

VERSAR INC
Form 10-Q
February 10, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended
December 27, 2013

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____
Commission File Number 1-9309

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

54-0852979
(I.R.S. Employer Identification No.)

6850 Versar Center
Springfield, Virginia
(Address of principal executive offices)

22151
(Zip Code)

Registrant's telephone number, including area code (703) 750-3000

Not Applicable

(Former name, former address and former fiscal year, if changed since last report.)

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer”, and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

| | |
|--|--|
| Large accelerated filer <input type="checkbox"/> | Accelerated filer <input type="checkbox"/> |
| Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company <input type="checkbox"/> |

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

Yes No

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practical date.

| Class of Common Stock | Outstanding at February 06, 2014 |
|-----------------------|----------------------------------|
| \$.01 par value | 9,710,344 |

VERSAR, INC. AND SUBSIDIARIES

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VERSAR, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(In thousands, except share amounts)

| | As of December 27, 2013 (Unaudited) | June 28, 2013 |
|---|--|------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 4,045 | \$ 8,728 |
| Accounts receivable, net | 35,689 | 29,342 |
| Inventory | 1,189 | 1,225 |
| Prepaid expenses and other current assets | 1,192 | 1,074 |
| Deferred income taxes | 1,993 | 2,314 |
| Income tax receivable | 1,922 | 1,764 |
| Total current assets | 46,030 | 44,447 |
| Property and equipment, net | 2,256 | 2,108 |
| Deferred income taxes, non-current | 890 | 622 |
| Goodwill | 9,420 | 7,515 |
| Intangible assets, net | 2,887 | 1,798 |
| Other assets | 1,188 | 887 |
| Total assets | \$ 62,671 | \$ 57,377 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities | | |
| Accounts payable | \$ 11,904 | \$ 10,788 |
| Accrued salaries and vacations | 3,541 | 3,042 |
| Other current liabilities | 3,527 | 3,304 |
| Income tax payable | 293 | - |
| Notes payable, current | 1,641 | 333 |
| Total current liabilities | 20,906 | 17,467 |
| Notes payable, non-current | 635 | 333 |
| Deferred income taxes | 1,098 | 849 |
| Other long-term liabilities | 1,501 | 1,104 |
| Total liabilities | 24,140 | 19,753 |
| Commitments and contingencies | | |
| Stockholders' equity | | |
| Common stock, \$.01 par value; 30,000,000 shares authorized; 9,962,885 shares issued and 9,658,107 shares outstanding as of December 27, 2013 | 100 | 99 |
| 9,849,773 shares issued and 9,579,753 shares outstanding as of June 28, 2013 | | |
| Capital in excess of par value | 30,101 | 29,758 |
| Retained earnings | 10,122 | 9,366 |
| Treasury stock, at cost | (1,396) | (1,224) |
| Accumulated other comprehensive loss; foreign currency translation | (396) | (375) |
| Total stockholders' equity | 38,531 | 37,624 |
| Total liabilities and stockholders' equity | \$ 62,671 | \$ 57,377 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

VERSAR, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
(Unaudited-in thousands, except per share amounts)

| | For the Three Months Ended | | For the Six Months Ended | |
|---|----------------------------|-----------|--------------------------|-----------|
| | December | December | December | December |
| | 27, | 28, | 27, | 28, |
| | 2013 | 2012 | 2013 | 2012 |
| GROSS REVENUE | \$ 28,037 | \$ 24,122 | \$ 57,158 | \$ 46,518 |
| Purchased services and materials, at cost | 14,359 | 9,540 | 28,769 | 17,237 |
| Direct costs of services and overhead | 11,347 | 10,617 | 23,105 | 21,845 |
| GROSS PROFIT | 2,331 | 3,965 | 5,284 | 7,436 |
| Selling, general and administrative expenses | 2,415 | 2,249 | 4,285 | 4,174 |
| OPERATING (LOSS) INCOME | (84) | 1,716 | 999 | 3,262 |
| OTHER (INCOME) EXPENSE | | | | |
| Interest income | (13) | - | (13) | (1) |
| Interest expense | 42 | 22 | 67 | 46 |
| (LOSS) INCOME BEFORE INCOME TAXES, from continuing operations | (113) | 1,694 | 945 | 3,217 |
| Income tax (benefit) expense | (34) | 511 | 364 | 1,092 |
| NET (LOSS) INCOME FROM CONTINUING OPERATIONS | (79) | 1,183 | 581 | 2,125 |
| Income (Loss) from discontinued operations, net of tax (expense) benefit of \$(105) and \$121 and \$(105) and \$174 | 179 | (258) | 176 | (355) |
| NET INCOME | \$ 100 | \$ 925 | \$ 757 | \$ 1,770 |
| NET (LOSS) INCOME PER SHARE-BASIC and DILUTED | | | | |
| Continuing operations | \$ (0.01) | 0.12 | \$ 0.06 | 0.22 |
| Discontinued operations | 0.02 | (0.03) | 0.02 | (0.04) |
| NET INCOME PER SHARE-BASIC and DILUTED | \$ 0.01 | \$ 0.09 | \$ 0.08 | \$ 0.18 |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING-BASIC | 9,653 | 9,507 | 9,611 | 9,450 |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING-DILUTED | 9,789 | 9,536 | 9,748 | 9,479 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

VERSAR, INC. AND SUBSIDIARIES
 Condensed Consolidated Statements of Comprehensive (Loss) Income
 (Unaudited-in thousands)

| | For the Three Months Ended | | For the Six Months Ended | |
|--|----------------------------|-----------------|--------------------------|-----------------|
| | December | December | December | December |
| | 27, | 28, | 27, | 28, |
| | 2013 | 2012 | 2013 | 2012 |
| COMPREHENSIVE INCOME | | | | |
| Net income | \$ 100 | \$ 925 | \$ 757 | \$ 1,770 |
| Foreign currency translation adjustments, net of tax | (172) | 186 | (22) | 38 |
| TOTAL COMPREHENSIVE (LOSS) INCOME | \$ (72) | \$ 1,111 | \$ 735 | \$ 1,808 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

VERSAR, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Unaudited-in thousands)

| | For the Six Months Ended | |
|--|--------------------------|----------------------|
| | December 27, 2013 | December 28, 2012 |
| Cash flows from operating activities: | | |
| Net income | \$ 757 | \$ 1,770 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 951 | 894 |
| Loss on sale of property and equipment | 23 | - |
| Provision for doubtful accounts receivable | (199) | (271) |
| (Gain) loss on life insurance policy cash surrender value | (57) | 1 |
| Deferred tax benefit | 90 | 162 |
| Share based compensation | 258 | 219 |
| Changes in assets and liabilities: | | |
| Decrease in accounts receivable | 382 | 4,085 |
| (Increase) decrease in prepaid and other assets | (112) | 778 |
| Decrease in inventories | 117 | 33 |
| (Decrease) increase in accounts payable | (959) | 1,340 |
| (Decrease) increase in accrued salaries and vacation | (160) | 6 |
| Increase (decrease) in income tax payable | 131 | (667) |
| Decrease in other assets and liabilities | (1,583) | (2,176) |
| Net cash (used in) provided by operating activities | (361) | 6,174 |
| Cash flow from investing activities: | | |
| Purchase of property and equipment | (217) | (140) |
| Payment for Geo-Marine acquisition, net of cash acquired | (3,100) | - |
| Payment for Charron acquisition, net of cash acquired | - | (297) |
| Premiums paid on life insurance policies | (24) | (42) |
| Net cash used in investing activities | (3,341) | (479) |
| Cash flow from financing activities: | | |
| Proceeds from exercise of stock options | 84 | 119 |
| Repayments of notes payable | (884) | (167) |
| Purchase of treasury stock | (171) | (47) |
| Net cash used in financing activities | (971) | (95) |
| Effect of exchange rate changes on cash and cash equivalents | (10) | 38 |
| Net (decrease) increase in cash and cash equivalents | (4,683) | 5,638 |
| Cash and cash equivalents at the beginning of the period | 8,728 | 8,012 |
| Cash and cash equivalents at the end of the period | \$ 4,045 | \$ 13,650 |
| Supplemental disclosure of non-cash financing activities: | | |
| Promissory notes-payable issued in connection with GMI acquisition | \$ 2,250 | \$ - |
| Promissory notes-payable issued in connection with Charron acquisition | \$ - | \$ 1,000 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

VERSAR, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE A BASIS OF PRESENTATION

The condensed consolidated financial statements of Versar, Inc. and its wholly-owned subsidiaries (“Versar” or the “Company”) contained in this report are unaudited but reflect all normal recurring adjustments which, in the opinion of management, are necessary for the fair presentation of the results of the interim periods reflected. All intercompany balances and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) have been omitted pursuant to applicable rules and regulations of the Securities and Exchange Commission (“SEC”). Therefore, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10 K for the fiscal year ended June 28, 2013. The results of operations for the three-month and six-month periods reported herein are not necessarily indicative of results to be expected for the full year. The fiscal year-end balance sheet data included in this report was derived from audited financial statements. The Company’s fiscal year is based upon a 52 - 53 week calendar, ending on the Friday nearest June 30. The three-month periods ended December 27, 2013 and December 28, 2012, each include 13 weeks and the corresponding six-month periods each include 26 weeks. Fiscal year 2013 and 2014 each include 52 weeks.

NOTE B BUSINESS SEGMENTS

The company is aligned into three reportable segments: Engineering and Construction Management (“ECM”), Environmental Services (“ESG”), and Professional Services (“PSG”); all described below.

ECM

This business segment performs Title I Design Services, Title II Construction Management Services, and Title III Construction Services. This business segment also provides other related engineering and construction type services both in the United States and internationally and provides national security services in several markets that require ongoing services and support and which have received funding priority.

ESG

This business segment provides full service environmental solutions and includes our remediation and compliance, exposure and risk assessment, natural resources, unexploded ordnance (“UXO”)/military munitions response program (“MMRP”), air, greenhouse gas, and cultural resources services. Clients include a wide-range of federal and state agencies.

PSG

This business segment provides onsite environmental management, planning and engineering services to the Department of Defense (“DOD”) installations and to the U.S. Department of Commerce (“DOC”). Versar’s provision of on-site services, or staff augmentation, serves to enhance the mission of the customer with subject matter experts fully dedicated to mission objectives. These services are particularly attractive in this economic environment as DOD shifts emphasis to its core military mission and downsizes due to increasing budgetary pressure. Primarily at the U.S. Army Installation level or DOD Joint Base level (two or more DOD facilities realigning management functions to establish a single entity) this segment serves government business by supporting customers in areas where their capabilities and capacities are lacking.

Presented below is summary operating information from continuing operations for the Company by segment for the three-month and six-month periods ended December 27, 2013 and December 28, 2012.

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| | For the Three Months Ended | | For the Six Months Ended | |
|---|---|-------------------------|---|-------------------------|
| | December 27, 2013 (in thousands) | December 28, 2012 | December 27, 2013 (in thousands) | December 28, 2012 |
| GROSS REVENUE | | | | |
| ECM | \$ 13,474 | \$ 12,454 | \$ 25,895 | \$ 23,067 |
| ESG | 11,861 | 7,793 | 24,876 | 16,017 |
| PSG | 2,702 | 3,875 | 6,387 | 7,434 |
| | \$ 28,037 | \$ 24,122 | \$ 57,158 | \$ 46,518 |
| GROSS PROFIT (a) | | | | |
| ECM | \$ 1,490 | \$ 2,355 | \$ 3,208 | \$ 4,949 |
| ESG | 635 | 690 | 1,108 | 1,044 |
| PSG | 206 | 920 | 968 | 1,443 |
| | \$ 2,331 | \$ 3,965 | \$ 5,284 | \$ 7,436 |
| Selling, general and administrative expenses | 2,415 | 2,249 | 4,285 | 4,174 |
| OPERATING (LOSS) INCOME | \$ (84) | \$ 1,716 | \$ 999 | \$ 3,262 |

(a) - Gross profit is defined as gross revenues less purchased services and materials, at cost, less direct costs of services and overhead allocated on a proportional basis.

NOTE C ACQUISITIONS

On September 3, 2013, Versar purchased all of the issued and outstanding shares of Geo-Marine, Inc. (“GMI”) for an aggregate price of up to \$6.5 million. We paid a cash amount equal to \$3.1 million and issued a promissory note with an aggregate principal amount of \$1.25 million, a three-year term, and interest accruing at 5% per year. In addition, the Company may issue two additional contingent promissory notes with an aggregate principal amount of up to \$2.15 million under certain contingent consideration provisions of the purchase agreement (discussed further in Note D) based on two proposals identified by GMI that resulted in contract awards to GMI with payment in part contingent on achievement of certain revenue targets. GMI has contributed approximately \$5.9 million in revenue and \$6.6 million in expenses through December 27, 2013. Additionally, we have incurred approximately \$0.1 million of transaction costs through December 27, 2013..

Headquartered in Plano, Texas, GMI provides design and construction services, natural and cultural resources planning, programming and implementation, as well as other services in support of a wide range of government, industry, and commercial clients. GMI is a strategic acquisition for Versar and their design, construction, and environmental expertise and customer base will allow us to expand our reach in terms of clients, technical capabilities, and geography.

The preliminary purchase price allocation in the table below reflects the Company’s estimate of the fair value of the assets acquired and liabilities assumed on the September 3, 2013 acquisition date. Goodwill will be allocated between our ECM and ESG segments; however, as of the time of the filing of this Form 10-Q the segments allocation has not been finalized.

| Description | Amount (in thousands) |
|--------------------------------|--------------------------|
| Accounts receivable | \$ 6,505 |
| Property and equipment | 606 |
| Other assets | 237 |
| Goodwill | 1,905 |
| Intangibles(a) | 1,317 |
| Total assets acquired | 10,570 |
| Accounts payable | 1,884 |
| Accrued salaries and vacations | 660 |
| Other current liabilities | 1,569 |
| Deferred income taxes | 217 |
| Total liabilities assumed | 4,330 |
| Acquisition purchase price | \$ 6,240 |

(a) Intangible assets included customer relationships. Our preliminary analysis estimates a useful life of 15 years, used as our basis for amortization.

NOTE D FAIR VALUE MEASUREMENT

Versar applies ASC 820 *Fair Value Measurements and Disclosures* in determining the fair value to be disclosed for financial and nonfinancial assets and liabilities.

ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. It establishes a fair value hierarchy and a framework which requires categorizing assets and liabilities into one of three levels based on the assumptions (inputs) used in valuing the asset or liability. Level 1 provides the most reliable measure of fair value, while Level 3 generally requires significant management judgment.

Level 1 inputs are unadjusted, quoted market prices in active markets for identical assets or liabilities.

Level 2 inputs are observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets or liabilities in inactive markets.

Level 3 inputs include unobservable inputs that are supported by little, infrequent, or no market activity and reflect management's own assumptions about inputs used in pricing the asset or liability.

As a result of the acquisition of GMI, the Company has assets and liabilities it is required to report at fair value. The valuation techniques utilized in the fair value measurement of the assets and liabilities presented were based on the definitions outlined above and the methodologies used by an external valuation firm, primarily a probability weighted discounted cash-flow analysis of the contingent notes payable approximating \$1.9 million in total. As noted in the acquisition footnote, these Level 3 liabilities are based on two proposals identified by GMI that result in contract awards to GMI and achievement of certain revenue targets. We will continue to assess the conditions that would trigger the issuance of both the contingent note payable and the revenue earn-out liability at each reporting period and adjust the fair values of these liabilities, if required, until the payment conditions are met through the term of the contingency period, which expires two years from the acquisition date.

NOTE E ACCOUNTS RECEIVABLE

| | As of December 27, 2013 (in thousands) | June 28, 2013 |
|---------------------------------|---|------------------|
| Billed receivables | | |
| U.S. Government | \$ 16,459 | \$ 12,692 |
| Commercial | 5,628 | 3,329 |
| Unbilled receivables | | |
| U.S. Government | 13,407 | 13,365 |
| Commercial | 1,566 | 1,485 |
| Total receivables | 37,060 | 30,871 |
| Allowance for doubtful accounts | (1,371) | (1,529) |
| Accounts receivable, net | \$ 35,689 | \$ 29,342 |

Billed receivables at December 27, 2013 and June 28, 2013 were \$22.1 million and \$16.0 million, respectively. Based on our preliminary purchase price allocation, the acquisition of GMI contributed approximately \$6.5 million in accounts receivable. As discussed in Note C, we are currently evaluating the preliminary purchase price allocation and as of the time of the filing of this Form 10-Q, the allocation has not been finalized.

Unbilled receivables represent amounts earned which have not yet been billed and other amounts which can be invoiced upon completion of fixed-price contract milestones, attainment of certain contract objectives, or completion of federal and state governments' incurred cost audits. Management anticipates that such unbilled receivables will be substantially billed and collected in fiscal year 2014; therefore, they have been presented as current assets in accordance with industry practice.

We collected approximately \$0.3 million during the second quarter of this fiscal year that related to a previously realized bad-debt expense included in discontinued operations.

NOTE F GOODWILL

The carrying value of goodwill at December 27, 2013 and June 28, 2013 was \$9.4 million and \$7.5 million, respectively. The Company's goodwill balance was derived from the acquisition of GMI in fiscal year 2014, Charron Construction Consulting, Inc. ("Charron") in fiscal year 2012, the acquisitions of PPS and ADVENT in fiscal year 2010, and the acquisition of VGI in fiscal year 1998. We recorded a goodwill balance with a preliminary fair value of \$1.9 million from our acquisition of GMI, preliminarily allocated between our ECM and ESG segments as presented in the table below;

| | Goodwill Balances | | |
|----------------------------|-------------------|----------|----------|
| | ECM | ESG | Total |
| Balance, June 28, 2013 | \$ 5,547 | \$ 1,968 | \$ 7,515 |
| GMI Acquisition | 433 | 1,472 | 1,905 |
| Balance, December 27, 2013 | \$ 5,980 | \$ 3,440 | \$ 9,420 |

NOTE G INVENTORY

The Company's inventory balance includes the following:

| | As of December 27, 2013 (in thousands) | June 28, 2013 |
|-----------------|---|------------------|
| Raw Materials | \$ 695 | \$ 685 |
| Finished Goods | 323 | 390 |
| Work-in-process | 171 | 150 |
| Total | \$ 1,189 | \$ 1,225 |

NOTE H OTHER CURRENT LIABILITIES

The Company's other current liabilities balance includes the following:

| | As of December 27, 2013 (in thousands) | June 28, 2013 |
|-----------------------------|---|------------------|
| Project related reserves | \$ 676 | \$ 737 |
| Payroll related | 409 | 762 |
| Asset retirement obligation | - | 647 |
| Deferred rent | 699 | 467 |
| Earn-out obligations | 1,500 | - |
| Severance accrual | 37 | 51 |
| Other | 206 | 640 |
| Total | \$ 3,527 | \$ 3,304 |

As of December 27, 2013, other accrued liabilities include accrued legal, audit, value added tax liabilities, and foreign entity obligations. The \$0.6 million asset retirement obligation at June 28, 2013 pertained to discontinued operations and has been fully utilized. We do not have an asset retirement obligation for continuing operations at December 27, 2013.

NOTE I DEBT**Notes Payable**

As part of the purchase price for GMI in September 2013, the Company issued notes payable to Applied Research Associates, Inc. with an aggregate principal balance of up to \$1.25 million, which are payable quarterly over a three-year period with interest accruing at a rate of 5% per year. Accrued interest is recorded within the note payable line item in the consolidated balance sheet.

NOTE J NET INCOME PER SHARE

Basic net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share also includes common stock equivalents outstanding during the period, if dilutive. The Company's common stock equivalent shares consist of shares to be issued under outstanding stock options and unvested restricted stock units.

| | For the Three Months Ended | | For the Six Months Ended | |
|--|----------------------------|----------------------|--------------------------|-------------------------|
| | December 27, 2013 | December 28, 2012 | December 27, 2013 | December 28, 2012 |
| | (in thousands) | | (in thousands) | |
| Weighted average common shares outstanding-basic | 9,653 | 9,507 | 9,611 | 9,450 |
| Effect of assumed exercise of options and vesting of restricted stock unit awards, using the treasury stock method | 136 | 29 | 137 | 29 |
| Weighted average common shares outstanding-diluted | 9,789 | 9,536 | 9,748 | 9,479 |

For each of the three and six month periods ended December 27, 2013, there were approximately 137,000 shares related to stock awards that were not included in the computation of diluted earnings per share because the effect would be anti-dilutive. For each of the three and six month periods ended December 28, 2012, restricted and incentive options to purchase approximately 22,000 shares of common stock were not included in the computation of diluted earnings per share because the effect would be anti-dilutive.

NOTE K SHARE-BASED COMPENSATION**Restricted Stock Unit Activity**

In November 2010, the stockholders approved the Versar, Inc. 2010 Stock Incentive Plan (the "2010 Plan"), under which the Company may grant incentive awards to directors, officers, and employees of the Company and its affiliates and to service providers to the Company and its affiliates. One million shares of Versar common stock were reserved for issuance under the 2010 Plan. The 2010 Plan is administered by the Compensation Committee of the Board of Directors. Through December 27, 2013, a total of 393,545 restricted stock units have been issued under the 2010 Plan. There are 609,455 shares remaining available for future issuance of awards (including restricted stock units) under the 2010 Plan.

During the six-month period ended December 27, 2013, the Company awarded 101,235 restricted stock units to its executive officers and certain employees, which generally vest over a period of one or two years following the date of grant. The total unrecognized compensation cost, measured on the grant date, that relates to non-vested restricted stock awards at December 27, 2013, was approximately \$787,000, which if earned, will be recognized over the weighted average remaining service period of two years. Share-based compensation expense relating to all outstanding restricted stock unit awards totaled approximately \$132,000 and \$162,000 for the three months ended December 27, 2013 and December 28, 2012, respectively. Share-based compensation expense relating to all outstanding restricted stock unit awards totaled approximately \$238,000 and \$219,000 for the six months ended December 27, 2013 and December 28, 2012, respectively. These expenses were included in the direct costs of services and overhead and general and administrative lines of the Company's Condensed Consolidated Statements of

Operations.

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Stock Option Activity

There were approximately 23,000 incentive stock options outstanding and exercisable as of December 27, 2013 with a weighted average exercise price of \$3.81, weighted average remaining contractual life of 0.74 years, and an aggregate intrinsic value of \$30,000. No stock options were issued during the three months ended December 27, 2013.

Total non-qualified stock options granted under the Company's 2010 Plan and prior stock incentive plans are as follows:

| | Optioned # of shares | Weighted- Average Option Price Per Share | Intrinsic Value |
|----------------------------------|--|--|--------------------|
| | (in thousands, except per share price) | | |
| Outstanding at June 28, 2013 | 19 | 3.70 | \$ 72 |
| Exercised | (11) | 3.27 | (36) |
| Outstanding at December 27, 2013 | 8 | 4.58 | \$ 36 |

NOTE L INCOME TAXES

As of December 27, 2013 and June 28, 2013, the Company had approximately \$1.8 million and \$2.1 million, respectively, in net deferred income tax assets, which are primarily related to temporary differences between financial statement and income tax reporting. Such differences included depreciation, deferred compensation, accruals and reserves. The Company regularly reviews the recoverability of its deferred tax assets and establishes a valuation allowance as deemed appropriate. As of December 27, 2013 and June 28, 2013, the Company had \$166,000 recorded as a valuation allowance. The effective tax rates were approximately 38.3% and 38.1% for the first six months of fiscal 2014 and 2013, respectively.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

General Information

The following discussion and analysis relates to our financial condition and results of operations for the three-month and six-month periods ended December 27, 2013 and December 28, 2012. This discussion should be read in conjunction with our condensed consolidated financial statements and other information disclosed herein as well as the "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in our Annual Report on Form 10-K for the fiscal year ended June 28, 2013, including the critical accounting policies and estimates discussed therein. Unless this Form 10-Q indicates otherwise or the context otherwise requires, the terms "we," "our," the "Company," "us," or "Versar" as used in this Form 10-Q refer to Versar, Inc. and subsidiaries.

This quarterly report on Form 10-Q contains forward-looking statements in accordance with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, which are subject to risks and uncertainties. Forward-looking statements typically include assumptions, estimates or descriptions of our future plans, strategies and expectations, are generally identifiable by the use of the words "anticipate," "will," "believe," "estimate," "expect," "intend," "seek," or other expressions. Examples of these include discussions regarding our operations and financial growth strategy, projections of revenue, income or loss and future operations.

These forward-looking statements and our future financial performance may be affected by a number of factors, including, but not limited to, the "Risk Factors" contained in Part I, Item 1A., "Risk Factors" of our Annual Report on Form 10-K for the fiscal year ended June 28, 2013. Actual operations and results may differ materially from those forward-looking statements expressed in this Form 10-Q.

Overview

We are a global project management company providing sustainable value oriented solutions to government and commercial clients primarily in three market areas: (1) Engineering and Construction Management ("ECM"); (2) Environmental Services ("ESG"); and (3) Professional Services ("PSG"). We also provide tailored and secure solutions in harsh environments and offer specialized abilities in classified projects and hazardous material management.

Business Segments

ECM

This business segment performs Title I Design Services, Title II Construction Management Services, and Title III Construction Services, which are discussed further in the initial bullet below. This business segment also provides other related engineering and construction type services both in the United States and internationally and provides national security solutions in several markets that require ongoing services and support and which have received funding priority. Our services in this segment include the following:

Title I Design Services entails a broad-range of expertise including project scoping/development, design, cost estimation, value engineering, and feasibility studies. Title II Construction Management Services involve construction oversight, inspection, job site evaluations, and construction documentation among other areas. Other related services include system optimization and commissioning, scheduling, and quality assurance/control. Title III Construction Services are the actual construction services. Some staff members in this business segment also hold security clearances enabling Versar to provide services for classified construction efforts.

This segment consists of federal, state, local, international, and commercial clients. Examples of federal work include construction and construction management services for the U.S. Air Force ("USAF") and U.S. Army, construction management and personal services including electrical and engineering support to the U.S. Army Corps of Engineers

(“USACE”), project and construction management services for the District of Columbia Courts, and other construction efforts.

We continue to pursue the development of opportunities in energy/green initiatives in conjunction with the Environmental Services business segment.

The acquisition of Geo-Marine, Inc. (“GMI”) expands our capability and capacity to provide energy related services.

ESG

This business segment provides full service environmental solutions and includes our remediation and compliance, exposure and risk assessment, natural resources, unexploded ordnance (“UXO”)/military munitions response program (“MMRP”), air, greenhouse gas, energy, and cultural resources services. Clients include a wide-range of federal, state, and commercial agencies. Some examples include the following:

We have supported the U.S. Environmental Protection Agency for the past 30 years providing a wide-range of regulatory mandated services involving exposure assessment and regulatory review.

We provide support to USACE, the USAF, the U.S. Navy, and many local municipal entities assisting with environmental compliance, remediation, biological assessments, and natural resource management. This includes performance-based remediation (“PBR”) contracts for United States Air Force Civil Engineer Center (“AFCEC”).

For more than 30 years, Versar has supported the states of Virginia, Maryland, New York, Pennsylvania and Delaware on a variety of different environmental projects. For example, we have supported the State of Maryland in the assessment of the ecological health and natural resources risk of the Chesapeake Bay. Versar continues to assess how the Delaware River is affected by dredging programs. We assist several counties in Maryland and Virginia with their watershed programs, identifying impaired watersheds and providing cost-effective solutions for their restoration programs. We provide energy feasibility review, measurement and verification to the State of New York. ESG provides munitions response services at two of the world’s largest ranges including the National Training Center at Fort Irwin, California and one of the largest U.S. Air Force testing and training ranges. Our services include operational range clearance, operations and maintenance, and range sustainment services at both locations.

ESG is the prime contractor on three performance-based remediation (“PBR”) Task Orders under Versar’s 2009 United States Air Force Worldwide Environmental Restoration and Construction (“WERC”) contract for AFCEC. Each of the three contracts provide multi-year environmental remediation programs focused on achieving site-specific performance objectives (outcomes) for numerous project sites on USAF facilities in the Southwest, Midwest and Northeast. We are also a key team member on a fourth PBR program for AFCEC providing similar services at Western USAF facilities.

With the acquisition of GMI, this business segment expands its portfolio of clients to include the U.S. Navy and increases our Cultural Resources staff more than five times and doubles our Natural Resources capabilities.

PSG

This business segment provides onsite environmental management, planning and engineering services to DoD and to the U.S. Department of Commerce. Versar’s provision of on-site services, or staff augmentation, serves to enhance the mission of the customer with subject matter experts fully dedicated to mission objectives. This segment serves government business by realigning two or more facilities management functions to establish a single entity and by supporting customers in areas where their capabilities and capacities are lacking.

We provide expert services for the U.S. Army’s Net Zero energy, water, and solid waste program for certain U.S. Army installations. Net Zero energy means the installation produces as much energy/water/solid waste onsite as it uses. Our professionals facilitate strategic initiatives, develop implementation plans, conduct outreach, and apply technologies to deliver progress towards site-specific goals and objectives.

We have installation restoration managers fielded under the Defense Environmental Restoration Program to clean-up landfill and disposal sites throughout the nation.

Versar serves the DoD Joint Base communities with facility and utilities integration, National Environmental Policy Act considerations, water program management and wildlife program management. We manage hazardous materials and waste for large quantity generator sites through application of green procurement philosophies and hazardous material control program concepts.

We provide staff augmentation ranging from field support of archaeological investigations to senior level advisors. Our archaeological and historic preservation professionals advise government officials regarding the protection of

our nation's cultural resources.

We provide biological and physical sciences support to the National Oceanic Atmospheric Administration to ensure efficiencies and accuracies in the lab environment.

Financial Trends

On October 1, 2013, non-essential functions of the United States Government temporarily shut down because Congress was unable to pass legislation providing appropriations authority for the government to continue to operate for the U.S. Government's fiscal year 2014. Subsequently, on October 16, 2013 Congress passed a continuing resolution funding measure to finance all U.S. Government activities through January 15, 2014 and raised the debt ceiling through February 7, 2014. Under this continuing resolution, partial-year funding was available at prior year levels, subject to certain restrictions, but new spending initiatives were not authorized. We noted a slowdown of awards on nine of our existing contracts due to the shutdown, which resulted in approximately two weeks of furloughs. We partially funded the affected employees salaries during the furlough and, similar to other U.S. government contractors, were impacted as a result of the shutdown, however we do not anticipate further furloughs in the coming quarters.

On December 10, 2013 the U.S. Government reached a two-year budget agreement known as the Bipartisan Budget Agreement of 2013 ("BBA"). The BBA provides budget guidance through the U.S. Government's fiscal year 2015, restores certain projected reductions, and eliminates sequestration for two years. The BBA does not address core fiscal issues, long-term debt issues, or deficit issues, and it does not appropriate funds. It appears that the U.S. Government will continue to face substantial fiscal and economic challenges that affect funding for certain projects.

In this challenging economic environment, we focus on those opportunities where the U.S. Government continues to fund areas that clearly align with Versar's customers in the program management services segment such as sustainable range management, UXO, PBR, and construction contract management. We will also continue to focus on areas that we believe offer attractive enough returns to our clients that they will continue to fund efforts, such as construction type services both in the United States and internationally, improvements in energy efficiency, and facility upgrades.

Specifically, we see the following four elements driving our strategy going forward:

Pursuit of larger contract opportunities. Our move to a large business, coincident with development of a strong internal infrastructure and associated technologies, is allowing us to focus on pursuing larger prime contracts and expand our pool of opportunities. We continue to strengthen our relationships with other contractors to create teaming arrangements that better serve our clients. Where we have seen a shift in focus to contracts for qualified small businesses, we are strengthening and developing relationships with such businesses so we can enhance our opportunity to capture some of this work.

Leveraging of our services. The combination of our multiple skill sets and broad service offerings will allow us to work efficiently in the new economic environment whether selling sustainable risk management services utilizing our energy and environmental skill-sets, or via effective use of our project and construction management skills in relation to complex project oversight.

Expanding our international footprint. While strong internationally in the construction management business, incorporation of our non-construction services into our overseas client-base will allow for replication of our proven domestic skills into the international market and will help us meet growing overseas client needs.

Geographic and client expansion through acquisition. We have an active acquisition strategy and are focused on expanding our ability to offer our technical services to both new geographic areas and new clients, such as the U.S. Navy and the U.S. Department of State.

We believe our balance sheet is strong, and we are well positioned with our cash balance on hand to handle unforeseen challenges while we continue to pursue merger and acquisition activity. As of the quarter ended December 27, 2013 we had \$4.0 million of cash on hand and a working capital balance of \$25.1 million. We also

continue to have access to a line of credit of up to \$15 million.

Consolidated Results of Operations

The table below sets forth our consolidated results of operations for the three months and six months ended December 27, 2013 and December 28, 2012:

| | For the Three Months Ended | | For the Six Months Ended | |
|---|----------------------------|----------------------|--------------------------|----------------------|
| | December 27, 2013 | December 28, 2012 | December 27, 2013 | December 28, 2012 |
| | (dollars in thousands) | | (dollars in thousands) | |
| GROSS REVENUE | \$ 28,037 | \$ 24,122 | \$ 57,158 | \$ 46,518 |
| Purchased services and materials, at cost | 14,359 | 9,540 | 28,769 | 17,237 |
| Direct costs of services and overhead | 11,347 | 10,617 | 23,105 | 21,845 |
| GROSS PROFIT | \$ 2,331 | \$ 3,965 | \$ 5,284 | \$ 7,436 |
| Gross Profit percentage | 8 % | 16 % | 9 % | 16 % |
| Selling general and administrative expenses | 2,415 | 2,249 | 4,285 | 4,174 |
| OPERATING INCOME (LOSS) | (84) | 1,716 | 999 | 3,262 |
| OTHER (INCOME) EXPENSE | | | | |
| Interest (income) | (13) | - | (13) | (1) |
| Interest expense | 42 | 22 | 67 | 46 |
| INCOME (LOSS) FROM CONTINUING OPERATIONS, BEFORE INCOME TAXES | \$ (113) | \$ 1,694 | \$ 945 | \$ 3,217 |

Three Months Ended December 27, 2013 compared to the Three Months Ended December 28, 2012.

Gross revenue for the second quarter of fiscal year 2014 was \$28.0 million, an increase of 16% compared to \$24.1 million during the second quarter of the last fiscal year. This increase was primarily due to a \$4.5 million increase directly attributable to our acquisition of GMI, our ongoing Personal Services Contract (“PSC”) providing Afghan citizens to support the USACE construction program in Afghanistan, and our Great Lakes and New England PBR programs with AFCEC. These increases were partially offset by a \$1.2 million decline in revenue from PSG as we continue to see a decline in our contract positions as well as the continued shift to more contract solicitations being targeted at businesses that qualify for small business programs. As a result, we continue to seek new ways to develop our relationships with firms qualified for these programs to increase our ability to capture more of this work.

Purchased services and materials for the second quarter of fiscal year 2014 was \$14.4 million, an increase of 51% compared to \$9.5 million during the second quarter of the last fiscal year. This increase was primarily driven by an approximate \$2.4 million increase in purchased services related to our PSC contract and GMI related contracts, and an approximate \$2.4 million increase related to our PBR programs. We anticipate purchased services, as a percentage of

revenue, to continue to exceed prior years.

Direct costs of services and overhead for the second quarter of fiscal year 2014 were \$11.3 million, an increase of 7% compared to \$10.6 million during the second quarter of the last fiscal year. This increase was primarily due to increases in direct costs on certain Afghanistan projects.

Gross profit from continuing operations for the second quarter of fiscal 2014 was \$2.3 million, a decrease of 41% compared to \$4.0 million during the second quarter of the last fiscal year. The majority of this decrease was due to the decrease in gross profit related to our Title II work in Afghanistan, the majority of which is anticipated to end in the summer of 2014. Additionally, gross profit in our PSG group decreased due to the shift in solicitations and corresponding decline in contract positions to qualified small businesses discussed above.

Selling, general and administrative expenses for the second quarter of fiscal 2014 increased 7% to \$2.4 million, when compared to the second quarter of last fiscal year. The increase is primarily attributable to approximately \$0.1 million of final tax payments for the fiscal 2012 purchase of Charron and approximately \$0.1 million in severance costs related to the GMI acquisition included in the second quarter of this fiscal year

Loss from continuing operations, before income taxes, for the three months ended December 27, 2013 was \$0.1 million, compared to income from continuing operations, before income taxes, of \$1.7 million for the three months ended December 28, 2012. The majority of this decrease is directly related to the 51% increase in purchased services; however, in addition to the \$0.1 million tax payment discussed above, we also incurred approximately \$0.1 million in severance costs during the second quarter of this fiscal year related to our acquisition of GMI.

Six Months Ended December 27, 2013 compared to the Six Months Ended December 28, 2012.

Gross revenue for the first six months of fiscal year 2014 was \$57.2 million, an increase of 23% compared to \$46.5 million during the first six months of the last fiscal year. This increase was primarily due to a \$5.9 million increase directly attributable to our acquisition of GMI, our ongoing Personal Services Contract (“PSC”) providing Afghan citizens to support the USACE construction program in Afghanistan, and the ramp up of our Great Lakes and New England PBR programs. These increases were partially offset by a \$1.0 million decline in revenue from PSG due to the continuing shift in solicitations to qualified small businesses discussed above.

Purchased services and materials for the first six months of fiscal year 2014 was \$28.8 million, an increase of 67% compared to \$17.2 million during the first six months of the last fiscal year. This increase was primarily driven by an approximate \$4.0 million increase in purchased services related to our PSC contract, an approximate \$3.0 million increase for GMI related contracts, and a \$4.5 million increase related to our PBR programs. We anticipate purchased services, as a percentage of revenue, to continue to exceed prior years.

Direct costs of services and overhead for the first six months of fiscal year 2014 were \$23.1 million, an increase of 6% compared to \$21.8 million during the first six months of the last fiscal year. This increase was primarily due to increases in direct costs on certain Afghan projects.

Gross profit from continuing operations for the first six months of fiscal 2014 was \$5.3 million, a decrease of 29% compared to \$7.4 million during the first six months of the last fiscal year. The majority of this decrease was due to the decrease in gross profit related to our Title II work in Afghanistan, the majority of which is anticipated to end in the summer of 2014. Additionally, gross profit in our PSG group decreased as we continue to see an increase in solicitations aimed at qualified small businesses and corresponding decline in contract positions available to us.

Selling, general and administrative expenses for the first six months of fiscal 2014 increased 3% to \$4.3 million, when compared to the first six months of last fiscal year. This increase is primarily due to an approximate \$0.1 million final tax payment related to our fiscal 2012 purchase of Charron and approximately \$0.1 million of severance costs related to the acquisition of GMI.

Income from continuing operations, before income taxes, for the first six months ended December 27, 2013 was \$1.0 million, a 71% decrease when compared to the first six months of the last fiscal year. The majority of this decrease is directly related to the 67% increase in purchased services; however, in addition to the \$0.1 million tax payment discussed above, we also incurred approximately \$0.1 million in severance costs during the second quarter of this fiscal year related to our acquisition of GMI.

Backlog

We report “funded” backlog, which represents orders for goods and services for which firm contractual commitments have been received. As of December 27, 2013, funded backlog was approximately \$120 million, an increase of 11% compared to approximately \$108 million of backlog at the end of fiscal year 2013.

Results of Operations by Reportable Segment

The tables below set forth our operating results from continuing operations by reportable segment for the three month periods ended December 27, 2013 and December 28, 2012. The dollar amounts in the three segment tables that follow are in thousands.

Engineering and Construction Management

| | For the Three Months Ended | | For the Six Months Ended | |
|--|----------------------------|-------------------------|--------------------------|-------------------------|
| | December 27, 2013 | December 28, 2012 | December 27, 2013 | December 28, 2012 |
| GROSS REVENUE | \$ 13,474 | \$ 12,454 | \$ 25,895 | \$ 23,067 |
| Purchased services and materials, at cost | 8,723 | 6,303 | 15,801 | 10,209 |
| Direct costs of services and overhead | 3,261 | 3,796 | 6,886 | 7,909 |
| GROSS PROFIT, from continuing operations | 1,490 | 2,355 | 3,208 | 4,949 |
| Income (Loss) from discontinued operations | 284 | (364) | 281 | (523) |
| GROSS PROFIT | \$ 1,774 | \$ 1,991 | \$ 3,489 | \$ 4,426 |
| Gross profit percentage from continuing operations | 13 % | 19 % | 13 % | 21 % |

Three Months Ended December 27, 2013 compared to the Three Months Ended December 28, 2012

Gross revenue for the second quarter of fiscal 2014 was \$13.5 million, an increase of 8% compared to \$12.5 million during the second quarter of the last fiscal year. An additional \$3.1 million in revenue attributable to GMI was offset by decreases to our domestic construction management and special projects operations as certain projects associated with USACE continue to have delayed funding.

Gross profit from continuing operations for the second quarter of fiscal 2014 was \$1.5 million, a decrease of 37% compared to \$2.4 million during the second quarter of the last fiscal year. The majority of this decrease was due to the decrease in in gross profit related to our Title II work in Afghanistan, the majority of which is anticipated to end in the summer of 2014. In addition, we recognized approximately \$0.1 million in bad debt expense related to our domestic construction management operations and incurred costs associated with our business development efforts in the Middle East.

Six Months Ended December 27, 2013 compared to the Six Months Ended December 28, 2012

Gross revenue for the first six months of fiscal 2014 was \$25.9 million, an increase of 12% compared to \$23.1 million during the first six months of the last fiscal year. An additional \$4.2 million in revenue attributable to GMI was off-set by decreases in revenue of approximately \$0.1 million from our UK-based subsidiary Professional Protection Systems, Ltd. (“PPS”) which had higher revenue in fiscal 2013 attributable to the 2012 Olympic games and an approximate decrease of \$1.3 million from our domestic construction management and special project operations.

Gross profit from continuing operations for the first six months of fiscal 2014 was \$3.2 million, a decrease of 35% compared to \$4.9 million during the first six months of the last fiscal year. The majority of this decrease was due to the reduction in gross profit related to our Title II work in Afghanistan, the majority of which is anticipated to end in the summer of 2014. In addition, we recognized approximately \$0.1 million in bad debt expense related to our program and construction management operations and incurred costs associated with our business development efforts in the Middle East. These decreases to gross profit were partially offset by the subsequent collection of previously written off receivables of approximately \$0.3 million included in discontinued operations.

Environmental Services

| | For the Three Months Ended | | For the Six Months Ended | |
|---|----------------------------|----------------------|--------------------------|----------------------|
| | December 27, 2013 | December 28, 2012 | December 27, 2013 | December 28, 2012 |
| GROSS REVENUE | \$ 11,861 | \$ 7,793 | \$ 24,876 | \$ 16,017 |
| Purchased services and materials, at cost | 5,345 | 2,635 | 12,447 | 5,695 |
| Direct costs of services and overhead | 5,881 | 4,468 | 11,321 | 9,278 |
| GROSS PROFIT | \$ 635 | \$ 690 | \$ 1,108 | \$ 1,044 |
| Gross profit percentage | 5 % | 9 % | 4 % | 7 % |

Three Months Ended December 27, 2013 compared to the Three Months Ended December 28, 2012

Gross revenue for the second quarter of fiscal 2014 was \$11.9 million, an increase of 52% compared to \$7.8 million during the second quarter of the last fiscal year. This increase was primarily attributable to our work on the Great Lakes, New England, and Tinker PBR programs, all in conjunction with our PBR contracts with AFCEC. GMI contributed approximately \$1.2 million to this increase.

Gross profit for the second quarter of fiscal 2014 decreased 8% to \$0.6 million, compared to a \$0.7 million in the second quarter of the last fiscal year. The majority of this decrease is the result of a greater than 100% increase in purchased services associated with the subcontracted work in our PBR projects and the decrease in direct labor utilization associated with GMI as we worked through staff alignment during the integration process.

Six Months Ended December 27, 2013 compared to the Six Months Ended December 28, 2012

Gross revenue for the first six months of fiscal 2014 was \$24.9 million, an increase of 55% compared to \$16.0 million during the first six months of the last fiscal year. This increase was primarily attributable to the ramp up of our work on the Great Lakes, New England, and Tinker PBR programs; all in conjunction with our PBR contracts with AFCEC. GMI contributed approximately \$1.7 million to this increase.

Gross profit for the first six months of fiscal 2014 increased 6% to \$1.1 million, compared to \$1.0 million in the first six months of the last fiscal year. Although there was a year-over-year decline in gross profit for the three months ended December 27, 2013 due to an increase in purchased services and a decline in direct labor utilization associated with the integration of GMI, the first six months generated an increase in gross profit due to increased direct labor utilization over the entire period.

Professional Services

| | For the Three Months Ended | | For the Six Months Ended | |
|---|----------------------------|----------------------|--------------------------|----------------------|
| | December 27, 2013 | December 28, 2012 | December 27, 2013 | December 28, 2012 |
| GROSS REVENUE | \$ 2,702 | \$ 3,875 | \$ 6,387 | \$ 7,434 |
| Purchased services and materials, at cost | 291 | 602 | 521 | 1,333 |
| Direct costs of services and overhead | 2,205 | 2,353 | 4,898 | 4,658 |
| GROSS PROFIT | \$ 206 | \$ 920 | \$ 968 | \$ 1,443 |
| Gross profit percentage | 8 % | 24 % | 15 % | 19 % |

Three Months Ended December 27, 2013 compared to the Three Months Ended December 28, 2012

Gross revenue for the second quarter of fiscal 2014 was \$2.7 million, a decrease of 30% compared to \$3.9 million during the second quarter of the last fiscal year. This decrease was due to the completion of contracts at numerous sites, most significantly within the Mobile District and at the Fort Lee site. We continue to see a decline in our contract positions as well as a continued shift to more contract solicitations being targeted at businesses that qualify for small business programs. As a result, we continue to seek new ways to develop our relationships with firms qualified for these programs to increase our ability to capture more of this work and maintain current projects.

Gross profit for the second quarter of fiscal 2014 was \$0.2 million, a decrease of 78% compared to \$0.9 million during the second quarter of the last fiscal year. This decrease was primarily attributable to the decline in direct labor hours associated with the contracts previously discussed. Additionally, although we experienced furloughs during the two week U.S. Government shut down, we continued to partially fund the salaries of those employees that were affected.

Six Months Ended December 27, 2013 compared to the Six Months Ended December 28, 2012

Gross revenue for the first six months of fiscal 2014 was \$6.4 million, a decrease of 14% compared to \$7.4 million during the first six months of the last fiscal year. This decrease was due to the completion of contracts at numerous sites, most significantly within the Mobile District and at the Fort Lee site. This decrease was partially offset by our continuing work at Joint Base Lewis McChord.

Gross profit for the first six months of fiscal 2014 was \$1.0 million, a decrease of 33% compared to \$1.4 million during the first six months of the last fiscal year. This decrease was primarily attributable to the decline in direct labor hours associated with the contracts previously discussed. Purchased services for our work at certain U.S. Army facilities decreased 61% to \$0.5 million and partially offset the decline in gross profit.

Liquidity and Capital Resources

Our working capital as of December 27, 2013 was approximately \$25.1 million compared to working capital at June 28, 2013 of \$27.0 million. Our current ratio at December 27, 2013 was 2.20 compared to 2.54 at June 28, 2013.

We believe that our current cash balance of \$4.0 million, our anticipated cash flows from operations, and the funds available from our line of credit facility will be sufficient to meet our ongoing liquidity needs. Our expected capital requirements for the full 2014 fiscal year are approximately \$0.9 million, of which approximately \$0.2 million was funded in the first six months of the fiscal year. The remainder will be funded through existing working capital. These capital expenditures will be used primarily for upgrades to maintain our existing information technology systems, equipment related to our range management projects, and upgrades to our personal protective equipment manufacturing facility.

Critical Accounting Policies and Related Estimates

There have been no material changes with respect to the critical accounting policies and related estimates as disclosed in our Annual Report on Form 10-K for the fiscal year ended June 28, 2013.

ITEM 3. Quantitative and Qualitative Disclosure about Market Risk

We have not entered into any transactions using derivative financial instruments or derivative commodity instruments and we believe that our exposure to interest rate risk and other relevant market risk is not material.

ITEM 4. Controls and Procedures

As of the last day of the period covered by this report, the Company carried out an evaluation, under the supervision of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective, as of such date, to ensure that required information will be disclosed on a timely basis in its reports under the Exchange Act.

Further, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures have been designed to ensure that information required to be disclosed in reports filed by us under the Exchange Act is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, in a manner to allow timely decisions regarding the required disclosure.

There were no changes in the Company's internal control over financial reporting during the quarter ended December 27, 2013 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION**ITEM 1. Legal Proceedings**

We are parties from time to time to various legal actions arising in the normal course of business. We believe that any ultimate unfavorable resolution of these legal actions will not have a material adverse effect on our consolidated financial condition and results of operations.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the first quarter of fiscal year 2014 our employees surrendered shares of common stock to us to pay tax withholding obligations upon vesting of restricted stock units. The purchase price of this stock was based on the closing price of our common stock on the NYSE Amex on the date of vesting.

Purchase of Equity Securities

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs |
|---------------------------------------|---|------------------------------------|--|---|
| September 28 - October 25, 2013 | 14,820 | \$ 4.78 | - | - |
| October 26 - November 22, 2013 | 1,324 | \$ 4.90 | - | - |
| November 23, 2013 - December 27, 2013 | - | \$ - | - | - |
| Total | 16,144 | \$ 4.79 | - | - |

ITEM 6. Exhibits

| Exhibit No. | Description |
|--------------------|--|
| 31.1 | Certifications by Anthony L. Otten, Chief Executive Officer pursuant to Securities Exchange Rule 13a-14 |
| 31.2 | Certifications by Cynthia A. Downes, Executive Vice President, Chief Financial Officer and Treasurer pursuant to Securities Exchange Rule 13a-14 |
| 32.1 | Certifications Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 made by Anthony L. Otten, Chief Executive Officer |
| 32.2 | Certifications Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 made by Cynthia A. Downes, Executive Vice President, Chief Financial Officer and Treasurer |
| 101 | The following financial statements from Versar, Inc.'s Quarterly Report on Form 10-Q for the quarter ended December 27, 2013, formatted in eXtensible Business Reporting Language ("XBRL"): (i) Unaudited Condensed Consolidated Balance Sheets, (ii) Unaudited Condensed Consolidated Statements of Income, (iii) Unaudited Consolidated Statements of Comprehensive Income, (iv) Unaudited Condensed Consolidated Statements of Cash Flows, and (iiv) Notes to Condensed Consolidated Financial Statements, tagged as blocks of text |

SIGNATURES

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

VERSAR, INC.
(Registrant)

By: /S/ Anthony L. Otten
Anthony L. Otten
Chief Executive Officer

By: /S/ Cynthia A. Downes
Cynthia A. Downes
Executive Vice President,
Chief Financial Officer,
and Treasurer

Date: February 10, 2014