VERSAR INC
Form 10-Q
November 10, 2008

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

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the Quarterly Period Ended September 26, 2008

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _______ to _______
Commission File Number 1-9309

VERSAR, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	54-0852979
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
6850 Versar Center Springfield, Virginia	22151
(Address of principal executive offices)	(Zip Code)

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

Not Applicable
(Former name, former address and former fiscal year, if changed since last report.)

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

Yes [X] No [ ]

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

Large accelerated filer [ ]	Accelerated filer [ ]
Non-accelerated filer [ ]	Smaller reporting company [X]

(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 [X]

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

Class of Common Stock	Outstanding at November 3, 2008
$.01 par value	9,003,221

VERSAR, INC. AND SUBSIDIARIES

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VERSAR, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(In Thousands)

	September 26, 2008	June 27, 2008
ASSETS	(Unaudited)	
Current assets		
Cash and cash equivalents	$ 9,318	$ 11,938
Marketable securities	2,663	---
Accounts receivable, net	17,999	21,596
Prepaid expenses and other current assets	1,074	1,080
Deferred income taxes	860	1,015
Total current assets	31,914	35,629
Property and equipment, net	2,468	2,152
Deferred income taxes	512	517
Goodwill	776	776
Other assets	719	754
Total assets	$ 36,389	$ 39,828
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 5,279	$ 7,731
Billings in excess of revenue	94	156
Accrued salaries and vacation	2,207	1,719
Accrued bonus	481	2,066
Other liabilities	1,171	1,686
Total current liabilities	9,232	13,358
Other long-term liabilities	1,406	1,417
Total liabilities	10,638	14,775
Commitments and contingencies		
Stockholders' equity		
Common stock, $.01 par value; 30,000,000 shares authorized; 9,059,135 shares issued; 8,975,101 shares outstanding at September 26, 2008 and June 27, 2008	91	91
Capital in excess of par value	27,328	27,115
Accumulated deficit	(1,029)	(1,554)
Treasury stock	(578)	(578)
Accumulated other comprehensive loss	(61)	(21)
Total stockholders' equity	25,751	25,053
Total liabilities and stockholders' equity	$ 36,389	$ 39,828

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

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

	For the Three-Months Ended	
	September 26, 2008	September 28, 2007
GROSS REVENUE	$ 24,998	$ 28,882
Purchased services and materials, at cost	13,549	18,171
Direct costs of services and overhead	8,271	7,212
GROSS PROFIT	3,178	3,499
Selling, general and administrative expenses	2,036	1,776
OPERATING INCOME	1,142	1,723
OTHER (INCOME) EXPENSE		
Loss on marketable securities	352	---
Interest income	(55)	(64)
Income tax expense	320	770
NET INCOME	$ 525	$ 1,017
NET INCOME PER SHARE - BASIC	$ 0.06	$ 0.12
NET INCOME PER SHARE - DILUTED	$ 0.06	$ 0.11
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING - BASIC	9,059	8,809
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING - DILUTED	9,198	9,268

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

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

	For the Three-Months Ended	
	September 26, 2008	September 28, 2007
Cash flows from operating activities		
Net income	$ 525	$ 1,017
Adjustments to reconcile net income to net cash (used in) Provided by operating activities		
Depreciation and amortization	243	210
Loss on marketable securities	352	---
Share based compensation	213	105
Deferred taxes	163	720
Changes in assets and liabilities		
Decrease (increase) in accounts receivable	3,593	(635)
(Increase) decrease in prepaids and other assets	(25)	150
Decrease in accounts payable	(2,376)	(1,372)
Increase in accrued salaries and vacation	489	353
Decrease in other liabilities	(2,310)	(1,885)
Net cash provided by (used in) continuing operating activities	867	(1,337)
Cash flows used in investing activities		
Purchase of property and equipment	(568)	(236)
Purchase of marketable securities	(3,000)	---
Decrease (increase) in life insurance policies cash surrender value	44	(24)
Net cash used in investing activities	(3,524)	(260)
Cash flows from financing activities		
Proceeds from issuance of common stock	---	628
Net cash provided by financing activities	---	628
Effect of exchange rate changes	37	---
Net decrease in cash and cash equivalents	(2,620)	(969)
Cash and cash equivalents at the beginning of the period	11,938	6,296
Cash and cash equivalents at the end of the period	$ 9,318	$ 5,327

Supplementary disclosure of cash flow information:		
Cash paid during the period for		
Interest	$ 11	$ 12
Income taxes	427	50

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

VERSAR, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

(A) Basis of Presentation

The accompanying consolidated financial statements are presented in accordance with the requirements of Form 10-Q and consequently do not include all of the disclosures normally required by accounting principles generally accepted in the United States of America or those normally made in Versar, Inc.'s Annual Report on Form 10-K filed with the United States Securities and Exchange Commission. These financial statements should be read in conjunction with the Company's Annual Report filed on Form 10-K for the year ended June 26, 2008 for additional information.

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 financial information has been prepared in accordance with the Company's customary accounting practices. In the opinion of management, the information reflects all adjustments necessary for a fair presentation of the Company's consolidated financial position as of September 26, 2008, and the results of operations for the three-months ended September 26, 2008 and September 28, 2007. The results of operations for such periods, however, are not necessarily indicative of the results to be expected for a full fiscal year.

(B) Accounting Estimates

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

(C) Contract Accounting

Contracts in process are stated at the lower of actual cost incurred plus accrued profits or net estimated realizable value of incurred costs, reduced by progress billings. The Company records income from major fixed-price construction and engineering 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 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 realizable 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.

(D) Income Taxes

At September 26, 2008, the Company had approximately $1.4 million in deferred tax assets which primarily relate to temporary differences between financial statement and income tax reporting. Such differences include depreciation, deferred compensation, accruals and reserves. Given the Company's continued improved financial performance and funded backlog over the last three years, management believes the Company will be able to utilize the full benefit of the tax asset.

(E) 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 minus 0.5% (4.5% as of September 26, 2008). In October 2006, the Company obtained a letter of credit of approximately $1.6 million 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 availability on the line of credit. The line of credit capacity at September 26, 2008 was $5.9 million. Obligations under the credit facility are guaranteed by Versar and each subsidiary individually and are secured by accounts receivable, equipment and intangibles, plus all insurance policies on property constituting collateral of Versar and its subsidiaries. The line of credit matures in November 2009 and is subject to certain covenants related to the maintenance of financial ratios. These covenants require a minimum tangible net worth of $15 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. The Company was in compliance with such covenants as of September 26, 2008.

(F) Goodwill and Other Intangible Assets

On January 30, 1998, Versar completed the acquisition of The Greenwood Partnership, P.C. subsequently renamed (Versar Global Solutions, Inc. or VGSI). The transaction was accounted for as a purchase. Goodwill resulting from this transaction was approximately $1.1 million. Currently, the carrying value of goodwill is approximately $776,000 relating to the acquisition of VGSI, which is now part of the Company's Program Management business segment. The Company began reporting the Program Management business segment separately in fiscal year 2007, primarily due to the increase in business volume in Iraq and in 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, as necessary, to assist in performing this analysis. 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 substantially exceeded the carrying value of the net assets of $6.5 million as of June 27, 2008. 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.

(G) Net Income Per Share

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

	For the Three-Months Ended	
	September 26, 2008	September 28, 2007
Weighted average common shares outstanding - basic	9,059,135	8,809,255
Effect of assumed exercise of options and vesting of restricted stock awards (treasury stock method)	138,858	459,126
Weighted average common shares outstanding - diluted	9,197,993	9,268,381

VERSAR, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(H) Common Stock

Effective January 1, 2005, the Company implemented an Employee Stock Purchase Plan (ESPP) to allow eligible employees of Versar the opportunity to acquire an ownership interest in the Company's common stock. As amended, the Plan permits employees to purchase shares of Versar common stock from the open market at 95% of its fair market value. The Plan qualifies as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code.

(I) Stock-Based Compensation

In the first three months of fiscal year 2009, the Company awarded 90,000 shares of restricted stock to executive officers and employees. The awards vest over a period of 4.5 months to 16 months. Stock-based compensation expense relating to restricted stock and option awards totaled $213,000 and $105,000 for the first three months ended September 26, 2008 and September 28, 2007, respectively. This expense is included in the direct costs of services and overhead line of the Consolidated Statements of Income.

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 shall 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 September 26, 2008, approximately 141,000 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 are granted to any employee, service provider or director to whom a grant is 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. No shares remain for future grant under the 2002 Plan. The Company will continue to maintain the plan until all previously granted securities have vested, been forfeited or retired.

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. There were 83,500 shares of vested stock options outstanding as of September 26, 2008 under the 1996 Plan.

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. There were 179,761 shares of vested stock options outstanding as of September 26, 2008 under the 1992 Plan.

VERSAR, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

A summary of activity under the Company's stock option plans as of September 26, 2008, and changes during the first three months of fiscal year 2009 are presented below:

Options	Shares (in thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at June 27, 2008	571	$ 3.05		
Cancelled	(2)	3.43		
Outstanding at September 26, 2008	569	$ 3.04	4.81	$ 988
Exercisable at September 26, 2008	559	$ 2.96	4.61	$ 947

As of September 26, 2008, there were unvested options to purchase approximately 10,000 shares outstanding under the plans. Vesting of these options is conditioned on the Company's stock price reaching certain thresholds over a fixed period. The Company expects to recognize estimated compensation costs of $42,000 if the pricing and service conditions are met in the future.

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

The Program Management business segment manages larger more complex projects whose business processes and management are unique to the rest of the Company. The Compliance and Environmental Programs business segment provides 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 to meet our clients' needs.

VERSAR, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

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

	For the Three-Months Ended	
	September 26, 2008	September 28, 2007
	(In thousands)	
GROSS REVENUE		
Program Management	$ 15,650	$ 17,263
Compliance and Environmental Programs	4,760	8,226
Professional Services	2,178	1,455
National Security	2,410	1,938
	$ 24,998	$ 28,882
GROSS PROFIT (A)		
Program Management	$ 2,313	$ 2,282
Compliance and Environmental Programs	226	680
Professional Services	421	248
National Security	218	289
	$ 3,178	$ 3,499
Selling, general and administrative Expenses	(2,036)	(1,776)

OPERATING INCOME	$ 1,142	$ 1,723

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

	Years Ended	
	September 26, 2008	June 27, 2008
	(In thousands)	
IDENTIFIABLE ASSETS		
Program Management	$ 8,207	$ 11,405
Compliance and Environmental Programs	7,466	8,762
Professional Services	2,464	1,554
National Security	2,702	2,693
Corporate and Other	15,550	15,414
Total Assets	$ 36,389	$ 39,828

(K) Marketable Securities

During the first quarter of fiscal year 2009, the Company recorded a $352,000 loss on investments the Company was holding in FISCO Income Plus Funds. The FISCO fund received an immediate demand margin call from its broker, UBS, yet rather than allow the fund the customary time to satisfy the margin call to the end of the day, UBS demanded the fund cover all calls and puts at high premiums or they would take control of the fund and start liquidating the fund itself. The fund has terminated its relationship with UBS and transferred the assets to a new custodian. The fund will seek legal action against UBS to cover its losses to which the Company will be a part of any such settlement. The Company has taken steps to redeem all of its assets from marketable securities and reinvesting in its primary bank due to the volatile nature of the market.

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

This report contains certain forward-looking statements which are based on current expectations. Actual results may differ materially. The forward-looking statements include 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 government to fund certain programs in which the Company participates; delays in project funding; and such other risks and uncertainties, described in our Form 10-K for fiscal year ended June 27, 2008 and in other reports and other documents filed by the Company from time to time with the Securities and Exchange Commission.

Financial Trends

In fiscal year 2006, the Company's gross revenues declined primarily due to the continuation of federal government delays in funding, which in certain instances, spanned as much as nine months and the continued diversion of funding to the war in Iraq. The Company adapted to the funding shifts by expanding its services in Iraq work under existing contracts and seeking new contract work in Iraq. By the end of fiscal year 2006, the project funding began to return to normal levels and increased the Company's funded backlog by 55% to $48 million. By the end of fiscal year 2007, as a result of continued efforts to grow the business and with new contracts, funded backlog had increased by an additional 19% to $57 million. During fiscal year 2008, backlog continued to grow, increasing by 12% to $64 million at June 27, 2008.

In the first quarter of fiscal year 2009, the Company was awarded an additional $71 million in additional work, which increased funded backlog up to $110 million as of September 26, 2008. Although the Company has continued to exhibit success with the award of additional work, resulting in increased backlog, during the first quarter of fiscal year 2009, the Company experienced a 13% decline in gross revenues. This decline was primarily attributable to a decrease in the award of construction projects in the U.S. in the Project Management segment during fiscal year 2008 resulting in lower construction work and a decline in aquatic facility work in the Compliance and Environmental Programs segment. Several awards of new, larger projects for the Project Management segment were received late in the first quarter of fiscal year 2009 and the Company anticipates that these new awards will result in additional construction work during the second half of fiscal year 2009. There continues to be a decline in the award of additional aquatic facility work and the Company expects this segment to continue to face a decline in revenues during the 2009 fiscal year.

Approximately 53% of the Company's business volume related to the reconstruction efforts in Iraq in fiscal year 2008. However, the Company is taking steps to further diversify its business if opportunities in Iraq are reduced or are eliminated. The Company's primary focus is on BRAC efforts and requirements which have been delayed as a result of the war in Iraq. Gross revenues and gross profit increased among all business segments in fiscal year 2008. We see the Compliance and Environmental business segment being impacted by the funding of work into fiscal year 2009. We continue to follow the funding shifts in Iraq and Afghanistan to maintain and expand our business basis. The funding of BRAC work world-wide represents our greatest opportunity for growth in the second half of fiscal year 2009.

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 project 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;
* The ability to compete in a highly competitive environment; and
* Federal funding delays due to the war in Iraq.

Results of Operations

First Quarter Comparison of Fiscal Year 2009 and 2008

	For the Three-Months Ended	
	September 26, 2008	September 28, 2007
GROSS REVENUE		
Program Management	$ 15,650	$ 17,263
Compliance and Environmental Programs	4,760	8,226
Professional Services	2,178	1,455
National Security	2,410	1,938
	$ 24,998	$ 28,882

Gross revenue for the first quarter of fiscal year 2009 was $24,998,000, a decrease of $3,884,000 (13%) from the first quarter of fiscal year 2008. Gross revenues in the Program Management business segment for the first quarter of fiscal year 2009 was $15,650,000, a decrease of $1,613,000 (9%) from that reported in the first quarter of fiscal year 2008. The decrease is due to lower construction related work in the United States as several large projects in the pipeline were not awarded until late in the first quarter of fiscal year 2009. Gross revenues for the Compliance and Environmental Programs business segment for the first quarter of fiscal year 2009 was $4,760,000, a decrease of $3,466,000 (42%) from the first quarter of fiscal year 2008. The decrease is due the completion of several large municipal aquatic facility projects at the end of fiscal year 2008, and state and municipal budget constraints due to the poor economy for additional aquatic facility work. Gross revenues for the Professional Services business segment for the first quarter of 2009 was $2,178,000, an increase of $723,000 (50%) from the first quarter of fiscal year 2008. The increase is attributable to additional larger professional services outsourcing awards awarded in fiscal year 2008. Gross revenues for the National Security business segment for the first quarter of fiscal year 2009 was $2,410,000, an increase of $472,000 (24%) from the first quarter of fiscal year 2008. The increase is primarily due to additional chemical laboratory work during the first quarter of fiscal year 2009.

Purchased services and materials decreased by $4,622,000 (25%) in the first quarter of fiscal year 2009 compared to the first quarter of fiscal year 2008. The decrease is attributable to the decrease in construction work and municipal aquatic facility work in the Program Management and the Compliance and Environmental Programs business segments as mentioned above.

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 $1,059,000 (15%) in the first quarter of fiscal year 2009 compared to that reported in the first quarter of fiscal year 2008. Approximately 47% of the increase is due to the business growth in the Professional Services business segment. The balance of the increase is due to additional costs required to support business growth efforts in the Program Management business segment.

ITEM 2 Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Gross profit for the first quarter of fiscal year 2009 was $3,178,000, a decrease of $321,000 (9%) from that reported in the first quarter of fiscal year 2008. The decrease is primarily due to the decreased gross revenues in the Compliance and Environmental business segment as mentioned above.

	For the Three-Months Ended	
	September 26, 2008	September 28, 2007
GROSS PROFIT		
Program Management	$ 2,313	$ 2,282
Compliance and Environmental Programs	226	680
Professional Services	421	248

National Security	218	289
	$ 3,178	$ 3,499

Gross profit for the Program Management business segment for the first quarter of fiscal year 2009 was $2,313,000, an increase of $31,000 (1%) over that reported in the first quarter of fiscal year 2008. Gross profit for the Compliance and Environmental business segment for the first quarter of fiscal year 2009 was $226,000, a decrease of $454,000 (67%) lower than that reported in the first quarter of fiscal year 2008. Thirty-five percent of the decrease is due to the lower aquatic facility work. The balance of the decrease is due to funding delays and poor economic conditions. Gross profit for the Professional Services business segment for the first quarter of fiscal year 2009 was $421,000, an increase of $173,000 (70%) over that reported in the first quarter of fiscal year 2008. The increase is attributable to the increased gross revenues as mentioned above. Gross profit for the National Security business segment was $218,000, a decrease of $71,000 (25%) lower than that reported in the first quarter of fiscal year 2008. The decrease was due to delayed product shipments of personal protective equipment during the first quarter of fiscal year 2009.

Selling, general and administrative expenses increased by $260,000 (15%) during the first quarter of fiscal year 2009 compared to that reported in the first quarter of fiscal year 2008. The increase is primarily due to increased business development activities and compliance costs associated with Sarbanes Oxley.

Operating income for the first quarter of fiscal year 2009 was $1,142,000, a decrease of $581,000 (34%) lower than that reported for the first quarter of fiscal year 2008. The decrease is attributable to the decreased revenues, project funding delays, and higher selling, general and administrative costs as mentioned above.

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 Funds. The FISCO fund received an immediate demand margin call from its broker, UBS, yet rather than allow the fund the customary time to satisfy the margin call to the end of the day, UBS demanded the fund cover all calls and puts at high premiums or they would take control of the fund and start liquidating the fund itself. The fund has terminated its relationship with UBS and transferred the assets to a new custodian. The fund is pursuing legal action against UBS to cover its losses. The Company will participate in any such settlement. The Company has taken steps to redeem all of its assets from marketable securities and reinvesting in its primary bank due to the volatile nature of the market.

Interest income for the first quarter of fiscal year 2009 was $55,000, a decrease of $9,000 lower than that reported in the first quarter of fiscal year 2008. The decrease is due to lower interest rates in the first quarter of fiscal year 2009.

Income tax expense for the first quarter of fiscal year 2009 was $320,000, a $450,000 decrease from that reported in the first quarter of fiscal year 2008. The effective tax rates were 38% and 43% for the first quarter of fiscal year 2009 and 2008, respectively.

Versar's net income for the first quarter of fiscal year

2009 was $525,000 compared to $1,017,000 in the first quarter of fiscal year 2008. The decreased revenue, project funding delays, higher selling, general and administrative costs, and the marketable security loss accounted for the reduced net income for the first quarter of fiscal year 2009.

ITEM 2 Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Liquidity and Capital Resources

The Company's working capital as of September 26, 2008 approximated $22,682,000, an increase of $411,000 (2%) from June 29, 2007. In addition, at September 26, 2008, the Company's current ratio was 3.46, an improvement over the 2.67 current ratio reported on June 27, 2007. The increase was due to the reduction of current liabilities during the quarter.

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 minus 0.5% (4.5% as of September 26, 2008). In October 2006, the Company obtained a letter of credit of approximately $1.6 million 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 availability on the line of credit. The line of credit capacity at September 26, 2008 was $5.9 million. Obligations under the credit facility are guaranteed by Versar and each subsidiary individually and are secured by accounts receivable, equipment and intangibles, plus all insurance policies on property constituting collateral of Versar and its subsidiaries. The line of credit matures in November 2009 and is subject to certain covenants related to the maintenance of financial ratios. These covenants require a minimum tangible net worth of $15 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. The Company was in compliance with such covenants as of September 26, 2008.

Management believes that the current cash balance and marketable securities of over $12 million along with anticipated cash from operations and existing capacity on the line of credit, there is sufficient capital to meet its liquidity needs within the next year. Expected capital requirements for the remainder of fiscal year 2009 are approximately $750,000 primarily to maintain our existing information technology systems and software applications. Such capital requirements will be funded through existing working capital.

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-Q and in our annual report on Form 10-K filed for 2008 fiscal year.

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.

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. 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.

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 accreation expense to be approximately $180,000 to $190,000 per year over the next 2 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 September 26, 2008 the Company has accrued approximately $551,000 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, as necessary, to assist in performing this analysis. 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 $6.5 million on an enterprise value basis by a substantial margin. Should the Program Management business segments 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.

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. The Company is in the process of determining what effect, if any, the application of the provisions of SFAS 141(R) will have on its financial position and results of operations.

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.

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 include provisions for projected increases in labor and other costs.

Contingencies

Versar and its subsidiaries are parties to various legal actions arising in the normal course of business. The Company believes that the ultimate resolution of these legal actions will not have a material adverse effect on its consolidated financial position and results of operations. (See Part II, Item 1 - Legal Proceedings).

ITEM 2 Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Business Segments

Versar currently has four business segments: Program Management, Compliance and Environmental Programs, Professional Services, and National Security. See Note J of the Notes to the Consolidated Financial Statements for details regarding these segments.

Item 3 - 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 4T - Controls and Procedures

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

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

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

PART II - OTHER INFORMATION

Item 1 - Legal Proceedings

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 6 - Exhibits

(a) Exhibits

31.1 and 31.2 - Certification pursuant to Securities Exchange Act Section 13a-14.
32.1 and 32.2 - Certification under Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

VERSAR, INC.

(Registrant)

/S/ Theodore M. Prociv
By:______________________
Theodore M. Prociv
Chief Executive Officer,

President, and Director

/S/ Lawrence W. Sinnott
By:________________________
Lawrence W. Sinnott
Executive Vice President,
Chief Operating Officer,
Chief Financial Officer,
Treasurer, and Principal
Accounting Officer

Date: November 10, 2008