plan"). Under the 1998 Plan, the company may grant options for and sell up to an aggregate of 343,750 shares of common stock. Of the shares available for grant, 15,625 shares may be granted to non-employee directors of VSE, and 328,125 shares may be granted to executive officers and key employees. Each option granted under the 1998 Plan will be granted at the fair market value of VSE's 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 thereafter. No grant of options was made under the 1998 Plan in 1998. On January 1, 1999, the company granted options for 66,000 shares of common stock. The 1998 Plan will

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 terminate on the earliest of May 6, 2008, or the date on which all options under the 1998 Plan have been exercised or terminated.

(8) Income Taxes

<TABLE>

The company files consolidated federal income tax returns with all of its subsidiaries. The components of the provision (benefit) for income taxes for the years ended December 31, 1998, 1997, and 1996 are as follows (in thousands):

<CAPTION>

	1998	1997	1996
	-----	-----	-----
<S>	<C>	<C>	<C>
Current			
Federal .....	\$ 574	\$ 460	\$ 408
State .....	197	231	106
	-----	-----	-----
	771	691	514
Deferred			
Federal .....	249	(1,103)	413
State .....	71	(224)	89
	-----	-----	-----
	320	(1,327)	502
	-----	-----	-----
Provision (benefit) for income taxes	\$1,091	\$ (636)	\$1,016
	=====	=====	=====

</TABLE>

<TABLE>

The differences between the amount of tax computed at the federal statutory rate of 34% and the provision for income taxes for 1998, 1997, and 1996 are as follows (in thousands):

<CAPTION>

	1998	1997	1996
	-----	-----	-----
<S>	<C>	<C>	<C>
Tax at statutory federal income tax rate . . .	\$ 913	\$ (708)	\$1,007
Increases (decreases) in tax resulting from:			
State taxes, net of federal tax benefit . .	179	39	124
Permanent differences for tax . . . . .	38	33	3
Other, net . . . . .	(39)	0	(118)
	-----	-----	-----
Provision (benefit) for income taxes	\$1,091	\$ (636)	\$1,016
	=====	=====	=====

</TABLE>

<TABLE>

The company's deferred tax assets (liabilities) as of December 31, 1998 and 1997, 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>

	1998	1997
	-----	-----
<S>	<C>	<C>
Current deferred tax assets . . . . .	\$1,265	\$1,421
Current deferred tax liabilities . . . . .	(843)	(522)
	-----	-----
Net current deferred tax assets . . . . .	422	899
Noncurrent deferred tax assets . . . . .	1,251	1,151
Noncurrent deferred tax liabilities . . . . .	(752)	(792)
Valuation allowance . . . . .	(50)	(50)
	-----	-----
Net noncurrent deferred tax assets . . . . .	449	309
	-----	-----
Net deferred tax assets . . . . .	\$ 871	\$1,208
	=====	=====

</TABLE>

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

<TABLE>

The tax effect of temporary differences representing deferred tax assets and liabilities as of December 31, 1998 and 1997, are as follows (in thousands):

<CAPTION>

	1998	1997	
	-----	-----	
<S>	<C>	<C>	
Deferred compensation . . . . .	\$ 1,413	\$ 1,265	
Accrued expenses . . . . .	267	312	
Accelerated depreciation . . . . .	232	301	
Other . . . . .	182	150	
Allowance for contract and other disallowances . . . . .	129	109	
Bad debt expense . . . . .	35	57	
Retainages not taxed until billed. . . . .	(402)	(429)	
Deferred revenues . . . . .	(440)	65	
Intangible assets . . . . .	(495)	(572)	
	-----	-----	
Valuation allowance . . . . .	921	1,258	
	-----	-----	
Net deferred tax assets	\$ 871	\$ 1,208	
	=====	=====	

</TABLE>

#### (9) Commitments and Contingencies

##### Leases

The principal facilities of the company and its subsidiaries are generally rented under noncancelable operating leases for periods of one to ten years. The company and its subsidiaries also lease furniture and equipment generally under noncancelable operating leases for periods of one to five years. Rent expense for 1998, 1997, and 1996 was approximately \$2.4 million, \$3.2 million, and \$2.9 million, respectively, which was net of sublease income of approximately \$464 thousand, \$318 thousand, and \$425 thousand, respectively. The future minimum annual rental required under leases having remaining noncancelable lease terms in excess of one year, net of noncancelable sublease income, will approximate \$2 million in 1999, \$1.9 million in 2000, \$1.6 million in 2001, \$1 million in 2002, \$598 thousand in 2003 and \$2.4 million thereafter.

##### Litigation

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

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#### (10) Segment Information

VSE has two reportable segments: the engineering, logistics, management, and technical services segment which provides diversified engineering, technical, and management services ("ELMTS"), principally to agencies of the United States Government and to other government prime contractors; and the software products and services segment, which provides application software and services ("SPS") related to the installation of the software to primarily commercial customers.

The accounting policies are the same as those described in the summary of significant accounting policies for each segment. VSE's reportable segments are strategic business units that offer different products and services. They are

managed separately because each business requires different technology and marketing strategies. The software products and services segment was acquired as a unit, and the management has been maintained separately since the acquisition.

<TABLE>

The following table presents revenues and other financial information by business segment for the years 1998, 1997, and 1996, in thousands:

<CAPTION>

1998	ELMTS	SPS	Eliminations	Consolidated
<S>	<C>	<C>	<C>	<C>
Revenues from unaffiliated customers	\$177,191	\$3,042	\$	\$180,233
Interest expense	45	496		541
Depreciation and amortization		1,602	251	1,853
Operating income (loss)	4,949	(2,263)		2,686
Assets	63,278	2,345	(24,886)	40,737
Expenditures for capital assets	1,538	55		1,593
1997				
<S>	<C>	<C>	<C>	<C>
Revenues from unaffiliated customers	\$152,636	\$3,227	\$	\$155,863
Interest expense	130	376		506
Depreciation and amortization		1,622	2,465	4,087
Operating income (loss)	4,240	(6,323)		(2,083)
Assets	53,917	2,498	(18,367)	38,048
Expenditures for capital assets	1,826	974		2,800
1996				
<S>	<C>	<C>	<C>	<C>
Revenues from unaffiliated customers	\$115,616	\$4,471	\$	\$120,087
Interest expense	314	149		463
Depreciation and amortization		1,261	230	1,491
Operating income	2,943	19		2,962
Assets	51,141	4,421	(7,221)	48,341
Expenditures for capital assets	1,101	2,166		3,267

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Selected Quarterly Data

</TABLE>  
<TABLE>

Selected Quarterly Data (Unaudited)  
(in thousands, except earnings per share)  
<CAPTION>

	1998 Quarters			
	1st	2nd	3rd	4th
<S>	<C>	<C>	<C>	<C>
Revenues . . . . .	\$41,664	\$39,031	\$45,082	\$54,456
Gross profit . . . . .	\$ 641	\$ 707	\$ 1,308	\$ 1,341
Income from continuing operations . . .	\$ 178	\$ 189	\$ 673	\$ 555
Net income . . . . .	\$ 178	\$ 189	\$ 673	\$ 555
Weighted average shares outstanding . .	2,130	2,132	2,122	2,121
Basic earnings per share:				

Income from continuing operations	\$ .08	\$ .09	\$ .32	\$ .26
Net income per share	\$ .08	\$ .09	\$ .32	\$ .26
Diluted earnings per share:				
Weighted average shares outstanding	2,130	2,132	2,122	2,121
Income from continuing operations	\$ .08	\$ .09	\$ .32	\$ .26
Net income per share	\$ .08	\$ .09	\$ .32	\$ .26

1997 Quarters

	1st	2nd	3rd	4th
<S>	<C>	<C>	<C>	<C>
Revenues	\$47,494	\$32,170	\$34,564	\$41,635
Gross profit (loss)	\$ 142	\$ 11	\$ 641	\$(1,521)
(Loss) income from continuing operations	\$ (277)	\$ (156)	\$ 8	\$(1,022)
Net (loss) income	\$ (277)	\$ (156)	\$ 8	\$(1,022)
Weighted average shares outstanding	2,146	2,122	2,114	2,114
Basic earnings per share:				
Loss from continuing operations	\$ (.13)	\$ (.07)	\$ 0	\$ (.48)
Net loss per share	\$ (.13)	\$ (.07)	\$ 0	\$ (.48)
Diluted earnings per share:				
Weighted average shares outstanding	2,146	2,122	2,114	2,114
Loss from continuing operations	\$ (.13)	\$ (.07)	\$ 0	\$ (.48)
Net loss per share	\$ (.13)	\$ (.07)	\$ 0	\$ (.48)

</TABLE>

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Form 10-K

Securities and Exchange Commission  
Washington, D. C. 20509

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, 1998  
Commission File No. 0-3676

Registrant: VSE Corporation  
Incorporated in the State of Delaware  
IRS Employer Identification No. 54-0649263  
Address: 2550 Huntington Avenue Alexandria, Virginia 22303-1499  
Telephone: (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.

VSE Corporation 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  
and has been subject to such filing requirements for the past 90 days.

Disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is contained in definitive proxy statements incorporated by reference in Part III of this Form 10-K.

The aggregate market value (average of high and low sales prices) of VSE Corporation voting stock held by non-affiliates as of March 1, 1999, was approximately \$21 million.

As of March 1, 1999, 2,114,905 shares of VSE Corporation Common Stock were outstanding.

Portions of the Registrant's 1998 Annual Report for the year ended December 31, 1998, are incorporated by reference into Part I and II of this report.

Portions of the Registrant's Proxy Statement for the Annual Meeting of Stockholders expected to be held on May 6, 1999, are incorporated by reference in Part III of the Form 10-K.

#### Signatures

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

VSE Corporation

Registrant

C. S. Weber, Senior Vice President and Corporate Secretary

March 18, 1999

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed on March 17, 1999, by the following persons in the capacities indicated:

D. M. Ervine  
Chairman and Chief Executive Officer

J. M. Knowlton  
President and Chief Operating Officer

T. J. Corridon  
Senior Vice President and Principal Financial Officer

T. R. Loftus  
Vice President and Principal Accounting Officer

A majority of the Directors of the Registrant whose names appear on page 54.

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Form 10K Cross-Reference Index

Part	Item	Page(s)
I.	1. Business	14-20
	2. Properties	5-13
	3. Legal Proceedings	48
	4. Submission of Matters to a Vote of Security Holders	None
	- Executive Officers of the Registrant	31
II.	5. Market for Registrant's Common Stock and Related Stockholder Matters	31
	6. Selected Financial Data	1
	7. Management's Discussion and Analysis of Financial Condition and Results of Operations	21-30
	8. Financial Statements and Supplementary Data	33-49
	9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	None
III.	10. Directors and Executive Officers of the Registrant	*
	11. Executive Compensation	*
	12. Security Ownership of Certain Beneficial Owners and Management	*



	13. Certain Relationships and Related Transactions	*
IV.	14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K	
	(a) (1) Financial Statements:	
	Report of Independent Public Accountants	32
	Consolidated Balance Sheets	33
	Consolidated Statements of Income	34
	Consolidated Statements of Stockholder's Investments	35
	Consolidated Statements of Cash Flows	36
	Notes to Consolidated Financial Statements	37-49
	(a) (2) Financial Statement Schedules: None	
	(a) (3) Exhibits:	
	Exhibits Filed with the Report:	
	Subsidiaries of the Registrant	+
	Employment Agreement entered into as of October 21, 1998, by and between VSE Corporation and Donald M. Ervine	+
	Employment Agreement entered into as of January 15, 1999, by and between VSE Corporation and Energetics, Incorporated and Robert J. Kelly	+
	Employment Agreement entered into as of December 10, 1997, by and between VSE Corporation and James M. Knowlton	+
	Restated Certificate of Incorporation Amended By-Laws	+
	Exhibits Incorporated by Reference:	
	Specimen Stock Certificate	+
	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.	+
	Deferred Supplemental Compensation Plan	+

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Form 10K Cross-Reference Index

Part	Item	Pages(s)
	Stock Purchase Agreement dated August 19, 1995 by and between VSE Corporation and the - shareholders of Energetics Incorporated	+
(b)	Reports on Form 8-K: None	

\*The information required by Part III, Items 10 through 13, is incorporated by reference from portions of the VSE Corporation Notice of 1998 Annual Meeting and Proxy Statement.

+Copies of financial statement schedules and exhibits are available on request.

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Officers and Directors

Officers

Chairman of the Board  
and Chief Executive Officer  
Donald M. Ervine

President and  
Chief Operating Officer  
James M. Knowlton

Executive Vice President,  
Business Development  
Byron S. Bartholomew

Senior Vice President and  
Corporate Secretary  
Craig S. Weber

Senior Vice President,  
Chief Financial Officer  
and Treasurer  
Thomas J. Corridon

Senior Vice Presidents  
William R. Albertolli  
Thomas L. Prather, Jr.  
Mark A. Robin  
Jayne M. Tuohig  
Paul A. Vander Myde

Vice Presidents  
Sushil K. Baluja  
Peter J. Desrosiers  
John S. Gilroy  
Michael E. Hamerly  
H. Eugene Hosier  
Thomas R. Loftus  
Jeffrey H. McCurdy  
George M. Musick, III  
John J. Werbowski

Assistant Vice Presidents  
Bryan E. Adams  
Stephen W. Austin  
Deborah R. Blakeman  
Laura K. Forest  
Richard A. Hannah  
John P. Morse  
M. Darleen Stein

#### Board of Directors

Donald M. Ervine  
Chairman of the Board, VSE  
Corporation

Robert J. Kelly  
Admiral, U.S. Navy (Ret.);  
Chairman of the Board and  
President,  
Energetics Incorporated.

James M. Knowlton  
President, VSE Corporation

Calvin S. Koonce, Ph.D.  
President, Koonce Securities,  
Inc.

Joseph M. Marchello, P.E., Ph.D.  
Professor, Old Dominion  
University; formerly Chancellor  
of the University of Missouri  
Rolla

David M. Osnos  
Senior Member,  
Arent Fox Kintner Plotkin &  
Kahn, PLLC, Attorneys-at-Law

Jimmy D. Ross  
General, U.S. Army (Ret.);  
Senior Vice President,  
Biomedical Services, American  
Red Cross

Bonnie K. Wachtel  
Vice President and General  
Counsel, Wachtel & Co., Inc.  
Brokers and Underwriters

Director Emeritus

Harold P. Weinberg  
formerly Senior  
Vice President and Director  
(1961-1996), VSE Corporation

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Corporate Address

VSE's principal executive offices are located at 2550 Huntington Avenue, Alexandria, Virginia 22303-1499. The telephone number is (703) 960-4600. The telecopier number is (703) 960-2688. The Company's Internet address is <http://www.vsecorp.com>.

Stockholder Inquiries

Inquiries concerning stock ownership, dividends, and stockholder changes of address may be directed to Registrar and Transfer Company, 10 Commerce Drive, Cranford, New Jersey 07016, (1-800-346-6084) or to the company at 2550 Huntington Avenue, Alexandria, Virginia 22303-1499, Attention: Corporate Secretary.

This Annual Report contains statements which, to the extent that they are not recitations of historical fact, constitute "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All forward looking statements involve risks and uncertainties. The forward looking statements in this document are intended to be subject to the safe harbor protection provided by Sections 27A and 21E. For a discussion identifying some important factors that could cause actual VSE results to differ materially from those anticipated in the forward looking statements, please see VSE's Securities and Exchange Commission filings, including but not limited to the discussions captioned "Letter to Stockholders" on pages 2 through 4 and "Description of Business" including the discussion on "competition and risks" contained on pages 14 through 20 of VSE's Annual Report on Form 10-K for the fiscal year ended December 31, 1998 ("SEC Form 10-K"); "Management Discussion and Analysis" on pages 21 through 30 of this Annual Report; and "Note 1 -- Summary of Significant Accounting Policies" and "Note 9 - -- Commitments and Contingencies" included in the Notes to Consolidated Financial Statements included on pages 37 through 49 of this Annual Report and incorporated by reference into the SEC Form 10-K.

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EXHIBIT III

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EXHIBIT IV

VSE CORPORATION  
CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our reports incorporated by reference in this Form 10-K, into the Company's previously filed Registration Statement File Numbers 333-15307, 333-15309, and 333-15311.

/s/ ARTHUR ANDERSEN LLP

ARTHUR ANDERSEN LLP

Washington, D.C.,  
March 19, 1999

## EXHIBIT V

### BY-LAWS OF VSE CORPORATION (As Amended Through July 14, 1998)

#### ARTICLE I

##### OFFICES

Section 1. The registered office of the corporation shall be in the City of Wilmington, County of New Castle, State of Delaware.

Section 2. The corporation may also have offices at such other places both within and without the State of Delaware as the board of directors may from time to time determine or the business of the corporation may require.

#### ARTICLE II

##### MEETING OF STOCKHOLDERS

Section 1. All meetings of the stockholders for the election of directors shall be held in the Washington, D.C., metropolitan area, at such place as may be fixed from time to time by the board of directors, or at such other place as shall be designated from time to time by the board of directors and stated in the notice of the meeting. Meetings of stockholders for any other purpose may be held at such time and place, within or without the State of Delaware, as shall be stated in the notice of the meeting or in a duly executed waiver of notice thereof.

Section 2. Annual meetings of stockholders, commencing with the year 1986, shall be held in the month of May each year at a date and at a time to be fixed by the board of directors and stated in the notice of meeting, at which time they shall elect by a plurality vote a board of directors, and transact such other business as may properly be brought before the meeting.

Section 3. Written notice of the annual meeting stating the place, date and hour of the meeting shall be given to each stockholder entitled to vote thereat at least ten days before the date of the meeting.

Section 4. The officer who has charge of the stock ledger of the corporation shall prepare and make, at least ten days before every meeting of stockholders, a complete list of the stockholders entitled to vote at said meeting, arranged in alphabetical order, showing the address of and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten days prior to the meeting, either at a place within the city, town or village where the meeting is to be held and which place shall be specified in the notice of the meeting, or, if not specified, at the place where said meeting is to be held. The list shall also be produced and kept at the time and place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present.

Section 5. Special meetings of the stockholders, for any purpose or purposes, unless otherwise prescribed by statute or by the certificate of incorporation, may be called by the chairman and chief executive officer and shall be called by the chairman and chief executive officer or secretary at the request in writing of a majority of the board of directors, or at the request in writing of stockholders owning twenty-five percent (25%) in amount of the entire capital stock of the corporation issued

and outstanding and entitled to vote. Such request shall state the purpose or purposes of the proposed meeting.

Section 6. Written notice of a special meeting of stockholders, stating the place, date and hour of the meeting and the purpose or purposes for which the meeting is called, shall be given to each stockholder entitled to vote thereat, at least five days before the date fixed for the meeting.

Section 7. Business transacted at any special meeting of stockholders shall be limited to the purposes stated in the notice.

Section 8. The holders of a majority of the stock issued and outstanding and entitled to vote thereat, present in person or represented by proxy, shall constitute a quorum at all meetings of the stockholders for the transaction of business except as otherwise provided by statute or by the certificate of incorporation. If, however, such quorum shall not be present or represented at any meeting of the stockholders, the stockholders entitled to vote thereat, present in person or represented by proxy, shall have power to adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present or represented. At such adjourned meeting at which a quorum shall be present or represented any business may be transacted which might have been transacted at the meeting as originally notified. If the adjournment is for more than thirty days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting.

Section 9. When a quorum is present at any meeting, the vote of the holders of a majority of the stock having voting power present in person or represented by proxy shall decide any question brought before such meeting, unless the question is one upon which by express provision of the statutes or of the certificate of incorporation, a different vote is required in which case such express provision shall govern and control the decision of such question.

Section 10. Unless otherwise provided in the certificate of incorporation, each stockholder shall at every meeting of the stockholders be entitled to one vote in person or by proxy for each share of the capital stock having voting power held by such stockholder, but no proxy shall be voted on after three years from its date, unless the proxy provides for a longer period.

Section 11. Unless otherwise provided in the certificate of incorporation, any action required to be taken at any annual or special meeting of stockholders of the corporation, or any action which may be taken at any annual or special meeting of such stockholders, may be taken without a meeting, without prior notice and without a vote, if a consent in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted. Prompt notice of the taking of the corporate action without a meeting by less than unanimous written consent shall be given to those stockholders who have not consented in writing.

### ARTICLE III

#### DIRECTORS

Section 1. The number of directors which shall constitute the whole board shall be a minimum of six directors and a maximum of ten directors. Within the limits above specified, the number of directors shall be determined by resolution of the board of directors or by the stockholders at the annual meeting. The

directors shall be elected at the annual meeting of the stockholders, except as provided in Section 2 of this Article, and each director elected shall hold office until his successor is elected and qualified; however, no person who is not serving as a director of the corporation as of January 1, 1993, who has attained 65 years of age or more, shall be nominated, elected or qualified to serve as a director of the corporation. Directors need not be stockholders.

Section 2. Vacancies and newly created directorships resulting from any increase in the authorized number of directors may be filled by a majority of the directors then in office, though less than a quorum, or by a sole remaining director, and the directors so chosen shall hold office until the next annual election and until their successors are duly elected and shall qualify, unless sooner displaced. If there are no directors in office, then an election of directors may be held in the manner provided by statute. If, at the time of filling any vacancy or any newly created directorship, the directors then in office shall constitute less than a majority of the whole board (as constituted immediately prior to such increase), the Court of Chancery may, upon application of any stockholder or stockholders holding at least ten percent of the total number of the shares at the time outstanding having a right to vote for such directors, summarily order an election to be held to fill any such vacancies or newly created directorships, or to replace the directors chosen by the directors then in office.

Section 3. The business of the corporation shall be managed by or shall be under the direction of its board of directors which may exercise all such powers of the corporation and do all such lawful acts and things as are not by statute or by the certificate of incorporation or by these by-laws directed or required to be exercised or done by the stockholders.

Section 4. Stockholders of the corporation may recommend persons to be nominated for election as directors of the corporation at the annual meeting of stockholders. To be considered for nomination, such recommendation must be received in writing by the secretary of the corporation no later than ninety (90) days before the date which corresponds to the date on which the annual meeting of stockholders was held during the immediate prior year. Such recommendation shall be accompanied by the name of the stockholder proposing the candidate, evidence that stockholder is a beneficial owner of the outstanding stock of the corporation as of the record date established for the determination of stockholders entitled to notice of and to vote at the annual meeting of stockholders, the name of candidate being proposed for nomination, and the candidate's biographical data and qualifications.

#### MEETINGS OF THE BOARD OF DIRECTORS

Section 4. The board of directors of the corporation may hold meetings, both regular and special, either within or without the State of Delaware.

Section 5. The first meeting of each newly elected board of directors shall be held at such time and place as shall be fixed by the vote of the stockholders at the annual meeting and no notice of such meeting shall be necessary to the newly elected directors in order legally to constitute the meeting, provided a quorum shall be present. In the event of the failure of the stockholders to fix the time or place of such first meeting of the newly elected board of directors, or in the event such meeting is not held at the time and place so fixed by the stockholders, the meeting may be held at such time and place as shall be specified in a notice given as hereinafter provided for special meetings of the board of directors, or as shall be specified in a written waiver signed by all of the directors.

Section 6. Regular meetings of the board of directors may be held on two days' written notice at such time and at such



place as shall from time to time be determined by the board.

Section 7. Special meetings of the board may be called by the chairman and chief executive officer on two days' notice to each director; special meetings shall be called by the chairman and chief executive officer or secretary in like manner and on like notice on the written request of two directors unless the board consists of only one director; in which case special meetings shall be called by the chairman or secretary in like manner and on like notice on the written request of the sole director.

Section 8. At all meetings of the board a majority of the directors shall constitute a quorum for the transaction of business and the act of a majority of the directors present at any meeting at which there is a quorum shall be the act of the board of directors, except as may be otherwise specifically provided by statute or by the certificate of incorporation. If a quorum shall not be present at any meeting of the board of directors the directors present thereat may adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present.

Section 9. Unless otherwise restricted by the certificate of incorporation or these by-laws, any action required or permitted to be taken at any meeting of the board of directors or of any committee thereof may be taken without a meeting, if a written consent thereto is signed by all members of the board or of such committee as the case may be, and such written consent is filed with the minutes of proceedings of the board or committee.

Section 10. Unless otherwise restricted by the certificate of incorporation or these by-laws, members of the board of directors, or any committee designated by the board of directors, may participate in a meeting of the board of directors, or any committee, by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other, and such participation in a meeting shall constitute presence in person at the meeting.

#### COMMITTEES OF DIRECTORS

Section 11. The board of directors may, by resolution passed by a majority of the whole board, designate one or more committees, each committee to consist of one or more of the directors of the corporation; however, no committee shall be empowered by the board to initiate or take any action without prior ratification of such proposed action by the majority of the board of directors then in office.

No such committee or committees of the board of directors shall have the power or authority

- (a) to amend the certificate of incorporation (except that committee may, to the extent authorized in the resolution or resolutions providing for the issuance of shares of stock adopted by the board of directors as provided in Section 151(a), fix any of the preferences or rights of such shares relating to dividends, redemption, distribution of assets of the corporation or the conversion into, or the exchange of such shares for, shares of any other class or classes or any other series of the same or any other class or classes of stock of the corporation),
- (b) to adopt an agreement of merger or consolidation,
- (c) to recommend to the stockholders the sale, lease or exchange of all or substantially all of the corporation's property and assets,
- (d) to recommend to the stockholders a dissolution of the corporation or a revocation of a dissolution, or
- (e) to amend the by-laws of the corporation; and, unless the resolution or certificate of incorporation expressly so provide, no such committee shall have the power or authority
- (f) to declare a dividend or to authorize the issuance of stock or to adopt a certificate of ownership and merger.

Such committee or committees shall have such name or names as may be determined from time to time by resolution adopted by the board of directors.

The standing committees of the board of directors shall have authority to make recommendations to the board, as follows:

- \* the Audit Committee shall have authority to make recommendations to the board with respect to the appointment of an independent public accounting firm to review the corporation's books and records, to review the corporation's internal and external audit programs, and to receive the audited opinion and "management report" of the independent accounting firm appointed by the corporation;
- \* the Compensation Committee shall have the authority to review and recommend to the board the compensation of the Chief Executive Officer and to review the compensation of other officers of the corporation;
- \* the Finance Committee shall have the authority to make recommendations to the board with respect to the corporation's capitalization and long-term funding alternatives;
- \* the Nominating and Corporate Ethics Committee shall have the authority, from time to time,
  - (a) to recommend to the Board
    - i. nominees for election to the Board and, in the event of vacancies on the Board, nominees for appointment to the Board,
    - ii. corporate policies regarding, among other things, business conduct and securities trading, including compliance with law and related policies,
    - iii. corporate policies regarding indemnification of VSE directors and officers, and
    - iv. corporate policies regarding conflicts of interests involving VSE directors, officers, and employees;
  - (b) to provide, as the Committee deems advisable or appropriate, review and oversight in respect of the implementation of and compliance with any of the above-mentioned policies adopted by the Board, including the provision of administrative and interpretative advice and directives to VSE's Insider Trading Compliance Officer and to other VSE directors and officers and, in respect of the previously-described corporate policies, sales of VSE securities by VSE's Employee Stock Ownership Plan that may directly or indirectly benefit VSE; and
  - (c) in connection with the foregoing matters set forth in clauses (a) and (b), to consult with and obtain the advice of VSE's legal, accounting, financial and other advisors;
- \* the Planning Committee shall have the authority to review and to make recommendations to the board with respect to business development and capitalization.

Further, each of the aforesaid standing committees shall have and may exercise a general oversight responsibility respecting the management of the business and affairs of the corporation as related to the specified powers of the committee, as aforesaid, and as related to such other matters as may be referred thereto by resolution of the board.

Section 12. Each committee shall keep regular minutes of its meetings and report the same to the board of directors when required.

#### COMPENSATION OF DIRECTORS

Section 13. Unless otherwise restricted by the certificate of incorporation or these by-laws, the board of directors shall have the authority to fix the compensation of directors. The directors may be paid their expenses, if any, of attendance at each meeting of the board of directors and may be paid a fixed sum for attendance at each meeting of the board of directors or a stated salary as director. No such payment shall preclude any director from serving the corporation in any other capacity and receiving compensation therefor. Members of special or standing committees may be allowed like compensation for attending committee meetings.

## REMOVAL OF DIRECTORS

Section 14. Unless otherwise restricted by the certificate of incorporation or by law, any director or the entire board of directors may be removed, with or without cause, by the holders of a majority of shares entitled to vote at an election of directors.

## DIRECTORS EMERITUS

Section 15. Unless otherwise restricted by the corporation's certificate of incorporation or by law, the corporation may have and appoint such directors emeritus as shall seem advisable to the board of directors. To qualify for appointment as a director emeritus, the nominee shall be a retired director of the corporation. The term "director emeritus" is an honorary title entitling the holder thereof to all of the rights and privileges thereunto pertaining. No compensation shall be paid by the corporation to a director emeritus for service as such; however, the board of directors shall have the authority to award honoraria or to reimburse expenses, if any, under specified conditions set forth in a resolution of the board. The holder of the title "director emeritus" shall not act as and shall not be considered a director, officer or otherwise as an employee or agent of the corporation.

## ARTICLE IV

### NOTICES

Section 1. Whenever, under the provisions of the statutes or of the certificate of incorporation or of these by-laws, notice is required to be given to any director or stockholder, it shall be given in writing, by mail, addressed to such director or stockholder, at his address as it appears on the records of the corporation, with postage thereon prepaid, and such notice shall be deemed to be given at the time when the same shall be deposited in the United States mail. Notice to directors may also be given by telegram or telecopy.

Section 2. Whenever any notice is required to be given under the provisions of the statutes or of the certificate of incorporation or of these by-laws, a waiver thereof in writing, signed by the person or persons entitled to said notice, whether before or after the time stated therein, shall be deemed equivalent thereto.

## ARTICLE V

### OFFICERS

Section 1. The offices of the corporation shall be a chairman and chief executive officer, a president and chief operating officer, one or more vice-presidents, a chief financial officer, a secretary, a treasurer, and a comptroller, and such other offices as shall seem advisable to the board. Two or more offices may be held by the same person, unless the certificate of incorporation or these by-laws otherwise provide.

Section 2. The board of directors at its first meeting after each annual meeting of stockholders shall choose a chairman and chief executive officer from among the directors, and shall choose a president and chief operating officer, one or more vice-presidents, a chief financial officer, a secretary, a treasurer, and a comptroller, none of whom need be a member of the board. The board may also choose such additional vice-presidents and assistant secretaries, treasurers, and comptrollers as shall seem advisable to the board.

Section 3. The board of directors may appoint such other

officers and agents as it shall deem necessary who shall hold their offices for such terms and shall exercise such powers and perform such duties as shall be determined from time to time by the board.

Section 4. The salary of the Chairman and Chief Executive Officer shall be reviewed by the Compensation Committee. The Chairman of the Compensation Committee will present the recommendations of the Compensation Committee on the salary of the Chairman and Chief Executive Officer to the board of directors for ratification and approval. The salaries of all officers of the corporation (other than the Chairman and Chief Executive Officer) shall be reviewed by the Compensation Committee and fixed by the Chairman and Chief Executive Officer.

Section 5. The officers of the corporation shall hold office until their successors are chosen and qualify. Any officer elected or appointed by the board of directors may be removed at any time by the affirmative vote of a majority of the board of directors. Any vacancy occurring in any office of the corporation shall be filled by the board of directors.

#### THE CHAIRMAN AND CHIEF EXECUTIVE OFFICER

Section 6. The chairman and chief executive officer of the corporation shall be ex officio a member of all standing committees, shall have general and active management of the business of the corporation, shall see that all orders and resolutions of the board of directors are carried into effect, and, unless otherwise provided by the board of directors, shall preside at all meetings of the stockholders and the board of directors.

Section 7. He shall execute bonds, mortgages and other contracts requiring a seal, under the seal of the corporation, except where required or permitted by law to be otherwise signed and executed and except where the signing and execution thereof shall be expressly delegated by the board of directors to some other officer or agent of the corporation.

Section 8. He shall, as chairman and chief executive officer, be vested with authority to perform, singly or together with other officers of the corporation, all of the duties given or imposed by these by-laws or the board of directors of the other officers or employees of the corporation.

#### THE PRESIDENT AND CHIEF OPERATING OFFICER

Section 9. The president shall be the chief operating and administrative officer of the corporation and shall have such other powers as may be prescribed by the board of directors or chairman and chief executive officer, under whose supervision he shall be.

Section 10. In the absence or disability of the chairman and chief executive officer, or in the event of his inability or refusal to act, the president and chief operating officer shall perform the duties of the chairman and chief executive officer, and when so acting, shall have all the powers of and be subject to all the restrictions upon the chairman and chief executive officer.

In the absence or disability of the president and chief operating officer, the chairman and chief executive officer shall select and recommend to the board of directors for ratification a candidate to fill the office of president and chief operating officer. Candidates may be selected from the board of directors, officers or employees of the corporation or from sources outside of the corporation. The chairman and chief executive officer will perform the duties of the president and chief operating officer until a candidate is chosen and ratified by the board of directors and has qualified to perform the duties of the office of president and chief operating officer.

## THE VICE-PRESIDENTS

Section 11. The vice-president, or if there shall be more than one, the vice presidents in the order determined by the board of directors (such as executive vice president, senior vice president, vice president, and assistant vice president, or in the absence of any determination, then in the order of their election), shall perform such duties and have such powers as prescribed by the Chairman and Chief Executive Officer under whose supervision they will be.

## CHIEF FINANCIAL OFFICER

Section 12. The chief financial officer of the corporation shall have the financial management of the business and shall perform such other duties as may be prescribed by the board of directors or chief executive officer, under whose supervision he shall be.

## THE SECRETARY AND ASSISTANT SECRETARIES

Section 13. The secretary shall attend all meetings of the board of directors and all meetings of the stockholders and record all the proceedings of the meetings of the corporation and of the board of directors in a book to be kept for that purpose and shall perform like duties for the standing committees when required. He shall give, or cause to be given, notice of all meetings of the stockholders and special meetings of the board of directors, and shall perform such other duties as may be prescribed by the board of directors or chairman and chief executive officer, under whose supervision he shall be. He shall keep in safe custody the seal of the corporation and he, or an assistant secretary, shall have authority to affix the same to any instrument requiring it and, when so affixed, it may be attested by his signature or by the signature of such assistant secretary. The board of directors may give general authority to any other officer to affix the seal of the corporation and to attest the affixing by his signature.

Section 14. The assistant secretary, or if there be more than one, the assistant secretaries in the order determined by the board of directors (or if there be no such determination, then in the order of their election), shall, in the absence of the secretary or in the event of his inability or refusal to act, perform the duties and exercise the powers of the secretary and shall perform such other duties and have such other powers as the board of directors may from time to time prescribe.

## THE TREASURER AND ASSISTANT TREASURERS

Section 15. The treasurer shall have the custody of the corporate funds and securities and shall keep full and accurate accounts of receipts and disbursements in books belonging to the corporation and shall deposit all moneys and other valuable effects in the name and to the credit of the corporation in such depositories as may be designated by the board of directors.

Section 16. He shall disburse the funds of the corporation as may be ordered by the board of directors, taking proper vouchers for such disbursements, and shall render to the chairman and chief executive officer and the board of directors, at its regular meetings, or when the board of directors so requires, an account of all his transactions as treasurer and of the financial condition of the corporation.

Section 17. The assistant treasurer, or if there shall be more than one, the assistant treasurers in the order determined by the board of directors (or if there be no such determination, then in the order of their election) shall, in the absence of the treasurer or in the event of his inability or refusal to act, perform the duties and exercise the powers of the treasurer and shall perform such other duties and have such other powers as the board of directors may from time to time prescribe.

## THE COMPTROLLER AND ASSISTANT COMPTROLLERS

Section 18. The comptroller of the corporation shall be the chief accounting officer of the corporation and shall perform such other duties as may be prescribed by the board of directors or chief executive officer, under whose supervision he shall be.

Section 19. The assistant comptroller, or if there be more than one, the assistant comptrollers in the order determined by the board of directors (or if there be no such determination, then in the order of their election), shall, in the absence of the comptroller or in the event of his inability or refusal to act, perform the duties and exercise the powers of the comptroller and shall perform such other duties and have such other powers as the board of directors may from time to time prescribe.

### ARTICLE VI

#### CERTIFICATES OF STOCK

Section 1. Every holder of stock in the corporation shall be entitled to have a certificate, signed by, or in the name of the corporation by, the chairman and chief executive officer, the president, or a vice-president, and by the treasurer or an assistant treasurer or the secretary or an assistant secretary of the corporation, bearing the corporate seal or a facsimile thereof certifying the number of shares owned by him in the corporation.

Section 2. Where a certificate is signed (1) by a transfer agent or an assistant transfer agent or (2) by a transfer clerk acting on behalf of the corporation and a registrar, the signature of any such chairman and chief executive officer, president, vice-president, treasurer, assistant treasurer, secretary, or assistant secretary may be facsimile. In case any officer or officers who have signed, or whose facsimile signature or signatures have been used on, any such certificate or certificates shall cease to be such officer or officers of the corporation, whether because of death, resignation or otherwise, before such certificate or certificates have been delivered by the corporation, such certificate or certificates may nevertheless be adopted by the corporation and be issued and delivered as though the person or persons who signed such certificate or certificates or whose facsimile signature or signatures have been used thereon had not ceased to be such officer or officers of the corporation.

#### LOST CERTIFICATES

Section 3. The Secretary or Treasurer who has charge of the transfer and issuance of stock of the corporation shall issue a new certificate or certificates in place of any certificate or certificates theretofore issued by the corporation allegedly lost, upon the submission by the owner of such lost or destroyed certificate, or his legal representative, to the corporation of a bond in such sum as it may direct as indemnity against any claim that may be made against the corporation with respect to the certificate alleged to have been lost or destroyed.

#### TRANSFERS OF STOCK

Section 4. Upon surrender to the corporation or the transfer agent of the corporation of a certificate for shares duly endorsed or accompanied by proper evidence of succession, assignment or authority to transfer, it shall be the duty of the corporation to issue a new certificate to the person entitled thereto, cancel the old certificate, and record the transaction upon its books.

#### FIXING RECORD DATE

Section 5. In order that the corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders or and adjournment thereof, or to express consent to corporate action in writing without a meeting, or entitled to receive payment of any dividend or other distribution or allotment of any rights, or entitled to exercise any rights in respect of any change, conversion or exchange of stock or for the purpose of any other lawful action, the board of directors may fix, in advance, a record date, which shall not be more than sixty nor less than ten days before the date of such meeting, nor more than sixty days prior to any other action; except that the record date for the determination of stockholders entitled to notice of and to vote at the annual meeting of stockholders shall be forty-five days prior to the date of said annual meeting of stockholders, or if the forty-fifth day shall not be a business day, then on the first business day next following the forty-fifth day prior to the date of said annual meeting of stockholders. A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the board of directors may fix a new record date for the adjourned meeting.

#### REGISTERED STOCKHOLDERS

Section 6. The corporation shall be entitled to recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, and to hold liable for calls and assessments a person registered on its books as the owner of shares, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of Delaware.

#### ARTICLE VII

#### GENERAL PROVISIONS

#### DIVIDENDS

Section 1. Dividends upon the capital stock of the corporation, subject to the provisions of the certificate of incorporation, if any, may be declared by the board of directors at any regular or special meeting, pursuant to law. Dividends may be paid in cash, in property, or in shares of the capital stock, subject to the provisions of the certificate of incorporation.

Section 2. Before payment of any dividend, there may be set aside out of any funds of the corporation available for dividends such sum or sums as the directors from time to time, in their absolute discretion, think proper as a reserve or reserves to meet contingencies, or for equalizing dividends, or for repairing or maintaining any property of the corporation, or for such other purpose as the directors shall think conducive to the interest of the corporation, and the directors may modify or abolish any such reserve in the manner in which it was created.

#### ANNUAL STATEMENT

Section 3. The board of directors shall present at each annual meeting, and at any special meeting of the stockholders when called for by vote of the stockholders, a full and clear statement of the business and condition of the corporation.

#### CHECKS

Section 4. All checks or demands for money and notes of the corporation shall be signed by such officer or officers or such other person or persons as the board of directors may from time

to time designate.

#### FISCAL YEAR

Section 5. The fiscal year of the corporation shall be fixed by resolution of the board of directors.

#### SEAL

Section 6. The corporate seal shall have inscribed thereon the name of the corporation, the year of its organization and the words "Corporate Seal, Delaware". The seal may be used by causing it or a facsimile thereof to be impressed or affixed or reproduced or otherwise.

#### INDEMNIFICATION

Section 7. The corporation shall indemnify its officers, directors, employees and agents to the extent permitted by the General Corporation Law of Delaware.

#### ARTICLE VIII

##### AMENDMENTS

Section 1. These by-laws may be altered, amended or repealed or new by-laws may be adopted by the stockholders or by the board of directors, when such power is conferred upon the board of directors by the certificate of incorporation at any regular meeting of the stockholders or of the board of directors or at any special meeting of the stockholders or of the board of directors if notice of such alteration, amendment, repeal or adoption be contained in the notice of such special meeting. If the power to adopt, amend or repeal by-laws is conferred upon the board of directors by the certificate of incorporation it shall not divest or limit the power of the stockholders to adopt, amend or repeal by-laws.



## EXHIBIT VIII

### EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT is made and entered into as of December 10, 1997, by and between VSE Corporation, a Delaware corporation ("Employer"), and James M. Knowlton ("Employee");

WHEREAS, Employee currently is employed by Employer as a senior corporate officer;

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

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

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

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

WHEREAS, Employee desires to have the foregoing assurances;

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

1. Term. The term of Employee's employment hereunder shall commence on the date hereof and shall continue until January 1, 1999, except as otherwise provided in Section 7. If the term of Employee's employment hereunder shall have continued until January 1, 1999, thereafter, such term of Employee's employment hereunder shall be deemed to be renewed automatically, on the same terms and conditions contained herein, for successive periods of one year each, unless and until Employee, at least 90 days prior to the expiration of the original term or any such extended term, shall give written notice to the other of intent not to renew the term of Employee's employment hereunder. All references herein to the Term refer to the original term of Employee's employment hereunder and all extensions thereof.

#### 2. Duties

##### (a) Offices

During the Term, Employee shall serve in Employee's current or comparable capacity, and the Board shall renominate Employee, and Employee shall perform duties as assigned. Employer agrees that Employee will be assigned only duties of the type, nature and dignity

normally assigned to someone in a comparable position at a corporation of the size, stature and nature of Employer. During the Term, Employee shall have, at a minimum, the same prerequisites of office as on the date hereof, and shall report directly to the Employer's Chief Operating Officer.

(b) Full-Time Basis

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

3. Compensation

(a) Salary

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

(b) Performance Bonus

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

(c) Other Compensation Plans or Arrangements

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

(d) Tax Withholdings

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

4. Benefits. During the Term, Employee shall be entitled to such comparable fringe benefits and

perquisites as may be provided to any or all of Employer's senior officers pursuant to policies established from time to time. These fringe benefits and perquisites shall include holidays, group health insurance, disability insurance, and life insurance.

5. Expenses and Other Perquisites. Employer shall reimburse Employee for all reasonable and proper business expenses incurred in the performance during the Term of duties hereunder, in accordance with Employer's customary practices for senior officers, and provided such business expenses are reasonably documented.
6. Exclusive Services, Confidential Information, Business Opportunities and Non-Solicitation

(a) Exclusive Services

- (i) During the Term, Employee shall at all times devote full-time attention, energies, efforts and skills to Employer's business and shall not, directly or indirectly, engage in any other business activity, whether or not for profit, gain or other pecuniary advantages, without the written consent of the Chief Executive Officer or Chief Operating Officer, provided that such prior consent shall not be required with respect to (1) business interests that neither compete with Employer or any Subsidiaries nor interfere with Employee's duties and obligations hereunder, and (2) Employee's charitable, eleemosynary, philanthropic or professional association activities.
- (ii) During the Term, Employee shall not, without the prior written consent of the Chief Executive Officer or Chief Operating Officer, directly or indirectly, either as an officer, director, employee, agent, advisor, consultant, principal, stockholder, partner, owner or in any other capacity, on Employee's own behalf or otherwise, in any way engage in, represent, be connected with or have a financial interest in, any business which is, or to Employee's knowledge, is about to become, engaged in the business of providing engineering, management, energy or environmental services to the United States Government or any department, agency, or instrumentality thereof or any state or local government agency or to any person, corporation or other entity (collectively a "Person") with which Employer or any Subsidiary is currently or has previously done business or any subsequent line of business developed by Employee or any Subsidiary during the Term. Notwithstanding the foregoing, Employee shall be permitted to own passive investments in publicly held companies provided that such investments do not exceed five percent of any such company's outstanding equity.

(b) Confidential Information

During the Term and for the first 24 consecutive months after the termination of

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

(c) Business Opportunities

- (i) During the Term, Employee shall promptly disclose to Employer each business opportunity of a type which, based upon its prospects and relationship to the existing businesses of Employer or any Subsidiary, Employer or any Subsidiary might reasonably consider pursuing. Upon termination of the Term, regardless of the circumstances thereof, Employer shall have the exclusive right to participate in or undertake any such opportunity on its own behalf without any involvement of Employee.
- (ii) During the Term, Employee shall refrain from engaging in any activity, practice or act which conflicts with, or has the potential to conflict with, the interests of Employer or its Subsidiaries, and shall avoid any acts or omissions which are disloyal to, or competitive with Employer or its Subsidiaries.

(d) Non-Solicitation of Employees

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

(e) Covenant Not To Compete

- (i) If Employee voluntarily terminates the

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

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

(f) Employee Acknowledgment

Employee hereby agrees and acknowledges that the restrictions imposed upon by the provisions of this Section 6 are fair and reasonable considering the nature of Employer's business, and are reasonably required for Employer's protection.

(g) Invalidity

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

(h) Specific Performance

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

7. Termination

(a) By Employer

(i) Termination for Cause

Employer may for Cause (as defined below) terminate the Term at any time by written notice to Employee. For purposes of this Agreement, the term Cause shall mean any one or more of the following: (1) conduct by Employee which is materially illegal or fraudulent or a material breach of Company policy; (2) the breach or violation by Employee of any of the material provisions of this Agreement, provided that Employee must first be given notice by the Board of the alleged breach or violation and 30 days to cure said alleged breach or violation; (3) Employee's use of illegal drugs or abuse of alcohol or authorized drugs which impairs Employee's ability to perform duties hereunder, provided that Employee must be given notice by the Board of such impairment and 60 days to cure the impairment; (4) Employee's knowing and willful neglect of duties or negligence in the performance of duties which materially affects Employer's or any Subsidiary's business, provided that Employee must first be given notice by the Board of such alleged neglect or negligence and 30 days to cure said alleged neglect or negligence. If a termination occurs pursuant to clause (1) above, the date on which the Term is terminated (the "Termination Date") shall be the date Employee receives notice of termination and, if a termination occurs pursuant to clauses (2), (3) or (4) above, the Termination Date shall be the date on which the specified cure period expires. In any event, as of the Termination Date (in the absence of satisfying the alleged breach or violation within the applicable cure period), Employee shall be relieved of all duties hereunder and Employee shall not be entitled to the accrual or provision of any compensation or benefit, after the Termination Date but Employee shall be entitled to the provision of all compensation and other benefits that shall have accrued as of the Termination Date, including Base Salary, Performance Bonuses, paid leave benefits, Deferred Compensation Units, Deferred Supplemental Compensation to the extent permitted by the plans, and reimbursement of incurred business expenses.

(ii) Termination Without Cause

Employer may, in its sole discretion, without Cause, terminate the Term at any time by providing Employee with (a) 60 days prior notice thereof and (b) on or prior to the Termination Date, a lump sum severance compensation payment equal to the total amount of Employee's Base Salary payable for one (1) year hereunder, based upon the amount in effect as of the effective Termination Date. If Employee has less than five

years of service with the Employer as of the Termination Date, the lump sum severance compensation payment shall equal 6 months pay rather than one year of pay. Employee shall not be entitled to the accrual or provision of any other compensation or benefit after the Termination Date other than (a) the medical and hospitalization benefits after the Termination Date, in accordance with COBRA or other Company policy if covered by a Company-sponsored plan, (b) the provision of all compensation and other benefits that shall have accrued as of the Termination Date, including Base Salary, Performance Bonus, paid leave benefits, Deferred Compensation Units, Deferred Supplemental Compensation and reimbursements of incurred expenses; and (c) all stock options or similar rights to acquire capital stock granted by Employer to Employee shall automatically become vested and exercisable in whole or in part.

(b) Death or Disability

The Term shall be terminated immediately and automatically upon Employee's death or Disability. The term Disability shall mean Employee's inability to perform all of the essential functions of Employee's position hereunder for a period of 26 consecutive weeks or for an aggregate of 150 work days during any 12-month period by reason of illness, accident or any other physical or mental incapacity, as may be permitted by applicable law. Employee's capability to continue performance of Employee's duties hereunder shall be determined by a panel composed of two independent medical doctors appointed by the Board and one appointed by the Employee or designated representative. If the panel is unable to reach a decision the matter will be referred to arbitration in accordance with Section 8. In the event of Employee's death or Disability for any period of six consecutive months, Employee (or designated beneficiary) will be paid Base Salary then in effect for one full year following the date of death or disability (6 months pay rather than one year of pay if Employee has less than five years of service with Employer as of the final day worked).

(c) By Employee

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

medical and hospitalization benefits to the extent permitted by COBRA or other Company policy.

(ii) If, during the Term, a Change of Control (as defined below) occurs, Employee may, in Employee's sole discretion, terminate the Term upon 30 days notice of Employer. If Employee exercises such termination right, Employer may, at its option, at any time after receiving such notice from Employee, relieve Employee of all duties hereunder and terminate the Term at any time prior to the expiration of said notice period. If this Agreement is terminated by Employee or Employer pursuant to this Section 7(c)(ii), Employee shall be entitled:

(a) to receive on or prior to the Termination Date a lump sum severance compensation payment equal to two (2) times the total amount of Employee's Base Salary payable hereunder, based on the amount in effect as of the Termination Date. If Employee has less than five years of service with the Employer as of the date of Employee's notice to Employer, the lump sum severance compensation payment shall be equal to one (1) times the total amount of the Employee's Base Salary rather than two (2) times the total amount;

(b) the medical and hospitalization benefits and all compensation and other benefits that shall have accrued as of the Termination Date, as described in Section 7(a)(ii)(1); and

(c) to the automatic vesting and exercisability in whole or in part of all stock options or similar rights to acquire capital stock granted by Employer to Employee; provided that Employee shall not be entitled, after the Termination Date to the accrual or provision of any other compensation payable hereunder, including the Performance Bonus, but shall be permitted to continue medical and hospitalization benefits to the extent permitted by COBRA or other Company policy.

(d) Change of Control

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

(i) any person, including a group, as such terms as defined in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended, and the rules promulgated thereunder (collectively the Exchange Act"), other than a trustee or other fiduciary holding voting securities of Employer ("Voting Securities") under any Employer-sponsored benefit plan, becomes the beneficial owner, as defined



under the Exchange Act, directly or indirectly, whether by purchase or acquisition or agreement to act in concert or otherwise, of 30% or more of the outstanding Voting Securities;

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

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

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

(e) No Duty to Mitigate

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

(f) Other Policies

This Agreement supersedes and replaces applicable provisions of General Policy Memorandum (GPM) No. 31 and GPM 31-1 concerning Executive Severance Program for Corporate Officers.

8. Arbitration. Whenever a dispute arises between the parties concerning this Agreement or any of the obligations hereunder, or Employee's employment generally, Employer and Employee shall use their best efforts to resolve the dispute by mutual agreement. If any dispute cannot be resolved by Employer and Employee, it shall be submitted to arbitration to the exclusion of all other avenues of relief and adjudicated pursuant to the American

Arbitration Association's Rules for Employment Dispute Resolution then in effect. The decision of the arbitrator must be in writing and shall be final and binding on the parties, and judgment may be entered on the arbitrator's award in any court having jurisdiction thereof. The arbitrator's authority in granting relief to Employee shall be limited to an award of compensation, benefits and unreimbursed expenses as described in Sections 3, 4, and 5 above, and to the release of Employee from the provisions of Section 6 and the arbitrator shall have no authority to award other types of damages or relief to Employee, including consequential or punitive damages. The arbitrator shall also have no authority to award consequential or punitive damages to Employer for violations of this Agreement by Employee. The expenses of the arbitration shall be borne by the losing party to the arbitration and the prevailing party shall be entitled to recover from the losing party all of its own costs and attorneys' fees with respect to the arbitration. Nothing in this Section 8 shall be construed to derogate Employer's rights to seek legal and equitable relief in a court of competent jurisdiction as contemplated by Section 6(h).

9. **Non-Waiver.** It is understood and agreed that one party's failure at any time to require the performance by the other party of any of the terms, provisions, covenants or conditions hereof shall in no way affect the first party's right thereafter to enforce the same, nor shall the waiver by either party of the breach of any term, provision, covenant or condition hereof be taken or held to be a waiver of any succeeding breach.
10. **Severability.** If any provision of this Agreement conflicts with the law under which this Agreement is to be construed, or if any such provision is held invalid or unenforceable by a court of competent jurisdiction or any arbitrator, such provision shall be deleted from this Agreement and the Agreement shall be construed to give full effect to the remaining provision thereof.
11. **Survivability.** Unless otherwise provided herein, upon termination of the Term, the provisions of Sections 6(b), (d) and (e) shall nevertheless remain in full force and effect.
12. **Governing Law.** This Agreement shall be interpreted, construed and governed according to the laws of the Commonwealth of Virginia, without regard to the conflict of law provisions thereof.
13. **Construction.** The paragraph headings and captions contained in this Agreement are for convenience only and shall not be construed to define, limit or affect the scope or meaning of the provisions hereof. All references herein to Sections shall be deemed to refer to Sections of this Agreement.
14. **Entire Agreement.** This Agreement contains and represents the entire agreement of Employer and Employee and supersedes all prior agreements, representations or understandings, oral or written, express or implied with respect to the subject matter hereof. This Agreement may not be modified or amended in any way unless in a writing signed by each of Employer and Employee. No representation, promise or inducement has been made by either Employer or Employee that is not embodied in this Agreement, and neither Employer nor Employee shall

be bound by or liable for any alleged representation, promise or inducement not specifically set forth herein.

15. Assignability. Neither this Agreement nor any rights or obligations of Employer or Employee hereunder may be assigned by Employer or Employee without the other party's prior written consent. Subject to the foregoing, this Agreement shall be binding upon and inure to the benefit of Employer and Employee and their heirs, successors and assigns.

16. Notices. All notices required or permitted hereunder shall be in writing and shall be deemed properly given if delivered personally or sent by certified or registered mail, postage prepaid, return receipt requested, or sent by telegram, telex, telecopy or similar form of telecommunication, and shall be deemed to have been given when received. Any such notice or communication shall be addressed: (a) if to Employer, to President, 2550 Huntington Avenue, Alexandria, Virginia 22303-1499 or (b) if to Employee, to the last known home address on file with Employer, or to such other address as Employer or Employee shall have furnished to the other in writing.

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

VSE CORPORATION  
a Delaware corporation

Date: December 10, 1997      By: /s/ R. B. McFarland

\_\_\_\_\_  
R. B. McFarland  
President and  
Chief Operating Officer

Date: December 10, 1997      /s/ J. M. Knowlton

\_\_\_\_\_  
J. M. Knowlton  
Employee

## EXHIBIT VIII

### EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT is made and entered into as of December 10, 1997, by and between VSE Corporation, a Delaware corporation ("Employer"), and James M. Knowlton ("Employee");

WHEREAS, Employee currently is employed by Employer as a senior corporate officer;

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

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

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

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

WHEREAS, Employee desires to have the foregoing assurances;

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

1. Term. The term of Employee's employment hereunder shall commence on the date hereof and shall continue until January 1, 1999, except as otherwise provided in Section 7. If the term of Employee's employment hereunder shall have continued until January 1, 1999, thereafter, such term of Employee's employment hereunder shall be deemed to be renewed automatically, on the same terms and conditions contained herein, for successive periods of one year each, unless and until Employee, at least 90 days prior to the expiration of the original term or any such extended term, shall give written notice to the other of intent not to renew the term of Employee's employment hereunder. All references herein to the Term refer to the original term of Employee's employment hereunder and all extensions thereof.

#### 2. Duties

##### (a) Offices

During the Term, Employee shall serve in Employee's current or comparable capacity, and the Board shall renominate Employee, and Employee shall perform duties as assigned. Employer agrees that Employee will be assigned only duties of the type, nature and dignity

normally assigned to someone in a comparable position at a corporation of the size, stature and nature of Employer. During the Term, Employee shall have, at a minimum, the same prerequisites of office as on the date hereof, and shall report directly to the Employer's Chief Operating Officer.

(b) Full-Time Basis

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

3. Compensation

(a) Salary

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

(b) Performance Bonus

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

(c) Other Compensation Plans or Arrangements

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

(d) Tax Withholdings

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

4. Benefits. During the Term, Employee shall be entitled to such comparable fringe benefits and

perquisites as may be provided to any or all of Employer's senior officers pursuant to policies established from time to time. These fringe benefits and perquisites shall include holidays, group health insurance, disability insurance, and life insurance.

5. Expenses and Other Perquisites. Employer shall reimburse Employee for all reasonable and proper business expenses incurred in the performance during the Term of duties hereunder, in accordance with Employer's customary practices for senior officers, and provided such business expenses are reasonably documented.
6. Exclusive Services, Confidential Information, Business Opportunities and Non-Solicitation

(a) Exclusive Services

- (i) During the Term, Employee shall at all times devote full-time attention, energies, efforts and skills to Employer's business and shall not, directly or indirectly, engage in any other business activity, whether or not for profit, gain or other pecuniary advantages, without the written consent of the Chief Executive Officer or Chief Operating Officer, provided that such prior consent shall not be required with respect to (1) business interests that neither compete with Employer or any Subsidiaries nor interfere with Employee's duties and obligations hereunder, and (2) Employee's charitable, eleemosynary, philanthropic or professional association activities.
- (ii) During the Term, Employee shall not, without the prior written consent of the Chief Executive Officer or Chief Operating Officer, directly or indirectly, either as an officer, director, employee, agent, advisor, consultant, principal, stockholder, partner, owner or in any other capacity, on Employee's own behalf or otherwise, in any way engage in, represent, be connected with or have a financial interest in, any business which is, or to Employee's knowledge, is about to become, engaged in the business of providing engineering, management, energy or environmental services to the United States Government or any department, agency, or instrumentality thereof or any state or local government agency or to any person, corporation or other entity (collectively a "Person") with which Employer or any Subsidiary is currently or has previously done business or any subsequent line of business developed by Employee or any Subsidiary during the Term. Notwithstanding the foregoing, Employee shall be permitted to own passive investments in publicly held companies provided that such investments do not exceed five percent of any such company's outstanding equity.

(b) Confidential Information

During the Term and for the first 24 consecutive months after the termination of

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

(c) Business Opportunities

- (i) During the Term, Employee shall promptly disclose to Employer each business opportunity of a type which, based upon its prospects and relationship to the existing businesses of Employer or any Subsidiary, Employer or any Subsidiary might reasonably consider pursuing. Upon termination of the Term, regardless of the circumstances thereof, Employer shall have the exclusive right to participate in or undertake any such opportunity on its own behalf without any involvement of Employee.
- (ii) During the Term, Employee shall refrain from engaging in any activity, practice or act which conflicts with, or has the potential to conflict with, the interests of Employer or its Subsidiaries, and shall avoid any acts or omissions which are disloyal to, or competitive with Employer or its Subsidiaries.

(d) Non-Solicitation of Employees

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

(e) Covenant Not To Compete

- (i) If Employee voluntarily terminates the

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

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

(f) Employee Acknowledgment

Employee hereby agrees and acknowledges that the restrictions imposed upon by the provisions of this Section 6 are fair and reasonable considering the nature of Employer's business, and are reasonably required for Employer's protection.

(g) Invalidity

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

(h) Specific Performance

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

7. Termination



(a) By Employer

(i) Termination for Cause

Employer may for Cause (as defined below) terminate the Term at any time by written notice to Employee. For purposes of this Agreement, the term Cause shall mean any one or more of the following: (1) conduct by Employee which is materially illegal or fraudulent or a material breach of Company policy; (2) the breach or violation by Employee of any of the material provisions of this Agreement, provided that Employee must first be given notice by the Board of the alleged breach or violation and 30 days to cure said alleged breach or violation; (3) Employee's use of illegal drugs or abuse of alcohol or authorized drugs which impairs Employee's ability to perform duties hereunder, provided that Employee must be given notice by the Board of such impairment and 60 days to cure the impairment; (4) Employee's knowing and willful neglect of duties or negligence in the performance of duties which materially affects Employer's or any Subsidiary's business, provided that Employee must first be given notice by the Board of such alleged neglect or negligence and 30 days to cure said alleged neglect or negligence. If a termination occurs pursuant to clause (1) above, the date on which the Term is terminated (the "Termination Date") shall be the date Employee receives notice of termination and, if a termination occurs pursuant to clauses (2), (3) or (4) above, the Termination Date shall be the date on which the specified cure period expires. In any event, as of the Termination Date (in the absence of satisfying the alleged breach or violation within the applicable cure period), Employee shall be relieved of all duties hereunder and Employee shall not be entitled to the accrual or provision of any compensation or benefit, after the Termination Date but Employee shall be entitled to the provision of all compensation and other benefits that shall have accrued as of the Termination Date, including Base Salary, Performance Bonuses, paid leave benefits, Deferred Compensation Units, Deferred Supplemental Compensation to the extent permitted by the plans, and reimbursement of incurred business expenses.

(ii) Termination Without Cause

Employer may, in its sole discretion, without Cause, terminate the Term at any time by providing Employee with (a) 60 days prior notice thereof and (b) on or prior to the Termination Date, a lump sum severance compensation payment equal to the total amount of Employee's Base Salary payable for one (1) year hereunder, based upon the amount in effect as of the effective Termination Date. If Employee has less than five

years of service with the Employer as of the Termination Date, the lump sum severance compensation payment shall equal 6 months pay rather than one year of pay. Employee shall not be entitled to the accrual or provision of any other compensation or benefit after the Termination Date other than (a) the medical and hospitalization benefits after the Termination Date, in accordance with COBRA or other Company policy if covered by a Company-sponsored plan, (b) the provision of all compensation and other benefits that shall have accrued as of the Termination Date, including Base Salary, Performance Bonus, paid leave benefits, Deferred Compensation Units, Deferred Supplemental Compensation and reimbursements of incurred expenses; and (c) all stock options or similar rights to acquire capital stock granted by Employer to Employee shall automatically become vested and exercisable in whole or in part.

(b) Death or Disability

The Term shall be terminated immediately and automatically upon Employee's death or Disability. The term Disability shall mean Employee's inability to perform all of the essential functions of Employee's position hereunder for a period of 26 consecutive weeks or for an aggregate of 150 work days during any 12-month period by reason of illness, accident or any other physical or mental incapacity, as may be permitted by applicable law. Employee's capability to continue performance of Employee's duties hereunder shall be determined by a panel composed of two independent medical doctors appointed by the Board and one appointed by the Employee or designated representative. If the panel is unable to reach a decision the matter will be referred to arbitration in accordance with Section 8. In the event of Employee's death or Disability for any period of six consecutive months, Employee (or designated beneficiary) will be paid Base Salary then in effect for one full year following the date of death or disability (6 months pay rather than one year of pay if Employee has less than five years of service with Employer as of the final day worked).

(c) By Employee

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

medical and hospitalization benefits to the extent permitted by COBRA or other Company policy.

(ii) If, during the Term, a Change of Control (as defined below) occurs, Employee may, in Employee's sole discretion, terminate the Term upon 30 days notice of Employer. If Employee exercises such termination right, Employer may, at its option, at any time after receiving such notice from Employee, relieve Employee of all duties hereunder and terminate the Term at any time prior to the expiration of said notice period. If this Agreement is terminated by Employee or Employer pursuant to this Section 7(c)(ii), Employee shall be entitled:

(a) to receive on or prior to the Termination Date a lump sum severance compensation payment equal to two (2) times the total amount of Employee's Base Salary payable hereunder, based on the amount in effect as of the Termination Date. If Employee has less than five years of service with the Employer as of the date of Employee's notice to Employer, the lump sum severance compensation payment shall be equal to one (1) times the total amount of the Employee's Base Salary rather than two (2) times the total amount;

(b) the medical and hospitalization benefits and all compensation and other benefits that shall have accrued as of the Termination Date, as described in Section 7(a)(ii)(1); and

(c) to the automatic vesting and exercisability in whole or in part of all stock options or similar rights to acquire capital stock granted by Employer to Employee; provided that Employee shall not be entitled, after the Termination Date to the accrual or provision of any other compensation payable hereunder, including the Performance Bonus, but shall be permitted to continue medical and hospitalization benefits to the extent permitted by COBRA or other Company policy.

(d) Change of Control

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

(i) any person, including a group, as such terms as defined in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended, and the rules promulgated thereunder (collectively the Exchange Act"), other than a trustee or other fiduciary holding voting securities of Employer ("Voting Securities") under any Employer-sponsored benefit plan, becomes the beneficial owner, as defined

under the Exchange Act, directly or indirectly, whether by purchase or acquisition or agreement to act in concert or otherwise, of 30% or more of the outstanding Voting Securities;

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

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

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

(e) No Duty to Mitigate

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

(f) Other Policies

This Agreement supersedes and replaces applicable provisions of General Policy Memorandum (GPM) No. 31 and GPM 31-1 concerning Executive Severance Program for Corporate Officers.

8. Arbitration. Whenever a dispute arises between the parties concerning this Agreement or any of the obligations hereunder, or Employee's employment generally, Employer and Employee shall use their best efforts to resolve the dispute by mutual agreement. If any dispute cannot be resolved by Employer and Employee, it shall be submitted to arbitration to the exclusion of all other avenues of relief and adjudicated pursuant to the American

Arbitration Association's Rules for Employment Dispute Resolution then in effect. The decision of the arbitrator must be in writing and shall be final and binding on the parties, and judgment may be entered on the arbitrator's award in any court having jurisdiction thereof. The arbitrator's authority in granting relief to Employee shall be limited to an award of compensation, benefits and unreimbursed expenses as described in Sections 3, 4, and 5 above, and to the release of Employee from the provisions of Section 6 and the arbitrator shall have no authority to award other types of damages or relief to Employee, including consequential or punitive damages. The arbitrator shall also have no authority to award consequential or punitive damages to Employer for violations of this Agreement by Employee. The expenses of the arbitration shall be borne by the losing party to the arbitration and the prevailing party shall be entitled to recover from the losing party all of its own costs and attorneys' fees with respect to the arbitration. Nothing in this Section 8 shall be construed to derogate Employer's rights to seek legal and equitable relief in a court of competent jurisdiction as contemplated by Section 6(h).

9. **Non-Waiver.** It is understood and agreed that one party's failure at any time to require the performance by the other party of any of the terms, provisions, covenants or conditions hereof shall in no way affect the first party's right thereafter to enforce the same, nor shall the waiver by either party of the breach of any term, provision, covenant or condition hereof be taken or held to be a waiver of any succeeding breach.
10. **Severability.** If any provision of this Agreement conflicts with the law under which this Agreement is to be construed, or if any such provision is held invalid or unenforceable by a court of competent jurisdiction or any arbitrator, such provision shall be deleted from this Agreement and the Agreement shall be construed to give full effect to the remaining provision thereof.
11. **Survivability.** Unless otherwise provided herein, upon termination of the Term, the provisions of Sections 6(b), (d) and (e) shall nevertheless remain in full force and effect.
12. **Governing Law.** This Agreement shall be interpreted, construed and governed according to the laws of the Commonwealth of Virginia, without regard to the conflict of law provisions thereof.
13. **Construction.** The paragraph headings and captions contained in this Agreement are for convenience only and shall not be construed to define, limit or affect the scope or meaning of the provisions hereof. All references herein to Sections shall be deemed to refer to Sections of this Agreement.
14. **Entire Agreement.** This Agreement contains and represents the entire agreement of Employer and Employee and supersedes all prior agreements, representations or understandings, oral or written, express or implied with respect to the subject matter hereof. This Agreement may not be modified or amended in any way unless in a writing signed by each of Employer and Employee. No representation, promise or inducement has been made by either Employer or Employee that is not embodied in this Agreement, and neither Employer nor Employee shall

be bound by or liable for any alleged representation, promise or inducement not specifically set forth herein.

15. Assignability. Neither this Agreement nor any rights or obligations of Employer or Employee hereunder may be assigned by Employer or Employee without the other party's prior written consent. Subject to the foregoing, this Agreement shall be binding upon and inure to the benefit of Employer and Employee and their heirs, successors and assigns.

16. Notices. All notices required or permitted hereunder shall be in writing and shall be deemed properly given if delivered personally or sent by certified or registered mail, postage prepaid, return receipt requested, or sent by telegram, telex, telecopy or similar form of telecommunication, and shall be deemed to have been given when received. Any such notice or communication shall be addressed: (a) if to Employer, to President, 2550 Huntington Avenue, Alexandria, Virginia 22303-1499 or (b) if to Employee, to the last known home address on file with Employer, or to such other address as Employer or Employee shall have furnished to the other in writing.

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

VSE CORPORATION  
a Delaware corporation

Date: December 10, 1997      By: /s/ R. B. McFarland

\_\_\_\_\_  
R. B. McFarland  
President and  
Chief Operating Officer

Date: December 10, 1997      /s/ J. M. Knowlton

\_\_\_\_\_  
J. M. Knowlton  
Employee

## EXHIBIT VIII

### EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT is made and entered into as of December 10, 1997, by and between VSE Corporation, a Delaware corporation ("Employer"), and James M. Knowlton ("Employee");

WHEREAS, Employee currently is employed by Employer as a senior corporate officer;

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

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

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

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

WHEREAS, Employee desires to have the foregoing assurances;

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

1. Term. The term of Employee's employment hereunder shall commence on the date hereof and shall continue until January 1, 1999, except as otherwise provided in Section 7. If the term of Employee's employment hereunder shall have continued until January 1, 1999, thereafter, such term of Employee's employment hereunder shall be deemed to be renewed automatically, on the same terms and conditions contained herein, for successive periods of one year each, unless and until Employee, at least 90 days prior to the expiration of the original term or any such extended term, shall give written notice to the other of intent not to renew the term of Employee's employment hereunder. All references herein to the Term refer to the original term of Employee's employment hereunder and all extensions thereof.

#### 2. Duties

##### (a) Offices

During the Term, Employee shall serve in Employee's current or comparable capacity, and the Board shall renominate Employee, and Employee shall perform duties as assigned. Employer agrees that Employee will be assigned only duties of the type, nature and dignity

normally assigned to someone in a comparable position at a corporation of the size, stature and nature of Employer. During the Term, Employee shall have, at a minimum, the same prerequisites of office as on the date hereof, and shall report directly to the Employer's Chief Operating Officer.

(b) Full-Time Basis

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

3. Compensation

(a) Salary

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

(b) Performance Bonus

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

(c) Other Compensation Plans or Arrangements

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

(d) Tax Withholdings

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

4. Benefits. During the Term, Employee shall be entitled to such comparable fringe benefits and



perquisites as may be provided to any or all of Employer's senior officers pursuant to policies established from time to time. These fringe benefits and perquisites shall include holidays, group health insurance, disability insurance, and life insurance.

5. Expenses and Other Perquisites. Employer shall reimburse Employee for all reasonable and proper business expenses incurred in the performance during the Term of duties hereunder, in accordance with Employer's customary practices for senior officers, and provided such business expenses are reasonably documented.
6. Exclusive Services, Confidential Information, Business Opportunities and Non-Solicitation

(a) Exclusive Services

- (i) During the Term, Employee shall at all times devote full-time attention, energies, efforts and skills to Employer's business and shall not, directly or indirectly, engage in any other business activity, whether or not for profit, gain or other pecuniary advantages, without the written consent of the Chief Executive Officer or Chief Operating Officer, provided that such prior consent shall not be required with respect to (1) business interests that neither compete with Employer or any Subsidiaries nor interfere with Employee's duties and obligations hereunder, and (2) Employee's charitable, eleemosynary, philanthropic or professional association activities.
- (ii) During the Term, Employee shall not, without the prior written consent of the Chief Executive Officer or Chief Operating Officer, directly or indirectly, either as an officer, director, employee, agent, advisor, consultant, principal, stockholder, partner, owner or in any other capacity, on Employee's own behalf or otherwise, in any way engage in, represent, be connected with or have a financial interest in, any business which is, or to Employee's knowledge, is about to become, engaged in the business of providing engineering, management, energy or environmental services to the United States Government or any department, agency, or instrumentality thereof or any state or local government agency or to any person, corporation or other entity (collectively a "Person") with which Employer or any Subsidiary is currently or has previously done business or any subsequent line of business developed by Employee or any Subsidiary during the Term. Notwithstanding the foregoing, Employee shall be permitted to own passive investments in publicly held companies provided that such investments do not exceed five percent of any such company's outstanding equity.

(b) Confidential Information

During the Term and for the first 24 consecutive months after the termination of

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

(c) Business Opportunities

- (i) During the Term, Employee shall promptly disclose to Employer each business opportunity of a type which, based upon its prospects and relationship to the existing businesses of Employer or any Subsidiary, Employer or any Subsidiary might reasonably consider pursuing. Upon termination of the Term, regardless of the circumstances thereof, Employer shall have the exclusive right to participate in or undertake any such opportunity on its own behalf without any involvement of Employee.
- (ii) During the Term, Employee shall refrain from engaging in any activity, practice or act which conflicts with, or has the potential to conflict with, the interests of Employer or its Subsidiaries, and shall avoid any acts or omissions which are disloyal to, or competitive with Employer or its Subsidiaries.

(d) Non-Solicitation of Employees

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

(e) Covenant Not To Compete

- (i) If Employee voluntarily terminates the

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

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

(f) Employee Acknowledgment

Employee hereby agrees and acknowledges that the restrictions imposed upon by the provisions of this Section 6 are fair and reasonable considering the nature of Employer's business, and are reasonably required for Employer's protection.

(g) Invalidity

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

(h) Specific Performance

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

7. Termination

(a) By Employer

(i) Termination for Cause

Employer may for Cause (as defined below) terminate the Term at any time by written notice to Employee. For purposes of this Agreement, the term Cause shall mean any one or more of the following: (1) conduct by Employee which is materially illegal or fraudulent or a material breach of Company policy; (2) the breach or violation by Employee of any of the material provisions of this Agreement, provided that Employee must first be given notice by the Board of the alleged breach or violation and 30 days to cure said alleged breach or violation; (3) Employee's use of illegal drugs or abuse of alcohol or authorized drugs which impairs Employee's ability to perform duties hereunder, provided that Employee must be given notice by the Board of such impairment and 60 days to cure the impairment; (4) Employee's knowing and willful neglect of duties or negligence in the performance of duties which materially affects Employer's or any Subsidiary's business, provided that Employee must first be given notice by the Board of such alleged neglect or negligence and 30 days to cure said alleged neglect or negligence. If a termination occurs pursuant to clause (1) above, the date on which the Term is terminated (the "Termination Date") shall be the date Employee receives notice of termination and, if a termination occurs pursuant to clauses (2), (3) or (4) above, the Termination Date shall be the date on which the specified cure period expires. In any event, as of the Termination Date (in the absence of satisfying the alleged breach or violation within the applicable cure period), Employee shall be relieved of all duties hereunder and Employee shall not be entitled to the accrual or provision of any compensation or benefit, after the Termination Date but Employee shall be entitled to the provision of all compensation and other benefits that shall have accrued as of the Termination Date, including Base Salary, Performance Bonuses, paid leave benefits, Deferred Compensation Units, Deferred Supplemental Compensation to the extent permitted by the plans, and reimbursement of incurred business expenses.

(ii) Termination Without Cause

Employer may, in its sole discretion, without Cause, terminate the Term at any time by providing Employee with (a) 60 days prior notice thereof and (b) on or prior to the Termination Date, a lump sum severance compensation payment equal to the total amount of Employee's Base Salary payable for one (1) year hereunder, based upon the amount in effect as of the effective Termination Date. If Employee has less than five

years of service with the Employer as of the Termination Date, the lump sum severance compensation payment shall equal 6 months pay rather than one year of pay. Employee shall not be entitled to the accrual or provision of any other compensation or benefit after the Termination Date other than (a) the medical and hospitalization benefits after the Termination Date, in accordance with COBRA or other Company policy if covered by a Company-sponsored plan, (b) the provision of all compensation and other benefits that shall have accrued as of the Termination Date, including Base Salary, Performance Bonus, paid leave benefits, Deferred Compensation Units, Deferred Supplemental Compensation and reimbursements of incurred expenses; and (c) all stock options or similar rights to acquire capital stock granted by Employer to Employee shall automatically become vested and exercisable in whole or in part.

(b) Death or Disability

The Term shall be terminated immediately and automatically upon Employee's death or Disability. The term Disability shall mean Employee's inability to perform all of the essential functions of Employee's position hereunder for a period of 26 consecutive weeks or for an aggregate of 150 work days during any 12-month period by reason of illness, accident or any other physical or mental incapacity, as may be permitted by applicable law. Employee's capability to continue performance of Employee's duties hereunder shall be determined by a panel composed of two independent medical doctors appointed by the Board and one appointed by the Employee or designated representative. If the panel is unable to reach a decision the matter will be referred to arbitration in accordance with Section 8. In the event of Employee's death or Disability for any period of six consecutive months, Employee (or designated beneficiary) will be paid Base Salary then in effect for one full year following the date of death or disability (6 months pay rather than one year of pay if Employee has less than five years of service with Employer as of the final day worked).

(c) By Employee

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

medical and hospitalization benefits to the extent permitted by COBRA or other Company policy.

(ii) If, during the Term, a Change of Control (as defined below) occurs, Employee may, in Employee's sole discretion, terminate the Term upon 30 days notice of Employer. If Employee exercises such termination right, Employer may, at its option, at any time after receiving such notice from Employee, relieve Employee of all duties hereunder and terminate the Term at any time prior to the expiration of said notice period. If this Agreement is terminated by Employee or Employer pursuant to this Section 7(c)(ii), Employee shall be entitled:

(a) to receive on or prior to the Termination Date a lump sum severance compensation payment equal to two (2) times the total amount of Employee's Base Salary payable hereunder, based on the amount in effect as of the Termination Date. If Employee has less than five years of service with the Employer as of the date of Employee's notice to Employer, the lump sum severance compensation payment shall be equal to one (1) times the total amount of the Employee's Base Salary rather than two (2) times the total amount;

(b) the medical and hospitalization benefits and all compensation and other benefits that shall have accrued as of the Termination Date, as described in Section 7(a)(ii)(1); and

(c) to the automatic vesting and exercisability in whole or in part of all stock options or similar rights to acquire capital stock granted by Employer to Employee; provided that Employee shall not be entitled, after the Termination Date to the accrual or provision of any other compensation payable hereunder, including the Performance Bonus, but shall be permitted to continue medical and hospitalization benefits to the extent permitted by COBRA or other Company policy.

(d) Change of Control

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

(i) any person, including a group, as such terms as defined in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended, and the rules promulgated thereunder (collectively the Exchange Act"), other than a trustee or other fiduciary holding voting securities of Employer ("Voting Securities") under any Employer-sponsored benefit plan, becomes the beneficial owner, as defined

under the Exchange Act, directly or indirectly, whether by purchase or acquisition or agreement to act in concert or otherwise, of 30% or more of the outstanding Voting Securities;

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

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

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

(e) No Duty to Mitigate

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

(f) Other Policies

This Agreement supersedes and replaces applicable provisions of General Policy Memorandum (GPM) No. 31 and GPM 31-1 concerning Executive Severance Program for Corporate Officers.

8. Arbitration. Whenever a dispute arises between the parties concerning this Agreement or any of the obligations hereunder, or Employee's employment generally, Employer and Employee shall use their best efforts to resolve the dispute by mutual agreement. If any dispute cannot be resolved by Employer and Employee, it shall be submitted to arbitration to the exclusion of all other avenues of relief and adjudicated pursuant to the American

Arbitration Association's Rules for Employment Dispute Resolution then in effect. The decision of the arbitrator must be in writing and shall be final and binding on the parties, and judgment may be entered on the arbitrator's award in any court having jurisdiction thereof. The arbitrator's authority in granting relief to Employee shall be limited to an award of compensation, benefits and unreimbursed expenses as described in Sections 3, 4, and 5 above, and to the release of Employee from the provisions of Section 6 and the arbitrator shall have no authority to award other types of damages or relief to Employee, including consequential or punitive damages. The arbitrator shall also have no authority to award consequential or punitive damages to Employer for violations of this Agreement by Employee. The expenses of the arbitration shall be borne by the losing party to the arbitration and the prevailing party shall be entitled to recover from the losing party all of its own costs and attorneys' fees with respect to the arbitration. Nothing in this Section 8 shall be construed to derogate Employer's rights to seek legal and equitable relief in a court of competent jurisdiction as contemplated by Section 6(h).

9. **Non-Waiver.** It is understood and agreed that one party's failure at any time to require the performance by the other party of any of the terms, provisions, covenants or conditions hereof shall in no way affect the first party's right thereafter to enforce the same, nor shall the waiver by either party of the breach of any term, provision, covenant or condition hereof be taken or held to be a waiver of any succeeding breach.
10. **Severability.** If any provision of this Agreement conflicts with the law under which this Agreement is to be construed, or if any such provision is held invalid or unenforceable by a court of competent jurisdiction or any arbitrator, such provision shall be deleted from this Agreement and the Agreement shall be construed to give full effect to the remaining provision thereof.
11. **Survivability.** Unless otherwise provided herein, upon termination of the Term, the provisions of Sections 6(b), (d) and (e) shall nevertheless remain in full force and effect.
12. **Governing Law.** This Agreement shall be interpreted, construed and governed according to the laws of the Commonwealth of Virginia, without regard to the conflict of law provisions thereof.
13. **Construction.** The paragraph headings and captions contained in this Agreement are for convenience only and shall not be construed to define, limit or affect the scope or meaning of the provisions hereof. All references herein to Sections shall be deemed to refer to Sections of this Agreement.
14. **Entire Agreement.** This Agreement contains and represents the entire agreement of Employer and Employee and supersedes all prior agreements, representations or understandings, oral or written, express or implied with respect to the subject matter hereof. This Agreement may not be modified or amended in any way unless in a writing signed by each of Employer and Employee. No representation, promise or inducement has been made by either Employer or Employee that is not embodied in this Agreement, and neither Employer nor Employee shall



be bound by or liable for any alleged representation, promise or inducement not specifically set forth herein.

15. Assignability. Neither this Agreement nor any rights or obligations of Employer or Employee hereunder may be assigned by Employer or Employee without the other party's prior written consent. Subject to the foregoing, this Agreement shall be binding upon and inure to the benefit of Employer and Employee and their heirs, successors and assigns.

16. Notices. All notices required or permitted hereunder shall be in writing and shall be deemed properly given if delivered personally or sent by certified or registered mail, postage prepaid, return receipt requested, or sent by telegram, telex, telecopy or similar form of telecommunication, and shall be deemed to have been given when received. Any such notice or communication shall be addressed: (a) if to Employer, to President, 2550 Huntington Avenue, Alexandria, Virginia 22303-1499 or (b) if to Employee, to the last known home address on file with Employer, or to such other address as Employer or Employee shall have furnished to the other in writing.

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

VSE CORPORATION  
a Delaware corporation

Date: December 10, 1997      By: /s/ R. B. McFarland

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R. B. McFarland  
President and  
Chief Operating Officer

Date: December 10, 1997      /s/ J. M. Knowlton

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J. M. Knowlton  
Employee