VERSAR INC
Form 10-K/A
October 04, 2005

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549
FORM 10-K/A
Amendment No. 1
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended July 1, 2005	**Commission File No. 1-9309**

(Exact name of registrant as specified in its charter)

DELAWARE	**54-0852979**
(I.R.S. employer identification no.) incorporation or organization)	**(State or other jurisdiction of**
6850 Versar Center, Springfield, Virginia	**22151**
(Address of principal executive offices)	(Zip code)

(703) 750-3000
(Registrant s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:
Common Stock, $.01 par value
(Title of Class)
American Stock Exchange
(Name of each exchange on which registered)
Securities registered pursuant to Section 12(g) of Act: NONE

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

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. ( )

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes o No þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

The aggregate market value of the voting stock held by non-affiliates of the registrant as of December 31, 2004 was approximately $25,034,193.

The number of shares of Common Stock outstanding as of September 2, 2005 was 7,998,701.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement to be filed with the Securities and Exchange Commission with respect to the 2005 Annual Meeting of Stockholders are incorporated by reference into Part III hereof.

Explanatory Note

Versar, Inc. is filing this amendment to Form 10-K for the fiscal year ended July 1, 2005, which was filed with the Securities and Exchange Commission on September 26, 2005. The table in Note K Quarterly Financial Information on page F-20 of the 2005 Form 10-K, reported quarterly loss from discontinued operations for fiscal year 2005 as $164,000, $185,000, $111,000 and $699,000 for quarters ended October 1, 2004, December 31, 2004, April 1, 2005 and July 1, 2005, respectively. The corrected loss from discontinued operations are $96,000, $111,000, $185,000 and $767,000 for quarters ended October 1, 2004, December 31, 2004, April 1, 2005 and July 1, 2005, respectively. Additionally, the correct gross revenue for quarter ended July 1, 2005 is $14,842,000 instead of the $14,845,000 as reported in Form 10-K.

Except for the amendments described above, this Form 10-K/A does not modify or update other disclosures in, or exhibits to, Versar, Inc. 2005 Form 10-K.

PART I

Item 1. Business

Forward-Looking Statements

This report contains certain forward-looking statements which are based on current expectations. Actual results may differ materially. The forward-looking statements include those regarding the continued award of future work or task orders from government and private clients, cost controls and reductions, the expected resolution of delays in billing of certain projects, and the possible impact of current and future claims against the Company based upon negligence and other theories of liability. Forward-looking statements involve numerous risks and uncertainties that could cause actual results to differ materially, including, but not limited to, the possibilities that the demand for the Company s services may decline as a result of possible changes in general and industry specific economic conditions and the effects of competitive services and pricing; the possibility the Company will not be able to perform work within budget or contractual limitations; one or more current or future claims made against the Company may result in substantial liabilities; the possibility the Company will not be able to attract and retain key professional employees; changes to or failure of the Federal government to fund certain programs in which the Company participates; and such other risks and uncertainties as are described in reports and other documents filed by the Company from time to time with the Securities and Exchange Commission.

Business Overview

Versar, Inc., a Delaware corporation organized in 1969, (the Company or Versar), is a professional services firm that provides the government and the private sector with value-added, high quality innovative solutions for infrastructure, facilities management, construction, environmental quality, defense and homeland security needs. Versar operates in two primary business segments: 1) Infrastructure and Management Services and 2) National Security.

The Infrastructure and Management Services business segment provides services including environmental compliance management, environmental restoration, environmental conservation, engineering, design, and construction management services. The National Security business segment provides a comprehensive range of testing, evaluation, system integration and field support services in the chemical domain. Capabilities include systems testing and evaluation; development and evaluation of detection technologies; development and production of personal protective systems; counter-terrorism planning; air quality analysis; and information technology support.

In fiscal year 2005, Versar combined the Infrastructure and Management Services and the former Engineering and Construction business segment because many of the services provided were similar to the Company s remediation business, shared similar customers, business opportunities and was duplicative in nature. Such a combination provided a more efficient use of resources and more effective management of the business operations.

In fiscal year 2005, Versar expanded both our capabilities and geographic support to the government sector by adding a cultural resources unit and providing extensive Title II engineering oversight services overseas in Iraq. In addition, management continued to reduce overhead and facility costs, and refocus the marketing and sales efforts on our core business and strategic business targets.

In fiscal year 2005, the Company discontinued its biological laboratory operations due to poor financial performance, market concentration, and poor business outlook. As such, the financial results have been segregated into discontinued operations and the assets and liabilities have been segregated until the final disposition of the laboratory has occurred.

Infrastructure and Management Services

Versar s customers are incorporating environmental health and safety activities into their management systems and day-to-day operations. Versar supports our customers by providing the full range of scientific, engineering and program management services to address prevention, detection, control, management, and clean-up of toxic substances and hazardous waste. The Infrastructure and Management Services business segment is the largest component of Versar s business base. Support to the Department of Defense (DoD), the U.S. Environmental Protection Agency (EPA) and state and local governments comprise the majority of this work. Programs generally focus on six major service areas, described below: compliance with environmental regulations, restoration of contaminated sites, prevention of pollution at the source, conservation of natural and cultural resources, engineering and design, and construction oversight.

Compliance: Versar provides support for regulatory compliance programs involving air, water and other media. The trend in DoD compliance services is to use the capabilities of personnel from professional services firms to support on-site activity at DoD facilities. In 2005, Versar continued its growth in its professional services division providing on-site environmental management and compliance services. Our onsite professional services are an increasingly attractive alternative as DoD shifts emphasis to its core mission of defense of the nation. Versar s company-wide federal outsourcing technical support business revenue increased by 14% in fiscal year 2005 providing technical and professional staff primarily to the U. S. Army and Air Force. Versar in 2005 added over 20 professional and administrative on-site support staff at over 19 DoD installations and industrial facilities not previously serviced. The current Administration s public commitment to utilize the resources of the private sector to meet its personnel needs is another factor that has driven this segment of the business.

Compliance and scientific support for the U.S. Environmental Protection Agency (EPA) continued to show stable revenue in fiscal year 2005. All existing contracts were used to capacity, with EPA adding options to several base contracts.

Environmental Restoration: Federal restoration program revenue generally stayed stable in fiscal year 2005 as DoD restoration projects were converted from traditional cost plus to performance-based, fixed price contracts. Versar recognized this shift in contract needs and adjusted its bidding process to accommodate the new contracting process. As a result, Versar was awarded three such contracts in fiscal years 2004 and 2005 by the Air Force Center for Environmental Excellence (AFCEE). The first contract, awarded in 2004, is a contract for remediation of chlorinated solvents and hydrocarbons at Charleston AFB, SC, and will result in payments aggregating $4 million over a four-year period. The second contract, also awarded in 2004, is a $2.8 million performance-based contract to close a missile launch control facility and a fire training facility at Vandenberg AFB, CA. Two follow-on Task Orders representing $2.5 million in additional work are scheduled for award in early fiscal year 2006. The third contract, in fiscal year 2005 was a $6 million, 6-year contract from the Army to clean up sites and provide onsite O&M support at Schofield barracks and Tripler Medical facility in Honolulu, Hawaii. This project opens Versar to the Pacific Rim arena for additional DoD infrastructure services support.

Another significant development in the restoration arena in 2005 was the award of two grants through the Environmental Security Technology Certification Program (ESTCP) to develop decision support tools for investigating sites with munitions and explosives of concern.

The Air Force, however, continues to be our largest remediation customer, and through our existing AFCEE contracts we continue to bid and win task efforts at bases worldwide. In 2005, Versar continued to perform restoration support services at Vandenberg AFB, Beale AFB, and Buckley AFB, in the U.S., and Ramstein and Moron AFB, in Europe. Work at military training ranges is also expanding, through subcontracting opportunities with large DoD operations and maintenance firms. We have increased our staff of field personnel at Nellis AFB, Nevada, on a 15-year contract, and expect to provide more personnel at Nellis AFB and other ranges in fiscal year 2006. At Nellis AFB, Versar is saving and recycling UXO residue. The residue is sold as scrap and the resultant funds are turned over to the installation for further range cleaning.

Remediation of mold has also been a growth area for Versar. Versar s indoor air quality business has increased in the past year led by an expansion in mold investigation and remedial services. In fiscal year 2004, Versar completed an $11 million project involving mold remediation, moisture infiltration mitigation and engineering management services for a national real estate development company, John Laing Homes.

Pollution Prevention: Versar has been involved with innovative pollution prevention (P2) programs since the 1980s. The market has shifted from the assessment of opportunities for P2 to engineering solutions that use sustainable, low impact technology to replace traditional processes.

Our premiere P2 program continues to revolve around the technology associated with cleaning oxygen systems aboard military aircraft. The Aircraft Oxygen Line Cleaning System (OLCS) development project is complete, and has successfully been demonstrated on a number of aircraft platforms in the DoD inventory, including the B-1 bomber, the F-15 and F-16 fighter aircraft, and the C-130 transport. In 2004, a smaller-scale Oxygen Cart Cleaning System was developed and tested. Work continued in fiscal year 2005 as we demonstrated the technology on a B-52 aircraft and helped an aircraft manufacturer prove that crew-expansion projects could be performed in a clean manner relative to oxygen systems. We also provided oxygen converter cleaning services in the Tinker AFB oxygen shop.

Conservation of Natural and Cultural Resources: Versar continues to grow our specialized expertise in ecological assessment, restoration and resource management. For more than 30 years we have supported the states of Maryland, Virginia and Delaware as well as the EPA, National Oceanic and Atmospheric Administration (NOAA), United States Fish and Wildlife Service (USFWS) and U.S. Army Corps of Engineers (USACE) in the assessment of the ecological health of the Chesapeake Bay, and the development of management practices to restore this endangered ecosystem. In 2005, Versar was awarded a 5-year contract to continue monitoring of biota living in the Bay s sediments and an additional contract to monitor the small planktonic organisms that serve as food for fish. As a cooperator with the University of Maryland, Versar is currently conducting an ecological risk assessment of the proposal by various states to introduce the Asian oyster to the Bay to enhance the Bay s ecology and sustain commercial fishing in the region. Through our contracts with the Philadelphia and Wilmington Districts of the U.S. Army Corps of Engineers, Versar has continued to assess the ecological consequences of beach restoration through removal of sand from offshore deposits. Our recent work has employed innovative technologies, such as underwater video, to evaluate how fish and other marine organisms may respond to USACE dredging programs.

Our watershed planning and storm water management programs have expanded and diversified in the past year. For a comprehensive planning project in an urban watershed in Fairfax County, Virginia, Versar has been developing low impact development (LID) alternatives for improving water and habitat quality. For Frederick County, Maryland, we have been identifying sites in impaired watersheds that may present cost-effective and ecologically beneficial locations for restoration programs.

Versar s Cultural Resources (CR) Division, newly acquired in April 2005 from Parsons Corporation, added a new dimension to Versar s broad range of professional services that already included professional services cultural staff supporting several DoD installations. Operating since 1977, the CR Division has successfully executed nearly 1,000 projects for federal, state, local and municipal, commercial, industrial and private clients in 49 states, Puerto Rico, Argentina and Japan. The staff of 12 professionals with a full-scale archaeological laboratory conducts projects in compliance with the National Environmental Protection Act, the National Historic Preservation Act, and other legislation. As cultural resources compliance is an integral and mandatory part of environmental planning, the addition of this group gives Versar the edge in satisfying customers total environmental needs in future projects.

Engineering and Design: In 2005, Versar completed the renovation and security upgrades of a materials processing center for a confidential federal client in the metropolitan Washington, DC area which includes 76,000 square feet of renovation and fit-out. This state-of-the-art facility provides worker and facility protection, including protection from explosive, radiological, biological and chemical agent exposure, which is technically superior to that currently being utilized by other similar facilities in the public and private sectors.

Versar has completed design services and performed construction inspection for infrastructure projects at industrial process facilities, cleanrooms, laboratories (e.g., BSL-3 and Entomology), and weapons destruction facilities, for example, at Merck, Printpack, Barr Laboratories, Newport News Shipbuilding, Dynax, U.S. Air Force, U.S. Army and the Defense Threat Reduction Agency.

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Construction Management: Versar completed three major construction projects that were initiated in late fiscal year 2004 including a roofing systems repair/replacement project for the Defense Logistics Agency (DLA) for two buildings at the DLA Defense Distribution Center in San Diego, California; a modular infectious disease laboratory for the Air Force Surgeon General at Lackland AFB, Texas; and a demolition and remediation project at Vandenberg AFB, California.

Versar was also awarded a task order by AFCEE to provide Quality Assurance and Construction Oversight (Title II services) at AFCEE reconstruction projects throughout Iraq. Under the $4 million task order, Versar quickly demonstrated its construction expertise through an initiative to develop skilled-labor trade schools for the Iraqi workforce and an initiative to create the first ever, comprehensive Constructions Standards for Iraq.

Versar s repeat federal and state engineering and construction clients in fiscal year 2005 included U.S. Air Force, U.S. Army, General Services Administration, U.S. Department of State, Virginia Department of Transportation, Virginia Department of Mental Health, Virginia Tech, University of Virginia, and Virginia Commonwealth University. For these customers, Versar has provided a wide variety of services including those described above, ranging from new facility design, facility renovations, energy improvement projects, infrastructure evaluation, and related support services.

Versar is recognized by our clients for providing vulnerability assessment, environmental health and safety systems integration and facility hardening, along with innovative design/build services. Versar has the expertise to cost-effectively design/construct facilities on an expedited basis, including those with homeland defense and anti-terrorism/force protection considerations.

National Security

The National Security segment consists primarily of the operations of GEOMET Technologies, LLC. The National Security segment operates in several defense markets:

Personal Protection Equipment: GEOMET, is a leader in developing, testing and manufacturing personal protection equipment (PPE). In fiscal year 2004, GEOMET announced its DTAPS® (Disposable Toxicological Agent Protective System) Level B coverall chemical/biological protective suits, which are the first in the industry to be certified by the Safety Equipment Institute (SEI) to the National Fire Protection Association (NFPA) 1994, Class 2 standards. This certification, called the NFPA 1994, *Standard on Protective Ensembles for Chemical/Biological Terrorism Incidents*, will help fire and emergency services personnel select the proper personal protective equipment to use when conducting assessment, extrication, rescue, triage, and treatment operations at domestic terrorism incidents involving dual-use industrial chemicals, chemical terrorism agents, or biological terrorism agents. The DTAPS® Level B coverall ensemble is a fully integrated and chemical warfare agent tested protective system including a coverall suit, a reusable chemical splash hood, boots, and breathing system.

GEOMET was awarded a contract by the Greek government to supply DTAPS® Level A chemical protective suits and associated equipment plus training to the Greek military forces as part of their preparation to respond to possible terrorist incidents at the 2004 Olympic Games held in the summer of 2004 in Athens, Greece. Over the past eight years, Versar has provided chemical protective suits and associated equipment to United States and Australian military services to strengthen their chemical and biological capabilities to respond to terrorist incidents at both Summer and Winter Olympic Games.

The PPE marketplace will continue to be highly competitive, with decisions often based on price. Our strategy is to continue to work with customers to become a one stop supplier for protection needs, and to assist the customer in determining what systems are needed and how many to purchase.

The Company continues to be successful with submittals to the Technical Support Working Group (TSWG). TSWG is the U.S. national forum that identifies, prioritizes, and coordinates interagency and international research and development (R&D) requirements for combating terrorism. TSWG has awarded the Company an R&D task, for example, to develop a heat stress calculation system for personal protection system use which accurately predicts how long an individual can operate in specific conditions. The system, based on a personal data assistant device, allows the user to rapidly assess and calculate the heat stress on an individual outfitted with PPE, and how long they can operate safely. Work continues in 2006 towards deployment of an operational system for TSWG under this contract.

Chemical Surety Laboratory: Versar owns and operates one of four non-federal DoD licensed Surety Laboratories in the U.S. The laboratory provides cost-effective materials testing services to the U.S. Government and to private industries, particularly manufacturers of chemical protective equipment and clothing. Other laboratory services include evaluation of new chemical agent detection instrumentation, chemical agent decontamination and destruction techniques, site remediation/environmental cleanup support, analysis of environmental samples (air, soil, water, and sludge) for the presence of chemical and biological agents and degradation products, and testing of personal protective systems for component survivability.

GEOMET was also selected to be the lead subcontractor, providing nuclear, chemical and biological test and evaluation services to the West Desert Test Center (WDTC) located on the U.S. Army Dugway Proving Ground (DPG), Utah. The prime contract is a cost plus fixed fee contract with a value of $285 million and a one-year basic period of performance along with fourteen options and award terms, making the potential total contract period 15 years. Versar s estimated portion of this contract is $35 million over the 15 year period of performance. The WDTC test programs include evaluation of munitions, chemical/biological detection and protection devices, testing to determine nuclear, biological, chemical contamination and decontamination survivability of various Department of Defense material and equipment, and a wide range of developmental testing and applied research related to tactics, techniques, and procedures.

The Chemical Surety laboratory worked in fiscal year 2005 to improve its compliance with required regulations promulgated by the U.S. Army and the U.S. Department of Commerce, which are the agencies that provide oversight of operations and inspections of the facility. During fiscal year 2005, the Company was awarded a $6.9 million, five-year contract with the U.S. Marine Corps, Marine Logistics Command to support the Joint Service Chemical Agent Testing Program. GEOMET will provide chemical, and other testing services across a broad range of programs to protect military and homeland security personnel against weapons of mass destruction threats.

Versar/GEOMET Collaboration Programs

Navy Systems Engineering Support: The Company was selected as a team member on two teams for a major Navy Contract Vehicle, called SEAPORT II . These teams are headed by Lockheed Martin Corp. and ELS, Inc., and will compete for naval ship and weapon systems support services awarded by the Naval Sea Systems Command. Versar will support each team with vulnerability assessments, systems engineering, test and evaluation, science and technology, field support, Base Realignment and Closure (BRAC) support services, and environmental services. The Navy estimates the value to all contractors of this 15 year program will be worth up to $19.5 billion for the design, building and maintenance of the Navy s ships and combat systems. This is an opportunity to provide Versar s unique defense services to the Navy s ship and weapons program for the next 15 years.

GSA IT: In fiscal year 2004, GEOMET was awarded a General Services Administration (GSA) Information Technology (IT) schedule contract which simplifies the process for government agencies to obtain Versar IT services. Versar will now be able to support homeland security and e-government type initiatives and extend existing corporate IT capabilities in the area of processing real-time data. The five-year base contract (with five years of options) allows for a wide-range of IT services to the government including: database management, systems engineering, programming, web design/hosting, training, IT needs determination, modeling & simulation and scenario development.

Vulnerability Assessments: Versar continued to build a track record involving the assessment of critical infrastructure for vulnerability to terrorist attack. Versar is a licensee of Sandia National Laboratories (SNL) Risk Assessment Methodology for the execution of vulnerability assessments. Contracts were awarded by over 80 cities for water utility vulnerability assessments across the nation. The firm holds SNL licenses for Risk Assessment Methodology in the following areas: Water (W), Chemical Facilities (CF), Communities (C), Transmission Lines (T), and Dams (D). Versar has trainers in RAM-W™, RAM-CF™, and RAM-C™, and has offered training sessions from Atlanta to Honolulu. There are less than 100 trainers for these approaches in the U.S. for protection, and response to potential terrorist threats.

USAF Vulnerability Assessments: In fiscal year 2004, Versar was awarded a $1.1M contract by the Air Force Institute of Operational Health to perform food service vulnerability assessments (FSVAs) at over 90 Air Force installations around the country. The FSVAs use the Operational Risk Management (ORM) method to check the food supply chain from the vendors (both prime vendor and other vendors) to the fork of the airmen s mouths. Recommendations are made in the vulnerability assessments to improve protection of the food supply chain. By 2005, Versar had performed FSVAs at 12 Air Force Reserve Command (AFRC) bases, and 78 Air National Guard (ANG bases) around the U.S. during the past two years.

DoD Contract Support: The Company was successful as a subcontractor on the ECBC (Edgewood Chemical Biological Center) engineering support Contract awarded by the Edgewood Chemical Biological Center in Edgewood, MD. The Company will market this contract vehicle during fiscal year 2006 to secure task orders involving chemical and biological warfare agents, support systems and programs. Versar believes this contract will become an important foundation for future work in this arena.

Markets

Versar s services are continuing to evolve in response to clients changing needs and our market opportunities are being driven by the availability of technology aimed at enhancing operating performance and profitability. The Company has focused its emphasis on outsourcing professional services for government customers, developing long term level of effort contracts to stabilize the Company s business base and on the challenging homeland security market.

Terrorism and defense issues are the biggest short-term threat facing the economy, well ahead of government spending and the deficit. The next president will devote at least half of his time to the Middle East and terrorism. Management believes that each business segment has expertise to address the needs raised by these national security issues. The Company believes that Versar is well positioned in the defense and national security sectors in the coming years.

The industrial environmental marketplace, in our view, will remain highly competitive, as no major new regulatory requirements are expected to be placed on industry in the near future. Some of our private sector customers

are beginning to return to funding capital expenses for environmental projects. Given the current economic and regulatory situation, we will continue to pursue those opportunities that can be performed profitably.

Success in the federal markets continues to be driven by a cost-effective set of solutions, such as the Guaranteed Fixed Price Remediation Program, outsourcing at the point of need, and relationships with key customers.

We believe the next round of Base Realignment and Closure (BRAC) will drive a new round of base study and clean-up work, starting in fiscal year 2006. Government reorganization and privatization also present opportunities that we will continue to pursue. In addition, testing and training ranges have become more and more important to the environmental market, as new rules require more emphasis on the cleanup of munitions and safe disposal of unexploded ordnance. Water quality is also a focus area, and we have successfully entered new markets at the state and local level using our credentials gained from working at the federal level.

Competition

Versar continues to face substantial competition in each market in which it operates and expects to continue to face substantial competition as it diversifies its business. Competitors are often larger and have greater financial resources than Versar, which means that we have to be very selective in our marketing and sales program efforts. However, we believe that our larger size relative to many of the smaller, niche companies with which we compete is an advantage. We are better able to compete with these smaller companies for certain contracts available only to companies qualifying as a small business under federal regulations because we have greater resources than they do. Generally, a company with more than 500 hundred employees will not qualify as a small business so our larger competitors are unable to compete with us on these contracts. In addition, there has been major consolidation in the environmental services market, with two brackets of firms emerging the large, diversified firms with a wide range of capabilities, and the smaller, niche firms with limited capability in specific horizontal or vertical markets.

Our market areas of environmental, architecture and engineering and defense reflect a mix of business that we believe will be stable and allow for growth, while retaining our core capability. The synthesis of our core capabilities, however, is an important selling feature as customers look for one source to meet their needs. We believe that we are among the few firms that combine environmental health and safety/risk assessment, hard engineering design and construction, and chemical and biological defense capability in one package, and we are actively pursuing customers that require these combined services.

Our pricing structure has been adjusted to ensure that we remain competitive, particularly for outsourcing, where procurement decisions are very sensitive to pricing. Similarly, we are concentrating our marketing efforts on getting the most return on investment, through expanding support for existing customers, developing tasks under existing contracts, and collaborating with firms that need our niche expertise. We are targeting and identifying specific programs that match our capability.

Versar will also continue to target small business set aside opportunities in the federal marketplace, under the North American Industry Classification System (NAICS) codes that provide opportunities for firms with fewer than 500 employees. We continue to work with customers to make them aware of the benefits of setting aside work under these NAICS codes, and expect that trend to continue. Typically, for large, environmental contracts, at least one of the awards is targeted for a small business, and Versar believes it is well equipped with its depth of expertise to compete in that sector.

Backlog

Versar evaluates its backlog two ways: funded and total contract backlog. Funded backlog represents the total amount of uncompleted work for which the Company has received firm contractual commitments whether through a signed contract, written task order under a large contract vehicle or master contract or some other written authorization. Normally, at least 80% of all funded backlog is performed in the succeeding twelve months. Funded backlog amounts have historically resulted in revenue, however, no assurance can be given that all amounts included in funded backlog will ultimately be realized as revenue.

Total contract backlog includes funded backlog, existing written contracts and unutilized contract capacity, including option periods, in which funding for work or tasks has not yet been authorized. The amount of total contract backlog is what Versar reasonably believes, based on past experience and present expectations, will become funded backlog over the next five to seven years. There cannot be any assurance, however, that all amounts included in total contract backlog will ultimately become funded backlog and, when if funded, that it will ultimately be realized as revenue.

As of June 30, 2005, funded backlog for Versar was approximately $31 million, a decrease of 33% compared to approximately $46 million as of June 30, 2004. The backlog decrease was attributable to the substantial completion of two major construction projects that were awarded in the fourth quarter of fiscal year 2004.

As of June 30, 2005, total contract backlog for Versar, including unfunded government task orders, was approximately $405 million, as compared to approximately $370 million as of June 30, 2004, an increase of 9%. The increase is due to the award of six new contract vehicles during fiscal year 2005.

Employees

At July 1, 2005, Versar had approximately 379 full-time employees, of which eighty-five percent are engineers, scientists, and other professionals. Eighty-five percent of the Company s professional employees have a bachelor s degree, thirty-four percent have a master s degree, and six percent have a doctorate degree.

Item 2. Properties

The Company s executive office is located in Springfield, Virginia, a suburb of Washington, D.C. Versar currently leases 68,014 square feet in two buildings from Springfield Realty Investors, LLC. The rent is subject to a two-percent escalation per year through May 31, 2009.

As of September 2, 2005, the Company had under lease an aggregate of approximately 173,000 square feet of office and laboratory space in the following locations: Springfield, Lynchburg and Norfolk, VA; Tempe, AZ; Fair Oaks, CA; Northglenn, CO; Lombard, IL; Baltimore, Columbia, Gaithersburg and Germantown, MD; Oklahoma City, OK; San Antonio, TX; and Horsham, PA. The lease terms primarily range from two to six years.

Item 3. Legal Proceedings

In August 1997, Versar entered into a contract with the Trustees for the Enviro-Chem Superfund Site, which provided that, based upon an existing performance specification, Versar would refine the design, and construct and operate a soil vapor extraction system. During the performance of the contract, disputes arose between Versar and the Trustees regarding the scope of work. Eventually, Versar was terminated by the Trustees for convenience. The Trustees then failed to pay certain invoices and retainages due Versar.

On March 19, 2001, Versar instituted a lawsuit against the Trustees and three environmental consulting companies in the U.S. District Court of the Eastern District of Pennsylvania, entitled Versar, Inc. v. Roy O. Ball, Trustee, URS Corporation, Environmental Resources Management and Environ Corp., No. 01CV1302. Versar, in seeking to recover amounts due under the remediation contract from the Trustees of the Superfund Site, claimed breach of contract, interference with contractual relationships, negligent misrepresentations, breach of good faith and fair dealing, unjust enrichment and implied contract. Mr. Ball and several defendants moved to dismiss the action or, in the alternative, transfer the action to the U.S. District Court for the Southern District of Indiana, where, on April 20, 2001, the two Trustees had filed suit against Versar in the U.S. District Court for the Southern District of Indiana, entitled, Roy O. Ball and Norman W. Bernstein, Trustees v. Versar, Inc., Case No. IPO1-0531 C H/G. The Trustees alleged breach of contract and breach of warranty with respect to the remediation contract and asked for a declaratory judgment on a number of the previously stated claims.

On July 12, 2001, the Federal District Court in Pennsylvania granted defendants motion to transfer the Pennsylvania lawsuit and consolidate the two legal actions in Indiana. The Company filed an answer and counterclaim to the Indiana lawsuit. The plaintiffs and third-party defendants filed Motions to Dismiss the Company s counterclaim. The court granted the motions in part and denied them in part. Versar amended its answer and counterclaim. In the meantime, plaintiffs filed a Motion for Partial Summary Judgment which the Judge granted in part and denied in part. The Judge held that certain agreements entered into by the parties prevented Versar from recovering certain amounts under its counterclaim but that Versar could pursue its claim for fraud in other areas. Written and oral discovery which has continued for several years is now completed. The court granted Versar s demand that the Trustees supply requested information and documents. Versar continues to seek additional discovery compliance by the Trustees. Motions for summary judgement are expected to be filed by both parties. No trial date is presently scheduled. Based upon discussions with outside counsel, management does not believe that the ultimate resolution under the Trustees lawsuit will have a materially adverse effect on the Company s consolidated financial condition and results of operations.

Versar and its subsidiaries are parties from time to time to various other legal actions arising in the normal course of business. The Company believes that any ultimate unfavorable resolution of these legal actions will not have a material adverse effect on its consolidated financial condition and results of operations.

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

No matters were submitted to a vote of the Company s security holders during the last quarter of fiscal year 2005.

EXECUTIVE OFFICERS

The current executive officers of Versar, and their ages as of September 6, 2005, their current offices or positions and their business experience for at least the past five years are set forth below.

NAME	AGE	POSITION WITH THE COMPANY
Theodore M. Prociv	57	President and Chief Executive Officer
Lawrence W. Sinnott	43	Executive Vice President, Chief Operating Officer, Chief Financial Officer and Treasurer
Jerome B. Strauss	56	Senior Vice President, Infrastructure and Management Services Business Segment
Paul W. Kendall	52	Senior Vice President, National Security Business Segment
James C. Dobbs	60	Senior Vice President, General Counsel and Secretary

Theodore M. Prociv, Ph.D., joined Versar as President on November 1, 1999 and was elected Chief Executive Officer on July 1, 2000. From 1995 to August 1998, Dr. Prociv served as the Deputy Assistant to the Secretary of Defense for Chemical and Biological Matters, and subsequently as the Deputy Assistant Secretary of Army for Chemical Demilitarization. Before joining the Department of Defense, Dr. Prociv was Corporate Vice President of Environmental Business at Science Applications International Corporation, (SAIC) 1993-1994, and served as the Vice President for Government Systems at Battelle Memorial Institute 1979-1993.

Lawrence W. Sinnott, MBA, CPA, joined Versar in 1991 as Assistant Controller. In 1992, he became Corporate Controller. In 1993, he was elected Treasurer and Corporate Controller. In 1994, he became Vice President, Chief Financial Officer and Treasurer. In October 1999, he was elected Senior Vice President. On September 6, 2005, he was elected Executive Vice President and Chief Operating Officer. From 1989 to 1991, he was Controller of a venture capital company, Defense Group, Inc.

Jerome B. Strauss, P.E., joined Versar in 1977, was elected Vice President in 1999, and Senior Vice President in 2003. He served as Division Director for Waste Management from 1989-2002, and Unit Manager for Atlantic Operations from 2001-2002. Mr. Strauss has led work in virtually all areas of environmental services during his 27 years with Versar.

Paul W. Kendall, B.S., J.D., joined Versar in 1994 as Manager of Business Development, was elected Vice President in 2000, served as Vice President of Corporate Development from January to October 2003, and since November 2003 as Senior Vice President, Defense Business Segment and President of GEOMET Technologies LLC.

James C. Dobbs, J.D., L.L.M., joined Versar in 1992 as Vice President, General Counsel, and Secretary. In October 1999, he was elected Senior Vice President. From 1984 to 1992, Mr. Dobbs was employed by Metcalf & Eddy, Inc. as Vice President and General Counsel where he was responsible for providing legal and regulatory advice to senior management.

PART II

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

Common Stock

The Company s common stock is traded on the American Stock Exchange (AMEX), under the symbol VSR. At July 1, 2005, the Company had 1,156 stockholders of record, excluding stockholders whose shares were held in nominee name. The quarterly high and low sales prices as reported on the AMEX during fiscal years 2005 and 2004 are presented below.

Fiscal Year 2005	**High**	**Low**
4th Quarter	$ 3.80	$ 3.00
3rd Quarter	4.45	3.59
2nd Quarter	4.70	3.90
1st Quarter	4.88	3.70

Fiscal Year 2004	**High**	**Low**
4th Quarter	$ 5.40	$ 3.21
3rd Quarter	3.84	3.20
2nd Quarter	3.80	2.56
1st Quarter	3.29	2.55

No cash dividends have been paid by Versar since it began public trading of its stock in 1986. The Board of Directors intends to retain any future earnings for use in the Company s business and does not anticipate paying cash dividends in the foreseeable future. Under the terms of the Company s revolving line of credit, approval would be required from the Company s primary bank for the payment of any dividends.

The Company has established equity compensation plans to attract, motivate and reward good performance of high caliber employees, directors and service providers to serve Versar, Inc. and its affiliates. Currently, there are four stock option plans which were previously approved by the security holders: the 2002 Stock Incentive Plan, the 1996 Stock Option Plan, the 1992 Stock Option Plan and the 1987 Nonqualified Stock Option Plan.

Item 6. Selected Financial Data (unaudited)

The selected consolidated financial data set forth below should be read in conjunction with Versar s consolidated financial statements and notes thereto beginning on page F-3 of this report. The financial data is as follows:

	For the Years Ended				
	July 1, 2005	June 30, 2004	June 30, 2003	June 30, 2002	June 30, 2001
	(In thousands, except per share data)				
Consolidated Statement of Operations related data:					
Gross Revenue	$ 67,678	$ 60,067	$ 56,646	$ 67,988	$ 65,816
Net Service Revenue	35,638	33,656	34,747	38,189	39,481
Operating Income (Loss)	1,427	1,913	612	619	(352)
Income (Loss) from Continuing Operations	1,361	1,827	(658)	159	(1,030)
(Loss) Income from Discontinued Operations	(1,159)	(636)	(350)	(80)	243
Net Income (Loss)	202	1,191	(1,008)	79	(787)
Income (Loss) per share from Continuing Operations Diluted	$ .16	$ .24	$ (.09)	$ .02	$ (.16)
(Loss) income per share from Discontinued Operations Diluted	$ (.14)	$ (.09)	$ (.05)	$ (.01)	$. 04
Net Income (Loss) per share Diluted	$ .02	$ .16	$ (.14)	$ .01	$ (.12)
Weighted Average Shares Outstanding - Diluted	8,263	7,675	7,231	6,998	6,470
Consolidated Balance Sheet related data:					
Working Capital	$ 7,887	$ 7,494	$ 4,940	$ 6,600	$ 7,073
Current Ratio	1.86	1.87	1.47	1.70	1.86
Total Assets	20,912	20,085	19,336	21,273	20,117
Current Portion of Long-Term Debt					170
Long-Term Debt					
Total Debt, excluding bank line of credit					170
Stockholders Equity	$ 10,552	$ 10,065	$ 7,396	$ 8,324	$ 6,013

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

Financial trends

From fiscal year 2002 to 2004, the net service revenue of the Company declined as the Company wound down the Army STEPO suit production contract in the National Security business segment. With increased funded contract backlog in the fourth quarter of fiscal year 2004 and the first quarter of fiscal year 2005, the Company began to reverse that trend. Multi-million dollar contracts were awarded to the Infrastructure and Management Services business segment. These included roofing projects in San Diego in support of the Defense Logistic Agency and hurricane emergency response in various locations in Florida. The Company achieved significant gross revenue growth in the first half of fiscal year 2005 as a result of increased Infrastructure and Management Services work. Such continued growth is dependent upon winning additional follow-on projects and additional new contracts in order to keep the funded contract backlog at levels that would support continued growth. Management continues to pursue many business opportunities to continue such growth, and recently, the Company was awarded a $4 million contract for construction oversight in Iraq. However, there can be no assurance that the Company s efforts to grow the business base will be successful or that the Company will receive sufficient contract awards to replace work as contracts are completed.

During the third and fourth quarters of fiscal year 2005, gross revenues on the major construction projects declined compared to the first half of the fiscal year due to delays in obtaining follow-on and new projects. The resulting reduction in gross revenues along with the delay in resolution of several construction change orders negatively impacted the Company s operating results for the second half of fiscal year 2005.

Additionally, there were delays in contract funding for the Environmental Protection Agency and certain delays with civilian agencies also experienced delays because of the diversion of funds for the war effort, and the announcement of additional military base closings by the BRAC commission, which impacted funding by approximately $5 million.

In fiscal year 2005, the Company discontinued the operations of its biological laboratory primarily due to the continued poor operating performance, market saturation and future business outlook. Such results are presented as discontinued operations for financial statement purposes and the assets and liabilities have been segregated as the Company winds down the business affairs of the laboratory.

There are a number of risk factors or uncertainties that could significantly impact our financial performance including the following:

General economic or political conditions;

Threatened or pending litigation;

The timing of expenses incurred for corporate initiatives;

Employee hiring, utilization, and turnover rates;

The seasonality of spending in the federal government and for commercial clients;

Delays in project contracted engagements;

Unanticipated contract changes impacting profitability;

Reductions in prices by our competitors;

The ability to obtain follow on project work;

Failure to properly manage projects resulting in additional costs;

The cost of compliance for the Company s laboratories; - The impact of a negative government audit potentially impacting our costs, reputation and ability to work with the federal government;

Loss of key personnel;

The ability to compete in a highly competitive environment; and

Federal funding delays due to war in Iraq.

ITEM 7 Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

Results of Operations

This report contains certain forward-looking statements which are based on current expectations. Actual results may differ materially. The forward-looking statements include those regarding the continued award of future work or task orders from government and private clients, cost controls and reductions, the expected resolution of delays in billing of certain projects, and the possible impact of current and future claims against the Company based upon negligence and other theories of liability. Forward-looking statements involve numerous risks and uncertainties that could cause actual results to differ materially, including, but not limited to, the possibilities that the demand for the Company s services may decline as a result of possible changes in general and industry specific economic conditions and the effects of competitive services and pricing; the possibility the Company will not be able to perform work within budget or contractual limitations; one or more current or future claims made against the Company may result in substantial liabilities; the possibility the Company will not be able to attract and retain key professional employees; changes to or failure of the Federal government to fund certain programs in which the Company participates; and such other risks and uncertainties as are described in reports and other documents filed by the Company from time to time with the Securities and Exchange Commission.

Versar s gross revenue for fiscal year 2005 totaled $67,678,000, a $7,611,000 (13%) increase compared to gross revenue of $60,067,000 for fiscal year 2004. Gross revenue for fiscal year 2004 increased by 3,421,000 (6%) over that reported in fiscal year 2003. The increase in fiscal year 2005 was primarily due to increased construction revenues in the Infrastructure and Management Services business segment of $7,347,000 primarily in the first half of year. The increase in gross revenue in the Infrastructure and Management Services business segment is attributable to roof replacement work in San Diego, the construction of a specialized material handling facility, and Title II construction quality control work in Iraq in support of the Air Force and other government agencies. In the second half of fiscal year 2005, the Company has not been successful in replacing that business volume. The increase in fiscal year 2004 was due to increased revenues in the Infrastructure and Management Services business segment primarily related to subcontracted mold remediation work. This is further discussed under the heading Financial Trends .

Purchased services and materials for fiscal year 2005 totaled $32,040,000, a (21%) increase over that reported in fiscal year 2004. Purchased services and materials for fiscal year 2004 increased by $4,512,000 (21%) over fiscal year 2003. The increase in 2005 was due to increased subcontracted construction work in the Infrastructure and Management Services business segment as mentioned above. The increase in fiscal year 2004 was due to higher subcontractor costs associated with the increase in mold remediation activity as mentioned above.

Net service revenue is derived by deducting the costs of purchased services from gross revenue. Versar considers it appropriate to analyze operating margins and other ratios in relation to net service revenue, because such revenues reflect the actual work performed by the Company s labor force. Net service revenue increased by 6% in fiscal year 2005, primarily due to an increase in direct project labor, which generated higher margins as compared to fiscal year 2004. Net service revenues decreased by 3% in fiscal year 2004 due to a decrease in revenue generated from the Company s work force compared to fiscal year 2003.

Direct costs of service and overhead include the cost to Versar of direct and overhead staff, including recoverable and unallowable costs that are directly attributable to contracts. The percentage of these costs to net service revenue increased slightly to 78.2% in fiscal year 2005 compared to 78.1% in fiscal year 2004 and 79.3% in fiscal year 2003. The increase in the percentage in fiscal year 2005 is due to lower profit margins in the Company s Infrastructure and Management Services business segment in which the Company recorded lower revenue due to schedule slippage and a contract dispute that has not been resolved as of the end of the fiscal year. As per the Company s revenue recognition policy, the disputed revenue will not be recorded until resolved.

ITEM 7 Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

Selling, general and administrative expenses approximated 17.2% of net service revenue in fiscal year 2005, compared to 16.2% in fiscal year 2004 and 16.6% in fiscal year 2003. The increase is due to higher marketing labor, the engagement of consultants, and Sarbanes Oxley compliance costs to begin assessing and documenting internal controls in preparation for Section 404 internal control requirements.

In fiscal year 2005, the Company recorded a restructuring charge of $217,000 for the estimated costs of terminating a long term office lease in Versar s northeast regional office. Such costs were recorded due to a business downturn in that office, as a result of the BRAC closures. This made it no longer viable to continue occupying the facility. In fiscal year 2003, the Company recorded a restructuring charge of $800,000 to reduce the Company s overall cost structure and to reduce costs in non-performing divisions. These costs included severance payments to terminated employees and estimated costs to restructure certain facility leases.

Operating income for fiscal year 2005 was $1,427,000, compared to $1,913,000 in fiscal year 2004. Operating income from continuing operations decreased in fiscal year 2005 primarily due to the restructuring charge and lower profitability as a result of a contract dispute as mentioned above. Fiscal year 2004 operating income of $1,913,000 was $1,301,000 higher than that recorded in fiscal year 2003 due to the $800,000 restructuring charge recorded in fiscal year 2003 as mentioned above and improved operating results.

Interest expense during fiscal year 2005 was $66,000, a decrease of $87,000 from fiscal year 2004. The decrease is primarily attributable to reduced borrowing under the Company s line of credit. In fiscal year 2004, interest expenses decreased by $13,000 from fiscal year 2003. The reduction was due to lower interest rates on the Company s line of credit.

No tax expense was recorded in fiscal year 2005. In fiscal year 2004, the Company recorded a $67,000 tax benefit. In fiscal year 2003, the Company increased the tax valuation allowance by $1,096,000. The increase was due to the reduced operating performance in fiscal year 2003. The Company has approximately $4.4 million in deferred tax assets of which a $3.5 million valuation allowance has been established against such assets. Management provides for a valuation allowance until such time as it can conclude more likely than not that the Company will derive a benefit from such assets. The valuation allowance is adjusted as necessary based upon the Company s ability to generate taxable income, including management s ability to implement tax strategies that will enable the Company to benefit from such deferred tax assets.

Income from continuing operations for fiscal year 2005 was $1,361,000, compared to $1,827,000 in fiscal year 2004. Income from continuing operations decreased in fiscal year 2005 primarily due to the restructuring charge and lower profitability as a result of a contract dispute as mentioned above. Fiscal year 2004 income from continuing operations was $2,485,000 higher than that recorded in fiscal year 2003 due to the $800,000 restructuring charge recorded in fiscal year 2003 as mentioned above and improved operating results, and the increase to the tax valuation allowance recorded in fiscal year 2003.

In the fourth quarter of fiscal year 2005, management approved a plan to discontinue the operations of its biological laboratory facilities due to the lack of business volume, market concentration, and poor operating performance. Operating losses for the biological laboratory were $556,000, $636,000, and $350,000 for fiscal years 2005, 2004, and 2003, respectively. In addition, the Company recorded an additional loss of $603,000 for the disposition of the biological laboratory, which included a charge of $183,000 for the write-off of certain equipment and leasehold improvements and a charge of $420,000 for the estimated termination costs of the facilities lease.

In summary, Versar s net income for fiscal year 2005 was $202,000 compared to net income of $1,191,000 in fiscal year 2004 and net loss of $1,008,000 in fiscal year 2003.

ITEM 7 Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)
REVENUE

Versar provides professional services to various industries, serving government and commercial clients. A summary of revenue generated from the Company s client base is as follows:

	For the Years Ended					
	July 1, 2005		June 30, 2004		June 30, 2003	
	(In thousands, except for percentages)					
Government						
EPA	$ 3,972	6%	$ 4,315	7%	$ 3,312	6%
State & Local	8,620	13%	7,785	13%	8,865	16%
Department of Defense	31,182	46%	22,921	38%	24,343	43%
Other	14,786	22%	8,558	14%	7,644	13%
Commercial	9,118	13%	16,488	28%	12,482	22%
Gross Revenue	$ 67,678	100%	$ 60,067	100%	$ 56,646	100%

The increase in Department of Defense and other government revenues were primarily due to the large construction projects performed during fiscal year 2005. Such increases were in part offset by the winding down of a large commercial mold remediation project during the year.

Liquidity and Capital Resources

The Company s working capital as of July 1, 2005 approximated $7,887,000, an increase of $393,000 (5%). In addition, the Company s current ratio at July 1, 2005 was 1.86, which was slightly lower than that reported on June 30, 2004 due to the increase in receivables and prepaids and the utilization of the line of credit during the year.

In September 2003, Versar entered into a new line of credit facility with United Bank (the Bank) that provides for advances up to $5,000,000 based upon qualifying receivables. Interest on the borrowings is based on prime plus one and a half percent (7.25% as of July 1, 2005). As of July 1, 2005, Versar had outstanding borrowing of $777,000 and additional availability of $4,223,000 under the line of credit. Obligations under the credit facility are guaranteed by the Company and each subsidiary individually and are collectively secured by accounts receivable, equipment and intangibles, plus all insurance policies on property constituting collateral. The credit facility is scheduled for renewal in November 2005, and is subject to certain covenants related to the maintenance of financial ratios. These covenants require a minimum tangible net worth of $6,500,000, a maximum total liabilities to tangible net worth ratio not to exceed 2.5 to 1; and a minimum current ratio of at least 1.25 to 1. Failure to meet the covenant requirements gives the Bank the right to demand the amount due under the line of credit, which may impact the Company s ability to finance its working capital requirements. At July 1, 2005, the Company was in compliance with the financial covenants.

We believe that our borrowing capacity and the renewal of the line of credit, together with anticipated cash flows from operations, is sufficient to meet the Company s liquidity needs for the next year. There can be no assurance, however, that amounts available in the future from existing sources of liquidity will be sufficient to meet future capital needs.

ITEM 7 Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

Liquidity Requirements

At July 1, 2005, the Company had unfunded contractual payment obligations of approximately $3,361,000 due within the next twelve months. The table below specifies the total contractual payment obligations as of July 1, 2005.

Contractual Obligations	**Total Cost**	**Less than 1 year**	**1-3 years**	**4-5 years**	**After 5 years**
(In thousands)					
Operating leases	$ 10,977	$ 2,809	$ 4,653	$ 2,889	$ 626
Capital lease	1,007	46	99	109	753
Notes payable	529	506	23	00	00
Total contractual cash obligations	$ 12,513	$ 3,361	$ 4,775	$ 2,998	$ 1,379