VSE CORP
Form 10-K
March 06, 2015
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 December 31, 2014 Commission File Number: 0 3676

VSE CORPORATION
(Exact Name of Registrant as Specified in its Charter)

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

6348 Walker Lane

Alexandria, Virginia	22310	www.vsecorp.com
(Address of Principal Executive Offices)	(Zip Code)	(Webpage)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $.05 per share	The NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the 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 (section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition 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

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

The aggregate market value of outstanding voting stock held by nonaffiliates of the Registrant as of June 30, 2014, was approximately $290 million based on the last reported sales price of the registrant's common stock on The NASDAQ Global Select Market as of that date.

Number of shares of Common Stock outstanding as of March 1, 2015: 5,367,261.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Registrant's Proxy Statement for the Annual Meeting of Stockholders expected to be held on May 5, 2015, are incorporated herein by reference into Part III of this report.

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Forward Looking Statements

This Annual Report on Form 10-K ("Form 10-K") contains statements that, to the extent they are not recitations of historical fact, constitute "forward looking statements" under federal securities laws. All such statements are intended to be subject to the safe harbor protection provided by applicable securities laws. For discussions identifying some important factors that could cause actual VSE Corporation ("VSE," the "Company," "us," "our," or "we") results to differ materially from those anticipated in the forward looking statements contained in this filing, see VSE's "Narrative Description of Business" (Items 1, 1A, 2 and 3), and "Management's Discussion and Analysis." Readers are cautioned not to place undue reliance on these forward looking statements, which reflect management's analysis only as of the date hereof. The Company undertakes no obligation to publicly revise these forward looking statements to reflect events or circumstances that arise after the date hereof. Readers should also carefully review the risk factors described in other documents the Company files from time to time with the Securities and Exchange Commission, including Quarterly Reports on Form 10-Q filed by the Company subsequent to this Form 10-K and any Current Reports on Form 8-K filed by the Company.

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ITEM 1. Business

(a) General Background

VSE was incorporated in Delaware in 1959 and serves as a centralized managing and consolidating entity for our business operations. Our business operations are managed under groups consisting of one or more divisions or wholly owned subsidiaries that perform our services. VSE's operating groups include our Supply Chain Management Group, International Group, Federal Group, and IT, Energy and Management Consulting Group. The term "VSE" or "Company" means VSE and its subsidiaries and divisions unless the context indicates operations of only VSE as the parent company.

Our business operations consist of vehicle fleet and equipment sustainment services, including supply chain management services, and diversified technical services, including logistics, engineering, IT solutions, health care IT, and consulting services. Our services are performed for the United States Government (the "government"), including the United States Department of Defense ("DoD") and federal civilian agencies, the United States Postal Service ("USPS"), commercial customers, and other clients.

We seek to provide our customers with competitive, cost-effective solutions to specific problems. These problems generally require a detailed technical knowledge of vehicles, equipment, materials, processes, functional characteristics, information systems, technology and products and an in-depth understanding of the basic requirements for effective systems and business operations.

(b) Financial Information

Our operations are conducted within four reportable segments aligned with our management groups: (1) Supply Chain, which generated approximately 41% of our revenues in 2014; (2) International, which generated approximately 25% of our revenues in 2014; (3) Federal, which generated approximately 20% of our revenues in 2014; and (4) IT, Energy and Management Consulting, which generated approximately 14% of our revenues in 2014. Additional financial information for our reportable segments appears in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and in "Item 8. Financial Statements and Supplementary Data" of this Form 10-K.

(c) Description of Business

Services and Products

We use a broad array of capabilities and resources to support military, federal civilian, and other government and non-government vehicle fleets, systems, equipment and processes. We are focused on creating, sustaining and improving the vehicle fleets, systems, equipment and processes of our clients through core offerings in supply chain management, equipment refurbishment, logistics, engineering, IT solutions, health care IT, and consulting services.

Typical service offerings include supply chain and inventory management services; vehicle fleet sustainment programs; vehicle fleet parts; engineering support for military vehicles and combat trailers; military equipment refurbishment and modification; ship maintenance, overhaul, and follow-on technical support; logistics management support; machinery condition analysis; specification preparation for ship alterations; ship's force crew training; life cycle support for ships; ship communication systems; energy conservation, energy efficiency, sustainable energy supply, and electric power grid modernization projects; technology road-mapping; IT enterprise architecture development, information assurance/business continuity, security risk management, and network services; medical logistics; and medical command and control. See Item 7 "Management's Discussion and Analysis of Financial

Information and Results of Operations" for more information regarding our business.

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Revenues and Contracts

Our revenues are derived from contract services performed for DoD agencies or federal civilian agencies and from the delivery of products to our clients. The USPS, U.S. Army and Army Reserve, and U.S. Navy are our largest customers. Our customers also include various other government agencies and commercial entities.

Revenues by Customer
(dollars in thousands)
Years ended December 31,

Customer	2014	%	2013	%	2012	%
U.S. Army/Army Reserve	$101,714	24.0	$101,736	21.6	$182,412	33.4
U.S. Navy	88,007	20.7	123,307	26.1	120,867	22.1
U.S. Air Force	3,323	0.8	3,625	0.8	6,963	1.3
Total - DoD	193,044	45.5	228,668	48.5	310,242	56.8
U.S. Postal Service	167,268	39.4	142,203	30.1	130,866	23.9
Department of Energy	19,000	4.5	20,124	4.3	20,898	3.8
Department of Treasury	10,897	2.6	35,929	7.6	33,369	6.1
Department of Interior	1,431	0.3	1,545	0.3	16,884	3.1
Other government	28,751	6.8	40,919	8.7	32,231	5.9
Total – Federal civilian agencies	227,347	53.6	240,720	51.0	234,248	42.8
Commercial	3,680	0.9	2,250	0.5	2,265	0.4
Total	$424,071	100.0	$471,638	100.0	$546,755	100.0

Depending on solicitation requirements and other factors, we offer our products and professional and technical services through various ordering agreements, negotiated and competitive contract arrangements, and business units that are responsive to customer requirements. Some of the contracts permit the contracting agency to issue delivery orders or task orders in an expeditious manner to satisfy relatively short-term requirements for engineering and technical services.

Our Supply Chain Management Group revenues result from the sale of vehicle parts to the USPS and other clients. We recognize revenue from the sale of vehicle parts when the customer takes ownership of the parts.

Our International, Federal, and IT, Energy and Management Consulting Group revenues result primarily from cost plus fee, time and materials, or fixed-price contracts with the government. Revenues result from work performed on these contracts by our own employees, from work performed by our subcontractors, and from costs of materials used in performing the work. Revenues on cost-type contracts are recorded as allowable costs are incurred and fees are earned.

Revenues for time and materials contracts are recorded on the basis of allowable labor hours worked multiplied by the contract defined billing rates, plus the cost of materials used in performance on the contract. Profits or losses on time and material contracts result from the difference between the cost of services performed and the contract defined billing rates for these services.

Revenue recognition methods on fixed-price contracts vary depending on the nature of the work and the contract terms. Revenues on fixed-price service contracts are recorded as work is performed, typically ratably over the service period. Revenues on fixed-price contracts that require delivery of specific items are recorded based on a price per unit as units are delivered.

Backlog

Funded backlog represents a measure of potential future revenues from our government contracts. Funded backlog is defined by us as the total value of contracts that has been appropriated and funded by the procuring agencies, less the amount of revenues that have already been recognized on such contracts. Our reported backlog is comprised of funding received by us in incremental amounts intended to fund work that is generally expected to be completed within six to 12 months following the award of the funding. Accordingly, substantially our entire reported backlog is reasonably expected to be filled within this time. Our funded backlog as of December 31, 2014, was approximately $195 million. Funded backlog as of December 31, 2013 and 2012 was approximately $236 million and $250 million, respectively. Changes in funded backlog on contracts are sometimes unpredictable due to uncertainties associated with changing government program priorities and availability of funds, which is heavily dependent upon the congressional authorization and appropriation process. Delays in this process, such as those experienced in recent years, may temporarily diminish the availability of funds for ongoing and planned work.

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In addition to the funded backlog levels, we have contract ceiling amounts available for use on multiple award, indefinite delivery, indefinite quantity contracts with DoD and federal civilian agencies. While these contracts increase the opportunities available for us to pursue future work, the actual amount of future work is indeterminate until delivery orders are placed on the contracts. Frequently, these delivery orders are competitively awarded. Additionally, these delivery orders must be funded by the procuring agencies before we can perform work and begin generating revenues.

Marketing

Our marketing activities are conducted at the operating group level by our business development and marketing staff and our professional staff of engineers, program managers, and other personnel. Information concerning new programs, requirements and opportunities becomes available in the course of contract performance, through sales calls and client servicing, through negotiation with key business partners, through formal and informal briefings, from participation in professional organizations, and from literature published by the government, trade associations, professional organizations and commercial entities.

Personnel

Services are provided by our professional and technical personnel having high levels of education, experience, training and skills. As of December 31, 2014, we had 1,589 employees, a decrease from 1,872 as of December 31, 2013. Principal employee categories include (a) mechanics and vehicle and equipment technicians, (b) information technology professionals in computer systems, applications and products, configuration, change and data management disciplines, (c) engineers and technicians in mechanical, electronic, industrial, energy and environmental services, (d) logisticians, (e) environmental specialists, and (f) warehouse and sales personnel. The expertise required by our customers frequently includes knowledge of government administrative procedures. Approximately one-third of our employees have previously served as members in the U.S. Armed Forces.

Competition

The professional and technical services industry in which we are engaged is very competitive. Numerous other organizations, including large, diversified firms, have greater financial resources and larger technical staffs that are capable of providing the same services offered by us.

Government agencies emphasize awarding contracts on a competitive basis as opposed to a sole source or other noncompetitive basis. Most of the significant contracts under which we currently perform were either initially awarded on a competitive basis or have been renewed at least once on a competitive basis. Government agencies also order services through contracts awarded by the General Services Administration ("GSA"). GSA provides a schedule of services at fixed prices that may be ordered outside of the solicitation process. We have seven GSA schedule contracts for different classes of services. There is no assurance regarding the level of work we may obtain under these contracts. Government budgets, and in particular the budgets of certain government agencies, can also affect competition in our business. A general decline in government budgets, or a reallocation of government spending priorities that results in lower levels of potential business in the markets we serve or the services we offer, will cause increased competition. Further, contract awards frequently are protested to the Government Accounting Office ("GAO").

The extent and range of competition that we will encounter as a result of changing economic or competitive conditions, customer requirements or technological developments is unpredictable. We believe the principal competitive factors for our business are technical and financial qualifications, past performance, government budgetary stress, and price.

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Available Information

Copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports are filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended. They are available free of charge through our website www.vsecorp.com as soon as reasonably practicable after the reports are electronically filed with the Securities and Exchange Commission ("SEC").

ITEM 1A. Risk Factors

Our future results may differ materially from past results and from those projected in the forward-looking statements contained in this Form 10-K due to various uncertainties and risks, including but not limited to those risks set forth below, non-recurring events and other important factors disclosed previously and from time to time in our other reports filed with the SEC.

Uncertain government budgets and shifting government priorities could delay contract awards and funding and adversely affect our ability to continue work under our government contracts. Additionally, federal procurement directives could result in our loss of work on current programs to set-asides and large multiple award contracts.

Our government business is subject to funding delays, terminations, reductions, extensions, and moratoriums caused by the government's budgeting and contracting process. The federal procurement environment is unpredictable and could adversely affect our ability to perform work under new and existing contracts. Contract award and funding delays extend across the federal technical services industry. We experienced delays in contract awards and funding on our contracts in recent years that have adversely affected our ability to continue existing work and to replace expiring work. Additionally, our government business is subject to the risk that one or more of our potential contracts or contract extensions may be awarded by the contracting agency to a small or disadvantaged or minority-owned business pursuant to set-aside programs administered by the Small Business Administration, or may be bundled into large multiple award contracts for very large businesses. These risks can potentially have an adverse effect on our revenue growth and profit margins.

Increased market competition resulting from decreases in government spending for contract services and government contracting award criteria could adversely affect our ability to sustain our revenue levels.

Continuing pressure on government budgets may adversely affect the flow of work to federal contractors, particularly new programs. Consequently, competitor contractors that experience a loss of government work have tended to redirect their marketing efforts toward the types of work that we perform. This increase in competition for our service offerings has adversely affected our ability to win new work or successor contracts to continue work that is currently performed by us under expiring contracts. Disappointed bidders frequently protest contract awards, which can delay or reverse the contract awards. Additionally, the government has trended toward contract award criteria that emphasizes lowest price, technically acceptable bids, which further intensifies competition in our government markets.

Our business could be adversely affected by incidents that could cause an interruption in our operations or impose a significant financial liability on us.

Disruption of our operations due to internal or external system or service failures, accidents or incidents involving employees or third parties working in high-risk locations, or natural disasters or other crises could adversely affect our financial performance and condition. Our Managed Inventory Program ("MIP") that supplies truck replacement parts for the United States Postal Service ("USPS") fleet, our Foreign Military Sales ("FMS") Program for the U.S. Navy, and our vehicle and equipment refurbishment work for the U.S. Army Reserve are our three largest revenue generators, accounting for 38%, 20%, and 11% of our 2014 revenues, respectively. A fire, flood, earthquake, or other natural disaster at physical facilities that support these operations, or a procurement system or contractual delay such as we experienced on our U.S. Army Reserve contract in 2013, could potentially interrupt the revenues from our operations.

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Certain programs comprise a material portion of our revenue.

Our USPS MIP, FMS Program, and U.S. Army Reserve vehicle and equipment refurbishment work constitute a material portion of our revenues. This concentration of our revenue in a few key programs subjects us to risk of material adverse revenue disruptions if USPS operational decisions, government contractual, or other issues prevent or delay the fulfillment of work requirements associated with these key programs. In recent years, our financial results have been adversely affected by revenue declines for our (a) FMS Program due to the government's inability to pass ship transfer legislation and (b) U.S. Army Reserve vehicle and equipment refurbishment work due to government procurement decisions.

The nature of our operations and work performed by our employees present certain challenges related to work force management.

Our financial performance is heavily dependent on the abilities of our operating and administrative staff with respect to technical skills, operating performance, pricing, cost management, safety, and administrative and compliance efforts. A wide diversity of contract types, nature of work, work locations, and legal and regulatory complexities challenges our administrative staff and skill sets. We also face challenges associated with our quality of workforce, quality of work, safety, and labor relations compliance. Our current and projected work in foreign countries exposes us to challenges associated with export and ethics compliance, local laws and customs, workforce issues, extended supply chain, political unrest and war zone threats. Failure to attract or retain an adequately skilled workforce, lack of knowledge or training in critical functions, or inadequate staffing levels can result in lost work, reduced profit margins, losses from cost overruns, performance deficiencies, workplace accidents, and regulatory noncompliance.

Our work on large government programs presents a risk to revenue and profit growth and sustainability.

The eventual expiration of large government programs or the loss of or disruption of revenues on a single contract may reduce our revenues and profits. Such revenue losses could also erode profits on our remaining programs that would have to absorb a larger portion of the fixed corporate costs previously allocated to the expiring programs or discontinued contract work. Our Supply Chain Management Group managed inventory program for USPS, International Group FMS Program, and Federal Group equipment refurbishment program for the U.S. Army Reserve provide significant amounts of revenues and profits, which if interrupted, could adversely impact our overall financial performance.

Acquisitions, which have been a part of our business strategy in recent years, present certain risks.

The decision to acquire a business that subsequently does not meet expected operating and financial performance targets, the failure to make or timely complete an acquisition, the ineffective integration of an acquisition, or the inability of our company to service debt associated with making an acquisition could adversely affect our financial performance.

Global economic conditions and political factors could adversely affect our revenues on current government programs.

Revenues from our government programs for which work is performed in foreign countries are subject to economic conditions in these countries and to political risks posed by ongoing foreign conflicts and potential terrorist activity. A significant amount of our revenues in past years resulted from the U.S. military involvement in Iraq and Afghanistan, and the winding down of this U.S. military involvement has adversely affected our revenues. Also, services performed by our employees on our FMS Program are, to a certain extent, dependent on our placement of employees in a client country. Due to significant domestic and political unrest in Egypt, we have been unable to maintain a consistent level of staffing in that country, resulting in a fluctuating level of services performed by our employees for our Egyptian Navy client. We cannot predict how the Egyptian political situation will unfold or the long range affect it will have on our Egyptian Navy support program. Our Egyptian Navy support services generated revenue of approximately $33 million for 2014 and approximately $48 million for 2013. Global economic and political risks could have an adverse effect on our future revenue levels.

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As a government contractor, we are subject to numerous of procurement rules and regulations that could expose us to potential liabilities or work loss. Additionally, we are exposed to contractual and financial liabilities if our subcontractors do not perform satisfactorily.

We must comply with and are affected by laws and regulations relating to the award, administration and performance of government contracts. Additionally, we are responsible for subcontractor compliance with these laws and regulations. Government contract laws and regulations affect how we conduct business with our customers and, in some instances, impose added costs to us. A violation of laws or regulations could result in the imposition of fines and penalties or the termination of contracts or debarment from working or bidding on government contracts.

In some instances, these government contract laws and regulations impose terms or rights that are significantly more favorable to the government than those typically available to commercial parties in negotiated transactions. For example, the government may terminate any government contract or subcontract at its convenience, as well as for performance default.

A termination for default could expose us to liability and have a material adverse effect on our ability to compete for future contracts and orders. A termination for default could also impact our past performance and ability to win new work. In addition, the government could terminate a prime contract under which we are a subcontractor, irrespective of the quality of services provided by us as a subcontractor.

Additionally, some of our contract work is performed by subcontractors, and such work is subject to government compliance, performance and financial risks. If unsatisfactory performance or compliance failure occurs on the part of subcontractors, we must bear the cost to remedy these deficiencies on our prime contracts.

Due to the nature of our work we could potentially be exposed to legal actions arising from our operations.

Our work includes many manual tasks, including warehousing, shipping and packing of truck parts inventory, maintaining and repairing military and non-military vehicles and equipment, and maintaining and overhauling U.S. Navy ships. Some of our work efforts involve the handling of hazardous materials. This may pose certain challenges that could cause us to be exposed to legal and other liabilities arising from performance issues, work related incidents, or employee misconduct that result in damages, injury or death to third parties (see "Item 3. Legal Proceedings"). Such events could cause us to suffer financial losses and adversely affect our financial condition.

Technology security risks could potentially impact our financial results.

Some of our contract work includes data management and technology services associated with Social Security Administration and military medical and health records. This exposes us to certain information and technology security risks. If there was a security breach of sensitive data in our custody or for which we provide services, we could possibly be held liable for damages to third parties related to such security breach and incur costs to prevent future incidents. Costs associated with preventing or remediating information management security breaches have not had a material adverse effect on our capital expenditures, earnings, or competitive position. However, the occurrence of a future security breach event could potentially have such an adverse effect.

Environmental and pollution risks could potentially impact our financial results.

Some of our contract work includes the use of chemical solvents and the handling of hazardous materials to maintain and refurbish vehicles and equipment. This exposes us to certain environmental and pollution risks. Costs associated with preventing or remediating pollution clean-up efforts and environmental regulatory compliance have not yet had a material adverse effect on our capital expenditures, earnings, or competitive position. However, the occurrence of a future environmental or pollution event could have such an adverse effect.

Investments in facilities could cause losses if certain work is disrupted or discontinued.

We have made investments in facilities and lease commitments to support specific business programs, work requirements, and service offerings. A slowing or disruption of these business programs, work requirements, or service offerings that results in operating below intended levels could cause us to suffer financial losses. We incurred charges against operating income of approximately $1.2 million in 2013 and $1.9 million in 2012 associated with the lease of warehouse facilities for our Seized Asset programs.

Our business could be adversely affected by government audits.

Government agencies, including the Defense Contract Audit Agency and the Department of Labor, routinely audit and investigate government contractors. These agencies review a contractor's performance under its contracts, cost structure and compliance with applicable laws, regulations and standards. The government also may review the adequacy of, and a contractor's compliance with, its internal control systems and policies, including the contractor's purchasing, property, estimating, compensation and management information systems. Any costs found to be improperly allocated to a specific contract will not be reimbursed and any such costs already reimbursed must be refunded. If an audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines and suspension or prohibition from doing business with the government. In addition, we could suffer serious harm to our reputation if allegations of impropriety were made.

New accounting standards could result in changes to our methods of quantifying and recording accounting transactions, and could affect our financial results and financial position.

Changes to generally accepted accounting principles in the United States ("GAAP") arise from new and revised guidance issued by the Financial Accounting Standards Board, the SEC, and others. The effects of such changes may include prescribing an accounting method where none had been previously specified, prescribing a single acceptable method of accounting from among several acceptable methods that currently exist, or revoking the acceptability of a current method and replacing it with an entirely different method, among others. These changes could result in unanticipated effects on results of operations, financial position and other financial measures.

ITEM 1B. Unresolved Staff Comments

None

ITEM 2. Properties

Our executive and administrative headquarters are located in a five-story building in Alexandria, Virginia, with approximately 95,000 square feet of office space leased by us through April 2027.

We own facilities located in an industrial park in Somerset, Pennsylvania that we use to conduct the operations of our subsidiary Wheeler Bros., Inc. These properties consist of approximately 30 acres of land and buildings totaling approximately 212,000 square feet of office, engineering, and warehouse space.

We own and operate two facilities in Ladysmith, Virginia. One of these properties consists of approximately 44 acres of land and multiple storage and vehicle maintenance buildings totaling approximately 56,000 square feet of space. The other property consists of 30 acres of land and buildings totaling approximately 13,500 square feet of space. We also own and operate a facility in Texarkana, Arkansas consisting of approximately 10 acres of land and buildings totaling approximately 79,000 square feet. We use these three properties primarily to provide refurbishment services for military equipment, storage and maintenance.

We also provide services and products from facilities generally occupied under short-term leases primarily located near customer sites to facilitate communications and enhance program performance. As of December 31, 2014, we leased approximately 27 such facilities with a total of approximately 884,000 square feet of office and warehouse space. Our employees often provide services at customer facilities, limiting our requirement for additional space. We also provide services from locations outside of the United States, generally at foreign shipyards or U.S. military installations.

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ITEM 3. Legal Proceedings

We may have, in the normal course of business, certain claims, including legal proceedings, against us and against other parties. In our opinion, the resolution of these claims will not have a material adverse effect on our results of operations or financial position. However, the results of any claims, including legal proceedings, cannot be predicted with certainty.

On or about May 24, 2012, four complaints were filed in the Circuit Court of the First Circuit, State of Hawaii, by the estates of five deceased individuals and certain of their relatives against VSE and certain other entities and individuals. The complaints allege, among other things, that the explosion of fireworks and diesel fuel that injured and killed the five individuals on or about April 8, 2011 was caused by negligence, actions and omissions of VSE and the other defendants and their employees, agents and representatives. The five deceased plaintiffs were employees of Donaldson Enterprises, Inc., which was a vendor retained by VSE to warehouse, store and dispose of fireworks and other explosives seized by the federal government from entities and persons illegally in possession of the fireworks and other explosives. We had a prime contract with the U.S. Department of Treasury ("Treasury") to support the Treasury Executive Office for Asset Forfeiture to manage various seized assets, including management and disposal of fireworks and other explosives seized by various federal government agencies.

We have denied the allegations and, together with our insurance carriers, will aggressively defend the proceedings, which are expected to proceed to trial in 2016. While the results of legal proceedings cannot be predicted with certainty, we do not anticipate that this lawsuit will have a material adverse effect on our results of operations or financial condition.

On or about March 8, 2013, a lawsuit, Anchorage v. Integrated Concepts and Research Corporation, et al., was filed in the Superior Court for the State of Alaska at Anchorage by the Municipality of Anchorage, Alaska against our wholly owned subsidiary Integrated Concepts and Research Corporation ("ICRC") and two former subcontractors of ICRC. Two additional defendants have been added to this litigation. With respect to ICRC, the lawsuit asserts, among other things, breach of contract, professional negligence and negligence in respect of work and services ICRC performed under the Port of Anchorage Intermodal Expansion Contract with the Maritime Administration, a federal agency with the United States Department of Transportation. On or about April 10, 2013, ICRC removed the case to the United States District Court for the District of Alaska. This litigation is expected to proceed to trial in 2016. Currently we cannot predict whether the lawsuit will have a material adverse effect on our results of operations or financial condition.

Further, from time-to-time, government agencies investigate whether our operations are being conducted in accordance with applicable contractual and regulatory requirements. Government investigations of us, whether relating to government contracts or conducted for other reasons, could result in administrative, civil or criminal liabilities, including repayments, fines or penalties being imposed upon us, or could lead to suspension or debarment from future government contracting. Government investigations often take years to complete and many result in no adverse action against us. We believe, based upon current information, that the outcome of any such government disputes and investigations will not have a material adverse effect on our results of operations or financial position.

ITEM 4. Mine Safety Disclosures

Not applicable.

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ITEM 4(a). Executive Officers of Registrant

Our executive officers are listed below, as well as information concerning their age and positions held with VSE. There is no family relationships among any of our executive officers. For executive officers who have been with us fewer than five years, their principal occupations and business experience during the last five years are provided. The executive officers are appointed annually to serve until the first meeting of VSE's Board of Directors (the "Board") following the next annual meeting of stockholders and until their successors are elected and have qualified, or until death, resignation or removal, whichever is sooner.

Name	Age	Position with Registrant
Maurice A. Gauthier	67	Director, Chief Executive Officer, President and Chief Operating Officer
John T. Harris	63	President, VSE's subsidiary Akimeka, LLC
Thomas M. Kiernan	47	Vice President, General Counsel and Secretary
Thomas R. Loftus	59	Executive Vice President and Chief Financial Officer
Nancy Margolis	59	President, VSE's subsidiary Energetics Incorporated
Chad Wheeler	40	President VSE's subsidiary Wheeler Bros., Inc.

Mr. Harris was appointed President and Chief Operating Officer of Akimeka, LLC in August 2010 immediately following VSE's acquisition of the company. Mr. Harris joined Akimeka LLC in 2001 as Chief Operating Officer. Prior to that, he was president of JJA Enterprises, an independent consulting firm specializing in acquisition, business and financial management, and business development services. Mr. Harris has a Bachelor of Science degree from Middle Tennessee State University and a Master of Science degree in Healthcare Administration from Southwest Texas State University. He also has a Masters equivalent in International Affairs from the Armed Forces Staff College in Norfolk, Virginia.

Mr. Wheeler was appointed President and Chief Operating Officer of Wheeler Bros., Inc. ("WBI"), in July 2013. He is involved in the executive management of day-to-day operations, government contract administration, new business development, supply chain initiatives and facilities management. He serves as a member of the operational board for WBI, and has played an active role at WBI since 1991. Previously, Mr. Wheeler assumed various roles at WBI, including Senior Vice President of Operations, Senior Vice President of Sales and Marketing, and Marketing and Sales Manager. While serving as Marketing and Sales Manager, Mr. Wheeler coordinated implementation of WBI's Managed Inventory Program which is used at the USPS' Vehicle Maintenance Facilities throughout the country. Mr. Wheeler graduated summa cum laude from Indiana University of Pennsylvania in 1998 with a degree in Marketing.

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PART II

ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

(a) Market Information

VSE common stock, par value $0.05 per share, is traded on The NASDAQ Global Select Market, trading symbol, "VSEC," Newspaper listing, "VSE."

The following table sets forth the range of high and low sales price (based on information reported by The NASDAQ Global Select Market) and cash dividend per share information for our common stock for each quarter and annually during the last two years.

Quarter Ended	High	Low	Dividends
2013:			
March 31	$25.93	$22.14	$ 0.08
June 30	41.09	25.00	0.09
September 30	49.12	42.05	0.09
December 31	52.20	42.08	0.09
For the Year	$52.20	$22.14	$ 0.35
2014:			
March 31	$53.00	$39.98	$ 0.09
June 30	70.35	52.85	0.10
September 30	74.86	47.51	0.10
December 31	66.23	48.85	0.10
For the Year	$74.86	$39.98	$ 0.39

(b) Holders

As of February 6, 2015, VSE common stock, par value $0.05 per share, was held by approximately 260 stockholders of record. The number of stockholders of record is not representative of the number of beneficial holders because many of VSE's shares are held by depositories, brokers or nominees.

(c) Dividends

In 2013 cash dividends were declared quarterly at the annual rate of $0.32 per share through March 31, 2013, and at the annual rate of $0.36 per share commencing June 1, 2013.

In 2014 cash dividends were declared quarterly at the annual rate of $0.36 per share through March 31, 2014, and at the annual rate of $0.40 per share commencing June 1, 2014.

Pursuant to our bank loan agreement (see Note 6, Debt, of "Notes to Consolidated Financial Statements" in Item 8 of this Form 10-K), the payment of cash dividends is subject to annual rate restrictions. We have paid cash dividends each year since 1973 and have increased our dividend each year since 2004.

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(d) Certain Sales and Repurchases of VSE Common Stock

During the fiscal year covered by this Form 10-K, VSE did not sell any equity securities of VSE that were not registered under the Securities Act of 1933, as amended. During the fourth quarter of the fiscal year covered by this Form 10-K, no purchases of equity securities of VSE were made by or on behalf of VSE or any "affiliated purchaser" (as defined in Exchange Act Rule 10b-18 (a)(3)).

(e) Equity Compensation Plan Information

We have two compensation plans approved by our stockholders under which our equity securities are authorized for issuance to employees and directors: (i) the VSE Corporation 2004 Non-Employee Directors Stock Plan and (ii) the VSE Corporation 2006 Restricted Stock Plan (the "2006 Plan"). On May 6, 2014, the stockholders approved amendments to the 2006 Plan extending the term thereof until May 6, 2021 and authorized an additional 250,000 shares of our common stock for issuance under the 2006 Plan.

As of December 31, 2014, 67,075 shares of VSE common stock were available for future issuance under the VSE Corporation 2004 Non-Employee Directors Stock Plan and 278,482 shares of VSE common stock were available for future issuance under the 2006 Plan.

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Performance Graph

Set forth below is a line graph comparing the cumulative total return of VSE common stock with (a) a performance index for the broad market (The NASDAQ Global Select Market) on which VSE common stock is traded and (b) a published industry index. VSE common stock is traded on The NASDAQ Global Select Market, and our industry group is engineering and technical services (formerly SIC Code 8711). Accordingly, the performance graph compares the cumulative total return for VSE common stock with (a) an index for The NASDAQ Global Select Market (U.S. companies) ("NASDAQ Index") and (b) our peer group.

Performance Graph Table

	2009	2010	2011	2012	2013	2014
VSE	100	73.65	54.72	55.94	110.68	152.94
NASDAQ Composite	100	117.61	118.70	139.00	196.83	223.74
Peer Group	100	100.27	89.51	93.46	143.65	142.86

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ITEM 6. Selected Financial Data

(In thousands, except per share data)

	Years ended December 31,				
	2014	2013	2012	2011	2010
Revenues	$424,071	$471,638	$546,755	$580,762	$810,955
Income from continuing operations	$20,489	$23,990	$27,364	$20,190	$23,505
(Loss) income from discontinued operations	(1,124)	(1,138)	(6,070)	362	182
Net income	$19,365	$22,852	$21,294	$20,552	$23,687
Basic earnings per share:					
Income from continuing operations	$3.83	$4.50	$5.18	$3.86	$4.53
(Loss) income from discontinued operations	(0.21)	(0.21)	(1.15)	0.07	0.03
Net income	$3.62	$4.29	$4.03	$3.93	$4.56
Diluted earnings per share:					
Income from continuing operations	$3.82	$4.49	$5.15	$3.83	$4.50
(Loss) income from discontinued operations	(0.21)	(0.21)	(1.14)	0.07	0.03
Net income	$3.61	$4.28	$4.01	$3.90	$4.53
Cash dividends per common share	$0.39	$0.35	$0.31	$0.27	$0.23

	As of December 31,				
	2014	2013	2012	2011	2010
Working capital	$34,871	$47,691	$64,976	$71,123	$54,569
Total assets	$355,330	$380,529	$410,211	$454,512	$288,426
Long-term debt	$23,563	$64,487	$116,377	$144,759	$11,111
Long-term lease obligations	$24,584	$25,721	$27,435	$33,938	$20,258
Stockholders' equity	$205,489	$186,803	$164,335	$143,600	$123,776

This consolidated summary of selected financial data should be read in conjunction with Management's Discussion and Analysis of the Financial Condition and Results of Operations included in Item 7 of this Form 10-K and with the Consolidated Financial Statements and related Notes included in Item 8 of this Form 10-K. The historical results set forth in this Item 6 are not necessarily indicative of the results of operations to be expected in the future.

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

Executive Overview

Customers and Services

We provide sustainment services for legacy systems and equipment and professional and technical services to: the United States Government (the "government"), including the United States Department of Defense ("DoD") and federal civilian agencies; the United States Postal Service ("USPS"); commercial customers; and to other customers. Our largest customers are DoD and USPS. Our operations consist primarily of vehicle fleet parts supply, supply chain management, ship and aircraft maintenance, vehicle and equipment maintenance and refurbishment, logistics, engineering, energy and environmental, IT solutions, health care IT, and consulting services performed on a contract basis. See Item 1 "Business – Revenues and Contracts" on page 6 for revenues by customer.

Acquisition

In January 2015, we acquired four businesses that specialize in maintenance, repair and overhaul ("MRO") services and parts supply for corporate and regional jet aircraft engines and engine accessories. The businesses acquired include Air Parts & Supply Co., Kansas Aviation of Independence, L.L.C., Prime Turbines LLC, and CT Aerospace LLC. These four businesses will operate as a combined group under our newly formed wholly owned subsidiary VSE Aviation, Inc., which has retained certain key management members of the former ownership group.

Organization and Segments

Our operations are conducted within four reportable segments aligned with our management groups: 1) Supply Chain Management; 2) International; 3) Federal; and 4) IT, Energy and Management Consulting. Beginning in 2015, we are consolidating our International and Federal groups into a single management group and one reportable segment. Also beginning in 2015, the newly acquired companies operating under our subsidiary VSE Aviation, Inc. will be included in our current segments or in a new segment.

Supply Chain Management Group – Our Supply Chain Management Group provides sourcing, acquisition, scheduling, transportation, shipping, logistics, data management, and other services to assist our clients with supply chain management efforts. This group consists of our wholly owned subsidiary Wheeler Bros., Inc. ("WBI"). Significant current work efforts for this group include WBI's ongoing USPS Managed Inventory Program ("MIP") that supplies vehicle parts for the USPS truck fleet, other projects to support the USPS, managed inventory services and parts sales to support commercial client truck fleets, and parts sales to DoD.

International Group – Our International Group provides engineering, industrial, logistics, maintenance, information technology, fleet-wide ship and aircraft support, aircraft sustainment and maintenance, facility operations, storage and disposal support for seized and forfeited general property programs, and foreign military sales services to the U.S. military branches, government agencies, and other customers. This group provides its services to the U.S. Navy, Air Force, Department of Justice, Bureau of Alcohol, Tobacco, Firearms and Explosives ("ATF"), and other customers. Current and recent work efforts for this group include assistance to the U.S. Navy in executing its Foreign Military Sales ("FMS") Program for surface ships sold, leased or granted to foreign countries, various task orders under the U.S. Air Force Contract Field Teams ("CFT") Program, and management of seized and forfeited general property programs ("Seized Asset Programs").

Federal Group - Our Federal Group provides engineering, technical, management, and integrated logistics support services to U.S. military branches, government agencies and other customers. These services include full life cycle engineering, logistics, maintenance, field support, and refurbishment services to extend and enhance the life of existing vehicles and equipment; comprehensive systems and software engineering, systems technical support, configuration management, obsolescence management, prototyping services, technology insertion programs, and technical documentation and data packages; and management and execution of government programs under large multiple award contracts. This group provides its services to the U.S. Army, Army Reserve, Marine Corps, and other customers. Significant current work efforts for this group include our ongoing U.S. Army Reserve vehicle refurbishment program and various vehicle and equipment maintenance and sustainment programs for U.S. Army commands.

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IT, Energy and Management Consulting Group – Our IT, Energy and Management Consulting Group consists of our wholly owned subsidiaries Energetics Incorporated ("Energetics") and Akimeka, LLC ("Akimeka"). This group provides technical and consulting services primarily to various DoD and federal civilian agencies, including the United States Departments of Energy, Homeland Security, Commerce, Interior, Labor, Agriculture, and Housing and Urban Development; the Social Security Administration; the Pension Benefit Guaranty Corporation; the National Institutes of Health; customers in the military health system; and other government agencies and commercial clients. Energetics provides technical, policy, business, and management support in areas of energy modernization, clean and efficient energy, climate change mitigation, infrastructure protection, and measurement technology. Akimeka offers solutions in fields that include medical logistics, medical command and control, e-health, information assurance, public safety, enterprise architecture development, information assurance/business continuity, program and portfolio management, network IT services, systems design and integration, quality assurance services, and product and process improvement services.

Concentration of Revenues

	(in thousands)					
	Years ended December 31,					
Source of Revenues	2014	%	2013	%	2012	%
USPS MIP	$160,742	38	$142,147	30	$129,392	24
FMS Program	86,399	20	94,950	20	88,167	16
U.S. Army Reserve	47,765	11	60,162	13	78,269	14
Other	129,165	31	174,379	37	250,927	46
Total Revenues	$424,071	100	$471,638	100	$546,755	100

Management Outlook

Our January 2015 acquisition of four aviation businesses operating under VSE Aviation, Inc. ("VAI") represents a logical next step in our strategy to expand the markets for our sustainment services. We have been performing aircraft maintenance, repair, and overhaul ("MRO") services on our CFT IDIQ contract since 2008, and we have a long history of providing ship and vehicle MRO services to our DoD markets. Our 2011 acquisition of WBI was our first step in bringing the supply chain element of sustainment in house. Our successful foray into aviation MRO provided us with the platform to enter the aviation supply chain market. The lion's share of WBI and VAI business extends beyond our traditional markets, and neither depends upon federal budget actions.

The VAI acquisition enhances our range of service offerings, broadens our client base, and decreases our reliance on federal government procurement and budgeting decisions. The addition of these aviation MRO and supply chain management competencies is in furtherance of our long range strategic growth efforts that focus on extending our vehicle, ship, and aircraft sustainment and logistics services to new markets. We are committed to providing value to our clients and optimizing their investment in existing physical assets by assisting them in extending service life and enhancing performance as an attractive alternative to costly replacement. With this aviation acquisition, we expect to become less reliant on DoD with respect to sustaining and growing our revenues.

Managed inventory services centered on vehicle fleet sustainment will continue to be a key service offering of our Supply Chain Management Group. WBI's USPS MIP provides ongoing mission critical supply chain support to the USPS, which provides us with a steady revenue and earnings source. This program does not rely on appropriated government spending, as it is primarily self-funded through revenues generated by USPS business operations. The USPS is challenged by an aging fleet and constrained vehicle procurement resources. We have been successful in competitively winning work for modifying the existing fleet to address the sharp increase in demand for package delivery. WBI is our largest revenue source and we experienced growth in this program in 2014. Additionally, WBI's managed inventory competency is being successfully marketed to commercial clients operating large vehicle fleets.

WBI's successful operating performance has increased the likelihood that certain financial performance thresholds in our acquisition agreement will be met requiring us to make certain post-closing earn-out payments to WBI's sellers. Accordingly, we recorded charges related to this earn-out obligation that offset increases in our Supply Chain Management Group operating income by approximately $3.1 million in 2014. Success in WBI's offerings to both traditional and commercial markets has encouraged us to focus our strategic direction on this part of our business and direct financial and management resources toward such efforts.

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Decreases in government spending for certain programs and services and increased competition for fewer opportunities has led to declines in our DoD and other federal civilian agency revenues. As revenues in our legacy markets have declined, we have responded by taking active measures to adjust our cost structure and operating model to better meet the needs of these markets. We have eliminated certain management positions, consolidated our operations into a fewer number of facilities, and reduced other costs that have supported these activities. Going forward, we will consolidate our International and Federal Groups into a single operating group and report their results as a combined reporting segment beginning in 2015. We expect the cost reductions and consolidation made in the third and fourth quarters of 2014 to provide an estimated annual savings of approximately $4 million. We will continue cost balancing efforts to remain competitive and profitable as we go forward. Despite these challenges to our revenue base, we have key programs in our legacy markets that continue to provide a substantial portion of our business. These programs include our U.S. Navy FMS Program, and our military vehicle and equipment refurbishment work.

Our U.S. Navy FMS Program is our second largest source of revenue. This program does not rely on appropriated government spending as it is largely funded by foreign government clients. Historically, supporting the U.S. Navy in reactivating, transferring and providing follow on technical support to receiving navies constituted the majority of our FMS business. FMS Program revenues for the past few years have been impeded by protracted delays in passing legislation required for the transfer of naval vessels to allied navies. In December 2014, legislation was passed allowing the transfer of certain vessels to selected foreign nations, which is expected to provide us with future FMS Program revenue increases. The revenues associated with these transfers will take time to ramp up, and we expect to begin realizing these revenues in late 2015 and in 2016. Our current contract supporting this work gives us potential contract coverage of up to $1.5 billion over a five-year period that began in January 2012. This contract coverage, combined with the eligibility, upon approval, of U.S. Navy ships for transfer to foreign government clients, presents us with additional revenue opportunities pending future passage of Naval Vessel Transfer Act legislation.

Without the benefit of revenues from vessel transfers in recent years, follow on technical support work has generated the majority of revenues under our FMS Program. These services are provided to several foreign client countries, the largest of which is the Egyptian Navy. Due to significant domestic and political unrest in Egypt, we have been unable to maintain a consistent level of staffing in that country, and accordingly, our revenues associated with follow on technical support services provided to the Egyptian Navy have fluctuated in recent years. Our Egyptian Navy support services generated approximately $33 million of revenue for 2014 and approximately $48 million of revenue for 2013. We believe that our long term relationship with the Egyptian Navy remains strong, and as a result, we anticipate benefiting if the political situation in Egypt stabilizes and U.S. and Egyptian relations improve. We cannot, however, predict how the Egyptian political situation will unfold or the long range affect it will have on our Egyptian Navy support program.

Our vehicle and equipment refurbishment work for the U.S. Army Reserve has been our third largest source of revenue. The U.S. Army Reserve has been adversely affected by DoD and Department of the Army budget reductions, and we have experienced changes to contractual coverage that have adversely affected the flow of work on this program in recent years. This has resulted in a reduction in revenues and lower profit margins on this program compared to previous years. This program generated approximately $48 million of revenue for 2014, a decline from approximately $60 million of revenue for 2013. Contractual coverage on a portion of the work on our current task orders expired in August 2014, and revenue will be lower going forward. Revenue for this program was approximately $8 million for the fourth quarter of 2014. Contractual coverage on our current task orders has been extended for varying periods of time at lower levels, and it remains uncertain how much of this work will be re-competed, continued or extended.

Our work as the prime contractor for the U.S. Department of Treasury Executive Office for Asset Forfeiture general property program ended in 2014, and substantially all of our work on this program was completed as of March 2014. This program generated approximately $9 million of revenue for 2014 and approximately $36 million of revenue for

2013.

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Bookings and Funded Backlog

Revenues for federal government contract work performed by our International, Federal, and IT, Energy and Management Groups depend on contract funding ("bookings"), and bookings generally occur when contract funding documentation is received. Funded contract backlog is an indicator of potential future revenue for these groups. While bookings and funded contract backlog generally result in revenue, occasionally we will have funded contract backlog that expires or is de-obligated upon contract completion and does not generate revenue.

Our Supply Chain Management Group revenues are affected by maintenance schedules and the rate and timing of parts failure on customer vehicles. Bookings for this group occur at the time of sale. Accordingly, this group does not generally have funded contract backlog and it is not an indicator of potential future revenues.

A summary of our bookings and revenues for our International, Federal, and IT, Energy and Management Groups for the years ended December 31, 2014, 2013 and 2012, and funded contract backlog for these groups as of December 31, 2014, 2013 and 2012 is as follows (in millions).

	(in millions)		
	2014	2013	2012
Bookings	$391	$501	$539
Revenues	$424	$472	$547
Funded Backlog	$195	$236	$250

The addition of our acquired aviation businesses and growth of our Supply Chain Management Group revenues is expected to cause our federal government contract revenues to become a smaller proportion of our aggregate revenues in the future. Accordingly, bookings and backlog may become less indicative of future revenues.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The ASU is based on the principle that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to fulfill a contract. The ASU will become effective for us on January 1, 2017. We currently are assessing the impact that this standard will have on our consolidated financial statements.

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, which require us to make estimates and assumptions. We believe the following critical accounting policies affect the more significant accounts, particularly those that involve judgments, estimates and assumptions used in the preparation of our consolidated financial statements.

Revenue Recognition

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the fee is fixed or determinable, and collectability is probable.

Substantially all of our Supply Chain Management Group revenues result from the sale of vehicle parts to clients. We recognize revenue from the sale of vehicle parts when the customer takes ownership of the parts.

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Substantially all of our International, Federal, and IT, Energy and Management Consulting work is performed for our customers on a contract basis. The three primary types of contracts used are time and materials, cost-type, and fixed-price. Revenues result from work performed on these contracts by our employees and our subcontractors and from costs for materials and other work related costs allowed under our contracts.

Revenue recognition methods on fixed-price contracts will vary depending on the nature of the work and the contract terms. Revenues on fixed-price service contracts are recorded as work is performed, typically ratably over the service period. Revenues on fixed-price contracts that require delivery of specific items are recorded based on a price per unit as units are delivered. We classify our Supply Chain Management Group revenues as fixed-price revenue.

Revenues on cost-type contracts are recorded as contract allowable costs are incurred and fees are earned. Our FMS Program contract is a cost plus award fee contract. This contract has terms that specify award fee payments that are determined by performance and level of contract activity. Award fees are made during the year through a contract modification authorizing the award fee that is issued subsequent to the period in which the work is performed. We recognize award fee income on the FMS Program contract when the fees are fixed or determinable. Due to such timing, and to fluctuations in the level of revenues, profits as a percentage of revenues on this contract will fluctuate from period to period.

Revenues for time and materials contracts are recorded on the basis of contract allowable labor hours worked multiplied by the contract defined billing rates, plus the direct costs and indirect cost burdens associated with materials and subcontract work used in performance on the contract. Generally, profits on time and materials contracts result from the difference between the cost of services performed and the contract defined billing rates for these services.

Revenues by contract type for the years ended December 31 were as follows (in thousands):

	2014		2013		2012	
Contract Type	Revenues	%	Revenues	%	Revenues	%
Fixed-price	$260,289	61.4	$257,189	54.5	$224,478	41.1
Cost-type	120,915	28.5	119,350	25.3	124,908	22.8
Time and materials	42,867	10.1	95,099	20.2	197,369	36.1
	$424,071	100.0	$471,638	100.0	$546,755	100.0

We will occasionally perform work at risk, which is work performed prior to formalizing contract funding for such work. Revenue related to work performed at risk is not recognized until it can be reliably estimated and its realization is probable. We recognize this "risk funding" as revenue when the associated costs are incurred or the work is performed. We are at risk of loss for any risk funding not received. Revenues recognized as of December 31, 2014 include approximately $2.9 million for which we had not received formalized funding. We believe that we are entitled to reimbursement and expect to receive all of this funding.

Earn-out Obligations

We utilize the Monte Carlo valuation model for our earn-out obligation. Significant unobservable inputs used to value the contingent consideration include projected earnings before interest, taxes, depreciation and amortization and the discount rate. Interest expense and subsequent changes in the fair value of the earn-out obligations are recognized in earnings for the period of the change.

Goodwill and Intangible Assets

Goodwill is subject to a review for impairment at least annually. We perform this review at the beginning of our fourth quarter and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The impairment assessment requires us to estimate the fair value of our reporting units and involves the use of subjective assumptions. We estimated the fair value of our reporting units using a weighting of fair values derived from the income approach, market approach, and comparative transactions approach with the heaviest weighting placed on the income approach. Under the income approach, we calculate the fair value of a reporting unit based on the present value of estimated future cash flows. Cash flow projections are based on our estimates of revenue growth rates and operating margins, taking into consideration industry and market conditions. The discount rate used is based on a weighted average cost of capital adjusted for the relevant risk associated with the characteristics of the business and the projected cash flows.

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In the fourth quarter of 2014, we performed our annual goodwill impairment analysis for each of our reporting units. The results of the impairment analysis indicated that the estimated fair values of our reporting units substantially exceeded their carrying values.

As of December 31, 2014, we have no intangible assets with indefinite lives and we had an aggregate of approximately $92 million of goodwill associated with our acquisitions.

Results of Operations

	Revenues (in thousands) Years ended December 31,					
	2014	%	2013	%	2012	%
Supply Chain Management Group	$172,482	40.7	$154,702	32.8	$143,014	26.2
International Group	106,369	25.1	146,908	31.2	167,193	30.6
Federal Group	84,392	19.9	95,435	20.2	142,323	26.0
IT, Energy and Management Consulting Group	60,828	14.3	74,593	15.8	94,225	17.2
	$424,071	100.0	$471,638	100.0	$546,755	100.0

Our revenues decreased by approximately $48 million or 10% for the year ended December 31, 2014 as compared to the prior year. The change in revenues for this period resulted from a decrease in our International Group of approximately $41 million; a decrease in our IT, Energy, and Management Consulting Group of approximately $14 million; and a decrease in our Federal Group of approximately $11 million. These decreases were partially offset by an increase in our Supply Chain Management Group of approximately $18 million.

Our revenues decreased by approximately $75 million or 14% for the year ended December 31, 2013 as compared to the prior year. The change in revenues for this period resulted from a decrease in our Federal Group of approximately $47 million; a decrease in our International Group of approximately $20 million and a decrease in our IT, Energy, and Management Consulting Group of approximately $20 million. These decreases were partially offset by an increase in our Supply Chain Management Group of approximately $12 million.

	Consolidated Statements of Income (in thousands) Years ended December 31,					
	2014	%	2013	%	2012	%
Revenues	$424,071	100.0	$471,638	100.0	$546,755	100.0
Contract costs	383,001	90.3	424,250	90.0	490,686	89.8
Selling, general and administrative expenses	4,140	1.0	3,285	0.7	3,968	0.7
Impairment of goodwill and intangible assets	-	0.0	-	0.0	1,025	0.2
Operating income	36,930	8.7	44,103	9.3	51,076	9.3
Interest expense, net	3,983	0.9	5,789	1.2	7,224	1.3
Income before income taxes	32,947	7.8	38,314	8.1	43,852	8.0
Provision for income taxes	12,458	3.0	14,324	3.0	16,488	3.0
Income from continuing operations	20,489	4.8	23,990	5.1	27,364	5.0
(Loss) income from discontinued operations, net of tax	(1,124)	(0.2)	(1,138)	(0.2)	(6,070)	(1.1)
Net income	$19,365	4.6	$22,852	4.9	$21,294	3.9

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Contract costs consist primarily of direct costs including labor, inventory, material, and supplies used in the performance of our work and delivery of our products, and indirect costs associated with these direct costs. These costs will generally increase or decrease in conjunction with our level of work or products sold and associated revenues.

Our contract costs decreased by approximately $41 million or 10% in 2014 as compared to 2013. The decrease resulted from a decrease in our International Group of approximately $37 million, a decrease in our IT, Energy, and Management Consulting Group of approximately $11 million, a decrease in our Federal Group of approximately $8 million, and an increase in our Supply Chain Management Group of approximately $15 million.

Our contract costs decreased by approximately $66 million or 14% in 2013 as compared to 2012. The decrease resulted from a decrease in our Federal Group of approximately $39 million, a decrease in our International Group of approximately $21 million, a decrease in our IT, Energy, and Management Consulting Group of approximately $17 million, and an increase in our Supply Chain Management Group of approximately $9 million.

Selling, general and administrative expenses consist primarily of costs and expenses that are not chargeable or reimbursable on our operating unit contracts. These costs increased by approximately $900 thousand for 2014 as compared to the prior year due to legal, consulting, professional services fees and other costs associated with strategic planning efforts, including costs related to the acquisition of our aviation businesses, which was completed in January 2015, of approximately $1.1 million.

Our operating income decreased by approximately $7.2 million or 16% in 2014 as compared to 2013. The decrease resulted primarily from a decrease of approximately $3.3 million in our International Group, a decrease of approximately $2.7 million in our Federal Group, and a decrease of approximately $2.4 million in our IT, Energy and Management Consulting Group. These decreases were partially offset by an increase in operating income in our Supply Chain Management Group of approximately $2.4 million.

Our operating income decreased by approximately $7 million or 14% in 2013 as compared to 2012. The decrease resulted primarily from a decrease in operating income of approximately $8 million in our Federal Group and a decrease in operating income in our IT, Energy and Management Consulting Group of approximately $2.8 million. These decreases were partially offset by an increase in operating income in our Supply Chain Management Group of approximately $3.3 million and an increase in operating income in our International Group of approximately $1 million.

Interest expense decreased in 2014 as compared to 2013, and in 2013 as compared to 2012, due to reductions in our level of borrowing as we paid down our bank loan. Interest expense also includes interest related to our executive and administrative headquarters facility lease. The amount of interest expense associated with capital leases is approximately $1.7 million for 2014, approximately $1.7 million for 2013, and approximately $1.2 million for 2012.

Provision for Income Taxes

Our effective tax rate from continuing operations was 37.8% for 2014, 37.4% for 2013, and 37.6% for 2012. Our tax rate is affected by discrete items that may occur in any given year, but may not be consistent from year to year. In addition to state income taxes, certain tax credits and other items had an impact on the difference between our statutory U.S. Federal income tax rate of 35% and our effective tax rate. Permanent differences and federal and state tax credits such as the work opportunity tax credit and a state educational improvement tax credit provided a benefit to our tax rates of 1.7% for 2014, 1.9% for 2013 and 1.7% for 2012.

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Supply Chain Management Group Results

The results of operations for our Supply Chain Management Group are (in thousands):

	Years ended December 31,					
	2014	%	2013	%	2012	%
Revenues	$172,482	100.0	$154,702	100.0	$143,014	100.0
Contract costs	142,201	82.5	126,869	82.0	118,146	82.6
Selling, general and administrative expenses	587	0.3	534	0.4	854	0.6
Operating income	$29,694	17.2	$27,299	17.6	24,014	16.8

Revenues for our Supply Chain Management Group increased approximately $18 million or 11% for 2014, as compared to the prior year. The revenue increase resulted primarily from an increase in WBI's USPS MIP revenues and to additional revenues associated with other projects performed for the USPS and revenues from new customers. DoD revenues for this group declined slightly in 2014 as compared to the prior year. Contract costs for our Supply Chain Management Group increased by approximately $15 million or 12% for 2014 as compared to the prior year. Operating income for our Supply Chain Management Group increased by approximately $2.4 million or 9% for 2014 as compared to the prior year. Contract cost and operating income increases resulted primarily from the increase in USPS MIP revenues. Operating income for this segment was decreased by approximately $3.1 million in 2014 and by approximately $183 thousand in 2013 due to adjustments to the accrued earn-out obligation associated with our acquisition of WBI.

Revenues for our Supply Chain Management Group increased approximately $12 million or 8% for 2013, as compared to the prior year. The revenue increase resulted primarily from an increase in WBI's USPS MIP revenues of approximately $11.4 million. Contract costs for our Supply Chain Management Group increased by approximately $9 million or 7% for 2013 as compared to the prior year. Operating income for our Supply Chain Management Group increased by approximately $3 million or 14% for 2013 as compared to the prior year. Contract cost, operating income and profit percentage increases resulted primarily from the increase in USPS MIP revenues. Operating income for this segment was decreased by approximately $183 thousand in 2013 and by approximately $802 thousand in 2012 due to adjustments to the accrued earn-out obligation associated with our acquisition of WBI.

International Group Results

The results of operations for our International Group are (in thousands):

	Years ended December 31,					
	2014	%	2013	%	2012	%
Revenues	$106,369	100.0	$146,908	100.0	$167,193	100.0
Contract costs	102,055	95.9	138,857	94.5	159,967	95.7
Selling, general and administrative expenses	519	0.5	982	0.7	1,174	0.7
Operating income	$3,795	3.6	$7,069	4.8	$6,052	3.6

Revenues for our International Group decreased approximately $41 million or 28% for 2014, as compared to the prior year. The decrease in revenues for 2014 was primarily attributable to a decrease of approximately $27 million associated with the completion of our U.S. Treasury Seized Assets Program in March 2014, to a decrease of approximately $9 million on our FMS Program, and to smaller decreases in our CFT Program services and other work.

Revenues for our International Group decreased approximately $20 million or 12% for 2013, as compared to the prior year. The decrease in revenues for 2013 was primarily attributable to a decline of approximately $18 million in pass-through work provided on engineering and technical services task orders, and to lesser declines in revenues from our CFT Program services. These decreases were partially offset by increases in revenues on our FMS and Seized Asset Programs.

Contract costs for our International Group decreased approximately $37 million or 27% for 2014, as compared to the prior year. The decrease in contract costs for 2014 was primarily attributable to a decrease of approximately $23 million associated with the completion of our U.S. Treasury Seized Assets Program in March 2014, to a decrease of approximately $8 million on our FMS Program, and to smaller decreases in our CFT Program services and other work.

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Contract costs for our International Group decreased approximately $21 million or 13% for 2013, as compared to the prior year. The decrease in contract costs for 2013 was primarily attributable to a decline of approximately $18 million in pass-through work provided on engineering and technical services task orders, and to lesser declines in revenues from our CFT Program services. These decreases were partially offset by increases on our FMS and Seized Asset Programs.

Operating income for our International Group decreased by approximately $3.3 million or 46% for 2014, as compared to the prior year. The decrease in operating income for 2014 was primarily attributable to a decrease of approximately $3.5 million associated with the completion of our U.S. Treasury Seized Assets Program in March 2014. Our operating income was reduced in 2014 by a charge of approximately $398 thousand for a Department of Treasury claim for an inventory shortage, and was reduced in 2013 by a charge of approximately $1.2 million associated with idle warehouse facilities and a charge of $485 thousand for a Department of Treasury claim for flood damage to vehicles, all of which were associated with our Seized Asset Programs. In 2014, we recovered a net amount of approximately $206 thousand associated with the Department of Treasury vehicle flood damage claim. Profit margins in this group can vary due to fluctuations in contract activity and the timing of contract award fees associated with our FMS Program. Award fee evaluations on our FMS Program occur three times per year and we recognize award fee revenue and income in the period we receive contractual notification of the award. We recognized award fee revenue and income in 2014 from three award fee notifications.

Operating income for our International Group increased by approximately $1 million or 17% for 2013, as compared to the prior year. Our operating income was reduced for these two years by: 1) charges of approximately $1.9 million in 2012 and approximately $1.2 million in 2013 associated with idle warehouse facilities; 2) a charge of $485 thousand in December 2013 for a Department of Treasury claim for flood damage to vehicles; and 3) a loss of $750 thousand in 2012 associated with the final payment on a work share agreement with a subcontractor, all of which were associated with our Seized Asset Programs. The year over year change in operating income was also impacted by an increase in operating income in 2013 associated with the increased revenues on our Seized Asset Programs and the timing of award fee recognition on our FMS Program. We recognized award fee revenue and income in 2013 from three award fee notifications. Due to a catch up of delays in government contractual notification, we recognized revenue and income from four award fees in 2012, including approximately $1.1 million in award fee revenue and income that would typically have been recognized in the prior year. This effectively increased 2012 operating income associated with this program as compared to the typical pattern.

Federal Group Results

The results of operations for our Federal Group are (in thousands):

	Years ended December 31,					
	2014	%	2013	%	2012	%
Revenues	$ 84,392	100.0	$95,435	100.0	$142,323	100.0
Contract costs	84,635	100.3	92,681	97.1	131,269	92.2
Selling, general and administrative expenses	100	0.1	354	0.4	636	0.5
Operating income	$ (343)	(0.4)	$2,400	2.5	$10,418	7.3

Revenues for our Federal Group decreased approximately $11 million or 12% for the year ended 2014, as compared to the prior year. The decrease in revenues is primarily due to a reduction in our Army Reserve vehicle refurbishment work of approximately $12 million. Our Army Reserve vehicle refurbishment work decreased as a result of a transition of contractual coverage in the third quarter of 2013 which resulted in a temporary suspension of work and generally lower levels of revenues subsequent to such transition. Additionally, contractual coverage on a portion of the work on our current task orders expired in the third quarter of 2014.

Revenues for our Federal Group decreased approximately $47 million or 33% for the year ended 2013, as compared to the prior year. The decrease in revenues is primarily due to the expiration of a contract at the end of 2012 to provide mechanical maintenance services for Mine Resistance Ambush Protected ("MRAP") vehicles and systems in Kuwait and to a reduction in revenues from our vehicle and equipment refurbishment work for the U.S. Army Reserve due to the suspension of work in the third quarter of 2013. The reduction in revenues due to the expiration of the MRAP contract was approximately $26 million. The reduction in revenues from our vehicle and equipment refurbishment work for the U.S. Army Reserve was approximately $18 million.

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Contract costs for our Federal Group decreased approximately $8 million or 9% for 2014, as compared to the prior year. The decrease in contract costs is primarily due to a reduction in contract costs from our U.S. Army Reserve vehicle refurbishment program of approximately $11 million. We incurred contract costs for increases in other Federal Group work.

Contract costs for our Federal Group decreased approximately $39 million or 29% for 2013, as compared to the prior year. The decrease in contract costs is primarily due to the expiration of the MRAP contract and to a reduction in contract costs from our U.S. Army Reserve vehicle refurbishment program. The reduction in contract costs due to the expiration of the MRAP contract was approximately $24 million. The reduction in contract costs from our vehicle and equipment refurbishment work for the U.S. Army Reserve was approximately $13 million.

Operating income for our Federal Group decreased by approximately $2.7 million or 114% for 2014 as compared to the prior year. The decrease resulted primarily from a reduction of profits on our U.S. Army Reserve program of approximately $1 million due to the reduction in revenues on this program and to the continuation of fixed infrastructure costs during the time that revenue levels have declined.

Operating income for our Federal Group decreased by approximately $8 million or 77% for 2013 as compared to the prior year. The decrease resulted primarily from a reduction of profits on our U.S. Army Reserve program of approximately $5 million due to the reduction in revenues on this program and to the continuation of fixed infrastructure costs during the time that work was suspended, and to a decrease of approximately $2 million in profits associated with the expiration of the MRAP contract. The decrease in the profit percentage in 2013 as compared to 2012 is also primarily due to the continuation of fixed infrastructure costs while work was suspended under the U.S. Army Reserve program.

IT, Energy and Management Consulting Group Results

The results of operations for our IT, Energy and Management Consulting Group are (in thousands):

	Years ended December 31,					
	2014	%	2013	%	2012	%
Revenues	$60,828	100.0	$74,593	100.0	$94,225	100.0
Contract costs	54,119	89.0	65,359	87.6	82,085	87.1
Selling, general and administrative expenses	75	0.1	173	0.2	324	0.4
Operating income	$6,634	10.9	$9,061	12.2	$11,816	12.5

Revenues for our IT, Energy and Management Consulting Group decreased approximately $14 million or 18% for 2014, as compared to the prior year. Contract costs for our IT, Energy and Management Consulting Group decreased approximately $11 million or 17% for 2014, as compared to the prior year. The decreases in revenues and contract costs were due primarily to a decline in services ordered by clients on continuing contracts and the expiration of a contract in the fourth quarter of 2013. Revenue on the expired contract was approximately $7.6 million for 2013. Operating income for this segment decreased approximately $2.4 million, or 27% for 2014, as compared to the prior year. The decrease in operating income is primarily attributable to the decreases in revenues and lower profit margins associated with new contracts that replaced predecessor contracts, which were partially offset by indirect cost reductions and efficiencies.

Revenues for our IT, Energy and Management Consulting Group decreased approximately $20 million or 21% for 2013, as compared to the prior year. Contract costs for our IT, Energy and Management Consulting Group decreased approximately $17 million or 20% for 2013, as compared to the prior year. The decreases in revenues and contract costs were due primarily to a decrease in services performed due to contract expirations and a decline in services ordered by clients on continuing contracts. Operating income for this segment decreased approximately $2.8 million, or 23% for 2013, as compared to the prior year. The decrease in operating income is primarily attributable to a reduction of $5.1 million in the accrued earn-out obligation associated with our acquisition of Akimeka that increased prior year operating income. There was no earn-out obligation adjustment in 2013. Without the prior year earn-out obligation adjustment, operating income for 2013 would be higher than in the prior year due to improved operating and cost efficiencies.

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Financial Condition

Our financial condition did not change materially in 2014. We used our cash flow to reduce our bank debt by approximately $41 million in 2014. Changes to other asset and liability accounts were due primarily to our earnings, our level of business activity, contract delivery schedules, subcontractor and vendor payments required to perform our work, and the timing of associated billings to and collections from our customers.

Liquidity and Capital Resources

Cash Flows

Cash and cash equivalents increased by approximately $43 thousand during 2014.

Cash provided by operating activities decreased by approximately $6.9 million in 2014 as compared to 2013. The change is attributable to a decrease of approximately $8.2 million due to changes in the levels of operating assets and liabilities; an increase of approximately $4.8 million in depreciation and amortization and other non-cash operating activities; and a decrease of approximately $3.5 million in cash provided by net income. Our largest operating assets are our accounts receivable and inventories. Our largest operating liabilities are our accounts payable and accrued expenses. A significant portion of our accounts receivable, accounts payable, and inventories result from the use of subcontractors to perform work on our contracts, from the purchase of materials to fulfill our contract requirements, and from the purchase and sale of inventory products. Accordingly, our levels of accounts receivable, accounts payable and inventories may fluctuate depending on the timing of services or products ordered, government funding delays, the timing of billings received from subcontractors and material and inventory vendors, and the timing of payments received from customers in payment of services and products. Such timing differences have the potential to cause increases and decreases in our accounts receivable, accounts payable, and inventories in short time periods. Our levels of accrued expenses tend to vary in accordance with our levels revenues and services performed.

Cash used in investing activities decreased approximately $1.0 million in 2014 as compared to 2013. Cash used in investing activities consisted of purchases of property and equipment.

Cash used in financing activities decreased approximately $7.2 million in 2014 as compared to 2013. Cash used in financing activities consisted primarily of repayments on our bank loan, earn-out obligation payments, and dividends.

Cash provided by operating activities decreased by approximately $3.2 million in 2013 as compared to 2012. The change is attributable to a decrease of approximately $1.2 million due to changes in the levels of operating assets and liabilities; a decrease of approximately $3.6 million in depreciation and amortization and other non-cash operating activities; and an increase of approximately $1.6 million in cash provided by net income.

Cash used in investing activities decreased approximately $21 million in 2013 as compared to 2012. This was primarily due to nonrecurring events in 2012, including cash used of approximately $9 million for capital investments related to the move of our corporate headquarters offices in May 2012 and approximately $9 million to purchase office, warehouse and distribution facilities that support our WBI operations in December 2012.

Cash used in financing activities increased approximately $20 million in 2013 as compared to 2012. This was primarily due to an increase of approximately $26 million in repayments on our bank loan.

We paid quarterly cash dividends totaling approximately $2.0 million or $0.38 per share during 2014. Pursuant to our bank loan agreement, our payment of cash dividends is subject to annual restrictions. We have paid cash dividends each year since 1973 and have increased our dividend each year since 2004.

Liquidity

Our internal sources of liquidity are primarily from operating activities, specifically from changes in the level of revenues and associated accounts receivable and accounts payable, and from profitability. Significant increases or decreases in revenues and accounts receivable and accounts payable can impact our liquidity. Our accounts receivable and accounts payable levels can be affected by changes in the level of the work we perform, by the timing of large materials purchases and subcontractor efforts used in our contracts, the timing of large inventory purchases to support our product offerings, and by government delays in the award of contractual coverage and funding and payments. Government funding delays can cause delays in our ability to invoice for revenues earned, resulting in a negative impact on our days sales outstanding.

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We also purchase property and equipment and invest in expansion, improvement, and maintenance of our operational and administrative facilities. In 2012, we made approximately $9 million in capital investments related to the move of our corporate headquarters offices in May 2012 and in December 2012 we used approximately $9 million to purchase office, warehouse and distribution facilities that support our WBI operations. From time to time, we may also invest in the acquisition of other companies.

Our external financing consists of a loan agreement with a group of banks. In January 2015, we amended and restated the loan agreement to facilitate our acquisition of four aviation businesses. Both the former and the amended and restated loan agreements are comprised of a term loan facility and a revolving loan facility. The revolving loan facility provides for revolving loans and letters of credit. The amended and restated loan agreement expires in January 2020.

The amended and restated term loan requires quarterly installment payments. Our scheduled term loan payments after December 31, 2014 are $11.2 million in 2015, $17.8 million in 2016, $21.6 million in 2017, $28.1 million in 2018, $30 million in 2019, and $41.3 million after 2019. The amount of term loan borrowings outstanding as of December 31, 2014 under the former loan agreement was $25 million. The amount of term loan borrowings outstanding at inception of the amended and restated loan agreement in January 2015 was $150 million.

The maximum amount of credit available to us from the banking group for revolving loans and letters of credit under the former loan agreement as of December 31, 2014 was $125 million. The maximum amount for revolving loans and letters of credit under the amended and restated agreement is $150 million. We may borrow and repay the revolving loan borrowings as our cash flows require or permit. We pay an unused commitment fee and fees on letters of credit that are issued. We had approximately $23.6 million in revolving loan amounts outstanding and no of letters of credit outstanding as of December 31, 2014 under the former loan agreement. The timing of certain payments made and collections received associated with our subcontractor, materials, and inventory requirements and other operating expenses can cause fluctuations in our outstanding revolving loan amounts. Delays in government funding of our work performed can also cause additional borrowing requirements.

Under the amended and restated loan agreement we may elect to increase the maximum availability of the term loan facility, the revolving loan facility, or both facilities up to an aggregate additional amount of $75 million.

We pay interest on the term loan borrowings and revolving loan borrowings at LIBOR plus a base margin or at a base rate (typically the prime rate) plus a base margin. As of December 31, 2014, the LIBOR base margin was 1.75% and the base rate base margin was 0.00%. At inception of the amended and restated loan agreement the LIBOR base margin is 2.25% and the base rate base margin was 1.00%. The base margins increase or decrease in increments as our Total Funded Debt/EBITDA Ratio increases or decreases.

We had interest rate hedges on a portion of our outstanding borrowings that expired June 30, 2014. Between June 30, 2014 and December 31, 2014, we had no interest rate hedges on our outstanding borrowings. The terms of the amended and restated loan agreement require us to have interest rate hedges on a portion of the outstanding term loan for the first three years of the agreement, and for such interest rate hedges to be in place within 60 days after inception of the agreement. We executed such compliant interest rate hedges in February 2015. As of December 31, 2014, interest rates on portions of our outstanding debt range from 1.91% to 3.25%, and the effective interest rate on our aggregate outstanding debt was 3.15%.

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Both the former and amended and restated loan agreements contain collateral requirements to secure our loan agreement obligations, restrictive covenants, a limit on annual dividends, and other affirmative and negative covenants, conditions and limitations. Upon execution of the amended and restated loan agreement, all restrictive covenants and the December 31, 2014 restrictive covenant measurement date under the former loan agreement were replaced by the restrictive covenants under the amended and restated agreement, with the initial measurement date being the date of inception of the amended and restated agreement. Restrictive covenants under the amended and restated loan agreement include a maximum Total Funded Debt/EBITDA Ratio and a minimum Fixed Charge Coverage Ratio, for which calculations as of the amended and restated agreement inception date are shown below. We were in compliance with required ratios and other terms and conditions at inception of the amended and restated loan agreement.

	Current Maximum Ratio	Actual Ratio
Total Funded Debt/EBITDA Ratio	3.50 to 1	3.17 to 1

	Minimum Ratio	Actual Ratio
Fixed Charge Coverage Ratio	1.20 to 1	1.97 to 1

We currently do not use public debt security financing.

Contractual Obligations

Our contractual obligations as of December 31, 2014 are (in thousands):

	Payments Due by Period				
Contractual Obligations	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Bank loan debt	$48,633	$25,000	$23,633	$-	$-
Operating leases, net of non-cancelable sublease income	9,106	3,613	4,306	1,187	-
Corporate headquarters lease	57,549	3,985	8,325	8,793	36,446
Purchase obligations	2,153	1,612	517	24	-
Total	$117,441	$34,210	$36,781	$10,004	$36,446

As of the date of inception of the amended and restated agreement in January 2015, our bank loan debt was $250 million and payments due by period were: $11.2 million in less than one year, $39.4 million in one to three years, $199.4 million in four to five years, and $0 after five years. Estimated cash requirements for interest on our bank loan debt are approximately $6.0 million for 2015 and $4.9 million for 2016.

Operating lease commitments are primarily for leased facilities for office, shop, and warehouse space. Equipment and software leases are also included in these amounts.

We have a 15-year lease agreement whereby lease payments began in May of 2012 for executive and administrative headquarters space. Terms of our lease agreement have required us to capitalize the construction costs of the leased building and account for the lease upon occupancy in May 2012 under the finance method of lease accounting rules.

Purchase obligations consist primarily of contractual commitments associated with our information technology systems. The table excludes contractual commitments for materials or subcontractor work purchased to perform government contracts. Such commitments for materials and subcontractors are reimbursable when used on the contracts, and generally are also reimbursable if a contract is "terminated for convenience" by the government pursuant to federal contracting regulations.

Inflation and Pricing

Most of our contracts provide for estimates of future labor costs to be escalated for any option periods, while the non-labor costs in our contracts are normally considered reimbursable at cost. Our property and equipment consists principally of computer systems equipment, furniture and fixtures, shop and warehouse equipment, and land, buildings and improvements. We do not expect the overall impact of inflation on replacement costs of our property and equipment to be material to our future results of operations or financial condition.

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ITEM 7A. Quantitative and Qualitative Disclosures About Market Risks

Interest Rates

Our bank loans provide available borrowing to us at variable interest rates. Accordingly, future interest rate changes could potentially put us at risk for a material adverse impact on future earnings and cash flows. To mitigate the risks associated with future interest rate movements we have, at times, used interest rate hedges to fix the rate on portions of our outstanding borrowings. The resulting fixed rates on these portions of our debt is initially higher than the variable rate at the time the hedge is put in place, but gives us protection against future interest rate increases.

As of December 31, 2014, we did not have any interest rate hedges on our debt. In February 2015, we entered into an amortizing LIBOR based interest rate swap on our term loan for a term of four years with a notional amount of $100 million. The swap amount on our term loan decreases in increments on an annual basis. With the term loan swap in place, we pay an effective rate of 1.129% plus our base margin as of February 2015. Also in February 2015, we entered into a LIBOR based interest rate swap on our revolving loan for a term of three years with a notional amount of $25 million. With the revolving loan swap in place, we pay an effective rate of 0.95% plus our base margin as of February 2015.

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ITEM 8. Financial Statements and Supplementary Data

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of VSE Corporation

We have audited the accompanying consolidated balance sheets of VSE Corporation and Subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of VSE Corporation and Subsidiaries at December 31, 2014 and 2013, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), VSE Corporation and Subsidiaries' internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) and our report dated March 6, 2015 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

McLean, Virginia
March 6, 2015

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VSE Corporation and Subsidiaries
Consolidated Balance Sheets

(in thousands, except share and per share amounts)

	As of December 31	
	2014	2013
Assets		
Current assets:		
Cash and cash equivalents	$263	$220
Receivables, principally U.S. Government	59,391	78,387
Inventories	49,363	39,315
Deferred tax assets	1,834	863
Other current assets	11,517	10,641
Total current assets	122,368	129,426
Property and equipment, net	52,911	57,738
Intangible assets, net	72,209	82,257
Goodwill	92,052	92,052
Deferred tax assets	-	2,545
Other assets	15,790	16,511
Total assets	$355,330	$380,529
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of long-term debt	$24,837	$24,837
Current portion of earn-out obligation	9,455	-
Accounts payable	29,424	31,757
Accrued expenses and other current liabilities	23,245	24,661
Dividends payable	536	480
Total current liabilities	87,497	81,735
Long-term debt, less current portion	23,563	64,487
Deferred compensation	12,563	11,454
Long-term lease obligations, less current portion	24,584	25,721
Earn-out obligations, less current portion	-	9,062
Deferred income taxes	1,634	-
Other liabilities	-	1,267
Total liabilities	149,841	193,726
Commitments and contingencies		
Stockholders' equity:		
Common stock, par value $0.05 per share, authorized 15,000,000 shares; issued and outstanding 5,358,261 and 5,333,077 respectively	268	267
Additional paid-in capital	20,348	19,139
Retained earnings	184,873	167,598
Accumulated other comprehensive loss	-	(201)
Total stockholders' equity	205,489	186,803

Total liabilities and stockholders' equity	$355,330	$380,529

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

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VSE Corporation and Subsidiaries
Consolidated Statements of Income

(in thousands, except share and per share amounts)

	For the years ended December 31,		
	2014	2013	2012
Revenues:			
Services	$251,085	$314,306	$398,682
Products	172,986	157,332	148,073
Total revenues	424,071	471,638	546,755
Contract costs			
Services	240,004	295,223	368,540
Products	142,997	129,027	122,146
Total contract costs	383,001	424,250	490,686
Selling, general and administrative expenses	4,140	3,285	3,968
Impairment of intangible assets	-	-	1,025
Operating income	36,930	44,103	51,076
Interest expense, net	3,983	5,789	7,224
Income from continuing operations before income taxes	32,947	38,314	43,852
Provision for income taxes	12,458	14,324	16,488
Income from continuing operations	20,489	23,990	27,364
Loss from discontinued operations, net of tax	(1,124)	(1,138)	(6,070)
Net income	$19,365	$22,852	$21,294
Basic earnings per share:			
Income from continuing operations	$3.83	$4.50	$5.18
Loss from discontinued operations	(0.21)	(0.21)	(1.15)
Net income	$3.62	$4.29	$4.03
Basic weighted average shares outstanding	5,353,912	5,329,208	5,282,047
Diluted earnings per share:			
Income from continuing operations	$3.82	$4.49	$5.15
Loss from discontinued operations	(0.21)	(0.21)	(1.14)
Net income	$3.61	$4.28	$4.01
Diluted weighted average shares outstanding	5,371,200	5,343,267	5,309,862

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

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VSE Corporation and Subsidiaries
Consolidated Statements of Comprehensive Income
(in thousands)

	For the years ended December 31,		
	2014	2013	2012
Net income	$19,365	$22,852	$21,294
Change in fair value of interest rate swap agreements, net of tax	201	536	(45)
Comprehensive income	$19,566	$23,388	$21,249

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

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VSE Corporation and Subsidiaries
Consolidated Statements of Stockholders' Equity

(in thousands except per share data)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance at December 31, 2011	5,247	$ 262	$ 17,069	$ 126,961	$ (692)	$ 143,600
Net income	-	-	-	21,294	-	21,294
Stock-based compensation	46	3	1,124	-	-	1,127
Change in fair value of interest rate swap agreements, net of tax	-	-	-	-	(45)	(45)
Dividends declared ($0.31)	-	-	-	(1,641)	-	(1,641)
Balance at December 31, 2012	5,293	265	18,193	146,614	(737)	164,335
Net income	-	-	-	22,852	-	22,852
Stock-based compensation	40	2	946	-	-	948
Change in fair value of interest rate swap agreements, net of tax	-	-	-	-	536	536
Dividends declared ($0.35)	-	-	-	(1,868)	-	(1,868)
Balance at December 31, 2013	5,333	267	19,139	167,598	(201)	186,803
Net income	-	-	-	19,365	-	19,365
Stock-based compensation	25	1	1,209	-	-	1,210
Change in fair value of interest rate swap agreements, net of tax	-	0	-	-	201	201
Dividends declared ($0.39)	-	-	-	(2,090)	-	(2,090)
Balance at December 31, 2014	5,358	$ 268	$ 20,348	$ 184,873	$ -	$ 205,489

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

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VSE Corporation and Subsidiaries
Consolidated Statements of Cash Flows

(in thousands)

	For the years ended December 31,		
	2014	2013	2012
Cash flows from operating activities:			
Net income	$19,365	$22,852	$21,294
Adjustments to reconcile net income to net cash provided by operating activities:			
Impairment of goodwill and intangible assets	-	790	8,953
Depreciation and amortization	18,770	20,016	21,162
Loss on sale of property and equipment	125	246	-
Deferred taxes	3,083	(874)	(1,253)
Stock-based compensation	1,739	1,576	1,076
Earn-out obligation adjustment	3,059	183	(4,337)
Changes in operating assets and liabilities, net of impact of acquisitions:			
Receivables, net	18,996	14,130	25,051
Inventories	(10,048)	2,240	435
Other current assets and noncurrent assets	(627)	(3,798)	5,938
Accounts payable and deferred compensation	(1,224)	1,922	(17,279)
Accrued expenses and other current liabilities	(1,149)	(843)	(1,719)
Long-term lease obligations	(1,107)	(1,826)	(506)
Other liabilities	(1,267)	(16)	992
Net cash provided by operating activities	49,715	56,598	59,807
Cash flows from investing activities:			
Purchases of property and equipment	(3,414)	(4,416)	(20,863)
Cash paid for acquisitions, net of cash acquired	-	-	(4,607)
Net cash used in investing activities	(3,414)	(4,416)	(25,470)
Cash flows from financing activities:			
Borrowings on loan arrangement	295,513	290,137	269,388
Repayments on loan arrangement	(336,601)	(340,627)	(293,409)
Earn-out obligation payments	(1,972)	(180)	(6,787)
Payments on capital lease obligations	(850)	(725)	(562)
Payment of taxes for equity transactions	(314)	(257)	(332)
Payment of debt financing costs	-	-	-
Dividends paid	(2,034)	(1,811)	(1,585)
Net cash used in financing activities	(46,258)	(53,463)	(33,287)
Net increase (decrease) in cash and cash equivalents	43	(1,281)	1,050
Cash and cash equivalents at beginning of year	220	1,501	451
Cash and cash equivalents at end of year	$263	$220	$1,501

Supplemental cash flow disclosures (in thousands):

Cash paid for:			
Interest	$2,135	$4,192	$5,512
Income taxes	$9,934	$15,638	$10,686

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

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VSE Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2014

(1) Nature of Business and Significant Accounting Policies

Nature of Business

The term "VSE," the "Company," "us," "we," or "our" means VSE and its subsidiaries and divisions unless the context indicates operations of only VSE as the parent company.

Our operations consist primarily of vehicle fleet parts supply, supply chain management, ship and aircraft maintenance, vehicle and equipment maintenance and refurbishment, logistics, engineering, energy and environmental, IT solutions, health care IT, and consulting services performed on a contract basis. Our services are performed for the United States Government (the "government"), including the United States Department of Defense ("DoD") and federal civilian agencies, the United States Postal Service ("USPS"), commercial customers, and other clients.

Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements consist of the operations of our parent company, our unincorporated divisions and our wholly owned subsidiaries, Energetics Incorporated ("Energetics"), Akimeka, LLC ("Akimeka") and Wheeler Bros., Inc. ("WBI"). All intercompany transactions have been eliminated in consolidation. These consolidated financial statements also account for the classification of the Infrastructure Group as discontinued operations of our subsidiary Integrated Concepts and Research Corporation ("ICRC") and therefore any financial impact of such group has been presented as discontinued operations in the 2014, 2013 and 2012 reporting periods.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates affecting the financial statements include accruals for contract disallowance reserves, recoverability of goodwill and intangible assets and earn-out obligations.

Stock-Based Compensation

We account for share-based awards in accordance with the applicable accounting rules that require the measurement and recognition of compensation expense for all share-based payment awards based on estimated fair values. The compensation expense, included in contract costs, is amortized over the requisite service period. See Note 8, Stock-Based Compensation Plans, for further discussion of our stock-based compensation plans and related activity.

Earnings Per Share

Basic earnings per share ("EPS") have been computed by dividing net income by the weighted average number of shares of common stock outstanding during each period. Shares issued during the period are weighted for the portion of the period that they were outstanding. Our calculation of diluted earnings per common share includes the dilutive effects for the assumed vesting of restricted stock awards.

	Years Ended December 31,		
	2014	2013	2012
Basic weighted average common shares outstanding	5,353,912	5,329,208	5,282,047
Effect of dilutive shares	17,288	14,059	27,815
Diluted weighted average common shares outstanding	5,371,200	5,343,267	5,309,862

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Cash and Cash Equivalents

We consider all highly liquid investments with an original maturity of three months or less to be cash equivalents. Due to the short maturity of these instruments, the carrying values on our consolidated balance sheets approximate fair value.

Property and Equipment

Property and equipment are recorded at cost. Depreciation of computer equipment, furniture, other equipment is provided principally by the straight-line method over periods of 3 to 15 years. Depreciation of buildings and land improvements is provided by the straight-line method over periods of approximately 15 to 20 years. Amortization of leasehold improvements is provided by the straight-line method over the lesser of their useful life or the remaining term of the lease.

Concentration of Credit Risk/Fair Value of Financial Instruments

Financial instruments that potentially subject us to concentration of credit risk consist primarily of cash, cash equivalents and trade receivables. Contracts with the government, either as a prime or subcontractor, accounted for approximately 99 % of revenues for each of the years ended December 31, 2014, 2013, and 2012. We believe that concentrations of credit risk with respect to trade receivables are limited as they are primarily government receivables. We believe that the fair market value of all financial instruments, including debt, approximate book value.

Revenues

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the fee is fixed or determinable, and collectability is probable.

Substantially all of our Supply Chain Management Group revenues result from the sale of vehicle parts to clients. We recognize revenue from the sale of vehicle parts when the customer takes ownership of the parts.

Substantially all of our International, Federal, and IT, Energy and Management Consulting work is performed for our customers on a contract basis. The three primary types of contracts used are time and materials, cost-type, and fixed-price. Revenues result from work performed on these contracts by our employees and our subcontractors and from costs for materials and other work related costs allowed under our contracts.

Revenue recognition methods on fixed-price contracts will vary depending on the nature of the work and the contract terms. Revenues on fixed-price service contracts are recorded as work is performed, typically ratably over the service period. Revenues on fixed-price contracts that require delivery of specific items are recorded based on a price per unit as units are delivered. We classify our Supply Chain Management Group revenues as fixed-price revenue.

Revenues on cost-type contracts are recorded as contract allowable costs are incurred and fees are earned. Our FMS Program contract is a cost plus award fee contract. This contract has terms that specify award fee payments that are determined by performance and level of contract activity. Award fees are made during the year through a contract modification authorizing the award fee that is issued subsequent to the period in which the work is performed. We recognize award fee income on the FMS Program contract when the fees are fixed or determinable. Due to such timing, and to fluctuations in the level of revenues, profits as a percentage of revenues on this contract will fluctuate from period to period.

Revenues for time and materials contracts are recorded on the basis of contract allowable labor hours worked multiplied by the contract defined billing rates, plus the direct costs and indirect cost burdens associated with materials and subcontract work used in performance on the contract. Generally, profits on time and materials contracts result from the difference between the cost of services performed and the contract defined billing rates for these services.

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Revenue related to work performed on contracts at risk, which is work performed at the customer's request prior to the government formalizing funding, is not recognized until it can be reliably estimated and its realization is probable.

A substantial portion of contract and administrative costs are subject to audit by the Defense Contract Audit Agency. Our indirect cost rates have been audited and approved for 2007 and prior years with no material adjustments to our results of operations or financial position. While we maintain reserves to cover the risk of potential future audit adjustments based primarily on the results of prior audits, we do not believe any future audits will have a material adverse effect on our results of operations or financial position.

Receivables and Allowance for Doubtful Accounts

Receivables are recorded at amounts earned less an allowance for doubtful accounts. We review our receivables regularly to determine if there are any potentially uncollectible accounts. The majority of our receivables are from government agencies, where there is minimal credit risk. We record allowances for bad debt as a reduction to receivables and an increase to bad debt expense. We assess the adequacy of these reserves by considering general factors, such as the length of time individual receivables are past due and historical collection experience.

Inventories

Inventories are stated at the lower of cost or market using the first-in, first-out ("FIFO") method. Included in inventory are related purchasing, storage, and handling costs. Our inventory primarily consists of vehicle replacement parts.

Deferred Compensation Plans

We have a deferred compensation plan, the VSE Corporation Deferred Supplemental Compensation Plan ("DSC Plan"), to provide incentive and reward for certain management employees based on overall corporate performance. We maintain the underlying assets of the DSC Plan in a Rabbi Trust and changes in asset values are included in contract costs on the accompanying consolidated statements of income. We invest the assets held by the Rabbi Trust in both corporate owned life insurance ("COLI") products and in mutual funds. The COLI investments are recorded at cash surrender value and the mutual fund investments are recorded at fair value. The DSC Plan assets are included in other assets and the obligation to the participants is included in deferred compensation on the accompanying consolidated balance sheets.

Deferred compensation plan expense recorded as contract costs in the accompanying consolidated statements of income for the years ended December 31, 2014, 2013, and 2012 was approximately $1.3 million, $1.4 million, and $1.2 million, respectively.

Impairment of Long-Lived Assets

Long-lived assets include property and equipment to be held and used. We review the carrying values of long-lived assets other than goodwill for impairment if events or changes in the facts and circumstances indicate that their carrying values may not be recoverable. We assess impairment by comparing the estimated undiscounted future cash flows of the related asset to its carrying value. If an asset is determined to be impaired, we recognize an impairment charge in the current period for the difference between the fair value of the asset and its carrying value.

During 2012, impairment charges of approximately $1 million were recorded for the intangible assets related to our acquisition of Akimeka. Also during 2012, an impairment charge of approximately $1.9 million was recorded for the intangible assets related to our acquisition of ICRC (see Note 5, Goodwill and Intangible Assets). No impairment charges related to intangible assets, other than goodwill, were recorded in the years ended December 31, 2014 and

December 31, 2013.

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Income Taxes

Income taxes are accounted for under the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. This method also requires the recognition of future tax benefits, such as net operating loss carryforwards, to the extent that realization of such benefits is more likely than not. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The carrying value of net deferred tax assets is based on assumptions regarding our ability to generate sufficient future taxable income to utilize these deferred tax assets.

Goodwill

We review goodwill for impairment annually at the beginning of the fourth quarter and whenever events or changes in circumstances indicate the carrying value of goodwill may not be recoverable. The goodwill impairment test involves a two-step process. In the first step, we compare the fair value of each reporting unit to its carrying value. If the fair value of the reporting unit exceeds its carrying value, goodwill is not impaired and no further testing is required. If the fair value of the reporting unit is less than the carrying value, we must perform the second step of the impairment test to measure the amount of impairment loss. In the second step, the reporting unit's fair value is allocated to all of the assets and liabilities of the reporting unit, including any unrecognized intangible assets, in a hypothetical analysis that calculates the implied fair value of goodwill in the same manner as if the reporting unit was being acquired in a business combination. If the implied fair value of the reporting unit's goodwill is less than the carrying value, the difference is recorded as an impairment loss. Based on our annual goodwill impairment analysis we performed during the fourth quarter of 2014, we found no impairment in the carrying value of goodwill.

During 2013, goodwill of $790 thousand was impaired (See Note 15, Discontinued Operations). Based on the results of the impairment analyses performed during 2012, goodwill impairment charges of approximately $6 million were recorded related to our ICRC acquisition (see Note 5, Goodwill and Intangible Assets).

Intangibles

Intangible assets consist of the value of contract-related intangible assets, trade names and acquired technologies acquired in acquisitions. We amortize on a straight-line basis intangible assets acquired as part of acquisitions over their estimated useful lives unless their useful lives are determined to be indefinite. The amounts we record related to acquired intangibles are determined by us considering the results of independent valuations. Our contract-related intangibles are amortized over their estimated useful lives of approximately 8 to 12 years with a weighted-average life of approximately 11.8 years as of December 31, 2014. We have three trade names that are amortized over an estimated useful life of approximately 8.4 years. We have an acquired technologies intangible asset that is amortized over an estimated useful life of 11 years. The weighted-average life for all amortizable intangible assets is approximately 11.4 years as of December 31, 2014.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The ASU is based on the principle that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to fulfill a contract. The ASU will become effective for us on January 1, 2017. We currently are assessing the impact that this standard will have on its consolidated financial statements.

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(2) Receivables

The components of receivables as of December 31, 2014 and 2013 were as follows (in thousands):

	2014	2013
Billed	$26,709	$36,703
Unbilled	32,682	41,684
Total receivables	$59,391	$78,387

The unbilled balance includes certain costs for work performed at risk but which we believe will be funded by the government totaling approximately $2.9 million and $5 million as of December 31, 2014, and 2013, respectively. We expect to invoice substantially all unbilled receivables during 2015.

(3) Other Current Assets and Other Assets

At December 31, 2014 and 2013, other current assets primarily consisted of contract inventories, vendor advances, prepaid rents and deposits, prepaid income taxes, software licenses and prepaid maintenance agreements. At December 31, 2014, other current assets also included approximately $1.6 million of deferred contract costs. At December 31, 2014 and 2013, other assets primarily consisted of deferred compensation plan assets, cash surrender value of life insurance policies and an acquired software license.

(4) Property and Equipment

Property and equipment consisted of the following as of December 31, 2014 and 2013 (in thousands):

	2014	2013
Buildings and building improvements	$45,825	$45,418
Computer equipment	25,327	24,933
Furniture, fixtures, equipment and other	17,603	16,604
Leasehold improvements	3,567	3,567
Land and land improvements	3,410	3,410
	95,732	93,932
Less accumulated depreciation and amortization	(42,821)	(36,194)
Total property and equipment, net	$52,911	$57,738

Depreciation and amortization expense for property and equipment for the years ended December 31, 2014, 2013 and 2012 was approximately $7.9 million, $9 million and $9.2 million, respectively.

(5) Goodwill and Intangible Assets

Changes in goodwill for the years ended December 31, 2014 and 2013 are as follows (in thousands):

	Supply Chain Management	IT, Energy and Management Consulting	Total
Balance as of December 31, 2012	$ 61,169	$ 30,883	$92,052

Balance as of December 31, 2013	$ 61,169	$ 30,883	$92,052
Balance as of December 31, 2014	$ 61,169	$ 30,883	$92,052

The results of our annual impairment testing indicated that the fair value of our reporting units exceeded their carrying values as of October 1, 2014.

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Intangible assets consist of the value of contract-related assets, technologies and trade names. Amortization expense for the years ended December 31, 2014, 2013 and 2012 was approximately $10 million, $10.2 million and $11.2 million, respectively.

Intangible assets were composed of the following (in thousands):

	Cost	Accumulated Amortization	Accumulated Impairment Loss	Net Intangible Assets
December 31, 2014				
Contract and customer-related	$93,304	$ (33,840)	$ (1,025)	$ 58,439
Acquired technologies	12,400	(4,024)	-	8,376
Trade names – amortizable	10,100	(4,706)	-	5,394
Total	$115,804	$ (42,570)	$ (1,025)	$ 72,209
December 31, 2013				
Contract and customer-related	$93,304	$ (26,287)	$ (1,025)	$ 65,992
Acquired technologies	12,400	(2,896)	-	9,504
Trade names – amortizable	10,100	(3,339)	-	6,761
Total	$115,804	$ (32,522)	$ (1,025)	$ 82,257

Future expected amortization of intangible assets is as follows for the years ending December 31, (in thousands):

	Amortization
2015	$ 9,439
2016	9,255
2017	9,255
2018	9,255
2019	9,190
Thereafter	25,815
Total	$ 72,209

(6) Debt

We have a loan agreement with a group of banks. In January 2015, we amended and restated the loan agreement to fund our acquisition of four aviation businesses, provide working capital for our continuing operations, and retire our existing debt. Both the former and the amended and restated loan agreements are comprised of a term loan facility and a revolving loan facility. The revolving loan facility provides for revolving loans and letters of credit. The amended and restated loan agreement expires in January 2020. Financing costs associated with the inception of the amended and restated loan agreement were approximately $2 million.

The amended and restated term loan requires quarterly installment payments. Our scheduled term loan payments after December 31, 2014 are $11.2 million in 2015, $17.8 million in 2016, $21.6 million in 2017, $28.1 million in 2018, $30 million in 2019, and $41.3 million after 2019. The amount of term loan borrowings outstanding as of December 31, 2014 under the former loan agreement was $25 million. The amount of term loan borrowings outstanding at inception of the amended and restated loan agreement was $150 million.

The maximum amount of credit available to us from the banking group for revolving loans and letters of credit under the former loan agreement as of December 31, 2014 was $125 million. The maximum amount for revolving loans and letters of credit under the amended and restated agreement is $150 million. We may borrow and repay the revolving loan borrowings as our cash flows require or permit. We pay an unused commitment fee and fees on letters of credit that are issued. We had approximately $23.6 million in revolving loan amounts outstanding and no of letters of credit outstanding as of December 31, 2014 under the former loan agreement. The amount of revolving loan borrowings outstanding at inception of the amended and restated loan agreement was $100 million. We had approximately $30.3 million in revolving loan amounts and $573 thousand of letters of credit outstanding as of December 31, 2013.

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Under the amended and restated loan agreement we may elect to increase the maximum availability of the term loan facility, the revolving loan facility, or both facilities up to an aggregate additional amount of $75 million.

Total bank loan borrowed funds outstanding as of December 31, 2014, including term loan borrowings and revolving loan borrowings, were approximately $48.6 million. Total bank loan borrowed funds outstanding as of December 31, 2013 were $89.7 million. The fair value of outstanding debt under our bank loan facilities as of December 31, 2014 approximates its carrying value using Level 2 inputs based on market data on companies with a corporate rating similar to ours that have recently priced credit facilities.

We pay interest on the term loan borrowings and revolving loan borrowings at LIBOR plus a base margin or at a base rate (typically the prime rate) plus a base margin. As of December 31, 2014, the LIBOR base margin was 1.75% and the base rate base margin was 0.00%. At inception of the amended and restated loan agreement, the LIBOR base margin was 2.25% and the base rate base margin was 1.00%. The base margins increase or decrease in increments as our Total Funded Debt/EBITDA Ratio increases or decreases.

We had interest rate hedges on a portion of our outstanding borrowings that expired June 30, 2014. Between June 30, 2014 and December 31, 2014, we had no interest rate hedges on our outstanding borrowings. The terms of the amended and restated loan agreement require us to have interest rate hedges on a portion of the outstanding term loan for the first three years of the agreement, and for such interest rate hedges to be in place within 60 days after inception of the agreement. We executed such compliant interest rate hedges in February 2015. As of December 31, 2014, interest rates on portions of our outstanding debt range from 1.91% to 3.25%, and the effective interest rate on our aggregate outstanding debt was 3.15%.

Interest expense incurred on bank loan borrowings and interest rate hedges was approximately $2 million and $3.7 million during the years ended December 31, 2014 and 2013, respectively.

Both the former and amended and restated loan agreements contain collateral requirements to secure our loan agreement obligations, restrictive covenants, a limit on annual dividends, and other affirmative and negative covenants, conditions and limitations. Upon execution of the amended and restated loan agreement, all restrictive covenants and the December 31, 2014 restrictive covenant measurement date under the former loan agreement were replaced by the restrictive covenants under the amended and restated agreement, with the initial measurement date being the date of inception of the amended and restated agreement. Restrictive covenants under the amended and restated loan agreement include a maximum Total Funded Debt/EBITDA Ratio and a minimum Fixed Charge Coverage Ratio. We were in compliance with required ratios and other terms and conditions at inception of the amended and restated loan agreement.

(7) Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist primarily of accrued compensation and benefits of approximately $16.7 million and $17.6 million as of December 31, 2014 and 2013, respectively. The accrued compensation and benefits amounts include bonus, salaries and related payroll taxes, vacation and deferred compensation.

(8) Stock-Based Compensation Plans

In 2006, our stockholders approved the VSE Corporation 2006 Restricted Stock Plan for its directors, officers and other employees (the "2006 Plan"). On May 6, 2014, the stockholders approved amendments to the 2006 Plan extending the term thereof until May 6, 2021 and authorized an additional 250,000 shares of our common stock for issuance under the 2006 Plan. Under the provisions of the 2006 Plan, we are authorized to issue up to 500,000 shares of our common stock. The Compensation Committee is responsible for the administration of the 2006 Plan, and determines each recipient of an award under the 2006 Plan, the number of restricted shares of common stock subject to such award and the period of continued employment required for the vesting of such award. These terms are included in award agreements between us and the recipients of the award. As of December 31, 2014, 278,482 shares of our common stock were available for issuance under the 2006 Plan.

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During 2014 and 2013, Non-employee directors were awarded 10,800 and 16,100 shares of restricted stock, respectively, under the 2006 Plan. The weighted average grant-date fair value of these restricted stock grants was $47.22 per share and $25.68 per share for the shares awarded in 2014 and 2013, respectively. The shares issued vested immediately and cannot be sold, transferred, pledged or assigned before the second anniversary of the grant date. Compensation expense related to these grants was approximately $510 thousand and $413 thousand during 2014 and 2013, respectively.

In January of every year since 2007, we have notified certain employees that they are eligible to receive awards of VSE stock under our 2006 Plan, as amended, based on our financial performance for the respective fiscal years. These restricted stock awards are expensed and a corresponding liability is recorded ratably over the vesting period of approximately three years. Upon issuance of shares on each vesting date, the liability is reduced and additional paid-in capital is increased. The date of award determination is expected to be in March 2015 for the 2014 awards. The date of award determination for the 2013 awards and the 2012 awards was March 2, 2014 and March 1, 2013, respectively. On each vesting date, 100 % of the vested award is paid in our shares. The number of shares issued is based on the fair market value of our common stock on the vesting date. The earned amount is expensed ratably over the vesting period of approximately three years. On March 2, 2014, the employees eligible for the 2013 awards, 2012 awards and 2011 awards received a total of 12,221 shares of common stock. The grant-date fair value of these awards was $47.07 per share.

The total stock-based compensation expense related to restricted stock awards for the years ended December 31, are as follows (in thousands):

	2014	2013	2012
Employees	$1,104	$1,163	$650
Non-employee Directors	510	413	272
Total	$1,614	$1,576	$922

Employees are permitted to forfeit a certain number of shares of restricted stock to cover their personal tax liability for restricted stock awards. We paid approximately $314 thousand, $257 thousand and $332 thousand, to cover this liability in the years ended December 31, 2014, 2013 and 2012, respectively. These payments are classified as financing cash flows on the consolidated statements of cash flows. As of December 31, 2014, the total compensation cost related to non-vested awards not yet recognized was approximately $764 thousand with a weighted average amortization period of 1.8 years.

Stock-based compensation, which includes compensation recognized on stock option grants and restricted stock awards, was included in contract costs and the following line items on the accompanying statements of income for the years ended December 31, 2014, 2013 and 2012 (in thousands):

	2014	2013	2012
Stock-based compensation included in contract costs	$1,739	$1,576	$1,076
Income tax benefit recognized for stock-based compensation	(669)	(606)	(414)
Total stock-based compensation expense, net of income tax benefit	$1,070	$970	$662

(9) Income Taxes

We are subject to U.S. federal income tax as well as income tax in multiple state and local jurisdictions. We have concluded all U.S. federal income tax matters as well as material state and local tax matters for years through 2010.

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We file consolidated federal income tax returns that include all of our subsidiaries. The components of the provision for income taxes from continuing operations for the years ended December 31, 2014, 2013, and 2012 are as follows (in thousands):

	2014	2013	2012
Current			
Federal	$7,889	$12,654	$14,782
State	1,486	2,544	2,959
	9,375	15,198	17,741
Deferred			
Federal	2,595	(848)	(999)
State	488	(26)	(254)
	3,083	(874)	(1,253)
Provision for income taxes	$12,458	$14,324	$16,488

The differences between the amount of tax computed at the federal statutory rate of 35% and the provision for income taxes from continuing operations for the years ended December 31, are as follows (in thousands):

	2014	2013	2012
Tax at statutory federal income tax rate	$11,531	$13,410	$15,348
Increases (decreases) in tax resulting from:			
State taxes, net of federal tax benefit	1,486	1,630	1,901
Permanent differences, net	(516)	(685)	(522)
Other, net	(43)	(31)	(239)
Provision for income taxes	$12,458	$14,324	$16,488

The tax effect of temporary differences representing deferred tax assets and liabilities as of December 31, 2014 and 2013, are as follows (in thousands):

	2014	2013
Gross deferred tax assets		
Deferred compensation and accrued paid leave	$6,992	$6,805
Accrued expenses	1,276	1,489
Stock-based compensation	592	510
Interest rate swaps	-	125
Reserve for contract disallowances	287	326
Acquisition-related expenses	982	603
Capitalized inventory	589	409
Other	5	-
Total gross deferred tax assets	10,723	10,267
Gross deferred tax liabilities		
Depreciation	(2,830)	(3,237)
Deferred revenues	(2,676)	(1,921)
Goodwill and intangible assets	(5,017)	(1,701)
Total gross deferred tax liabilities	(10,523)	(6,859)
Net deferred tax assets	$200	$3,408

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(10) Commitments and Contingencies

(a) Leases and Other Commitments

We have various non-cancelable operating leases for facilities, equipment, and software with terms between two and 15 years. The terms of the facilities leases typically provide for certain minimum payments as well as increases in lease payments based upon the operating cost of the facility and the consumer price index. Rent expense is recognized on a straight-line basis for rent agreements having escalating rent terms. Lease expense for the years ended December 31, 2014, 2013 and 2012 were as follows (in thousands):

	Operating Lease Expense	Sublease Income	Net Expense
2014	$ 6,576	$ 119	$ 6,457
2013	$ 9,826	$ 531	$ 9,295
2012	$ 11,544	$ 671	$ 10,873

Future minimum annual non-cancelable commitments as of December 31, 2014 are as follows (in thousands):

	Operating Leases		
	Lease Commitments	Sublease Income	Net Commitments
2015	$ 3,859	$ 246	$ 3,613
2016	2,367	-	2,367
2017	1,939	-	1,939
2018	871	-	871
2019	316	-	316
Thereafter	-	-	-
Total	$ 9,352	$ 246	$ 9,106

We signed a lease in 2009 for a building to serve as our headquarters with a rent commencement date of May 1, 2012. Certain terms in the lease agreement resulted in the capitalization of construction costs due to specific accounting rules. We recorded a construction asset and corresponding long-term liability of approximately $27.3 million on May 1, 2012, which represents the construction costs incurred by the landlord as of that date. According to accounting rules, we have forms of continuing involvement that require us to account for this transaction as a financing lease upon commencement of the lease period. The building and building improvements will remain on our consolidated balance sheet and will be depreciated over a 15-year period. Payments made under the lease agreement are applied to service the financing obligation and interest expense based on an imputed interest rate amortizing the obligation over the life of the lease agreement.

Future minimum annual non-cancelable commitments under our headquarters lease as of December 31, 2014, which are not included in the table above, are as follows (in thousands):

	Lease Commitments
2015	$ 3,985
2016	4,104
2017	4,221
2018	4,336
2019	4,456

Thereafter		36,447
Total	$	57,549

(b) Contingencies

We are one of the primary defendants in a multiple plaintiff wrongful death action in Hawaii related to a fireworks explosion that occurred in April 2011 at a facility operated by one of our subcontractors, which resulted in the death of five subcontractor employees. The litigation is expected to proceed to trial in 2016. While the results of litigation cannot be predicted with certainty, we do not anticipate that this litigation will have a material adverse effect on our results of operations or financial position.

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On or about March 8, 2013, a lawsuit, Anchorage v. Integrated Concepts and Research Corporation, et al., was filed in the Superior Court for the State of Alaska at Anchorage by the Municipality of Anchorage, Alaska against our wholly owned subsidiary Integrated Concepts and Research Corporation ("ICRC") and two former subcontractors of ICRC. With respect to ICRC, the lawsuit asserts, among other things, breach of contract, professional negligence and negligence in respect of work and services ICRC rendered under the Port of Anchorage Intermodal Expansion Contract with the Maritime Administration, a federal agency with the United States Department of Transportation. In April 2013, ICRC removed the case to the United States District Court for the District of Alaska. ICRC's contract with the Maritime Administration expired on May 31, 2012. ICRC did not have a contract with the municipality of Anchorage. The litigation is expected to proceed to trial in 2016. Currently we cannot currently predict whether this litigation will have a material adverse effect on our results of operations or financial position.

In addition to the above-referenced litigation, we have, in the normal course of business, certain claims against us and against other parties and we may be subject to various governmental investigations. In our opinion, the resolution of these claims and investigations will not have a material adverse effect on our results of operations or financial position. However, the results of any legal proceedings cannot be predicted with certainty.

(11) Business Segments and Customer Information

Segment Information

Management of our business operations is conducted under four reportable operating segments:

Supply Chain Management Group – Our Supply Chain Management Group supplies vehicle parts primarily through a Managed Inventory Program ("MIP") direct sales to USPS and to other clients.

International Group - Our International Group provides engineering, industrial, logistics and foreign military sales services to the U.S. military and other government agencies.

Federal Group - Our Federal Group provides legacy equipment sustainment, engineering, technical, management, integrated logistics support and information technology services to DoD and other government agencies.

IT, Energy and Management Consulting Group – Our IT, Energy and Management Consulting Group provides technical and consulting services primarily to various civilian government agencies.

These segments operate under separate management teams and financial information is produced for each segment. The entities within each of the International Group, Federal Group, and IT, Energy and Management Consulting Group reportable segments meet the aggregation of operating segments criteria as defined by the accounting standard for segment reporting. We evaluate segment performance based on consolidated revenues and operating income. Net sales of our business segments exclude intersegment sales as these activities are eliminated in consolidation. Beginning with the second quarter of 2013, we no longer allocate interest to our reportable segments.

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Our segment information is as follows (in thousands):

For the years ended December 31,	2014	2013	2012
Revenues:			
Supply Chain Management Group	$172,482	$154,702	$143,014
International Group	106,369	146,908	167,193
Federal Group	84,392	95,435	142,323
IT, Energy and Management Consulting Group	60,828	74,593	94,225
Total revenues	$424,071	$471,638	$546,755
Operating income:			
Supply Chain Management Group	$29,694	$27,299	$24,014
International Group	3,795	7,069	6,052
Federal Group	(343)	2,400	10,418
IT, Energy and Management Consulting Group	6,634	9,061	11,816
Corporate	(2,850)	(1,726)	(1,224)
Operating income	$36,930	$44,103	$51,076
Depreciation and amortization expense:			
Supply Chain Management Group	$5,373	$4,265	$9,891
International Group	5,713	7,323	3,035
Federal Group	5,607	6,033	3,116
IT, Energy and Management Consulting Group	2,077	2,387	3,753
Total depreciation and amortization	$18,770	$20,008	$19,795
Capital expenditures:			
Supply Chain Management Group	$2,524	$895	$341
International Group	-	236	83
Federal Group	230	1,211	763
IT, Energy and Management Consulting Group	199	71	53
Corporate	461	2,003	19,623
Total capital expenditures	$3,414	$4,416	$20,863

	December 31,	
	2014	2013
Total assets:		
Supply Chain Management Group	$192,720	$185,976
International Group	17,235	33,355
Federal Group	18,990	20,846
IT, Energy and Management Consulting Group	49,790	57,610
Corporate	76,595	82,742
Total assets	$355,330	$380,529

Revenues are net of inter-segment eliminations. Corporate/unallocated expenses are primarily selling, general and administrative expenses not allocated to segments. Corporate assets are primarily cash and property and equipment.

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Customer Information

Our revenues are derived from contract services performed for DoD agencies or federal civilian agencies and from the delivery of products to our clients. The USPS, U.S. Army and Army Reserve, and U.S. Navy are our largest customers. Our customers also include various other government agencies and commercial entities. Our revenue by customer is as follows for the years ended December 31, (in thousands):

Revenues by Customer
(dollars in thousands)
Years ended December 31,

Customer	2014	%	2013	%	2012	%
U.S. Army/Army Reserve	$101,714	24.0%				