

VERSAR INC
Form 10-K
September 22, 2009

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended
June 26, 2009
Commission File
No. 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)

(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)

NYSE Amex

(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

The aggregate market value of the voting stock held by non-affiliates of the registrant as of December 31, 2008 was approximately \$25,790,780.

The number of shares of Common Stock outstanding as of September 4, 2009 was 9,083,835.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement to be filed with the Securities and Exchange Commission with respect to the 2009 Annual Meeting of Stockholders are incorporated by reference into Part III hereof.

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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, without limitation, 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 possibility 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 that 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 that the Company will not be able to attract and retain key professional employees; changes to or failure of the Federal or municipal governments to fund certain programs in which the Company participates; delays in project funding; and such other risks and uncertainties set forth in this report and in other 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 project and program management firm that provides the government, municipalities, and the private sector with value-added, high quality innovative solutions for infrastructure, facilities management, construction, environmental quality, professional services, defense and homeland security needs. Versar operates in four primary business segments: (1) Program Management, (2) Compliance and Environmental Programs, (3) Professional Services, and (4) National Security.

In fiscal year 2009, Versar completed an aggregate of approximately \$65 million of work internationally for the U.S. Air Force, U.S. Army, and commercial clients, providing program and project management services, construction management and quality assurance services, engineering services and personal services in Iraq, Afghanistan, Kuwait, and the United Arab Emirates. A majority of this work consists of providing construction management and quality assurance oversight to the U.S. Air Force construction operations in Iraq and Afghanistan, ensuring that these projects are constructed in accordance with building codes and requirements. This work has established an international baseline business upon which the Company can base its future growth internationally. In order to maintain and expand this business base, the Company is pursuing similar business opportunities in the Middle East, Africa and the Pacific Rim, as well as BRAC (Base Realignment and Closure) activities both in the United States and around the world through our Sustainment/Restoration and Modernization Acquisition Task Order Contract (SATOC) program.

In fiscal year 2009, with the downturn in the United States economy, the Company has expanded its activities to support U.S. BRAC funded projects and economic stimulus related work. We have started several new business initiatives that include providing infrastructure support for rural broadband telecommunications expansion as part of the United States federal economic stimulus package, green energy development projects and programs providing engineering, design and construction support, and further expanding our Professional Services and National Security businesses through offering cost effective business solutions and innovative technological solutions to meet the ever changing needs of our clients and the markets in which we operate.

Program Management Business Segment: The Program Management business segment is the largest component of Versar s business base. During fiscal year 2009, the Program Management business segment performed construction related services as further discussed below in Iraq, Afghanistan, the United Arab Emirates, and the continental United States.

These programs include our Air Force construction management and quality assurance work to support the rebuilding efforts in Iraq, Afghanistan and personal services support contract with the U.S. Army Corps of Engineers. We provide personnel to the U.S. Army who manage quality assurance on Army projects in Iraq, and infrastructure related construction work in the United States.

Versar's support for the Air Force construction programs in Iraq and Afghanistan continued in fiscal year 2009 resulting in approximately \$42 million of revenue during the fiscal year. This continued work is a direct result of the Air Force's commitment to a quality construction product that can be held to international construction standards. As the Air Force program in Iraq reaches completion, our services will be substantially reduced in that country in fiscal year 2010. This will be partially offset by an increase in these services in Afghanistan, but not to the magnitude of the decrease in Iraq.

In April 2006, Versar was awarded a contract to provide personal services support to the U.S. Army Corps of Engineers (USACE) in Iraq. During fiscal year 2009, the base contract grew from \$13 million per year to approximately \$20 million to serve the Army's growing needs. The Company's existing contract with the Army has been extended for an additional six months due to delays in the procurement process for the follow on contract. We expect that the follow on contract which is up for competitive rebid, will be for an additional year with two six month options at a reduced level of effort, because of the reduction of the U.S. Army's presence in Iraq in the coming years. We intend to participate in the competitive rebid.

In fiscal year 2009, the Company announced that its international subsidiary, VIAP, Inc. entered into a joint venture with Technical Resources International Limited (TRIL) to create a business venture to provide project and program management to private entities in the United Arab Emirates and other Gulf Cooperation Countries. The new Company, VIAP Technical Resources, LTD will be 50% owned by VIAP and 50% by TRIL.

Continental United States (CONUS) based construction work comprised approximately \$7 million of Versar's Program Management business segment revenue in fiscal year 2009 compared to \$6 million in fiscal year 2008. Such services were primarily provided for various design, build and renovation projects throughout the United States. In fiscal year 2008, the Company along with its partner Johnson Controls Federal Systems was awarded a construction and design build services contract from SATOC Air Force Civil Engineering Support Agency (AFCESA) to be performed around the world. The Company and Johnson Controls Federal Systems have jointly formed a 50/50 percent owned limited liability corporation to pursue this work. We anticipate this contract, along with prior infrastructure contract awards to support Ft. Lee's expansion, will continue to provide a strong business baseline for CONUS construction work for the foreseeable future. The Company will continue to pursue other business opportunities to further expand and develop this line of work for rural telecommunication expansion, green energy initiatives, and various other infrastructure work in the North American hemisphere.

Compliance and Environmental Programs Business Segment: Versar provides support for regulatory compliance programs involving air, water, cultural resources, chemical and transportation industries. The Company has supported the EPA for the past 20 years providing technical risk assessments for pollution prevention. Furthermore, the Company provides support to the U.S. Army Corps of Engineers and several municipal entities to help with environmental compliance, biological assessments, and resource management as well as many local municipalities in the United States.

For more than 30 years, Versar has supported the states of Virginia, Maryland, New York, Pennsylvania and Delaware. We have long term relationships with the EPA, National Oceanic and Atmospheric Administration (NOAA), and the United States Army Corps of Engineers (USACE). We have supported the state of Maryland in the assessment of the ecological health of the Chesapeake Bay for more than 20 years. Through our contracts with the Philadelphia and Wilmington Districts of the U.S. Army Corps of Engineers, Versar continues to help evaluate the marine life and how it is impacted by the USACE dredging programs. We also assist several counties in Maryland and Virginia with their watershed programs identifying impaired watersheds and providing cost-effective solutions for their restoration programs.

This business segment has been impacted by the United States economic downturn in particular in the state and municipal business market. With shrinking state and municipal budgets, municipal revenue streams have been

significantly reduced. These reductions have negatively impacted our aquatic facility work by approximately \$8 million in reduced revenues in fiscal year 2009 compared to the prior fiscal year. We are taking several concurrent actions to address the business downturn, including cost reductions, aggressive marketing and pricing as well as shifting resources to follow the changing market and business opportunities.

Professional Services Business Segment: Versar provides onsite environmental management and professional services to over 20 Department of Defense (DoD) installations and industrial facilities. Our onsite professional services are an increasingly attractive alternative as DoD shifts emphasis to its core military mission. Versar's Professional Services business segment has grown to over 100 professional and administrative onsite support staff and is focused on obtaining larger contract opportunities to further expand our client base as we have done with contract wins in fiscal year 2008 for Ft. Lewis and the U.S. Army Mobile District Corps. This segment provides a cost-effective solution to our clients to meet and exceed their requirements and has continued its growth in fiscal year 2009 through repeat work and the strong reputation Versar has with our clients. This segment represents approximately 10% of the Company's overall gross revenues in fiscal year 2009, and has grown revenues organically from \$7 million to \$11 million over the past three years. We continue to seek additional internal growth through obtaining larger contracts as well as through exploring acquisitions of complementary companies to integrate with our offerings. We believe the success of this business segment will be dependent on our providing cost effective service to our clients and maintaining our employee satisfaction to ensure retention of our experienced personnel.

National Security Business Segment: Versar provides national security services primarily through the operations of our subsidiary GEOMET Technologies, LLC (GEOMET). The National Security business segment operates in several defense markets:

Personal Protection Equipment: GEOMET is a leader in developing, testing, and manufacturing personal protection equipment (PPE). GEOMET provides its Disposable Toxicological Agent Protective System (DTAPS®) Level B coverall chemical/biological protective suits, which were 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*, helps 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. Current efforts involve developing and obtaining new product materials to be integrated into our business lines as well as new cooling vest garments to provide longer term solutions providing substantial operational savings to our customers with existing technology.

Chemical Testing Laboratory: GEOMET owns and operates the only declared Schedule I chemical agent laboratory in the United States under the Chemical Weapons Convention which is overseen by the Department of Commerce. 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 of 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 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 base 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 \$30 million over the 15 year period of performance. We are currently in our sixth year under this contract with our teaming partner Jacobs Engineering and anticipate that our efforts will expand in fiscal year 2010 based upon expected contract requirements.

See Note B to our Consolidated Financial Statements included herein for further financial information regarding our business segments.

Markets

Versar's services continue to evolve in response to clients' changing needs. Our market opportunities are driven by our clients' changing infrastructure requirements. The Company continues to focus on larger programs for government customers, developing long-term level of effort contracts to stabilize the Company's business base, and on several new expanding markets such as rural telecommunications and energy development. The poor U.S. economy in 2009 has required the Company to adapt to changes in demand for our services, pricing pressure and lack of project funding, which may impact the Company's profit margins in 2010 and the foreseeable future. Increased competition resulting from the decline in demand driven by economic conditions will put downward pressure on our margins, however, we are pursuing much larger volume programs with potentially better margins to offset this pressure.

The Company believes that reduced capital budgets, unemployment, and weak financial markets that impact the economy and increased government spending that further increases the U.S. deficit are our biggest near-term threats. Management believes that each business segment has expertise to address the needs raised by these national economic issues. Management believes that Versar is well positioned in the professional services and national security sectors in the coming years. With the recent addition of rural telecommunications development, the Company will provide turnkey network and tower solutions with rapid deployment for rural carriers in fiscal year 2010. These services combined with the services of our network solutions partner Lemko, provide carriers with cost effective business solutions at substantial savings.

The environmental marketplace, in our view, will remain highly competitive, as no major new regulatory requirements are expected to be enacted in the near future. Some of our federal sector customers are beginning to return to funding environmental projects, while municipal budgets continue to be constrained. Given the current economic and regulatory situation, we will continue to pursue those opportunities that can be performed profitably. We continue to pursue aggressively many new business opportunities and have the ability to adapt our cost structure to address market pressures unlike most larger entities. Client satisfaction and providing cost effective, timely solutions to our clients will always be our focus.

Success in the federal government markets continues to be driven by a cost-effective set of solutions, outsourcing at the point of need, and relationships with key customers. Pricing pressures from increased competition in an increasingly crowded market will continue to impact our margins. Being able to address these pressures will continue to be a management challenge in the next few years.

Initially, we expected that Base Realignment and Closure (BRAC) funding would occur late in fiscal year 2006. However, due to funding constraints from the war in Iraq, the BRAC funding to revitalize military bases infrastructure work did not start until fiscal year 2008 and we expect that it will continue at an increasing pace for the next couple of years.

Competition

Versar continues to face substantial competition in each market in which we operate as our markets become more crowded and price sensitive. We expect this trend to continue and we will continue to diversify our business to improve our competitive standing. Competitors are often larger and have greater financial resources than Versar, which means that we have to be 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, while we are small enough to continue meeting the small business criteria. Generally, a company with more than 500 employees will not qualify as a small business so our larger competitors are unable to compete with us on these contracts.

Our market areas of Program Management, Compliance and Environmental Programs, Professional Services, and National Security reflect a mix of business that we continue to believe will provide stability 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.

We continue to adjust our pricing structure to ensure that we remain competitive across all business segments. 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 specialized 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, indefinite delivery indefinite quantity (IDIQ) multi-award procurements, 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

For Versar, firm backlog is identified as funded backlog, which represents orders for goods and services for which firm contractual commitments have been received. Such contractual commitments may take the form of a signed contract, a written task order under a large contract vehicle, a master contract or other types of written authorization, including change orders to existing written agreements. In the case of contracts with governments or governmental agencies amounts are included in funded backlog when the firm contractual commitment is supported by funding that has been appropriated and authorized for expenditure. Based on past experience, the Company believes that at least 90% of funded backlog will be performed in the succeeding twelve month period.

The Company also reports total contract backlog which includes two components: funded backlog and expected backlog. Expected backlog reflects management's estimate of future revenue from existing written contracts, such as master contracts with large corporations and large federal, state and municipal multi-year contracts for which funding for work or tasks has not yet been authorized in writing by the other contracting party. Versar has a number of these large, multi-year (including option periods), multi-million dollar contracts with the federal and state governments. In many cases these contracts are identified as Indefinite Delivery/Indefinite Quantity multi-year contracts. These are unfunded contract vehicles through which the particular government client issues funded work to Versar by written task or work orders. When these task or work orders are issued, the Company then counts the portion covered by the task or work orders as funded backlog.

The amount of expected backlog included in the total contract backlog is not exact or guaranteed; however, it represents what Versar reasonably believes, based upon subjective factors such as past experience with the particular clients, the type of work and present budgetary expectations and information about the clients' needs and other business circumstances, will become funded backlog over the next five to seven years. These estimates are based upon the information Versar possesses at the time the estimate is made. If management does not accurately assess each of these factors, or if it does not include all of the variables that affect the revenue it will recognize from existing contracts in the estimating process, the potential value of these contracts, and accordingly, reported total contract backlog, will not reflect the actual revenue received from these contracts and task orders. As a result, there can be no assurance that Versar will ultimately receive amounts included in total contract backlog that are not included in funded backlog or that total contract backlog includes all revenue that Versar may ultimately receive under contracts existing at any one time. Further, many factors that affect the scheduling of projects could alter the actual timing of revenue on projects included in total contract backlog. There is also the possibility that contracts could be adjusted or cancelled in a manner that would affect the realization of revenues reflected in backlog. Nevertheless, the Company believes the number characterized as total contract backlog is important information for investors, reflecting on the potential future performance of the Company.

While total contract backlog is comprised of total funded backlog and management's estimate of additional amounts to be received under existing contracts, total contract backlog does not represent the full amount of the Company's contract capacity. Each of the contracts with unutilized contract capacity is reviewed individually and, based upon the various subjective factors described above, an estimate is made of the amount of this unutilized capacity Versar expects will become funded backlog in five to seven years. There is no specific formula for these

estimates. If sufficient information is not available upon which to base an estimate, or the Company does not have prior experience with the particular client, management may not include any unfunded portion of a contract in total contract backlog until such time as a reasonable estimate of expected future funded orders can be made.

Other companies with similar types of contracts to Versar may not calculate backlog in the same manner as Versar, because their calculations are based on different subjective factors or because they use a different methodology. Therefore, information presented by Versar regarding funded backlog and total contract backlog may not be comparable to similar presentations by others.

As of June 26, 2009, funded backlog for Versar was approximately \$57 million, a decrease of 11% compared to approximately \$64 million as of June 27, 2008. Funded backlog decreased in the fourth quarter of fiscal year 2009 primarily due to the cancellation of two construction projects in the Program Management business segment valued at approximately \$9 million.

As of June 26, 2009, total contract backlog for Versar, including unfunded expected government task orders, was approximately \$735 million, as compared to approximately \$610 million as of June 27, 2008, an increase of approximately 20%. The increased total contract backlog resulted from a large number of task order proposals for the SATOC AFCESA contract in the Program Management business segment and the utilization of our USACE Mobile District Army contract that supports all of the Company's business segments.

Employees

At June 26, 2009, Versar had approximately 435 full-time employees, of which eighty-three percent are engineers, scientists, and other professionals. Seventy-eight percent of the Company's professional employees have a bachelor's degree, twenty one percent have a master's degree, and three percent have a doctorate degree.

Item 1A. Risk Factors

We are dependent on government contracts for the majority of our revenue, and a reduction or delay in spending by government agencies could adversely affect our business and operating results.

Contracts with agencies of the United States government and various state and local governments represented approximately 94% of our revenue in fiscal year 2009, with only 6% of our revenue coming from commercial sources. Therefore, the majority of our revenue and the success of our business are materially dependent on contracts with governmental agencies. Companies engaged in government contracting are subject to certain unique business risks not shared by the general commercial sector. Among these risks are:

a competitive procurement process with no guaranty of being awarded contracts;

dependence on congressional appropriations and administrative allotment of funds;

policies and regulations that can be changed at any time by Congress or a presidential administration;

competing political priorities and changes in the political climate regarding funding and operations of the services;

changes in and delays or cancellations of government programs or requirements;

government contracts that are usually awarded for relatively short periods of time and are subject to renewal options in favor of the government; and

many contracts with Federal government agencies require annual funding and may be terminated at the agency's discretion.

Following the award of a federal government contract, payment for the work is dependent on congressional appropriations of the funds necessary to complete the task. The Federal government contracting laws also provide that the United States government is to do business only with responsible contractors. Accordingly, Federal agencies have the authority under certain circumstances to suspend or debar a contractor from bidding on government contracts.

A reduction or shift in spending priorities by Federal government agencies could limit or eliminate the continued funding of our existing government contracts. These reductions or shifts in spending, if significant, could have a material adverse effect on our business.

Our government contracts are subject to audit and potential reduction of costs and fees.

Contracts with the Federal government and many other state and local governmental agencies are subject to audit by governmental agencies, which could result in the disallowance of certain fees and costs. These audits can result in the disallowance of significant costs and expenses if the auditing agency determines, in its discretion, that certain costs and expenses were not warranted or were excessive. Disallowance of costs and expenses, if pervasive or significant, could have a material adverse effect on our business.

As a government contractor, we are subject to a number of procurement laws and regulations; a violation of any such law or regulation could result in sanctions, contract termination, forfeiture of profit, harm to our reputation or loss of our status as an eligible government contractor.

We must comply with and are affected by federal, state and local laws and regulations regarding the formation, administration and performance of government contracts. These laws and regulations affect how we transact business with our government clients and, in some instances, impose additional costs on our business operations. Even though we take precautions to prevent and deter fraud, misconduct and non-compliance, we face the risk that our personnel or outside partners may engage in misconduct, fraud or improper activities. Government contract violations could result in the imposition of civil and criminal penalties or sanctions, contract termination, forfeiture of profit and/or suspension of payment, any of which could make us lose our status as an eligible government contractor and could cause our reputation to suffer serious harm.

Since we depend on federal, state and local governments for a significant portion of our revenue, our inability to win or renew government contracts could harm our operations and financial condition.

Our inability to win or renew government contracts could harm our operations and significantly reduce or eliminate any potential profits. Government contracts are typically awarded through a heavily regulated procurement process. Some government contracts are offered to multiple competitors, causing increases in overall competition and pricing pressure. The competition and pricing pressure may require us to seek to reduce costs in order to realize revenues under these contracts. If we are not successful in reducing the amounts of costs we anticipate, our profitability on these contracts will be negatively impacted. Further, even if we are qualified to work on a government contract, we may not be awarded the contract if a competitor is selected or because of certain government policies.

Robust enforcement of regulations is important to our financial success.

Our business is materially dependent on the continued enforcement by local, state and federal governments of various environmental regulations. From time to time, depending on political pressures, local, state and federal agencies relax environmental clean-up standards to promote economic growth and to discourage industrial businesses from relocating. Any relaxation in clean-up standards impacts our ability to secure additional contracting work with such agencies or with other federal agencies that operate or manage contaminated property. Further, in a period of relaxed environmental standards, private industry may be less willing to allocate funds to consulting services designed to prevent or remediate environmental problems.

A large portion of our backlog is subject to cancellation and adjustments which makes backlog an uncertain indicator of future operating results.

Our funded backlog was approximately \$57 million as of June 26, 2009. Funded backlog represents orders for goods and services for which firm contractual commitments have been received. Such contractual commitments may take the form of a signed contract, a written task order under a large contract vehicle, a master contract or other types of written authorization, including change orders to existing written agreements. In the case of contracts with governments or governmental agencies amounts are included in funded backlog when the firm contractual commitment is supported by funding that has been appropriated and authorized for expenditure.

Our total contract backlog was \$735 million as of June 26, 2009. Total contract backlog includes two components: funded backlog and expected backlog. Expected backlog reflects management's estimate of future revenue from existing written contracts, such as master contracts with large corporations and large federal, state and municipal multi-year contracts for which funding for work or tasks has not yet been authorized in writing by the other contracting party. The amount of expected backlog included in total contract backlog is not exact or guaranteed; however, it represents what we reasonably believe, based upon subjective factors such as past experience with the particular clients, the type of work and present budgetary expectations and information about the clients' needs and other business circumstances, will become funded backlog over the next five to seven years. These estimates are based upon the information in our possession at the time the estimate is made. If Versar's management does not accurately assess each of these factors, or if it does not include all of the variables that affect the revenue it will recognize from existing contracts in the estimating process, the potential value of these contracts, and accordingly, reported total contract backlog, will not reflect the actual revenue received from contracts and task orders.

As a result, there can be no assurance that we will ultimately receive amounts included in total contract backlog that are not included in funded backlog or that total contract backlog includes all revenue that we may ultimately receive under contracts existing at any one time. Further, many factors that affect the scheduling of projects could alter the actual timing of revenue on projects included in total contract backlog. There is also the possibility that contracts could be adjusted or cancelled in a manner that would affect the realization of revenues reflected in backlog. The failure to realize all amounts in backlog could adversely affect our revenues and margins. Due to these uncertainties, our funded backlog and our total contract backlog as of any particular date may not be an accurate indicator of our future earnings.

We could face potential liability for failure to properly design remediation.

A part of our business involves the design and implementation of remediation at environmental clean-up sites. If we fail to properly design and build a remediation system or if someone claims that we did, we could face expensive litigation and settlement costs. If we failed to successfully defend against such a lawsuit, it could materially affect our business.

Our failure to properly manage projects may result in additional costs or claims.

Our engagements often involve complex projects. The quality of our performance on such projects depends in large part upon our ability to manage the relationship with our clients, and to effectively manage the projects and deploy appropriate resources in a timely manner. If we miscalculate the resources or time we need to complete a project with capped or fixed fees, or the resources or time we need to meet contractual milestones, our operating results could be adversely affected. Further, any defects or errors, or failures to meet our client's expectations, could result in claims for damages against us.

Our services expose us to significant risks of liability and it may be difficult to obtain or maintain adequate insurance coverage.

Our services involve significant risks of professional and other liabilities that may exceed the fees we derive from performance. Our business activities could expose us to potential liability under various environmental laws and under workplace health and safety regulations. In addition, we sometimes may assume liability by contract under indemnification agreements. We are not able to predict the magnitude of any such liabilities.

We obtain insurance from third parties to cover our potential risks and liabilities. It is possible that we may not be able to obtain adequate insurance to meet our needs, may have to pay an excessive amount for the insurance coverage we want, or may not be able to acquire any insurance for certain types of business risks.

Economic downturn.

Because of the present worldwide economic downturn and increasing competition, the Company may not be able to win all the competitive work it expects or has in the past. This could adversely affect the Company's financial performance while this situation exists.

If our partners fail to perform their contractual obligations on a project, we could be exposed to legal liability, loss of reputation or reduced profits.

We, from time to time, enter joint venture agreements and other contractual arrangements with outside partners to jointly bid on and execute a particular project. The success of these joint projects depends in part on the satisfactory performance of the contractual obligations by our partners. If any of our partners fail to satisfactorily perform their contractual obligations, we may be required to make additional investments and provide additional services to complete projects, increasing our cost on those projects. If we are unable to adequately address a partner's performance issues, then our client could terminate the joint project, exposing us to legal liability, loss of reputation or reduced profits.

We operate in highly competitive industries.

The markets for many of our services are highly competitive. There are numerous professional architectural, engineering, construction management, and environmental consulting firms, and other organizations which offer many of the same services offered by us. We compete with many companies, many of which have greater resources than us and we cannot assure you that such competitors will not substantially increase the resources devoted to their business in a manner competitive with the services provided by us. Competitive factors include reputation, performance, price, geographic location and availability of technically skilled personnel. In addition, we face competition from the use by our clients of in-house environmental, engineering and other staff.

Our quarterly and annual revenue, expenses and operating results may fluctuate significantly, which could have a negative effect on the price of our common stock.

Our quarterly and annual revenues, expenses and operating results have and may continue to fluctuate significantly because of a number of factors, including:

the seasonality of the spending cycle of our public sector clients, notably the Federal government, and the spending patterns of our private sector clients;

employee hiring and utilization rates in the United States and internationally;

the number and significance of client engagements commenced and completed during the period;

delays incurred in connection with an engagement because of weather or other factors;

ability to work within foreign countries' regulations, tax requirements and obligations;

business and financial risk working in foreign countries;

the ability of clients to terminate engagements without penalties;

the creditworthiness and solvency of clients;

the size and scope of engagements;

the ability to perform contracts within budget or contractual limitations;

the timing of expenses incurred for corporate initiatives;

threatened or pending litigation matters;

reductions in the prices of services offered by our competitors;

winning re-bids of our existing large government contracts;

general economic and political conditions; and

volatility of currencies in foreign countries.

Variations in any of these factors could cause significant fluctuations in our operating results from quarter to quarter and could result in net losses and have a material adverse affect on our stock price.

We are highly dependent on key personnel.

Our business is managed by a small number of key management and operating and professional personnel, the loss of certain of whom could have a material adverse effect on the Company. The market for these professionals is competitive and we believe that our ability to manage planned growth successfully will depend in large part on our continued ability to attract and retain highly skilled and qualified personnel.

Item 1B. Unresolved Staff Comments

Not Applicable.

Item 2. Properties

The Company's executive office is located in Springfield, Virginia, a suburb of Washington, D.C. Versar currently leases 53,242 square feet in two buildings from Springfield Realty Investors, LLC. The rent is subject to a two and one half percent escalation per year through November 30, 2015.

As of June 26, 2009, the Company had under lease an aggregate of approximately 145,000 square feet of office and laboratory space in the following locations: Springfield, Lynchburg, Richmond and Norfolk, VA; Mesa, AZ; Fair Oaks, CA; Westminster, CO; Lombard, IL; Baltimore, Columbia, Gaithersburg and Germantown, MD; San Antonio, TX; Makati City, the Republic of Philippines; and Abu Dhabi, United Arab Emirates. The lease terms primarily range from two to six years with the exception of the Springfield and Lynchburg offices. Lease terms for these two offices expire in 2015 and 2020, respectively.

The Company's National Security business segment office space is located in the Germantown and Gaithersburg, MD facilities listed above with the remainder of the office space being used by the other business segments.

Item 3. Legal Proceedings

Versar and its subsidiaries are parties from time to time to various 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 2009.

EXECUTIVE OFFICERS OF THE REGISTRANT

The current executive officers of Versar, and their ages as of September 10, 2009, 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. Procriv | 61 | President and Chief Executive Officer |
| Lawrence W. Sinnott | 47 | Executive Vice President, Chief Operating Officer, Chief Financial Officer and Treasurer |
| Jeffrey A. Wagonhurst | 61 | Executive Vice President, Program Management Business Segment |
| Paul W. Kendall | 56 | Senior Vice President, Global Marketing and Planning |
| James C. Dobbs | 64 | Senior Vice President, General Counsel and Secretary |
| Gina Foringer | 40 | Senior Vice President, Professional Services Business Segment |
| Michael J. Abram | 53 | Senior Vice President, Corporate Development and Chief Administrative Officer |
| Charles S. Cox | 64 | Senior Vice President and President, VIAP, Inc. (Versar International Assistance Projects) |
| Jeffrey M. Moran | 46 | Senior Vice President, Compliance and Environmental Programs Segment |
| Peter J. Cooper | 60 | Senior Vice President, National Security Business Segment |
| Daniel J. Cummings | 47 | Senior Vice President, CONUS based Program Management Business Segment |

Theodore M. Procriv, 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. Procriv served as the Deputy Assistant to the Secretary of Defense for Chemical and Biological Matters, and subsequently as the Deputy Assistant Secretary of the Army for Chemical Demilitarization. Before joining the Department of Defense, Dr. Procriv was Corporate Vice President of Environmental Business at Science Applications International Corporation, (SAIC) from 1993 to 1994, and served as the Vice President for Government Systems at Battelle Memorial Institute from 1979 to 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. In September 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.

Jeffrey A. Wagonhurst, MBC, MBA, joined Versar in February 1999 as an Army Program Manager. In 2001, he was elected Vice President of Human Resources and Facilities. In September 2006, he was elected Senior Vice President to lead the business unit that is now our Program Management business segment. In May 2009,

Mr. Wagonhurst was promoted to Executive Vice President, Program Management Group. Mr. Wagonhurst concluded

his 30 year career with the U.S. Army and retired in May 1997 as a Colonel. He commanded a Combat Engineer Brigade and Battalion during this period. He also served as a Deputy District Commander of the Mobile District, U.S. Army Corps of Engineers.

Paul W. Kendall, B.S., M.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, served from November 2003 to December 2007 as Senior Vice President, National Security business segment and President of GEOMET Technologies LLC. He currently serves as Senior Vice President, Global Marketing and Planning.

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.

Gina Foringer, MBA, PMP joined Versar in September 1999 as Senior Project Manager to support Army programs. In November 2003, she was elected Vice President of the Professional Services business segment. In April 2006, Ms. Foringer was elected Senior Vice President of the business unit that is now our Professional Services business segment. Prior to joining Versar, she was a US Army Transportation Officer, and worked for the Norfolk District, US Army Corps of Engineers as an on-site contractor.

Michael J. Abram, B.S., joined Versar in 2001 as Director of Acquisition Strategy. In 2002, he was appointed Vice President of the former Architect and Engineering Operations and in 2004 elected as a Corporate Vice President in charge of quality assurance. In July 2006, Mr. Abram became a Vice President of Versar supporting the former Infrastructure and Management Services segment which is now part of the Compliance and Environmental Programs business segment. He was elected Senior Vice President in September 2007 and promoted to Senior Vice President, Corporate Development and Chief Administrative Officer in May 2009. Mr. Abram oversees the Company's Mergers and Acquisitions, Strategic Planning and Human Resource functions. Prior to joining Versar, Mr. Abram worked 15 years for Mobil Oil Corporation.

Charles S. Cox was elected a Senior Vice President and President of VIAP, Inc., Versar's international business subsidiary, as of January 3, 2009. Mr. Cox concluded a 29 year career in the U.S. Army, retiring as a colonel in 1997. Since that time Mr. Cox provided independent consulting services to a diverse group of clients through C.S. Cox and Associates.

Jeffrey M. Moran, PE, was elected a Senior Vice President for Versar's Compliance and Environmental Programs business segment on May 14, 2009. Mr. Moran brings more than 20 years of experience to Versar and most recently has worked in management positions for Tetra Tech and Dewberry. Mr. Moran has managed over \$50 million in United States Army Corps of Engineer contracts. He is a Civil Engineer registered in the states of Maryland, Virginia and the District of Columbia. Mr. Moran is also very active in the Society of American Military Engineers (SAME) where he has held various executive posts with the Northern Virginia Chapter and the Mid-Atlantic Region.

Peter J. Cooper joined Versar in April 2008, and during the past fiscal year, re-established GEOMET's revenue and profit in each of its core competencies: Laboratory Services, Personal Protective Equipment, and outsourced T&E services with over 23 years experience in government manufacturing and developing international network of sales operations. Mr. Cooper has an HND in electrical engineering from the United Kingdom and has resided in the USA for the past 20 years. Prior to joining Versar, Mr. Cooper worked for TVI Corporation, an international supplier of personal protection products, from 2004 to 2008.

Daniel J. Cummings, MS, PE, PMP, LEED AP joined Versar in January 2009 as Vice President of US Engineering and Construction Division. In September 2009 he was elected as Senior Vice President of US Engineering and Construction Group responsible for all Versar's Domestic Engineering and Construction. Mr. Cummings concluded his 26 year career with the U.S. Army and retired in June 2009 as a colonel. His last assignment on active duty was as the Executive Director, Military Programs Directorate, Headquarters, U.S. Army Corps of Engineers. He also served as Deputy District Commander of Savannah District, USACE and Commander 84th Engineer Battalion, Schofield Barracks, Hawaii.

PART II**Item 5. Market for Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities****Common Stock**

The Company's common stock is traded on the NYSE Amex LLC, and was traded on the American Stock Exchange (AMEX) prior to its acquisition by NYSE Euronext, under the symbol VSR. At June 26, 2009, the Company had 970 stockholders of record, excluding stockholders whose shares were held in nominee name. The quarterly high and low sales prices as reported on the NYSE Amex or AMEX, as applicable, during fiscal years 2009 and 2008 are presented below.

| Fiscal Year 2009 | High | Low |
|-------------------------|-------------|------------|
| 4 th Quarter | \$ 5.20 | \$ 2.25 |
| 3 rd Quarter | 4.62 | 2.07 |
| 2 nd Quarter | 4.35 | 2.26 |
| 1 st Quarter | 6.00 | 4.20 |
| Fiscal Year 2008 | High | Low |
| 4 th Quarter | \$ 6.44 | \$ 4.70 |
| 3 rd Quarter | 7.00 | 5.36 |
| 2 nd Quarter | 9.25 | 5.42 |
| 1 st Quarter | 15.35 | 6.80 |

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 under which options remain outstanding, which were previously approved by the security holders: the 2005 and 2002 Stock Incentive Plans, the 1996 Stock Option Plan, and the 1992 Stock Option Plan. The Company does not maintain any equity compensation plans not approved by security holders.

Equity Compensation Plan Information

| | | | Number of securities remaining available for future issuance |
|--|--|--|---|
| | Number of Securities to be issued upon exercise of outstanding options, warrants | Weighted-average exercise price of outstanding options, warrants | under equity compensation plans (excluding securities reflected in column |

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| Plan Category | and rights (a) | and rights (b) | (a)) (c) |
|--|-------------------|-------------------|-------------|
| Equity compensation plans approved by security holders | 542,000 | \$ 3.10 | 275,000 |

During the third quarter of fiscal year 2009, employees of the Company surrendered shares of common stock to the Company to pay tax obligations due upon the vesting of restricted stock as reflected in the table below. The purchase price of this stock was based on the closing price of the Company's common stock on the NYSE Amex on the date of surrender.

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 |
|---------------------|----------------------------------|------------------------------|--|--|
| December 1-31, 2008 | 912 | \$ 3.57 | | |
| January 1-31, 2009 | 34,389 | 3.64 | | |
| Total | 35,301 | \$ 3.64 | | |

The following graph compares the cumulative 5-year total return provided shareholders on Versar's common stock relative to the cumulative total returns of the S&P 500 index, and a customized peer group of four companies that includes: Arcadis N.V., Michael Baker Corporation, Ecology & Environment, Inc. and Matrix Service Company. Versar's peer group used in last year's annual report also included CET Services, Inc., which was acquired by Biomedical Technology Solutions Holdings and is no longer publicly traded. Biomedical Technology Solutions Holdings Inc. is not included in the peer group as its aggregate business is not comparable to that of Versar's. An investment of \$100 (with reinvestment of all dividends) is assumed to have been made in our common stock, in the peer group, and the index on June 30, 2004 and its relative performance is tracked through June 30, 2009.

| | 6/04 | 6/05 | 6/06 | 6/07 | 6/08 | 6/09 |
|--------------|--------|--------|--------|--------|--------|--------|
| Versar, Inc. | 100.00 | 64.65 | 83.23 | 169.94 | 96.97 | 80.20 |
| S&P 500 | 100.00 | 106.32 | 115.50 | 139.28 | 121.01 | 89.29 |
| Peer Group | 100.00 | 128.57 | 236.38 | 449.11 | 369.39 | 295.16 |

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

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-2 of this report. The financial data is as follows:

| | June 26, 2009 | June 27, 2008 | June 29, 2007 | June 30, 2006 | July 1, 2005 |
|--|---------------------------------------|------------------|------------------|------------------|-----------------|
| | For the Years Ended | | | | |
| | (In thousands, except per share data) | | | | |
| Consolidated Statements of | | | | | |
| Income related data: | | | | | |
| Gross Revenue | \$ 112,196 | \$ 115,602 | \$ 102,726 | \$ 60,888 | \$ 67,678 |
| Gross Profit | 14,480 | 13,788 | 10,822 | 6,354 | 7,759 |
| Operating Income | 5,604 | 5,491 | 4,153 | 681 | 1,419 |
| Income from Continuing Operations | 3,169 | 3,391 | 5,282 | 1,637 | 1,361 |
| Loss from Discontinued Operations | | | | (290) | (1,159) |
| Net Income | 3,169 | 3,391 | 5,282 | 1,347 | 202 |
| Income per share from Continuing Operations Diluted | \$.35 | \$.36 | \$.62 | \$.20 | \$.16 |
| Loss per share from Discontinued Operations Diluted | \$ | \$ | \$ | \$ (.04) | \$ (.14) |
| Net Income per share Diluted | \$.35 | \$.36 | \$.62 | \$.16 | \$.02 |
| Weighted Average Shares Outstanding Diluted | 9,150 | 9,331 | 8,466 | 8,347 | 8,263 |
| Consolidated Balance Sheet | | | | | |
| related data: | | | | | |
| Working Capital | \$ 25,513 | \$ 22,271 | \$ 16,176 | \$ 9,119 | \$ 7,887 |
| Current Ratio | 3.04 | 2.67 | 2.01 | 1.99 | 1.86 |
| Total Assets | 42,594 | 39,828 | 36,817 | 22,802 | 20,912 |
| Stockholders' Equity | \$ 28,654 | \$ 25,053 | \$ 19,422 | \$ 12,572 | \$ 10,552 |

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

Financial Trends

Due to continued government emphasis on funding of a number of international programs that fit within the Company's core business, gross revenues and gross profit increased in all of Versar's business segments in fiscal year 2009, except for the Company's Compliance and Environmental business segment, which has been most significantly impacted by the declining U.S. economy. During fiscal year 2009, the Company continued to benefit from work for the Air Force in Iraq. Approximately 30% of the Company's business volume related to Air Force construction inspection and quality control of reconstruction efforts in Iraq during the fiscal year. However, work in Iraq began to decline during fiscal year 2009. During fiscal year 2008, approximately 53% of the Company's business volume related to reconstruction efforts in Iraq. The Company expects that the reconstruction efforts in Iraq will be significantly reduced during fiscal year 2010 because of reduced Air Force role in reconstruction work in Iraq. We currently anticipate a decrease in revenues during fiscal year 2010 of approximately \$25 million compared to the Company's revenues from Iraq in fiscal year 2009 because of reduced Air Force reconstruction work. To offset, in part, the loss of work in Iraq, the Company continues to follow funding shifts to Afghanistan attempting to maintain and expand its business there. Management currently anticipates an increase in revenues from work in Afghanistan of approximately \$5 million to \$10 million during fiscal year 2010, which will help offset but not completely replace the expected reduction in revenues from Iraq.

Management expects to continue to face challenges in the Compliance and Environmental business segment as municipalities continue to face funding shortfalls due to current economic conditions. Therefore, the Company continues to take steps to further diversify its business to replace reduced or eliminated opportunities in Iraq and reduced municipality work in its Compliance and Environmental business segment. The Company is focusing on U.S. based BRAC efforts, funding for which had been delayed as a result of the war in Iraq as well as the expanded U.S. efforts in Afghanistan. Funding for BRAC work began to increase in fiscal year 2009 and we expect that funding of BRAC work worldwide will continue to increase during fiscal year 2010. Versar is also focused on new initiatives in the rural broadband market, in the U.S., green energy development projects and programs providing engineering, design and construction support, and further expanding our Professional Services and National Security business segments to address cost constraints while effectively providing business solutions to meet our clients changing needs.

The Company's business is now operated through four segments as follows: Program Management, Compliance and Environmental Programs, Professional Services, and National Security. Program Management continues to be the largest business segment of the Company.

These segments were segregated based on the nature of the work, business processes, customer base and the business environment in which each of the segments operates.

There are a number of risk factors or uncertainties that could significantly impact our future 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 work;

Failure to properly manage projects resulting in additional costs;

The cost of compliance for the Company's laboratories;

The results of a negative government audit potentially impacting our costs, reputation and ability to work with the federal government;

Loss of key personnel;

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

The ability to compete in a highly competitive environment; and

Federal funding delays due to wars in Iraq and Afghanistan.

Results of Operations

Versar's gross revenue for fiscal year 2009 totaled \$112,196,000, a \$3,406,000 (3%) decrease compared to gross revenue of \$115,602,000 for fiscal year 2008. Gross revenue for fiscal year 2008 increased by \$12,876,000 (13%) over that reported in fiscal year 2007.

| | June 26, 2009 | Years Ended June 27, 2008 | June 29, 2007 |
|---------------------------------------|------------------|---------------------------------|------------------|
| | (In thousands) | | |
| GROSS REVENUE | | | |
| Program Management | \$ 71,526 | \$ 68,896 | \$ 58,765 |
| Compliance and Environmental Programs | 19,649 | 30,429 | 29,839 |
| Professional Services | 11,476 | 8,101 | 7,318 |
| National Security | 9,545 | 8,176 | 6,804 |
| | \$ 112,196 | \$ 115,602 | \$ 102,726 |

Gross revenue in the Program Management business segment for fiscal year 2009 was \$71,526,000, an increase of \$2,630,000 (4%) over that reported in fiscal year 2008. A majority of the increase is attributable to efforts to support both the Air Force and the Army in Iraq as part of the reconstruction efforts as well as new construction management work being performed in the United Arab Emirates. Gross revenue for the Program Management business segment for fiscal year 2008 was \$68,896,000, an increase of \$10,131,000 (17%) over that reported in fiscal year 2007. The increase is attributable to the Company's continued efforts to support both the Air Force and the Army in Iraq as part of the reconstruction support efforts. Gross revenue for the Compliance and Environmental Programs business segment for fiscal year 2009 were \$19,649,000, a decrease of \$10,780,000 (35%) over that reported in fiscal year 2008. Approximately 80% of the decrease was due to decreased work for municipal aquatic facilities as a result of the global economic business downturn which has significantly impacted our municipal clients capital expenditure budgets. The balance of the shortfall is also primarily related to reduced spending due to poor economic conditions by other clients of the Compliance and Environmental business segment. Gross revenue for the Compliance and Environmental Programs business segment for fiscal year 2008 was \$30,429,000, an increase of \$590,000 (2%) over that reported in fiscal year 2007. The increases are primarily attributable to increased work for municipal aquatic facilities. Gross revenue for the Professional Services business segment for fiscal year 2009, were \$11,476,000, an increase of \$3,375,000 (42%) over that reported in fiscal year 2008. Gross revenue for the Professional Services business segment for fiscal year 2008 was \$8,101,000, an increase of \$783,000 (11%) over that reported in fiscal year 2007. The increases in both periods are attributable to additional professional service work obtained from the U.S. Army to provide additional personnel in support of their missions. Gross revenues from the National Security business segment for fiscal year 2009 were \$9,545,000, an increase of \$1,369,000 (17%) over that reported in fiscal year 2009. The increase is attributable to increased personal protective suit sales as well as increased chemical laboratory testing during fiscal year 2009. The business management approach changed to focus on sustainable revenue streams to reduce business fluctuations and have more predictable revenue streams and improving operating margins in this business segment. Gross revenue for the National Security business segment for fiscal year 2008 was \$8,176,000, an increase of \$1,372,000 (20%) over that reported in fiscal year 2007. The increase in fiscal year 2008 is attributable to higher commercial laboratory testing work coupled with a decline in the level of activity in this segment during fiscal year 2007.

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

Purchased services and materials, primarily subcontractors, in fiscal year 2009 were \$60,583,000, a decrease of \$7,924,000 (12%) over that reported in fiscal year 2008. The decrease was the result of the decline in aquatic facility work in the Compliance and Environmental business segment in fiscal year 2009 as a result of the economic downturn. In fiscal year 2008, purchased services increased by \$5,757,000 (9%) over that reported in fiscal year 2007. The increase was due to higher subcontracted work in the Program Management business segment.

Direct costs of services and overhead include the cost to Versar of direct and overhead staff, including recoverable and unallowable costs that are directly attributable to contracts. Direct costs of services and overhead increased by \$3,826,000 (11%) in fiscal year 2009 compared to that reported in fiscal year 2008. Direct costs of services in fiscal year 2008 increased by \$4,153,000 (14%) over that reported in fiscal year 2007. The increase in fiscal year 2009 is attributable to the continuing changes in the Company's business mix among the business segments creating a demand for additional Professional Services personnel as well as increased National Security business volume resulting in increased staffing in those segments. The increase in fiscal year 2008 is attributable to the increase in overall business volume across all business segments in fiscal year 2008 to support the business growth of the Company.

Gross profit for fiscal year 2009 was \$14,480,000, an increase of \$692,000 (5%) over that reported in fiscal year 2008. Gross profit in fiscal year 2008 increased by \$2,966,000 (27%) over that reported in fiscal year 2007.

| | June 26, 2009 | Years Ended June 27, 2008 | June 29, 2007 |
|---------------------------------------|------------------|---------------------------------|------------------|
| | (In thousands) | | |
| GROSS PROFIT | | | |
| Program Management | \$ 10,467 | \$ 9,398 | \$ 7,037 |
| Compliance and Environmental Programs | 884 | 2,390 | 2,313 |
| Professional Services | 1,734 | 1,290 | 1,257 |
| National Security | 1,395 | 710 | 215 |
| | \$ 14,480 | \$ 13,788 | \$ 10,822 |

Gross profit for fiscal year 2009 in the Program Managements business segment was \$10,467,000, an increase of \$1,069,000 (11%) over that reported in fiscal year 2008. Gross profit in fiscal year 2008 for the Program Management business segment increased by \$2,361,000 (34%) over that reported in fiscal year 2007. The increase in both periods are primarily due to increased gross revenue and improved operating margins. Gross profit for fiscal year 2009 in the Compliance and Environmental business segment was \$884,000, a decrease of \$1,506,000 (63%) over that reported in fiscal year 2008. Gross profit in fiscal year 2008 for the Compliance and Environmental business segment increased by \$77,000 (3%) over that reported in fiscal year 2007. Approximately 40% of the decrease in 2009 is due to the decline in municipal aquatic facility work in fiscal year 2009. The remaining balance of the decrease is due to the poor economic conditions in the United States economy impacting our municipal clients. Gross profit for fiscal year 2009 in the Professional Services business segment was \$1,734,000, an increase of \$444,000 (34%) over that reported in fiscal year 2008. Gross profit in fiscal year 2008 for the Professional Services business segment increased by \$33,000 (3%) over that reported in fiscal year 2007. The 2009 increase was due to the increased gross revenues during fiscal year 2009. Gross profit for fiscal year 2009 in the National Security business segment was \$1,395,000, an increase of \$685,000 (96%) over that reported in fiscal year 2008. Gross profit in fiscal year 2008 for the National Security business segment increased by \$495,000 (230%) over that reported in fiscal year 2007. The increases are primarily due to increased gross revenue in fiscal years 2009 and 2008.

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

Selling, general and administrative expenses for fiscal year 2009 were \$8,876,000, an increase by \$579,000 (7%) over that reported in fiscal year 2008. Selling, general and administrative expenses in fiscal year 2008 increased by \$1,628,000 (24%) over that reported in fiscal year 2007. The increases in fiscal year 2009 are primarily due to increased business development activity for future business growth as well as increased Sarbanes Oxley compliance costs.

Operating income for fiscal year 2009 was \$5,604,000, an increase of \$113,000 (2%) over that reported in fiscal year 2008. Operating income for fiscal year 2008 increased by \$1,338,000 (32%) over that reported in fiscal year 2007. The slight increase in fiscal year 2009 was due to the improved financial performance in three out of four of the Company's business segments, which was in part offset by poor performance in the Compliance and Environmental business segment. The increase in fiscal year 2008 was primarily due to increased gross revenues and improved operating margins during fiscal year 2008.

During fiscal year 2009, the Company recorded a \$328,000 loss on marketable securities that the Company was holding in the FISCO Income Plus Fund. The FISCO fund received an immediate demand margin call from its broker, UBS. Rather than allow the fund the customary time to satisfy the margin call at the end of the day, UBS demanded the fund cover all calls and puts at high premiums immediately or indicated it would take control of the fund and start liquidating the fund. The fund has terminated its relationship with UBS and transferred the assets to a new custodian. The fund is currently taking legal action against UBS to cover its losses. The Company has participated in any recovery from such action to date. During the remaining periods of fiscal year 2009, the Company recovered \$24,000 of the initial loss before the funds were liquidated from the FISCO fund. The Company has liquidated its remaining assets from marketable securities and now holds them in depository accounts with its primary bank due to the volatile nature of the market.

Interest expense for fiscal year 2009 was \$36,000, compared to interest income of \$173,000 in fiscal year 2008. The increase in interest expense was due to costs associated with capital leases and the financing of insurance premiums and the lower federal prime rate of interest resulting in no offsetting interest income received on funds held by the Company in its bank depository account due to the lower federal prime rate.

Income tax expense for fiscal year 2009 was \$2,071,000, a decrease of \$202,000 compared to that reported for fiscal year 2008. Income tax expense for fiscal year 2008 increased by \$3,378,000 over that reported in fiscal year 2007 primarily due to the release of the Company's tax valuation allowance during fiscal year 2007 resulting in a tax benefit of \$1,105,000 for fiscal year 2007. During fiscal year 2007, the Company was carrying a valuation allowance against its deferred tax assets. In the third quarter of fiscal year 2007, the Company re-evaluated the need for the valuation allowance. Because of the Company's continued improved financial performance over the prior three years, management believes that the Company would be able to utilize the full benefit of the deferred tax asset. The effective tax rates were 39.5% and 40.1% for fiscal years 2009 and 2008, respectively.

In summary, Versar's net income for fiscal year 2009 was \$3,169,000 compared to \$3,391,000 in fiscal year 2008 and \$5,282,000 in fiscal year 2007. The reduction of net income is primarily attributable due to the loss from the FISCO fund in the first quarter of fiscal year 2009 as mentioned above.

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

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:

| | June 26, 2009 | | For the Years Ended June 27, 2008 | | June 29, 2007 | |
|-----------------------|---------------|------|--------------------------------------|------|---------------|------|
| | | | (In thousands) | | | |
| Government | | | | | | |
| EPA | \$ 1,891 | 2% | \$ 2,399 | 2% | \$ 2,753 | 3% |
| State & Local | 8,589 | 7% | 16,236 | 14% | 13,936 | 14% |
| Department of Defense | 92,583 | 83% | 88,245 | 76% | 65,997 | 64% |
| Other | 2,576 | 2% | 3,657 | 3% | 16,512 | 16% |
| Commercial | 6,557 | 6% | 5,065 | 5% | 3,528 | 3% |
| Gross Revenue | \$ 112,196 | 100% | \$ 115,602 | 100% | \$ 102,726 | 100% |

Liquidity and Capital Resources

The Company's working capital as of June 26, 2009 was approximately \$25,513,000, an increase of 15%. In addition, the Company's current ratio at June 26, 2009 was 3.04, compared to 2.67 reported on June 27, 2008. The Company's financial ratios have continued to improve due to the Company's strong financial performance during fiscal year 2009. Accounts receivables increased by approximately \$6 million primarily due to changes in contract vehicles that have caused payment delays.

The Company has a line of credit facility with United Bank (the Bank) that provides for advances up to \$7.5 million based upon qualifying receivables. Interest on borrowings is based upon the prime rate of interest less 1/2%. Borrowing rates at June 26, 2009 and June 27, 2008 were 2.75% and 4.5%, respectively. The Company currently has a stand by letter of credit of \$455,147, which serves as collateral for surety bond coverage provided by the Company's insurance carrier against project construction work. The letter of credit reduces the Company's borrowing base on the line of credit. The line of credit capacity as of June 26, 2009 was approximately \$7.0 million. Obligations under the credit facility are guaranteed by the Company and each subsidiary individually and collectively are secured by accounts receivable, equipment and intangibles, plus all insurance policies on property constituting collateral. The line of credit matures in November 2009. The Company is in the process of seeking a renewal of the line of credit facility with United Bank. The Company has obtained a commitment letter from United Bank to extend its line of credit to September 30, 2010. The line of credit is and will continue to be subject to certain covenants related to the maintenance of financial ratios. These covenants require a minimum tangible net worth of \$22.5 million; 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. Borrowings under the renewed line of credit will be at prime less 1/2% with a floor interest rate of 3.5%. Failure to meet the covenant requirements gives the Bank the right to demand outstanding amounts due under the line of credit, which may impact the Company's ability to finance its working capital requirements. As of June 26, 2009, the Company had no outstanding borrowings and was in compliance with the financial covenants.

The Company believes that with its current cash balance of over \$8 million along with anticipated cash flows from operations, working capital will be sufficient to meet the Company's liquidity needs within the next fiscal year. Expected capital requirements for fiscal year 2010 are approximately \$1,000,000, primarily for upgrades to maintain the Company's existing information technology systems. Such capital requirements will be funded through existing working capital.

As part of the Company's diversification and expansion efforts, the Company has provided short term financing to two business partners to help accelerate those business opportunities within fiscal year 2010. See footnotes D, Notes Receivable, and M, Subsequent Events, of the financial statements for further details.

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

At June 26, 2009, the Company has short-term and long-term obligations of approximately \$13,341,000, including short-term obligations of approximately \$3,146,000 which will become due over the next twelve months in fiscal year 2010. The Company has contractual obligations primarily related to lease commitments and notes payable. The table below specifies the total contractual payment obligations as of June 26, 2009.

| Contractual Obligations (In thousands) | Total Cost | Less than 1 year | 1-3 Years | 4-5 Years | After 5 Years |
|---|------------|---------------------|--------------|--------------|------------------|
| Operating lease obligations | \$ 11,950 | \$ 2,701 | \$ 3,939 | \$ 3,455 | \$ 1,855 |
| Capital lease obligations | 835 | 76 | 126 | 133 | 500 |
| Notes payable | 336 | 336 | | | |
| Estimated interest obligations | 220 | 33 | 54 | 49 | 84 |
| Total contractual cash obligations | \$ 13,341 | \$ 3,146 | \$ 4,119 | \$ 3,637 | \$ 2,439 |

Critical Accounting Policies and Related Estimates That Have a Material Effect on Versar's Consolidated Financial Statements

Below is a discussion of the accounting policies and related estimates that we believe are the most critical to understanding the Company's consolidated financial position and results of operations which require management judgments and estimates, or involve uncertainties. Information regarding our other accounting policies is included in the notes to our consolidated financial statements included elsewhere in this report on Form 10-K.

Revenue recognition: Contracts in process are stated at the lower of actual costs incurred plus accrued profits or incurred costs reduced by progress billings. On cost-plus fee contracts, revenue is recognized to the extent of costs incurred plus a proportionate amount of fee earned, and on time-and-material contracts, revenue is recognized to the extent of billable rates times hours delivered plus material and other reimbursable costs incurred. The Company records income from major fixed-price contracts, extending over more than one accounting period, using the percentage-of-completion method. During the performance of such contracts, estimated final contract prices and costs are periodically reviewed and revisions are made as required. Fixed price contracts can be significantly impacted by changes in contract performance, contract delays, liquidated damages and penalty provisions, and contract change orders, which may affect the revenue recognition on a project. Revisions to such estimates are made when they become known. Detailed quarterly project reviews are conducted with project managers to review all project progress accruals and revenue recognition.

There is the possibility that there will be future and currently unforeseeable adjustments to our estimated contract revenues, costs and margins for fixed price contracts, particularly in the later stages of these contracts. Such adjustments are common in the construction industry given the nature of the contracts. These adjustments could either positively or negatively impact our estimates due to the circumstances surrounding the negotiations of change orders, the impact of schedule slippage, subcontractor claims and contract disputes which are normally resolved at the end of the contract.

Allowance for doubtful accounts: Disputes arise in the normal course of the Company's business on projects where the Company is contesting with customers for collection of funds because of events such as delays, changes in contract specifications and questions of cost allowability and collectibility. Such disputes, whether claims or unapproved change orders in process of negotiation, are recorded at the lesser of their estimated net realizable value or actual costs incurred and only when realization is probable and can be reliably estimated.

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

Management reviews outstanding receivables on a quarterly basis and assesses the need for reserves, taking into consideration past collection history and other events that bear on the collectibility of such receivables. All receivables over 60 days old are reviewed as part of this process.

Net deferred tax asset: The Company has approximately \$1.5 million in net deferred tax assets as of June 26, 2009. During the third quarter of fiscal year 2007, the Company released the entire \$2.95 million tax valuation allowance that was previously established against such assets due to the improved earnings and likelihood of realizing such deferred tax assets in future periods.

Asset retirement obligation: During fiscal year 2007, the Company recorded an asset retirement obligation associated with the estimated clean-up costs for its chemical laboratory in its National Security business segment. In accordance with SFAS 143, the Company estimated the costs to clean up the laboratory and return it to its original state at a present value of approximately \$497,000. The Company currently estimates the amortization and accretion expense to be approximately \$180,000 to \$190,000 per year over the next 1 1/2 years. The Company is rigorously pursuing reimbursement for such costs and other costs from the U.S. Army as a significant portion of the chemical agent that was used in the chemical laboratory was government owned. If the Company determines that the estimated clean up cost is larger than expected or the likelihood of recovery from the U.S. Army is remote, such adjustments will be reflected when they become known in accordance with SFAS 143. At June 26, 2009, the Company has accrued approximately \$586,000 long-term liability to clean up the chemical laboratory.

Goodwill and other intangible assets: The carrying value of goodwill is approximately \$776,000 relating to the acquisition of Versar Global Solutions, Inc., which is now part of the Program Management business segment. The Program Management business segment was broken out separately in fiscal year 2007, primarily due to the increase in business volume in Iraq and in the United States construction related work. In performing its goodwill impairment analysis, management has utilized a market-based valuation approach to determine the estimated fair value of the Program Management business segment. Management engages outside professionals and valuation experts annually, as necessary, to assist in performing this analysis and would test more often if events and circumstances warrant it. An analysis was performed on public companies and company transactions to prepare a market-based valuation. Based upon the analysis, the estimated fair value of the Program Management business segment exceeds the carrying value of the net assets of \$12.7 million on an enterprise value basis by a substantial margin. Should the Program Management business segment's financial performance not meet estimates, then impairment of goodwill would have to be further assessed to determine whether a write down of goodwill value would be warranted. If such a write down were to occur, it would negatively impact the Company's financial position and results of operations. However, it would not impact the Company's cash flow or financial debt covenants.

Share-based compensation: The Company records stock based compensation in accordance with Financial Accounting Standards Board (FASB) SFAS No. 123 (Revised 2004), Share-Based Payment (FAS 123(R)). This statement requires companies to recognize the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards (the fair-value-based method).

The Company recorded share-based compensation expense related to the vesting of previously granted stock options in its consolidated financial statements of approximately \$4,000 and \$18,000 for fiscal years 2008 and 2007, respectively. There were no share-based compensation expenses recorded in fiscal year 2009 as all previously granted stock options were fully vested except 10,000 shares of non-qualified stock options which will vest based on the achievement of certain conditions are met, the Company will record the related expense.

The Company also awarded 125,000 shares, 121,500 shares and 42,800 shares of restricted stock to directors and employees in fiscal years 2009, 2008 and 2007, respectively. Share-based compensation expense related to the restricted stock was \$693,000, \$807,000 and \$114,000 for fiscal years 2009, 2008 and 2007, respectively.

New accounting pronouncements: In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), *Business Combinations* (SFAS 141(R)). SFAS 141(R) changes the requirements for an acquiring entity's recognition and measurement of the assets acquired and liabilities assumed in a business

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

combination. This statement is effective for fiscal years beginning after December 15, 2008. This standard will have an impact on accounting for business combinations but the effect is dependent upon acquisitions at that time.

In April 2009, the FASB issued FSP FAS 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies, (FSP FAS 141(R)-1). The FSP FAS 141(R)-1 amends and clarifies Statement of Financial Accounting Standards (SFAS) No. 141 (revised 2007), Business Combinations. FSP FAS 141(R)-1 is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. FSP FAS 141(R)-1 will have an impact on accounting for business combinations but the effect is dependent upon acquisitions at that time.

In September 2006, the Financial Accounting Standard Board (FASB) issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, FASB issued FASB Staff Position (FSP) No. FAS 157-2, *Effective Dates of FASB Statement No. 157*, which deferred the effective date of SFAS 157 for all nonrecurring fair value measurements of nonfinancial assets and liabilities until fiscal years beginning after November 15, 2008. Our adoption of SFAS 157 on December 29, 2008 was limited to financial assets and liabilities and had no impact on our consolidated financial statements. We do not believe this standard will have an effect on the non-financial assets and non-financial liabilities in our consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51* (SFAS 160). SFAS 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008. The Company will adopt this standard in fiscal year 2010. The Company does not believe the adoption of SFAS 160 will have a material impact on its consolidated financial statements.

In April 2008, the Financial Accounting Standards board issued FASB Staff Position (FSP) FAS 142-3, *Determination of the Useful Life of Intangible Assets*, to provide guidance for determining the useful life of recognized intangible assets and to improve consistency between the period of expected cash flows used to measure the fair value of a recognized intangible asset and the useful life of the intangible asset as determined under FASB Statement 142, *Goodwill and Other Intangible Assets*. The FSP requires that an entity consider its own historical experience in renewing or extending similar arrangements. However, the entity must adjust that experience based on entity-specific factors included in Statement 142. If the Company lacks historical experience to consider for similar arrangements, it would consider assumptions that market participants would use about renewal or extension, as adjusted for the entity-specific factors under Statement 142. The Company will adopt FSP FAS 142-3 in fiscal year 2010. The Company believes that upon adoption, FSP FAS 142-3 will not have an effect on the Company's financial statements.

In November 2008, the Financial Accounting Standards Board ratified a consensus opinion reached by the Emerging Issues Task Force (EITF) on EITF Issue 08-6, *Equity Method Investment Accounting Considerations*, to clarify accounting and impairment considerations involving equity method investments after the effective date of both FASB Statement 141 (revised 2007), *Business Combinations*, and FASB Statement 160, *Noncontrolling Interests in Consolidated Financial Statements*. EITF Issue 08-6 includes the Task Force's conclusions on how an equity method investor should (1) initially measure its equity method investment, (2) account for impairment charges recorded by its investee, and (3) account for shares issued by the investee. EITF Issue 08-6 is effective for fiscal years beginning on or after December 15, 2008. The Company will adopt EITF Issue 08-6 effective June 26, 2009 on a prospective basis. The Company does not currently have any investments that are accounted for under the equity method, and as a result, this EITF will not have a significant effect on its financial statements.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events*, (SFAS No. 165). SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 is effective for interim and annual

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

periods ending after June 15, 2009. Following adoption of SFAS No. 165, the Company will evaluate events occurring subsequent to the relevant transactions occurring after fiscal year cut offs for which financial statements are to be issued and will provide all required subsequent events disclosure. The Company adopted this standard in the fourth quarter of fiscal year 2009.

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162, (SFAS No. 168). SFAS No. 168 establishes that the FASB Accounting Standards Codification™ (Codification) will become the source for authoritative United States generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Effective for financial statements issued for interim and annual periods ending after September 15, 2009, the Codification will supersede all then-existing non-SEC accounting and reporting standards. Effective for the first quarter of 2010 references to legacy GAAP will be replaced by references to the Codification, where appropriate.

Impact of Inflation

Versar seeks to protect itself from the effects of inflation. The majority of contracts the Company performs are for a period of a year or less or are cost-plus-fixed-fee type contracts and, accordingly, are less susceptible to the effects of inflation. Multi-year contracts provide for projected increases in labor and other costs.

Business Segments

Versar currently has four business segments: Program Management, Compliance and Environmental Programs, Professional Services, and National Security. The details on these segments are contained in Note B of the Notes to the Consolidated Financial Statements included elsewhere in this report on Form 10-K.

ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk

The Company has not entered into any transactions using derivative financial instruments or derivative commodity instruments and believes that its exposure to interest rate risk and other relevant market risk is not material.

Item 8. Financial Statements and Supplementary Data

The consolidated financial statements and supplementary data begin on page F-2 of this report.

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

None.

Item 9(T). Controls and Procedures

Disclosure Controls and Procedures

Evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) was carried out as of June 26, 2009, the last day of the fiscal period covered by this report. This evaluation was made by the Company's Chief Executive Officer and Chief Financial Officer. Based upon this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (a) are effective to ensure that information required to be disclosed by the Company in reports filed or submitted under the Exchange Act is timely recorded, processed, summarized and reported and (b) include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in reports filed or submitted under the Exchange Act is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management's Annual Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal controls over financial reporting for the Company. Internal control over financial reporting is defined in Rule 13a-15(f) and 15d-15(f) promulgated under the Exchange Act as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failure. Internal control over financial reporting can also be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

The Company's management, including the Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of the Company's internal control over financial reporting as of June 26, 2009. In making this assessment, the Company's management used the criteria set forth by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission's Internal Control-Integrated Framework.

Based on our assessment, management has concluded that, as of June 26, 2009, the Company's internal control over financial reporting was effective based on those criteria.

Attestation Report of the Independent Registered Public Accounting Firm

This annual report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's independent registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this Annual Report.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting identified in connection with the evaluation of such internal control that occurred during the Company's fourth quarter of fiscal year 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

Information required by this item with respect to directors of the Company will be contained in the Company's Proxy Statement for its 2009 Annual Meeting of Stockholders, which is expected to be filed with the Securities and Exchange Commission not later than 120 days after the Company's 2009 fiscal year end and is incorporated herein by reference.

Information required by this item with respect to executive officers of the Company is included in Part I of this report and is incorporated herein by reference.

For the purpose of calculating the aggregate market value of the voting stock of Versar held by non-affiliates as shown on the cover page of this report, it has been assumed that the directors and executive officers of the Company and the Company's Employee 401(k) Plan are the only affiliates of the Company. However, this is not an admission that all such persons are, in fact, affiliates of the Company.

Item 11. Executive Compensation

Information required by this item is incorporated herein by reference to the Company's Proxy Statement for its 2009 Annual Meeting of Stockholders which is expected to be filed with the Commission not later than 120 days after the end of the Company's 2009 fiscal year.

Item 12. Security Ownership of Certain Beneficial Owners and Management

Information required by this item is incorporated herein by reference to the Company's Proxy Statement for its 2009 Annual Meeting of Stockholders which is expected to be filed with the Commission not later than 120 days after the end of the Company's 2009 fiscal year.

Item 13. Certain Relationships and Related Transactions

Information required by this item is incorporated herein by reference to the Company's Proxy Statement for its 2009 Annual Meeting of Stockholders which is expected to be filed with the Commission not later than 120 days after the end of the Company's 2009 fiscal year.

Item 14. Principal Accountant Fees and Services

Information required by this item is incorporated herein by reference to the Company's Proxy Statement for its 2009 Annual Meeting of Stockholders which is expected to be filed with the Commission not later than 120 days after the end of the Company's 2009 fiscal year.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(1) Financial Statements:

The consolidated financial statements and financial statement schedules of Versar, Inc. and Subsidiaries are filed as part of this report and begin on page F-1.

a) Report of Independent Registered Public Accounting Firm

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- b) Consolidated Balance Sheets as of June 26, 2009 and June 27, 2008
 - c) Consolidated Statements of Income for the Years Ended June 26, 2009, June 27, 2008, and June 29, 2007
 - d) Consolidated Statements of Changes in Stockholders' Equity for the Years Ended June 26, 2009, June 27, 2008 and June 29, 2007
 - e) Consolidated Statements of Cash Flows for the Years Ended June 26, 2009, June 27, 2008, and June 29, 2007
 - f) Notes to Consolidated Financial Statements
- (2) Financial Statement Schedules:
- a) Schedule II Valuation and Qualifying Accounts for the Years Ended June 26, 2009, June 27, 2008 and June 29, 2007

All other schedules, except those listed above, are omitted because they are not applicable or the required information is shown in the consolidated financial statements or note thereto.

(3) Exhibits:

The exhibits to this Form 10-K are set forth in a separate Exhibit Index which is included on pages 30 through 32 of this report.

Exhibit Index

| Item No. | Description | Reference |
|----------|---|-----------|
| 3.1 | Restated Articles of Incorporation of Versar, Inc. filed as an exhibit to the Registrant's Registration Statement on Form S-1 effective November 20, 1986 (File No. 33-9391) | (A) |
| 3.2 | Amended and Restated By-Laws of Versar, Inc. | (AE) |
| 4 | Specimen of Certificate of Common Stock of Versar, Inc. | (A) |
| 10.10 | Incentive Stock Option Plan * | (B) |
| 10.11 | Executive Tax and Investment Counseling Program | (A) |
| 10.12 | Nonqualified Stock Option Plan * | (B) |
| 10.105 | 4P Architect-Engineering Contract dated March 14, 2003 | (W) |
| 10.107 | Line of Credit Commitment Letter, dated September 16, 2003 between the Registrant and United Bank | (W) |
| 10.113 | 2002 Stock Incentive Plan* | (Y) |
| 10.114 | Employment Agreement dated February 8, 2005 between Versar, Inc. and Theodore M. Prociw* | (Z) |
| 10.115 | Form of Stock Option Agreement* | (Z) |
| 10.116 | Air National Guard Contract dated July 6, 2005 | (Z) |
| 10.117 | 2005 Stock Incentive Plan and definitions as approved by the Board of Directors on September 7, 2005 and by the stockholders on November 16, 2005 | (AA) |
| 10.123 | Modification Agreement of the Revolving Commercial Note, dated September 24, 2007, between Registrant and United Bank | (AB) |
| 10.124 | Amendment to Employment Agreement dated February 8, 2005 between Versar, Inc. and Theodore M. Prociw, September 25, 2007* | (AB) |
| 10.125 | Amended and Restated Change of Control Severance Agreements dated March 17, 2008 between the Registrant and each of Lawrence W. Sinnott, James C. Dobbs, Paul W. Kendall, Michael Abram and Jeffrey A. Wagonhurst (In reliance on instruction 2 to Item 601 of Regulation S-K, the Registrant has filed the form of Change of Control Severance Agreement entered into with each of the individuals listed above).* | (AC) |
| 10.126 | | (AD) |

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Employment agreement between Charles S. Cox and Versar, Inc. entered into on February 2, 2009 and effective as of January 3, 2009.*

| | | |
|--------|---|-------|
| 10.127 | Amendment to Employment Agreement dated September 3, 2008 between Versar, Inc. and Mr. Theodore M. Prociv.* | 35-47 |
| 10.128 | Form of Indemnification Agreement* | (AE) |

| Item No. | Description | Reference |
|----------|---|-----------|
| 21 | Subsidiaries of the Registrant | 48 |
| 23 | Consent of Independent Registered Public Accounting Firm, Grant Thornton LLP to the incorporation by reference of the previously filed Forms S-8. | 49 |
| 31.1 | Certifications by Theodore M. Prociv, Chief Executive Officer and President Pursuant to Securities Exchange Rule 13a-14 | 50 |
| 31.2 | Certifications by Lawrence W. Sinnott, Exec. Vice President, Chief Operating Officer, Chief Financial Officer and Treasurer pursuant to Securities Exchange Rule 13a-14 | 51 |
| 32.1 | Certifications Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 Of the Sarbanes-Oxley Act of 2002, for the period ending June 26, 2009 by Theodore M. Prociv, Chief Executive Officer and President | 52 |
| 32.2 | Certifications Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 Of the Sarbanes-Oxley Act of 2002, for the period ending June 26, 2009 by Lawrence W. Sinnott, Exec. Vice President, Chief Operating Officer, Chief Financial Officer and Treasurer | 53 |

* Indicates management contract or compensatory plan or arrangement

- (A) Incorporated by reference to the similarly numbered exhibit to the Registrant's Form S-1 Registration Statement effective November 20, 1986 (File No. 33-9391).

- (B) Incorporated by reference to the similarly numbered exhibit to the Registrant's Form 10-K Annual Report for the Fiscal Year Ended June 30, 1987 filed with the Commission on September 28, 1987.

- (W) Incorporated by reference to similarly numbered exhibit to the Registrant's Form 10-K Annual Report for Fiscal Year Ended June 30, 2003 filed with the Commission on September 26, 2003.

- (Y) Incorporated by reference to similarly numbered exhibit to the Registrant's Form S-8 Registration Statement filed

with the
Commission on
November 4, 2005
(File
No. 333-129489).

(Z) Incorporated by
reference to
similarly
numbered exhibit
to the Registrant's
Form 10-K
Annual Report for
Fiscal Year Ended
July 1, 2005 filed
with the
Commission on
October 4, 2005.

(AA) Incorporated by
reference to
similarly
numbered exhibit
to the Registrant's
Form 10-K
Annual Report for
Fiscal Year Ended
June 30, 2006
filed with the
Commission on
September 19,
2006.

(AB) Incorporated by
reference to
similarly
numbered exhibit
to the Registrant's
Form 10-K
Annual Report for
Fiscal Year Ended
June 29, 2007
filed with the
Commission on
September 27,
2007.

(AC) Incorporated by
reference to the
exhibit to the
Registrant's Form

8-K Current
Report dated
April 2, 2008 filed
with the
Commission on
April 4, 2008.

(AD) Incorporated by
reference to the
exhibit to the
Registrant's Form
8-K Current
Report dated
February 2, 2009
filed with the
Commission on
February 6, 2009.

(AE) Incorporated by
reference to the
exhibit to the
Registrant's Form
8-K Current
Report dated
May 6, 2009 filed
with the
Commission on
May 11, 2009.

SIGNATURES

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

VERSAR, INC.
(Registrant)

Date: September 21, 2009

/S/ Paul J. Hooper
Paul J. Hooper
Chairman and Director

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

| SIGNATURES | TITLE | DATE |
|--|--|--------------------|
| /S/ Paul J. Hooper Paul J. Hooper | Chairman and Director | September 21, 2009 |
| /S/ Theodore M. Procriv Theodore M. Procriv | Chief Executive Officer, President, and Director | September 21, 2009 |
| /S/ Lawrence W. Sinnott Lawrence W. Sinnott | Executive Vice President, Chief Operating Officer, Chief Financial Officer, Treasurer, and Principal Accounting Officer | September 21, 2009 |
| /S/ Michael Markels, Jr. Michael Markels, Jr. | Chairman Emeritus and Director | September 21, 2009 |
| /S/ Robert L. Durfee Robert L. Durfee | Director | September 21, 2009 |
| /S/ James L. Gallagher James L. Gallagher | Director | September 21, 2009 |

| SIGNATURES | TITLE | DATE |
|--|----------|--------------------|
| /S/ James V. Hansen James V. Hansen | Director | September 21, 2009 |
| /S/ Amoretta M. Hoeber Amoretta M. Hoeber | Director | September 21, 2009 |
| /S/ Amir A. Metry Amir A. Metry | Director | September 21, 2009 |
| /S/ Anthony L. Otton Anthony L. Otton | Director | September 21, 2009 |

Report of Independent Registered Public Accounting Firm

Board of Directors and
Shareholders of Versar, Inc.

We have audited the accompanying consolidated balance sheets of Versar, Inc. (a Delaware corporation) and subsidiaries as of June 26, 2009 and June 27, 2008, and the related consolidated statements of income, stockholders equity, and cash flows for each of the three years in the period ended June 26, 2009. Our audits of the basic financial statements included the financial statement schedule listed in the index appearing under Item 15(2)(a). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Versar, Inc. as of June 26, 2009 and June 27, 2008 and the results of their operations and their cash flows for each of the three years in the period ended June 26, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

/S/ Grant Thornton LLP

McLean, Virginia

September 21, 2009

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VERSAR, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(In Thousands, except per share amounts)

| | June 26, 2009 | June 27, 2008 |
|--|------------------|------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 8,400 | \$ 11,938 |
| Accounts receivable, net | 27,695 | 21,596 |
| Prepaid expenses and other current assets | 1,207 | 1,080 |
| Deferred income taxes | 720 | 1,015 |
| Total current assets | 38,022 | 35,629 |
| Property and equipment, net | | |
| Deferred income taxes | 2,348 | 2,152 |
| Goodwill | 765 | 517 |
| Other assets | 776 | 776 |
| | 683 | 754 |
| Total assets | \$ 42,594 | \$ 39,828 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities | | |
| Accounts payable | \$ 7,405 | \$ 7,731 |
| Billings in excess of revenue | | 156 |
| Accrued salaries and vacation | 1,959 | 1,719 |
| Accrued bonus | 1,358 | 2,066 |
| Other liabilities | 1,787 | 1,686 |
| Total current liabilities | 12,509 | 13,358 |
| Other long-term liabilities | 1,431 | 1,417 |
| Total liabilities | 13,940 | 14,775 |
| Commitments and contingencies | | |
| Stockholders equity | | |
| Common stock, \$.01 par value; 30,000,000 shares authorized; 9,193,635 shares and 9,059,135 shares issued; 9,074,300 shares and 8,975,101 shares outstanding | 92 | 91 |
| Capital in excess of par value | 27,734 | 27,115 |
| Retained earnings (accumulated deficit) | 1,615 | (1,554) |
| Treasury stock, at cost (119,335 and 84,034 shares, respectively) | (706) | (578) |
| Accumulated other comprehensive loss | (81) | (21) |
| Total stockholders equity | 28,654 | 25,053 |

| | | |
|--|-----------|-----------|
| Total liabilities and stockholders' equity | \$ 42,594 | \$ 39,828 |
|--|-----------|-----------|

The accompanying notes are an integral part of these consolidated financial statements.
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VERSAR, INC. AND SUBSIDIARIES
Consolidated Statements of Income
(In thousands, except per share amounts)

| | Years Ended | | |
|--|------------------|------------------|------------------|
| | June 26, 2009 | June 27, 2008 | June 29, 2007 |
| GROSS REVENUE | \$ 112,196 | \$ 115,602 | \$ 102,726 |
| Purchased services and materials, at cost | 60,583 | 68,507 | 62,750 |
| Direct costs of services and overhead | 37,133 | 33,307 | 29,154 |
| GROSS PROFIT | 14,480 | 13,788 | 10,822 |
| Selling, general and administrative expenses | 8,876 | 8,297 | 6,669 |
| OPERATING INCOME | 5,604 | 5,491 | 4,153 |
| OTHER EXPENSE | | | |
| Loss on marketable securities | 328 | | |
| Interest expense (income) | 36 | (173) | (24) |
| INCOME BEFORE INCOME TAXES | 5,240 | 5,664 | 4,177 |
| Income tax expense (benefit) | 2,071 | 2,273 | (1,105) |
| NET INCOME | \$ 3,169 | \$ 3,391 | \$ 5,282 |
| NET INCOME PER SHARE BASIC | \$ 0.35 | \$ 0.38 | \$ 0.64 |
| NET INCOME PER SHARE DILUTED | \$ 0.35 | \$ 0.36 | \$ 0.62 |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING BASIC | 9,123 | 8,932 | 8,201 |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING DILUTED | 9,150 | 9,331 | 8,466 |

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

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VERSAR, INC.
Consolidated Statements of Changes in Stockholders Equity
(In thousands)

Years Ended June 26, 2009, June 27, 2008, and June 29, 2007

| | Common Stock | | Capital in | (Accumu- Lated Deficit) | Treasury | | Accumu- lated Other | Total |
|--|--------------|--------|---------------------------|-------------------------------|----------|---------|--|-----------------------------|
| | Shares | Amount | Excess of Par Value | Retained Earnings | Shares | Stock | Compre- hensive Income (Loss) | Stock- holders Equity |
| Balance, July 1, 2006 | 8,145 | \$ 81 | \$ 22,790 | \$ (10,227) | (16) | \$ (72) | \$ | \$ 12,572 |
| Exercise of stock options | 231 | 2 | 713 | | | | | 715 |
| Issuance of restricted stock | 21 | 1 | 84 | | | | | 85 |
| Exercise of stock warrants | 180 | 2 | 717 | | | | | 719 |
| Stock exchange | 129 | 1 | 327 | | | | | 328 |
| Treasury stock | | | | | (38) | (327) | | (327) |
| Share-based compensation | | | 48 | | | | | 48 |
| Net income | | | | 5,282 | | | | 5,282 |
| Balance, June 29, 2007 | 8,706 | 87 | 24,679 | (4,945) | (54) | (399) | | 19,422 |
| Exercise of stock options | 275 | 3 | 1,052 | | | | | 1,055 |
| Issuance of restricted stock | 78 | 1 | 507 | | | | | 508 |
| Treasury stock | | | | | (30) | (179) | | (179) |
| Share-based compensation | | | 303 | | | | | 303 |
| Tax benefit from exercise of stock options | | | 574 | | | | | 574 |
| Comprehensive Income | | | | | | | | |
| Net income | | | | 3,391 | | | | 3,391 |
| Other Comprehensive | | | | | | | (21) | (21) |

| | | | | | | | | | |
|--|-------|-------|-----------|----------|-------|----------|---------|--|-----------|
| Income | | | | | | | | | |
| Foreign currency translations Adjustments | | | | | | | | | |
| Total Comprehensive Income | | | | | | | | | 3,370 |
| Balance, June 27, 2008 | 9,059 | 91 | 27,115 | (1,554) | (84) | (578) | (21) | | 25,053 |
| Exercise of stock options | 26 | | 48 | | | | | | 48 |
| Issuance of restricted stock | 109 | 1 | 691 | | | | | | 692 |
| Treasury stock | | | | | (35) | (128) | | | (128) |
| Tax shortfall in exercise of stock options | | | (120) | | | | | | (120) |
| Comprehensive Income | | | | | | | | | |
| Net income | | | | 3,169 | | | | | 3,169 |
| Other comprehensive income | | | | | | | | | |
| Foreign currency translations Adjustments | | | | | | | (60) | | (60) |
| Total Comprehensive Income | | | | | | | | | 3,109 |
| Balance, June 26, 2009 | 9,194 | \$ 92 | \$ 27,734 | \$ 1,615 | (119) | \$ (706) | \$ (81) | | \$ 28,654 |

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

VERSAR, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(In thousands)

| | June 26, 2009 | Years Ended June 27, 2008 | June 29, 2007 |
|---|------------------|---------------------------------|------------------|
| Cash flows from operating activities | | | |
| Net income | \$ 3,169 | \$ 3,391 | \$ 5,282 |
| Adjustments to reconcile net income to net cash (used in) provided by continuing operations | | | |
| Depreciation and amortization | 958 | 876 | 687 |
| Loss on sale of property and equipment | 1 | | 19 |
| Provision for doubtful accounts receivable | 155 | 1 | 336 |
| Loss on marketable securities | 328 | | |
| Loss (gain) on life insurance policy cash surrender value | 116 | 29 | (39) |
| Deferred tax (benefit) expense | (114) | 1,952 | (1,200) |
| Share-based compensation | 692 | 811 | 132 |
| Tax benefits on share-based compensation | | (574) | |
| Changes in assets and liabilities | | | |
| (Increase) decrease in accounts receivable | (6,256) | 909 | (6,616) |
| (Increase) decrease in prepaid expenses and other assets | 60 | 199 | 187 |
| (Decrease) increase in accounts payable | (260) | (2,723) | 4,504 |
| Increase in accrued salaries and vacation | 240 | 115 | 130 |
| (Decrease) increase in other liabilities | (823) | (12) | 2,320 |
| Net cash (used in) provided by continuing operations | (1,734) | 4,974 | 5,742 |
| Changes in net assets/liabilities of discontinued operations | | | (285) |
| Net cash (used in) provided by operating activities | (1,734) | 4,974 | 5,457 |
| Cash flows from investing activities | | | |
| Purchase of property and equipment | (1,172) | (722) | (693) |
| Purchase of marketable securities | (3,000) | | |
| Proceeds from sale of marketable securities | 2,672 | | |
| Premium paid on life insurance policies | (38) | (39) | (43) |
| Short term financing loan | (200) | | |
| Net cash used in investing activities | (1,538) | (761) | (736) |
| Cash flows from financing activities | | | |
| Purchase of treasury stock | (128) | (179) | (327) |
| Proceeds from exercise of options and warrants | 48 | 1,055 | 1,762 |
| Tax benefit on exercise of share-based compensation | | 574 | |

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| | | | |
|--|----------|-----------|----------|
| Net cash (used in) provided by financing activities | (280) | 1,450 | 1,435 |
| Effect of exchange rate changes | 14 | (21) | |
| Net (decrease) increase in cash and cash equivalents | (3,538) | 5,642 | 6,156 |
| Cash and cash equivalents at the beginning of the year | 11,938 | 6,296 | 140 |
| Cash and cash equivalents at the end of the year | \$ 8,400 | \$ 11,938 | \$ 6,296 |
| Supplementary disclosure of cash flow information: | | | |
| Cash paid during the period for | | | |
| Interest | \$ 60 | \$ 57 | \$ 70 |
| Income Taxes | \$ 1,762 | \$ 199 | \$ 55 |

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

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VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE A SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation and business operations: Versar, Inc., a Delaware corporation organized in 1969 (the Company or Versar), is a project and program management firm that provides the government, municipalities, and the private sector with value-added, high quality innovative solutions for infrastructure, facilities management, construction, environmental quality, professional services, defense and homeland security needs. Versar operates in four primary business segments: (1) Program Management, (2) Compliance and Environmental Programs, (3) Professional Services, and (4) National Security. The accompanying consolidated financial statements include the accounts of Versar, Inc. and its wholly-owned subsidiaries (Versar or the Company). All significant intercompany balances and transactions have been eliminated in consolidation. The Company's major business segments are Program Management, Compliance and Environmental Programs, Professional Services, and National Security (see Note B). The Company has evaluated subsequent events through September 21, 2009, the date in which the financial statements were issued.

Accounting estimates: The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Contract accounting: Contracts in process are stated at the lower of actual cost incurred plus accrued profits or incurred costs reduced by progress billings. The Company records income from major fixed-price contracts, extending over more than one accounting period, using the percentage-of-completion method. During performance of such contracts, estimated final contract prices and costs are periodically reviewed and revisions are made as required. The effects of these revisions are included in the periods in which the revisions are made. On cost-plus-fee type contracts, revenue is recognized to the extent of costs incurred plus a proportionate amount of fee earned, and on time-and-material contracts, revenue is recognized to the extent of billable rates times hours delivered plus material and other reimbursable costs incurred. Losses on contracts are recognized when they become known. Disputes arise in the normal course of the Company's business on projects where the Company is contesting with customers for collection of funds because of events such as delays, changes in contract specifications and questions of cost allowability or collectibility. Such disputes, whether claims or unapproved change orders in the process of negotiation, are recorded at the lesser of their estimated net realized value or actual costs incurred and only when realization is probable and can be reliably estimated. Claims against the Company are recognized where loss is considered probable and reasonably determinable in amount. Management reviews outstanding receivables on a regular basis and assesses the need for reserves taking into consideration past collection history and other events that bear on the collectibility of such receivables.

Pre-contract costs: Costs incurred by Versar prior to the execution of a contract, including bid and proposal costs, are expensed when incurred regardless of whether the bid is successful.

Depreciation and amortization: Property and equipment are carried at cost. Depreciation and amortization are computed on a straight-line basis over the estimated useful lives of the assets. Assets are evaluated in accordance with SFAS 144 Accounting for Impairment or Disposal of Long Lived Assets and written down to fair value when appropriate.

Goodwill and other intangible assets: The carrying value of goodwill is approximately \$776,000 which relates to the acquisition of Versar Global Solutions, Inc., which is now part of the Program Management business segment. In performing its goodwill impairment analysis, management has utilized a market-based valuation approach to determine the estimated fair value of the Program Management business segment. Management engages outside professionals and valuation experts annually, to assist in performing this analysis and would test more often if events or circumstances warrant it. The Company has elected to perform the annual goodwill impairment review on June 30 of each year. An analysis was performed on public companies and company transactions to prepare a market-based valuation. Based upon the analysis, the estimated fair value of the Program Management business segment exceeds

the carrying value of the net assets of \$12.7 million. Therefore, management concluded that the goodwill was not impaired.

Direct costs of services and overhead: These expenses represent the cost to Versar of direct and overhead staff, including recoverable overhead costs and unallowable costs that are directly attributable to contracts performed by the Company.

Notes receivable: Include short term receivables made in order to accelerate and advance the Company's business and business opportunities.

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VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Income taxes: The Company recognizes deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of certain assets and liabilities. A valuation allowance is established, as necessary, to reduce deferred income tax assets to the amount expected to be realized in future periods.

Asset retirement obligation: During fiscal year 2007, the Company recorded an asset retirement obligation associated with the estimated clean-up costs for its chemical laboratory in its National Security business segment. In accordance with SFAS 143, the Company estimated the costs to clean up the laboratory and return it to its original state at a present value of approximately \$497,000. The Company currently estimates the amortization and accretion expense to be between \$180,000 to \$190,000 per year over the next 1^{1/2} years. The Company is currently pursuing reimbursement for such costs and other costs from the U.S. Army as a significant portion of the chemical agent that was used in the chemical laboratory was government owned. If the Company determines that the estimated clean up cost is larger than expected or the likelihood of recovery from the U.S. Army is remote, such adjustments will be reflected when they become known in accordance with SFAS 143. At June 26, 2009, the Company has accrued approximately \$586,000 long-term liability to clean up the chemical laboratory.

Share-based compensation: The Company records share based compensation in accordance with Financial Accounting Standards Board (FASB) SFAS No. 123 (Revised 2004), Share-Based Payment (SFAS 123(R)). This statement requires companies to recognize the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards (the fair-value-based method).

As of June 26, 2009, options to purchase common stock under the plans were substantially vested except for options to purchase 10,000 shares of common stock, which will vest based on the achievement of market and service conditions.

The Company did not record share-based compensation expense related to the vesting of the previously granted stock options in its fiscal year 2009. The Company recorded approximately \$4,000 and \$18,000 of share-based compensation expenses for fiscal years 2008 and 2007, respectively.

The Company awarded 125,000 shares, 121,500 shares and 42,000 shares of restricted stock to directors and employees in fiscal years 2009, 2008 and 2007, respectively. Share-based compensation expense related to restricted stock for fiscal years 2009, 2008 and 2007 was approximately \$692,000, \$807,000 and \$114,000, respectively.

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 equivalent shares outstanding during the period, if dilutive. The Company's common equivalent shares consist of shares to be issued under outstanding stock options and shares of unvested restricted stock.

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The following is a reconciliation of weighted average outstanding shares for purposes of calculating basic net income per share compared to diluted net income per share, in thousands:

| | June 26, 2009 | Years Ended June 27, 2008 (In thousands) | June 29, 2007 |
|---|------------------|---|------------------|
| Weighted average number of shares outstanding basic | 9,123 | 8,932 | 8,201 |
| Effect of assumed exercise of stock options and vesting of restricted stock | 27 | 399 | 265 |
| Weighted average number of shares outstanding diluted | 9,150 | 9,331 | 8,466 |

For fiscal years 2009, 2008 and 2007, options to purchase approximately 169,000, 10,000 and 30,000 shares, respectively, were not included in the computation of diluted earnings per share because the effect would be anti-dilutive.

Deferred compensation: The Company permitted certain employees to defer a portion of their compensation, during fiscal years 1988 through 1991, to provide for future annual payments, including interest. Interest is accrued on a monthly basis at the amount stated in each employee's agreement. The Company had liabilities for deferred compensation of \$604,000 and \$636,000 at June 26, 2009 and June 27, 2008, respectively, which are included in other long-term liabilities on the accompanying consolidated balance sheets. Versar purchased key-man life insurance policies to fund the amounts due under the deferred compensation agreements. The cash surrender value of the policies was \$487,000 and \$566,000 at June 26, 2009 and June 27, 2008, respectively. The face value of the life insurance policies is in excess of the deferred compensation liability.

Cash and cash equivalents: All investments with an original maturity of three months or less when purchased are considered to be cash equivalents.

Foreign Currency Translation: The financial position and results of operations of the Company's foreign affiliates are translated using the local currency as the functional currency. Assets and liabilities of the affiliates are translated at the exchange rate in effect at year-end. Income statement accounts are translated at the average rate of exchange prevailing during the year. Translation adjustments arising from the use of differing exchange rates from period to period are included in accumulated other comprehensive income in stockholders' equity. Gains and losses resulting from foreign currency transactions included in operations are not material for the periods presented. At June 26, 2009, the Company has approximately \$540,000 of cash held in foreign banks.

Fair value of financial instruments: The carrying amounts of Versar's cash and cash equivalents, accounts receivable, accounts payable and amounts included in other current assets and current liabilities that meet the definition of a financial instrument approximate fair value because of the short-term nature of these amounts.

Classification: Certain prior year information has been reclassified to conform to current year presentation.

New accounting pronouncements: In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), *Business Combinations* (SFAS 141(R)). SFAS 141(R) changes the requirements for an acquiring entity's recognition and measurement of the assets acquired and liabilities assumed in a business combination. This statement is effective for fiscal years beginning after December 15, 2008. This standard will have an impact on accounting for business combinations but the effect is dependent upon acquisitions at that time.

VERSAR, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

In April 2009, the FASB issued FSP FAS 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies, (FSP FAS 141(R)-1). The FSP FAS 141(R)-1 amends and clarifies Statement of Financial Accounting Standards (SFAS) No. 141 (revised 2007), Business Combinations. FSP FAS 141(R)-1 is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. FSP FAS 141(R)-1 will have an impact on accounting for business combinations but the effect is dependent upon acquisitions at that time.

In September 2006, the Financial Accounting Standard Board (FASB) issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, FASB issued FASB Staff Position (FSP) No. FAS 157-2, *Effective Dates of FASB Statement No. 157*, which deferred the effective date of SFAS 157 for all nonrecurring fair value measurements of nonfinancial assets and liabilities until fiscal years beginning after November 15, 2008. Our adoption of SFAS 157 on December 29, 2008 was limited to financial assets and liabilities and had no impact on our consolidated financial statements. We do not believe this standard will have an effect on the non-financial assets and non-financial liabilities in our consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51* (SFAS 160). SFAS 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008. The Company does not believe the adoption of SFAS 160 will have a material impact on its consolidated financial statements.

In April 2008, the Financial Accounting Standards board issued FASB Staff Position (FSP) FAS 142-3, *Determination of the Useful Life of Intangible Assets*, to provide guidance for determining the useful life of recognized intangible assets and to improve consistency between the period of expected cash flows used to measure the fair value of a recognized intangible asset and the useful life of the intangible asset as determined under FASB Statement 142, *Goodwill and Other Intangible Assets*. The FSP requires that an entity consider its own historical experience in renewing or extending similar arrangements. However, the entity must adjust that experience based on entity-specific factors included in Statement 142. If the Company lacks historical experience to consider for similar arrangements, it would consider assumptions that market participants would use about renewal or extension, as adjusted for the entity-specific factors under Statement 142. The Company will adopt FSP FAS 142-3 in fiscal year 2010. The Company believes that upon adoption, FSP FAS 142-3 will not have an effect on the Company's financial statements.

In November 2008, the Financial Accounting Standards Board ratified a consensus opinion reached by the Emerging Issues Task Force (EITF) on EITF Issue 08-6, *Equity Method Investment Accounting Considerations*, to clarify accounting and impairment considerations involving equity method investments after the effective date of both FASB Statement 141 (revised 2007), *Business Combinations*, and FASB Statement 160, *Noncontrolling Interests in Consolidated Financial Statements*. EITF Issue 08-6 includes the Task Force's conclusions on how an equity method investor should (1) initially measure its equity method investment, (2) account for impairment charges recorded by its investee, and (3) account for shares issued by the investee. EITF Issue 08-6 is effective for fiscal years beginning on or after December 15, 2008. The Company adopted EITF Issue 08-6 effective June 26, 2009 on a prospective basis. The Company does not currently have any investments that are accounted for under the equity method, and as a result, does not expect the standard to have a significant effect on its financial statements.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events*, (SFAS No. 165). SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 is effective for interim and annual periods ending after June 15, 2009.

VERSAR, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards CodificationTM and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162, (SFAS No. 168). SFAS No. 168 establishes that the FASB Accounting Standards CodificationTM (Codification) will become the source for authoritative United States generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Effective for financial statements issued for interim and annual periods ending after September 15, 2009 the Codification will supersede all then-existing non-SEC accounting and reporting standards. Effective for the first quarter of 2010 references to legacy GAAP will be replaced by references to the Codification, where appropriate.

NOTE B BUSINESS SEGMENTS

The Company evaluates and measures the performance of its business segments based on gross revenue, gross profit and operating income. As such, selling, general and administrative expenses, interest and income taxes have not been allocated to the Company's business segments.

The Company's business is currently operated through four business segments as follows: Program Management, Compliance and Environmental Programs, Professional Services, and National Security.

These segments were segregated based on the nature of the work, business processes, customer base and the business environment in which each of the segments operates.

The Program Management business segment manages larger more complex projects with business processes and management unique to the rest of the Company. The Compliance and Environmental Programs business segment provides regulatory and environmental consulting support to several federal government and municipal agencies. The Professional Services business segment provides outsourced personnel to various government agencies providing our clients with cost-effective resources. The National Security business segment provides unique solutions to the federal government including testing and evaluation and personal protective solutions.

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Summary of financial information for each of the Company's segments follows:

| | June 26, 2009 | Years Ended June 27, 2008 | June 29, 2007 |
|--|------------------|---------------------------------|------------------|
| | (In thousands) | | |
| GROSS REVENUE | | | |
| Program Management | \$ 71,526 | \$ 68,896 | \$ 58,765 |
| Compliance and Environmental Programs | 19,649 | 30,429 | 29,839 |
| Professional Services | 11,476 | 8,101 | 7,318 |
| National Security | 9,545 | 8,176 | 6,804 |
| | \$ 112,196 | \$ 115,602 | \$ 102,726 |
| | | | |
| GROSS PROFIT (A) | | | |
| Program Management | \$ 10,467 | \$ 9,398 | \$ 7,037 |
| Compliance and Environmental Programs | 884 | 2,390 | 2,313 |
| Professional Services | 1,734 | 1,290 | 1,257 |
| National Security | 1,395 | 710 | 215 |
| | \$ 14,480 | \$ 13,788 | \$ 10,822 |
| Selling, general and administrative expenses | (8,876) | (8,297) | (6,669) |
| OPERATING INCOME | \$ 5,604 | \$ 5,491 | \$ 4,153 |

(A) Gross Profit is defined as gross revenue less purchased services and materials and direct costs of services and overhead.

| | Years Ended June 26, 2009 | June 27, 2008 |
|---------------------------------------|---------------------------------|------------------|
| | (In thousands) | |
| IDENTIFIABLE ASSETS | | |
| Program Management | \$ 19,531 | \$ 11,405 |
| Compliance and Environmental Programs | 5,910 | 8,762 |
| Professional Services | 2,561 | 1,554 |

| | | |
|---------------------|-----------|-----------|
| National Security | 2,447 | 2,693 |
| Corporate and Other | 12,145 | 15,414 |
| | | |
| Total Assets | \$ 42,594 | \$ 39,828 |

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VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE C CUSTOMER INFORMATION

A substantial portion of the Company's service revenue is derived from contracts with the U.S. Federal government as follows:

| | June 26, 2009 | Years Ended June 27, 2008 | June 29, 2007 |
|--------------------------------------|------------------|---------------------------------|------------------|
| | | (In Thousands) | |
| U.S. Department of Defense | \$ 92,583 | \$ 88,245 | \$ 65,997 |
| U.S. Environmental Protection Agency | 1,891 | 2,399 | 2,753 |
| Other U.S. Government Agencies | 2,576 | 3,657 | 16,512 |
| | | | |
| Total U.S. Federal Government | \$ 97,050 | \$ 94,301 | \$ 85,262 |

Majority of the Department of Defense works are to support the reconstruction of Iraq and Afghanistan with the U.S. Air Force and U.S. Army. Revenue was approximately \$63 million, \$62 million and \$40 million for fiscal years 2009, 2008 and 2007, respectively.

NOTE D NOTES RECEIVABLE

In June 2009, the company agreed to provide short term interim financing of \$400,000 to General Power Green Energy, LLC (GPC) to cover project start up costs. The project is to construct a green 25 mega watts co-generation plant by burning landfill gas in turbine engines equipped with a steam generation unit. The note carries an annual interest rate of 10 percent and is due by March 31, 2010 or earlier upon project financing. In addition, Versar will provide the program management and construct the facility. Versar also received a 7.5% ownership interest in connection with the loan. The Company has not valued the 7.5% ownership interest due to the fact that GPC is in its developmental stage. The fair value of the equity interest could not be determined at this time. Approximately, \$200,000 of the note was funded in late June 2009 and the balance in July 2009. The notes receivable is included in the June 26, 2009 balance sheet as part of the other current assets.

NOTE E ACCOUNTS RECEIVABLE

| | June 26, 2009 | Years Ended June 27, 2008 | |
|---------------------------------|------------------|---------------------------------|--|
| | | (In thousands) | |
| Billed receivables | | | |
| U.S. Government | \$ 9,516 | \$ 10,312 | |
| Commercial | 8,483 | 2,063 | |
| Unbilled receivables | | | |
| U.S. Government | 9,742 | 9,282 | |
| Commercial | 423 | 282 | |
| | | | |
| Allowance for doubtful accounts | 28,164 (469) | 21,939 (343) | |
| | \$ 27,695 | \$ 21,596 | |

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

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VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

receivables will be substantially billed and collected in fiscal year 2010, therefore, they have been presented as current assets in accordance with industry practice.

NOTE F PROPERTY AND EQUIPMENT

| | Estimated Useful Life in Years | Years Ended | |
|---|--|------------------|------------------|
| | | June 26, 2009 | June 27, 2008 |
| (In thousands) | | | |
| Furniture and fixtures | 10 | \$ 824 | \$ 827 |
| Equipment | 3 to 10 | 7,762 | 7,029 |
| Capital leases | Life of lease Shorter of lease term or asset | 568 | 568 |
| Leasehold improvements | life | 2,184 | 2,115 |
| | | 11,338 | 10,539 |
| Accumulated depreciation and amortization | | (8,990) | (8,387) |
| | | \$ 2,348 | \$ 2,152 |

Depreciation and amortization of property and equipment was \$958,000, \$876,000 and \$687,000 for the years ended June 26, 2009, June 27, 2008 and June 29, 2007, respectively.

Maintenance and repair expense approximated \$233,000, \$268,000 and \$251,000 for the years ended June 26, 2009, June 27, 2008 and June 29, 2007, respectively.

NOTE G MARKETABLE SECURITIES

During the first quarter of fiscal year 2009, the Company recorded a \$352,000 loss on marketable securities the Company was holding in the FISCO Income Plus Fund. The FISCO fund received an immediate demand margin call from its broker, UBS. Rather than allow the fund the customary time to satisfy the margin call at the end of the day, UBS demanded the fund cover all calls and puts at high premiums immediately or indicated it would take control and start liquidating the fund. The fund has terminated its relationship with UBS and transferred the assets to a new custodian. The fund has taken legal action against UBS to cover its losses. The Company will participate in any recovery from any such action. The Company has liquidated its remaining assets from marketable securities and moved them to cash with its primary bank due to the volatile nature of the market. During the remaining periods of fiscal year 2009, the Company recovered \$24,000 of the initial loss before the funds were liquidated from the FISCO fund. A loss on marketable securities of \$328,000 is reflected in the consolidated statement of income for the year ended June 26, 2009, as a result of the liquidation of the FISCO fund.

NOTE H DEBT

The Company has a line of credit facility with United Bank (the Bank) that provides for advances up to \$7.5 million based upon qualifying receivables. Interest on borrowings is based upon the prime rate of interest less 1/2%. Borrowing rates at June 26, 2009 and June 27, 2008 were 2.75% and 4.5%, respectively. The Company currently has a letter of credit of \$455,147, which serves as collateral for surety bond coverage provided by the Company's insurance carrier against project construction work. The letter of credit reduces the Company's borrowing base on the line of credit. The line of credit capacity at of June 26, 2009 was approximately \$7.0 million.

VERSAR, INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

Obligations under the credit facility are guaranteed by the Company and each subsidiary individually and collectively are secured by accounts receivable, equipment and intangibles, plus all insurance policies on property constituting collateral. The line of credit matures in November 2009. The Company is in the process of renewing the new credit facility with United Bank. The Company has obtained a commitment letter from United Bank to extend its line of credit to September 30, 2010. The line of credit is and will continue to be subject to certain covenants related to the maintenance of financial ratios. These covenants require a minimum tangible net worth of \$22.5 million; a maximum total liabilities to tangible net worth ratio not exceed 2.5 to 1; and a minimum current ratio of at least 1.25 to 1. Borrowings under the extended line of credit will be at prime less $\frac{1}{2}\%$ with a floor interest rate of 3.5%. Failure to meet the covenant requirements gives the Bank the right to demand outstanding amounts due under the line of credit, which may impact the Company's ability to finance its working capital requirements. As of June 26, 2009, the Company had no outstanding borrowings and was in compliance with the financial covenants.

NOTE I STOCK OPTIONS

In fiscal year 2009, the Company awarded 125,000 shares of restricted stock at a fair market value of approximately \$621,000 to executive officers, employees and directors. The awards vest over a period of 4.5 months to 16.5 months. Stock-based compensation expense relating to vested stock options and restricted stock awards totaled approximately \$692,000, \$811,000 and \$132,000 for fiscal years 2009, 2008 and 2007 and was included in the direct costs of services and overhead lines of the Consolidated Statements of Income. During fiscal year 2009, incentive stock options to purchase 6,000 shares of common stock and non-qualified stock options to purchase 20,000 shares of common stock with intrinsic value of approximately \$6,200 and \$42,000, respectively, were exercised. At June 26, 2009, there were approximately 39,000 shares of restricted stock valued at \$181,000 to be amortized over the next 12 months.

In November 2005, the stockholders approved the Versar, Inc. 2005 Stock Incentive Plan (the "2005 Plan"). The 2005 Plan provides for grants of incentive awards, including stock options, SARS, restricted stock, restricted stock units and performance based awards, to directors, officers and employees of the Company and its affiliates as approved from time to time by the Company's Compensation Committee. Only employees may receive stock options classified as incentive stock options, also known as ISO's. The per share exercise price for options and SARS granted under the 2005 Plan may not be less than the fair market value of the common stock on the date of grant. A maximum of 400,000 shares of common stock may be awarded under the 2005 Plan. No single director, officer, or employee may receive awards of more than 100,000 shares of common stock during the term of the 2005 Plan. The ability to make awards under the 2005 Plan will terminate in November 2015. As of June 26, 2009, approximately 90,000 shares are available for future grant under the 2005 Plan.

The Company also maintains the Versar 2002 Stock Incentive Plan (the "2002 Plan"), the Versar 1996 Stock Option Plan (the "1996 Plan") and the Versar 1992 Stock Option Plan (the "1992 Plan").

Under the 2002 Plan, restricted stock and other types of stock-based awards were granted to any employee, service provider or director to whom a grant was approved from time to time by the Company's Compensation Committee. A service provider is defined for purposes of the 2002 Plan as an individual who is neither an employee nor a director of the Company or any of its affiliates but who provides the Company or one of its affiliates substantial and important services. As of June 26, 2009, there were vested stock options to purchase 282,970 shares of common stock outstanding under the 2002 Plan.

Under the 1996 Plan, options were granted to key employees, directors and service providers at the fair market value on the date of grant. Each option expires on the earlier of the last day of the tenth year after the date of grant or after expiration of a period designated in the option agreement. The 1996 Plan has expired and no additional options may be granted under this plan. The Company will continue to maintain the plan until all previously granted options have been exercised, forfeited or expire. As of June 26, 2009, there were vested stock options to purchase 153,761 shares of common stock outstanding under the 1996 Plan.

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Under the 1992 Plan, options were granted to key employees at the fair market value on the date of grant and became exercisable during the five-year period from the date of the grant at 20% per year. Options were granted with a ten year term and expire if not exercised by the tenth anniversary of the grant date. The 1992 Plan has expired and no additional options may be granted under this plan. The Company will continue to maintain the plan until all previously granted options have been exercised, forfeited or expire. As of June 26, 2009, there were vested stock options to purchase 83,500 shares of common stock outstanding under the 1992 Plan.

Total incentive stock options granted under the 2002, 1996, and 1992 Plans are as follows:

| | Optioned Shares | Weighted- Average Option Price Per Share | Total |
|-------------------------------|--|--|----------|
| | (In thousands, except per share price) | | |
| Outstanding at June 30, 2006 | 1,026 | \$ 3.13 | \$ 3,210 |
| Exercised | (332) | 2.87 | (952) |
| Cancelled | (27) | 3.72 | (99) |
| Reclassified to non-qualified | (12) | 3.50 | (42) |
| | | | |
| Outstanding at June 29, 2007 | 656 | \$ 3.23 | \$ 2,117 |
| Exercised | (219) | 3.58 | (784) |
| Cancelled | (7) | 4.10 | (27) |
| | | | |
| Outstanding at June 27, 2008 | 430 | \$ 3.03 | \$ 1,306 |
| Exercised | (6) | 2.19 | (13) |
| Cancelled | (3) | 3.45 | (10) |
| | | | |
| Outstanding at June 26, 2009 | 421 | \$ 3.05 | \$ 1,283 |

Details of total exercisable incentive stock options at June 26, 2009 are as follows:

| Number of Shares Underlying Options | Range of Option Price | Weighted- Average Option Price (In thousands, except as noted) | Weighted- Average Remaining Life | Number of Shares Underlying Exercisable Options |
|---|--------------------------|---|---|---|
| 261 | \$1.81 to \$2.80 | 2.50 | 2.7-years | 261 |
| 113 | \$3.40 to \$3.82 | 3.73 | 5.1-years | 113 |

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| | | | | | |
|-----|---------------------|----|------|-----------|-----|
| 47 | \$4.00 to \$4.95 | | 4.38 | 5.5-years | 47 |
| 421 | | \$ | 3.05 | 3.9-years | 421 |

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VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Aggregate intrinsic value for all shares under the incentive stock option plan at June 26, 2009 is approximately \$483,000.

Total non-qualified stock options granted under the 2002, 1996, and 1992 plans as follows:

| | Optioned Shares (In thousands, except per share price) | Weighted- Average Option Price Per Share | Total |
|------------------------------|--|--|--------|
| Outstanding at June 30, 2006 | 203 | \$ 3.24 | \$ 659 |
| Exercised | (29) | 3.16 | (92) |
| Cancelled | (14) | 2.77 | (37) |
| Reinstated | 10 | 3.49 | 33 |
| Reclassified from ISO | 12 | 3.50 | 42 |
| | | | |
| Outstanding at June 29, 2007 | 182 | \$ 3.32 | \$ 605 |
| Granted | 10 | 7.77 | 78 |
| Exercised | (51) | 4.87 | (248) |
| | | | |
| Outstanding at June 27, 2008 | 141 | \$ 3.07 | \$ 435 |
| Exercised | (20) | \$ 1.75 | (35) |
| | | | |
| Outstanding at June 26, 2009 | 121 | \$ 3.31 | \$ 400 |

Details of total exercisable Non-Qualified Stock Options at June 26, 2009 are as follows:

| Number of Shares Underlying Options | Range of Option Price (In thousands, except as noted) | Weighted- Average Option Price | Weighted- Average Remaining Life | Number of Shares Underlying Exercisable Options |
|--|---|--------------------------------------|---|---|
| 55 | \$ 1.81 to \$2.80 | 1.91 | 3.5-years | 55 |
| 27 | \$ 3.10 to \$3.65 | 3.35 | 3.4-years | 27 |
| 29 | \$ 4.14 to \$4.58 | 4.35 | 5.5-years | 29 |
| 10 | \$7.77 | 7.77 | 8.4-years | |
| 121 | | \$ 3.31 | 4.3-years | 111 |

No stock options have been granted under the 2005 plan. Since its adoption, the Company has moved to granting restricted stock and restricted stock units in lieu of stock options.

The Company recorded share-based compensation expense related to the vesting of the previously granted stock options in its consolidated financial statements of approximately \$4,000 and \$18,000 for fiscal years 2008 and 2007, respectively. The Company did not record any share-based compensation expenses related to the vesting of previously granted stock options in fiscal year 2009. Had the remaining unvested options to purchase 10,000 shares of common stock vested in fiscal year 2009, the Company would have recorded approximately \$42,000 share based compensation expense. The aggregate intrinsic value for all shares under the non-qualified plan at June 26, 2009 is

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VERSAR, INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

approximately \$109,000. Aggregate intrinsic value for vested shares under the non-qualified plan at June 26, 2009 is approximately \$145,000.

NOTE J INCOME TAXES

The income tax expense (benefit) applicable to income from continuing operations consists of the following:

| | June 26, 2009 | Years Ended | |
|---------------------|---------------------|------------------|------------------|
| | | June 27, 2008 | June 29, 2007 |
| | | (In thousands) | |
| Current | | | |
| Federal | \$ 1,945 | \$ 274 | \$ 85 |
| State | 198 | 47 | 10 |
| Foreign | 42 | | |
| Deferred | | | |
| Federal | (225) | 1,528 | 1,404 |
| State | 115 | 421 | 350 |
| Foreign | (4) | 3 | |
| Valuation Allowance | | | (2,954) |
| | \$ 2,071 | \$ 2,273 | \$ (1,105) |

Deferred tax assets are comprised of the following (in thousands):

| | June 26, 2009 | June 27, 2008 |
|---------------------------------|------------------|------------------|
| Deferred Tax Assets: | | |
| Employee benefits | \$ 299 | \$ 295 |
| Bad debt reserves | 173 | 130 |
| All other reserves | 296 | 275 |
| Alternative minimum tax credits | | 134 |
| Net operating losses | 86 | 196 |
| State tax net operating losses | | 112 |
| Depreciation | 335 | 432 |
| Accrued expenses | 461 | 242 |
| Other | 202 | 132 |
| Total Deferred Tax Assets | 1,852 | 1,948 |
| Valuation Allowance | (48) | (47) |
| Deferred Tax Liabilities: | | |
| Goodwill | (189) | (177) |

| | | |
|-----------------------------|----------|----------|
| Asset retirement obligation | (79) | (189) |
| Foreign | (51) | (3) |
| Net Deferred Tax Assets | \$ 1,485 | \$ 1,532 |

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VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Given the Company's history of earnings and improved projected pre-tax income for future periods, management concluded in fiscal year 2007 that it was more likely than not the U.S. deferred tax assets will be realized in future periods. As such, the valuation allowance was no longer necessary on the U.S. deferred tax assets and was reversed in fiscal year 2007. As of the end of fiscal years 2009 and 2008, the Company had a valuation allowance of approximately \$48,000 and \$47,000, respectively, related to deferred tax assets in certain foreign jurisdictions as it is not more likely than not that the deferred tax assets will be realized. The Company has established a valuation allowance on its Philippine operations as it is not more likely than not that the deferred tax assets will be realized for these operations in future periods as current projections indicate periods of pre-tax loss.

At June 26, 2009, the Company has net operating loss carryforwards of approximately \$103,000 for federal income tax purposes, which will expire in the years 2010 through 2012.

In accordance with FASB Financial Interpretation No. 48 Accounting for Uncertainty in Income Taxes, the Company recognizes income tax benefits in its financial statements only when it is more likely than not that the tax positions creating those benefits will be sustained by the taxing authorities based on the technical merits of those tax positions. At June 26, 2009, the Company did not have any uncertain tax positions. The Company still has the 2008, 2007 and 2006 tax years open to audit in most jurisdictions.

The Company recognizes interest expense and penalties as a component of general and administrative expense.

A reconciliation of the Company's income tax expense (benefit) to the federal statutory rate is as follows:

| | June 26, 2009 | Years Ended June 27, 2008 | June 29, 2007 |
|--|---------------------|---------------------------------|------------------|
| | | (In thousands) | |
| Expected provision at federal statutory rate | \$ 1,782 | \$ 1,923 | \$ 1,447 |
| Change in valuation allowance | 1 | 47 | (2,954) |
| State income tax expense | 204 | 221 | 183 |
| Permanent items | 35 | 27 | 40 |
| Change in tax rates | 42 | | |
| NOL adjustments and other | 7 | 55 | 179 |
| | \$ 2,071 | \$ 2,273 | \$ (1,105) |

Income taxes paid for the years ended June 26, 2009, June 27, 2008 and June 29, 2007 were \$1,762,000, \$199,000 and \$55,000, respectively.

NOTE K EMPLOYEE SAVINGS AND STOCK OWNERSHIP PLAN

The Company continues to maintain a 401(k) Plan, which permits voluntary participation upon employment. The 401(k) Plan was adopted in accordance with Section 401(k) of the Internal Revenue Code.

Under the 401(k) Plan, participants may elect to defer up to 50% of their salary through contributions to the plan, which are invested in selected mutual funds or used to buy insurance. The Company matches 100% of the first 3% and 50% of the next 2% of the employee qualified contributions for a total match of 4%. The employer contribution may be made in the Company's stock or cash. In fiscal years 2009, 2008 and 2007, the Company made cash contributions of \$828,000, \$729,000 and \$649,000, respectively. All contributions to the 401(k) Plan vest immediately.

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

In January 2005, the Company established an Employee Stock Purchase Plan (ESPP) under Section 423 of the United States Internal Revenue Code. The ESPP allows eligible employees of the Company and its designated affiliates to purchase, through payroll deductions, shares of common stock of the Company from the open market.

The Company will not reserve shares of authorized but unissued common stock for issuance under the ESPP. Instead, a designated broker will purchase shares for participants on the open market. Eligible employees may purchase the shares at a discounted rate equal to 95% of the closing price of the Company's shares on the NYSE AMEX on the purchase date.

GEOMET, a wholly-owned subsidiary of Versar, maintained a profit-sharing retirement plan for the benefit of its employees until January 2008. Under the plan, contributions were made at the discretion of GEOMET's Board of Directors. No contributions have been made to this plan since fiscal year 1998. Vesting occurred over time, such that an employee is 100% vested after seven years of participation. In January 2008, the GEOMET profit sharing plan was terminated and merged into the Company's 401(k) plan.

NOTE L COMMITMENTS AND CONTINGENCIES

Versar has a substantial number of U.S. Government contracts, and certain of these contracts are cost reimbursable. Costs incurred on these contracts are subject to audit by the Defense Contract Audit Agency (DCAA). All fiscal years through 2006 have been audited and closed. Management believes that the effect of disallowed costs, if any, for the periods not yet audited and settled with DCAA will not have a material adverse effect on the Company's consolidated financial position and results of operations.

The Company leases approximately 145,000 square feet of office space, as well as data processing and other equipment under agreements expiring through 2020. Minimum future obligations under operating and capital leases are as follows:

| Years Ending June 30, | Total Amount (In thousands) |
|-----------------------|--------------------------------------|
| 2010 | \$ 2,777 |
| 2011 | 2,129 |
| 2012 | 1,937 |
| 2013 | 1,955 |
| 2014 | 1,633 |
| 2015 and thereafter | 2,354 |
| | \$ 12,785 |

Certain of the lease payments are subject to adjustment for increases in utility costs and real estate taxes. Total office rental expense approximated \$2,845,000, \$2,513,000 and \$2,111,000, for 2009, 2008 and 2007, respectively. Lease concessions and other tenant allowances are amortized over the life of the lease on a straight line basis. For leases with fixed rent escalations, the total lease costs including the fixed rent escalations are totaled and the total rent cost is recognized on a straight line basis over the life of the lease.

On February 8, 2005, Versar, Inc. entered into an employment agreement with its Chief Executive Officer (CEO), Mr. Theodore M. Prociv. The agreement provides for base compensation of \$285,000 and certain benefits that the CEO is entitled to under various termination conditions. The agreement was originally scheduled to expire on December 1, 2006 and was extended to December 1, 2007 in September 2006 and to December 1, 2008 in

VERSAR, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

September 2007. On September 3, 2008, the Compensation Committee extended Mr. Prociv's agreement for an additional year to December 1, 2009 and approved base salary of \$355,000 for the year extension.

On February 2, 2009, Versar, Inc. entered into an employment agreement with Charles S. Cox, a Senior Vice President and head of the Company's international operations effective as of January 3, 2009. The agreement has a term of one year from its effective date and provides for base compensation of \$390,000, which includes a base salary and certain additions for overseas service.

Legal Proceedings

Versar and its subsidiaries are parties from time to time to various 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.

NOTE M SUBSEQUENT EVENTS

Subsequent to the end of fiscal year 2009, the Company agreed to provide \$750,000 of short term financing to Lemko Corporation to enable them to buy long lead telecommunication equipment for several upcoming projects. Lemko and Versar had earlier announced a joint initiative to pursue the rural broadband telecommunications market. The note bears an annual interest rate of 12% and is due by May 31, 2010. The note is secured by the equipment inventory. The note also has a conversion feature to a senior convertible debenture, which must be addressed by October 2009, or the remaining terms and conditions will remain in effect. The Company is currently evaluating this feature.

In fiscal year 2009, the Company announced that its international subsidiary, VIAP, Inc. entered into a joint venture with Technical Resources International Limited (TRIL) to create a business venture to provide project and program management to private entities in the United Arab Emirates and other Gulf Cooperation Countries. The new Company, VIAP Technical Resources, LTD will be 50% owned by VIAP and 50% by TRIL. The joint venture did not have any assets or operations as of year end. The Company will assess the accounting and reporting requirements for this joint venture under SFAS 160.

VERSAR, INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)****NOTE N QUARTERLY FINANCIAL INFORMATION (UNAUDITED)**

Unaudited quarterly financial information for fiscal years 2009 and 2008 is as follows (in thousands, except per share amounts):

| Quarter Ending | Fiscal Year 2009 | | | | Fiscal Year 2008 | | | |
|---|------------------|-----------|-----------|-----------|------------------|-----------|-----------|-----------|
| | June 26 | Mar 27 | Dec 26 | Sep 26 | Jun 27 | Mar 28 | Dec 28 | Sep 28 |
| Gross Revenue | \$ 27,380 | \$ 31,851 | \$ 27,967 | \$ 24,998 | \$ 28,491 | \$ 28,874 | \$ 29,355 | \$ 28,882 |
| Gross Profit | 3,742 | 4,355 | 3,205 | 3,178 | 3,426 | 3,796 | 3,067 | 3,499 |
| Operating income | 1,625 | 1,830 | 1,007 | 1,142 | 1,011 | 1,546 | 1,211 | 1,723 |
| Net income | \$ 954 | \$ 1,125 | \$ 565 | \$ 525 | \$ 716 | \$ 913 | \$ 745 | \$ 1,017 |
| Net income per share diluted | \$ 0.10 | \$ 0.12 | \$ 0.06 | \$ 0.06 | \$ 0.08 | \$ 0.10 | \$ 0.08 | \$ 0.11 |
| Weighted average number of shares outstanding diluted | 9,307 | 9,199 | 9,112 | 9,198 | 9,406 | 9,257 | 9,231 | 9,268 |

Quarterly earnings per share data may not equal annual total due to fluctuations in common shares outstanding.

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Schedule II

VERSAR, INC. AND SUBSIDIARIES
Valuation and Qualifying Accounts

| | BALANCE AT BEGINNING OF YEAR | ADDITIONS CHARGED TO COSTS AND EXPENSES | CHARGE OFF | BALANCE AT END OF YEAR |
|-------------------------------------|---------------------------------------|---|---------------|------------------------------|
| ALLOWANCE FOR DOUBTFUL ACCOUNTS | | | | |
| 2007 | 348,501 | 335,518 | (310,043) | 373,976 |
| 2008 | 373,976 | 1,479 | (32,492) | 342,963 |
| 2009 | 342,963 | 154,477 | (28,297) | 469,143 |
| DEFERRED TAX VALUATION ALLOWANCE | | | | |
| 2007 | 2,954,000 | | (2,954,000) | |
| 2008 | | 47,000 | | 47,000 |
| 2009 | 47,000 | 1,000 | | 48,000 |

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