VERSAR INC
Form 10-K
March 28, 2017

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 July 1, 2016	Commission File No. 1-9309

Versar, Inc.
(Exact name of registrant as specified in its charter)

DELAWARE	54-0852979
(State or other jurisdiction of Incorporation or organization)	(I.R.S. employer identification no.)

6850 Versar Center, Springfield, Virginia	22151
(Address of principal executive offices)	(Zip code)

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

Securities registered pursuant to Section 12(b) of the Act:
Common Stock, $.01 par value
(Title of Class)

NYSE MKT
(Name of each exchange on which registered)
Securities registered pursuant to Section 12(g) of Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

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

Yes No

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

Yes No

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

Yes No

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

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

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

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

Yes No

The aggregate market value of the voting stock held by non-affiliates of the registrant as of March 1, 2017 was approximately $10,348,996.

The number of shares of Common Stock outstanding as of March 1, 2017 was 9,950,958.

PART I
Item 1. Business

Unless this report indicates otherwise the terms ”Versar,” the “Company,” “we,” “us,” and “our” refer to Versar, Inc. and consolidated subsidiaries. Versar’s fiscal year end is based upon a 52 or 53 week year ending on the last Friday of the fiscal period and therefore does not close on a calendar month end. The Company’s fiscal year 2016 included 53 weeks and fiscal years 2015 and 2014 included 52 weeks.

Cautionary Statement Regarding Forward-Looking Statements

This report contains certain forward-looking statements that are based on current expectations. Actual results may differ materially. The forward-looking statements include, without limitation, those regarding the continued award of future work or task orders from government and private clients, cost controls and reductions, the expected resolution of delays in billing of certain projects, and the possible impact of current and future claims against the Company based upon negligence and other theories of liability. Forward-looking statements involve numerous risks and uncertainties that could cause actual results to differ materially, including, but not limited to, the possibility that the demand for the Company's services may decline as a result of possible changes in general and industry specific economic conditions and the effects of competitive services and pricing; the possibility that the Company will not be able to perform work within budget or contractual limitations; one or more current or future claims made against the Company may result in substantial liabilities; the possibility that the Company will not be able to attract and retain key professional employees; failure to recover at-risk contract costs; changes to or failure of the Federal, State, or local governments to fund certain programs in which the Company participates; changes in customer procurement policies and practices; delays in project funding; effects of U.S. Government conflict of interest policies; loss of anticipated new contract vehicles either due to funding changes or competitive factors, and such other risks and uncertainties set forth in this report and in other reports and other documents filed by the Company from time to time with the Securities and Exchange Commission.

Business Overview

Versar, Inc. is a Delaware corporation incorporated in 1969. We are a global project management company providing value-oriented solutions to government and commercial clients in three business segments: (1) Engineering and Construction Management (ECM); (2) Environmental Services Group (ESG); and (3) Professional Services Group (PSG). We also provide tailored and secure engineering solutions in extreme environments and offer specialized abilities in construction management, security system integration, performance-based remediation, and hazardous materials mangement.

Fiscal 2016 proved to be an eventful year for Versar. The year began with the successful completion of the strategic acquisition of a federal security integration business from Johnson Controls, formerly known as Johnson Controls Security Systems, which is now known as Versar Security Systems (VSS). VSS is a security systems integrator that designs, installs and supports complex physical security, network security, and facilities management systems primarily for Federal Government clients such as Federal Aviation Administration (FAA), the Food and Drug Administration (FDA), Department of Justice (DOJ), the Federal Bureau of Investigation (FBI) and the Federal Emergency Management Agency (FEMA). The acquisition of VSS expanded Versar’s client base, technical capabilities, and geographic scope.

As the year progressed, Versar faced significant challenges as revised government procedures and other market factors resulted in longer timelines for contract awards and project start dates than the Company anticipated. This resulting impact on the Company’s financial performance created constraints that initiated covenant defaults with our lender and a related inability to file our required securities filings in a timely manner, resulting in additional oversight from the lender and the Company's related contracting of a Chief Restructuring Officer (CRO) and exploration of financial and strategic alternatives. The Company operated at a financial loss for fiscal 2016. In response, the Company initiated a wide range of deliberate cost cutting measures during fiscal 2016, the results of which will continue to be realized in future periods. We will continue to manage our costs based on financial performance. As we adapted internally to longer cycles in both contract award and project start dates, we experienced a decrease in our backlog as compared to fiscal 2015. To address this, we adjusted our bidding strategies and teaming partnerships, diversified our capabilities, and made strategic hires. As a service-based company, our revenue is primarily derived from the provision of labor-based services, rather than capital-intensive product offerings. Thus, our revenue is driven by our ability to retain existing clients, attract new clients, provide quality project and program management at competitive rates, and identify and retain qualified employees.

Business Segments

The company is aligned into three reportable segments: ECM, ESG, and PSG, all of which are described below.

ECM

ECM's services include facility planning and programming, engineering design, construction, construction management and security systems installation and support. ECM supports federal, state and local governments, as well as commercial clients worldwide. Our global network of engineering and construction resources facilitates the effective mobilization of highly skilled construction teams and advanced methodologies around the world.

The primary markets for ECM's services include a broad range of infrastructure, master planning, and engineering design for facilities, transportation, resource management, energy, and local, regional and international development.

Our services include:

Facility Condition Assessments and Space Utilization Analysis providing Architect-Engineer studies, master planning and area development plans, sustainability and energy audits, full Sustainment, Restoration and Modernization (SRM) and Military Construction (MILCON) design capabilities

Construction Management Services providing quality assurance services in Title II or as owner's representatives, providing a legally defensible record of the construction, earned value project management to objectively measure construction progress, engineering and schedule analysis and negotiation of change orders

Construction Services includes integrated design-build solutions for construction, horizontal and vertical SRM projects, construction of design-bid-build projects including all building trades, equipment installation and furnishings as specified

Security Systems planning and analysis that includes developing and updating physical security plans, site surveys and physical security risk assessments. Engineering and design turnkey solutions integrating physical and electronic security systems, full program/project documentation, and configuration management and design control expertise.

ECM's key projects that contributed to the revenue include integration and maintenance of access control and security systems for the FAA, construction management services for the U.S. Air Force (USAF) and U.S. Army, construction management and personal services including engineering, construction inspection, operations and maintenance and administrative support to the U.S. Army Corps of Engineers (USACE) and project and construction management services for the District of Columbia Courts and commercial customers. The largest ECM project during fiscal 2016 was the $109.5 million firm fixed price Design/Bid/Build runway repair task order at Dover Air Force Base (DAFB) awarded, on August 13, 2014 under Versar's S/R&M Acquisition Task Order Contract (SATOC) indefinite delivery/indefinite quantity (IDIQ) with the Air Force Civil Engineer Center (AFCEC), held with our joint venture partner, Johnson Controls Federal Systems. The SATOC IDIQ primarily services Air Force customers, providing a fast track, efficient method for execution of all types of facility repairs, renovations and construction. During the months of December 2016 through February 2017, the work on the task order was suspended due to normal seasonal weather conditions. Work resumed in March 2017 and the contract is anticipated to be completed by the end of June 2017.

ESG

ESG supports federal, state and local governments, and commercial clients worldwide. For over 40 years, our team of engineers, scientists, archeologists, and unexploded ordnance staff has performed thousands of investigations, assessments, and remediation safely and effectively. Our client-focused approach, complemented by our regulatory expertise, provides low risk with high value in today’s complex regulatory climate.

Our services include:

Compliance services include hazardous waste and hazardous materials management from permitting support to compliance with applicable federal laws, emergency response training, hazardous waste facility decommissioning, energy planning, energy audit and assessment, commission and metering, Energy Savings Performance Contract (ESPC) support and Executive Order 13514/sustainability services. We are a greenhouse gas verification body in California, one of the few companies certified to review greenhouse gas emissions data in that state.

Cultural Resources provides clients with reliable solutions from recognized experts, quality products that are comprehensive yet focused on client objectives, and large-business resources with small-business responsiveness and flexibility. ESG's staff has set the standard for management, methodologies, and products. Our expertise and experience in the design and management of innovative programs that are responsive to client needs and satisfy regulatory requirements.

Natural Resources services include protected species assessments and management, wetland delineations and Section 404 permitting, ecosystem and habitat restoration, and water quality monitoring, ecological modeling, and environmental planning. Our team has extensive expertise in developing innovative means for mitigation, managing the complex regulatory environment, and providing our clients with the knowledge and experience needed to meet or exceed goals and objectives.

Remediation services provides on-going federal remediation and restoration projects, including four Air Force Performance Based Remediation (PBR) projects operating at more than ten different locations in nine states. Our success is based in part on the understanding that the goal of remedial action projects is to eliminate our clients' long-term liability and reduce the life cycle costs of environmental restoration.

UXO/MMRP provides range sustainment services at two of the world's largest ranges. Our highly experience staff provide range sustainment services, range permitting, monitoring, and deconstruction, surface, subsurface, and underwater investigations and removals, geophysical surveys, and anomaly avoidance and construction support.

ESG's key projects that contributed to the revenue are our New England, Great Lakes, Tinker and Front Range PBRs, Range Sustainment Services at Nellis AFB, hydrodynamic flow modeling and sedimentation study at Naval Submarine Base Kings Bay, shoreline stabilization projects at Possum and Cedar Point for the Navy, an Environmental Impact Statement (EIS) for housing privatization for the USAF, fence to fence programs at Cannon, Holloman, Barksdale, Columbus AFBs and Joint Base McGuire-Dix-Lakehurst, large cultural resources efforts at Avon Park, Tyndall AFB, and Joint Base McGuire-Dix-Lakehurst, and numerous remedial actions for the U.S. Environmental Protection Agency (EPA).

PSG

PSG provides onsite environmental, engineering, construction management, and logistics services to the USAF, U.S. Army, U.S. Army Reserve, National Guard Bureau, FAA, Bureau of Land Management (BLM), and DOJ through the Drug Enforcement Agency (DEA). Versar provides on-site services that enhance a customer's mission through the use of subject matter experts who are fully dedicated to accomplish mission objectives. These services are particularly attractive as the federal agencies and Department of Defense (DOD) continue to be impacted by budgetary pressures. This segment focuses on providing onsite support to government clients to augment their capabilities and capacities.

Our services include:

Facilities and operational support by delivering comprehensive facility maintenance, life cycle management plan minimizing operating costs, space utilization, operational planning/forecasting, and automated planning technical support services ensuring operational readiness of reserve forces to the U.S. Army Reserve.

Versar assists the U.S. Army Reserve with assessing, improving, obtaining, maintaining, and sustaining environmental compliance, as well as conservation requirements, performing hazardous waste management, spill prevention and clean-up, biological assessments, wetland sustainment, and environmental training.

Environmental quality program services, to include facility and utilities integration, National Environmental Policy Act considerations, water program management, wildlife program management, archaeological and historical preservation to DOD Joint Base communities.

Microbiological and chemical support to the U.S. Army's designated Major Range and Test Facility Base for Chemical and Biological Testing and Training.

Biological, archaeological, and GIS support to plan restoration projects for wildlife habitat improvements and also field verification of GIS-generated disturbances and related mapping data.

Engineering expertise and program oversight for civil engineering activities related to various facilities services performed at the Air National Guard Readiness Center and National Guard Bureau.

Provides the DOJ's DEA engineering and facilities planning support for the implementation and completion of SRM projects.

Revenue Earned by Geographic Location

Our consolidated gross revenue for fiscal 2016 was $167.9 million, of which approximately $165.7 million was funded with U.S. currency and approximately $2.2 million was derived from PPS, and funded in Pounds sterling. Approximately 11% of our fiscal 2016 revenue was generated in international locations.

Our consolidated gross revenue for fiscal 2015 was $159.9 million, of which approximately $154.8 million was funded with U.S. currency and approximately $5.1 million was derived from PPS, and funded in Pounds sterling. Approximately 18% of our fiscal 2015 revenue was generated in international locations.

Our consolidated gross revenue for fiscal 2014 was $110.3 million, of which approximately $107.6 million was funded with U.S. currency and approximately $2.7 million of the remainder was derived from PPS, and funded in Pounds sterling. Approximately 30% of our fiscal 2014 business was conducted in international locations.

Our Strategy

In addressing fiscal 2016's challenges, Versar remains committed to our customers, shareholders, employees and partners. Versar will continue to provide technical expertise to our primarily federal customers. We will focus on international construction management in austere environments, security solutions, ongoing investments in military base efficiencies and renovation, compliance and environmental remediation. To reiterate our long-term strategy to reflect our new reality, the following elements are driving our strategy:

1. Re-Establish Financial Stability and Grow Shareholder Value. In the near term, Versar will become current with our financial reporting requirements with the NYSE MKT LLC (the Exchange) and Securities and Exchange Commission (SEC). While we continue to seek a long-term financial solution, we are exploring all strategic options. We are committed to conservatively managing our resources to ensure shareholder value and re-establish our financial stability.
2. Profitably execute current backlog. Our front-line project managers and employees will continue to control costs and streamline processes to profitably execute our current backlog. In addition, our back-office staff will redouble efforts to support our front-line employees efficiently and effectively serve our customers. We are committed to innovatively transform our business processes to be as efficient and cost-effective as possible.
3. Grow our pipeline. We are aggressively mining existing Indefinite Delivery Indefinite Quantity (IDIQ) contract vehicles to increase win rates. While we reduced back-office staff in our Business Development division, we remain committed to growing our pipeline and backlog by carefully managing our proposal efforts from identification through award to maximize our business development investments.
4. Retain and attract the best people. Our employees are critical to the execution of our strategy and we are committed to attracting and retaining the employees required to achieve all the elements of our strategy.

Competition

Government Contracting is a highly competitive industry, where price is often the deciding factor. In that environment, it is critical for Versar to differentiate our capabilities and offerings to ensure that our customers understand the value of our offerings. Versar carefully targets our business development and sales efforts and has developed strategic partnerships to enhance our competitive advantage.

The acquisition of VSS in fiscal 2016 expanded our customer base to include the FAA and FEMA, among others, as well as increased our service offerings into higher margin classified construction. During fiscal 2017, we will position the company to expand these new capabilities to existing customers and existing capabilities to new customers.

Backlog

We report "funded" backlog, which represents orders for goods and services for which we have received firm contractual commitments. Based on its history, the Company believes that approximately 90% of funded backlog will be performed in the succeeding twelve to eighteen-month period following the execution of the relevant contract. However, there can be no assurance that we will ultimately realize our full backlog. Additionally, other companies with similar types of contracts may not calculate backlog in the same manner we do, as their calculations may be based on different subjective factors or because they use a different methodology. Therefore, information presented by us regarding funded backlog may not necessarily be comparable to similar presentations by others.

As of July 1, 2016, funded backlog was approximately $136 million, a decrease of approximately 24% compared to approximately $179 million of funded backlog at the end of the fiscal year 2015. Backlog for the DAFB project at the end of fiscal 2015 was $55.1 million compared to $8.6 million at the end of fiscal 2016. During fiscal 2016, the DAFB revenue recognized was $50.2 million as compared to $43.2 million in fiscal 2015. The Company's funded backlog value at fiscal 2015 was the largest in the Company's history primarily driven by the August 13, 2014 award of DAFB contract of $98.3 million.

Employees

At July 1, 2016, we had 529 employees, of which 75% are engineers, scientists, and other professionals. 58% of our professional employees have a bachelor's degree, 38% have a master's degree, and 4% have a doctorate degree as their highest level of education earned.

Item 1A. Risk Factors

Our line of credit contains, and our future debt agreements may contain, covenants that may restrict our ability to engage in activities that may be in our long-term best interest, including financing future operations or capital needs or engaging in other business activities, and that require us to maintain specific financial ratios or levels.

Our line of credit restricts, among other things, our ability to:

incur additional debt;

pay dividends or distributions on our capital stock;

purchase, redeem or retire capital stock;

make acquisitions and investments;

create liens on our assets;

enter into certain transactions with affiliates;

merge or consolidate with another company;

obtain or maintain the appropriate bonding necessary to perform our work; or

transfer or sell assets outside the ordinary course of business.

In addition, our line of credit requires that we comply with certain consolidated Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA) financial ratios and levels,. These covenants may adversely impact our ability to finance our future operations or utilize the capital required to pursue available business opportunities.

During fiscal 2016, we were in default under certain of our financial maintenance covenants under our loan agreement, which defaults were addressed by amendment of the loan agreement subsequent to the end of the fiscal year; however, we are required to repay or replace the existing facility. In the future, our ability to fund our operations could be jeopardized if we cannot obtain alternative sources of funding. If in the future we again default under any future credit agreement, or if we are unable to obtain a new facility or refinance our existing indebtedness, it would have a material adverse impact on our financial position and operations.

On December 9, 2016, Versar, together with certain of its domestic subsidiaries acting as guarantors, entered into a First Amendment and Waiver (the Amendment) to the loan agreement (the Loan Agreement) dated September 30, 2015 with Bank of America, N.A. (the Lender), as the lender and letter of credit issuer for a revolving credit facility in the amount of $25,000,000 and a term facility in the amount $5,000,000. Under the Amendment, the Lender waived all existing events of default, and reduced the revolving facility to $13,000,000 from $25,000,000. The Amendment amends the Loan Agreement to remove the consolidated Total Leverage Ratio covenant, consolidated Senior Leverage Ratio covenant, consolidated Fixed Charge Coverage Ratio covenant, and the consolidated Asset Coverage Ratio covenant, and adds a covenant requiring Versar to maintain certain minimum quarterly consolidated EBITDA amounts and requires the Company to pursue alternative sources of funding for its ongoing business operations and to repay or replace the Loan Agreement.

If the Company is not able to repay or refinance the obligations under the Loan Agreement in accordance with the Loan Agreement requirements or meet certain other conditions, the Lender may exercise its rights and remedies with respect to such defaults. In such event, the Lender could demand immediate repayment of the outstanding borrowings and terminate the facility. The Lender could also seek to foreclose on its security interests in our assets and those of our subsidiaries, which would materially and negatively impact our ability to fund our business operations. We are currently seeking alternative sources of funding for our ongoing business operations as needed. There can be no assurance that we will be able to obtain alternative financing on terms acceptable to the Company, or at all. Failure to secure alternative financing would have a material adverse effect on the Company and its financial condition.

The Company is taking affirmative steps to modify operational plans and its internal organization to ensure that it can continue to operate with its existing cash resources. The actual amount of funds that the Company will need will be determined by many factors, some of which are beyond its control, and the Company may need funds sooner than currently anticipated.

The accompanying Financial Statements have been prepared assuming the Company will continue as a going concern. If the Company is unable to identify alternative sources of funding and raise additional capital as needed to fund operations, due to the Company’s negative cash flow from operations and accumulated deficit, there would be substantial doubt about its ability to continue as a going concern. The Financial Statements do not include any adjustments that might result from the outcome of this uncertainty.

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

Contracts with agencies of the United States government and various state and local governments represented approximately 90% of our revenue in fiscal 2016, with the remaining 10% of our revenue coming from commercial sources. Therefore, the success of our business is materially dependent on contracts with governmental agencies. Companies engaged in government contracting are subject to certain unique business risks not shared by those serving the general commercial sector. Among these risks are:

a competitive procurement process with no firm schedule or guarantee of contracts being awarded;

competitive pricing pressure that may require cost reductions in order to realize revenue under contracts;

award of work to competitors due primarily to policy reasons;

dependence on congressional and state appropriations and administrative allotment of funds;

policies and regulations that can be readily changed by governing bodies;

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

shifts in buying practices and policy changes regarding the use of contractors;

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

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

many contracts with U.S. government agencies require annual funding and may be terminated in the agency’s sole discretion.

The U.S. government’s contracting laws provide that the U.S. government can do business only with responsible contractors. Accordingly, U.S. government agencies have the authority under certain circumstances to suspend or debar a contractor from bidding on government contracts.

A reduction or shift in spending priorities by U.S. government agencies could limit or eliminate the continued funding of our existing government contracts or awards of new contracts or new task orders under existing contracts. Any such reductions or shifts in spending, if significant, could have a material adverse effect on our business.

Inability of the legislative and executive branches of the federal government to agree on a budget for key agencies or to enact appropriations in a timely manner has in the past delayed, and may in the future delay, the award of contracts. These delays, if significant, could have a material adverse effect on our business.

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

Contracts with the U.S. government and many other state and local governmental agencies are subject to auditing by governmental agencies, which could result in the disallowance of certain costs and expenses. These audits can result in the disallowance of significant costs and expenses if the auditing agency determines, in its discretion, that certain costs and expenses were unwarranted, allowable, or were excessive. Disallowance of costs and expenses, if pervasive or significant, could have a material adverse effect on our business.

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

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

Actual or perceived conflicts of interest may prevent us from being able to bid on or perform contracts.

U.S. government agencies have conflict of interest policies that may prevent us from bidding on or performing certain contracts. When dealing with U.S. government agencies that have such policies, we must decide, at times with incomplete information, whether to participate in a particular business opportunity when doing so could preclude us from participating in a related procurement at a future date. We have, on occasion, declined to bid on certain projects because of actual or perceived conflicts of interest. We will continue to encounter such conflicts of interest in the future, which could cause us to be unable to secure key contracts with U.S. government customers.

Robust enforcement of environmental regulations is important to our financial success.

Our business is materially dependent on the continued enforcement by local, state and federal governments of various environmental regulations. From time to time, depending on changed enforcement priorities, local, state and federal agencies modify environmental clean-up standards to promote economic growth and to discourage industrial businesses from relocating. Any relaxation in environmental and compliance standards could impact our ability to secure additional contracting work with such agencies or with other federal agencies that operate or manage contaminated property.

Many of our U.S. government customers procure goods and services through IDIQ, government wide acquisition contract (GWAC) or GSA Schedule contracts under which we must compete for post-award orders.

Budgetary pressures and reforms in the procurement process have caused many U.S. government customers to purchase goods and services through ID/IQ, GSA Schedule contracts and other multiple award and/or GWAC contract vehicles. These contract vehicles increase competition and pricing pressures, requiring us to make sustained efforts following the initial contract award to obtain ongoing awards and realize revenue. There can be no assurance that we will increase revenue or otherwise sell successfully under these contract vehicles. Any failure by the Company to compete effectively in this procurement environment could harm our business, financial condition, operating results and cash flows and our ability to meet our financial obligations.

If we fail to recover at-risk contract costs, we may have reduced fees or losses.

We are at risk for any costs incurred before a contract is executed, modified or renewed. A customer may choose not to pay us for these costs. While such costs are typically associated with specific anticipated contracts and funding modifications, we cannot be certain that our customers will execute these contracts or contract renewals, or that they will pay us for all our related at-risk costs. If any such unrecovered at-risk costs are significant, we may experience a decline in contract margins or experience losses on certain contracts or in certain periods, resulting in reduced profitability. We face increased pressure on profit margins and may need to lower margins to price projects at a more competitive rate to win awards.

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

Part of our business involves the design and implementation of remediation at environmental clean-up sites. If we fail to properly design and build a remediation system, or if a person claims that we did, we could face expensive litigation or regulatory enforcement efforts and potential settlement costs. If we fail to successfully defend against such a lawsuit, it could have a material adverse effect on our business.

Environmental laws and regulations and our use of hazardous materials may subject us to significant liabilities.

Our operations are subject to U.S. federal, state and local environmental laws and regulations, as well as environmental laws and regulations in the various countries in which we operate. We are also subject to environmental laws and regulations relating to the discharge, storage, treatment, handling, disposal and remediation of regulated substances and waste products, such as radioactive, biochemical or other hazardous materials and explosives. We may incur substantial costs in the future because of modifications to current laws and regulations, new laws and regulations, new guidance or new interpretation of existing laws or regulations, violations of environmental laws or required operating permits, or discovery of previously unknown contamination. Incurring such additional costs could have a material adverse effect on our business.

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

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

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

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

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

We are exposed to risks associated with operating internationally.

A certain portion of our business is conducted internationally. Consequently, we are subject to a variety of risks that are specific to international operations, including the following:

export regulations that could erode profit margins or restrict exports;

compliance with the U.S. Foreign Corrupt Practices Act;

compliance with the U.K Anti Bribery Act;

compliance with the anti-corruption laws of other jurisdictions in which we operate;

the burden and cost of compliance with foreign laws, treaties and technical standards and changes in those regulations;

contract award and funding delays;

potential restrictions on transfers of funds;

foreign currency fluctuations;

import and export duties and value added taxes;

transportation delays and interruptions;

uncertainties arising from foreign local business practices and cultural considerations; and

potential military conflicts, civil strife and political risks.

While we have and will continue to adopt and implement aggressive measures to reduce the potential impact of losses resulting from the risks of our foreign business, we cannot ensure that such measures will be adequate.

Political destabilization or insurgency in the regions in which we operate may have a material adverse effect on our business.

Certain regions in which we operate are highly politically unstable. Insurgent activities in the areas in which we operate may cause further destabilization in these regions. There can be no assurance that the regions in which we operate will continue to be stable enough to allow us to operate profitably or at all. We are required to increase compensation to our personnel as an incentive to deploy them to many of these regions. To date, we have been able to recover such costs under our contracts, but we may not be able to do so in the future. To the extent that we are unable to transfer such increased costs to our customers, our operating margins would be adversely impacted, which could adversely affect our operating performance. In addition, increased insurgent activities or destabilization, including civil unrest or a civil war in Iraq or Afghanistan, may lead to a determination by the U.S. government to halt our operations in a particular location, country or region and to perform the services that we provide using military personnel.

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

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

We operate in highly competitive industries.

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

Our long-term growth strategy includes acquisitions of other businesses, which may require us to incur costs and liabilities or have other unexpected consequences which may adversely affect our operating results and financial condition.

Like other companies with similar growth strategies, we may be unable to successfully implement our growth strategy, as we may be unable to identify suitable acquisition candidates, obtain acceptable financing, or consummate any future acquisitions. We frequently engage in evaluations of potential acquisitions and negotiations for possible acquisitions, certain of which, if consummated, could significantly enhance the Company's competitive position. Although it is our general objective only to acquire those companies which will be accretive to both earnings and cash flow, any potential acquisitions may result in material transaction expenses, increased interest and amortization expense, increased depreciation expense and increased operating expense, any of which could have a material adverse effect on our operating results. Acquisitions will require integration and management of the acquired businesses to realize economies of scale and control costs. In addition, acquisitions may involve other risks, including diversion of management resources otherwise available for ongoing development of our business and risks associated with entering new markets. Future acquisitions may also result in potential dilution of the Company's securities. Consummation of acquisitions may subject the Company to unanticipated business uncertainties or legal liabilities relating to those acquired businesses for which the sellers of the acquired businesses may not fully indemnify us. We may not realize the full anticipated benefit of any acquired business that has operated as a small business (as determined by the Small Business Administration based upon the North American Industry Classification Systems) if following their acquisition by us certain of their contracts are revoked or not renewed because they fail to continue to maintain small business status.

An economic downturn may have a material adverse effect on our business.

In an economic recession, or under other adverse macroeconomic conditions that may arise from natural or man-made events, customers and vendors may be less likely to meet contractual terms and payment or delivery obligations. In particular, if the U.S. government changes its operational priorities in Iraq and/or Afghanistan, reduces the DOD Operations and Maintenance budget, or reduces funding for Department of State initiatives in which we participate, our business, financial condition and results of operations could be severely affected.

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

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

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

the hiring and utilization rates of employees in the United States and internationally;

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

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

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

the business, financial, and security risks related to working in foreign countries;

the ability of clients to terminate engagements without penalties;

the creditworthiness and solvency of clients;

the size and scope of engagements;

the delay in federal, state and local government procurements;

the ability to perform contracts within budget or contractual limitations;

the timing of expenses incurred for corporate initiatives;

any threatened or pending litigation or other regulatory enforcement matters;

periodic reductions in the prices of services offered by our competitors;

the likelihood of winning the re-bids of our existing large government contracts;

the general economic and political conditions;

the loss of a major contract or the shutdown of a major program;

the volatility of currencies in foreign countries; and

our ability to integrate any acquisition or the ability of an acquired business to continue to perform as expected.

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

We are highly dependent on key personnel and our business could suffer if we fail to continue to attract, train and retain skilled employees.

Our business is managed by a number of key management and operating professional personnel. The loss of key personnel could have a material adverse effect on our business.

Availability of highly trained and skilled professional, administrative and technical personnel is critical to our future growth and profitability. Even in the current economic climate, competition in our industry for scientists, engineers, technicians, management and professional personnel is intense and competitors aggressively recruit key employees. Competition for experienced personnel, particularly in highly specialized areas, has occasionally made it more difficult for us to timely meet all our staffing needs. We cannot be certain that we will be able to continue to attract and retain required staff. Any failure to do so could have a material adverse effect on our business, financial condition, operating results and our ability to meet our financial obligations. Failure to recruit and retain a sufficient number of such employees could adversely affect our ability to maintain or grow our business. Some of our contracts require us to staff a program with personnel that the customer considers key to successful performance. If we cannot provide such personnel or acceptable substitutes, the customer may terminate the contract, and we may be unable to recover our costs.

In order to succeed, we will have to keep up with a variety of rapidly changing technologies. Various factors could affect our ability to keep pace with these changes.

Our success will largely depend on our ability to keep pace with changing technologies that can occur rapidly in our core business segments. We may incur significant expenses updating our technologies, which could have a material adverse effect on our margins and results of operations. Even if we keep up with the latest developments and available technology, newer services or technologies could negatively affect our business.

Our employees may engage in misconduct or other improper activities, which could harm our business.

Like all companies, we face the risk of employee fraud or other misconduct. Employee misconduct could include intentional failures to comply with U.S. government procurement regulations, unauthorized activities, attempts to obtain reimbursement for improper expenses, or submission of falsified time records. Employee misconduct could also involve improper use of our customers' sensitive or classified information, which could result in regulatory sanctions against us. Negative press reports regarding employee misconduct could harm our reputation with the government agencies for which we work. If our reputation with these agencies is negatively affected, or if we are suspended or debarred from contracting with government agencies for any reason, our future revenues and growth prospects would be adversely affected. It is not always possible to deter employee misconduct, and the precautions we take to prevent and detect this activity may not be effective in controlling unknown or unmanaged risks or losses, which could harm our business, financial condition, operating results and our ability to meet our financial obligations.

Internal system or service failures could disrupt our business and impair our ability to effectively provide our services and products to our customers, which could damage our reputation and adversely affect our revenue, profitability and operating results.

Our information technology systems are subject to systems failures, including network, software or hardware failures, whether caused by us, third-party service providers, cyber intruders or hackers, computer viruses, attacks on our computers systems, phishing attacks, natural disasters, power shortages or terrorist attacks. Any such failures or cyber-threat could cause loss of data and interruptions or delays in our business processes, cause us to incur remediation costs, subject us to claims and damage our reputation. Failure or disruption of our communications or utilities could cause us to interrupt or suspend our operations or otherwise adversely affect our business. Any system or service disruptions if not anticipated and appropriately mitigated could have a material adverse effect on our business including, among other things, an adverse effect on our ability to bill our customers for work performed on our contracts, collect the amounts that have been billed and produce accurate financial statements in a timely manner. Our property and business interruption insurance may be inadequate to compensate us for all losses that may occur as a result of any system or operational failure or disruption and, as a result, our results of operations could be materially and adversely affected. Versar has invested in and implemented systems that will allow it to achieve and remain in compliance with the regulations governing its business; however, there can be no assurance that such systems will be effective at achieving and maintaining compliance or that we will not incur additional costs in order to make such systems effective.

We have submitted claims to clients for work we performed beyond the initial scope of some of our contracts. If these clients do not approve these claims, our results of operations could be adversely impacted.

We typically have pending claims submitted under some of our contracts for payment of work performed beyond the initial contractual requirements for which we have already recorded revenue. In general, we cannot guarantee that such claims will be approved in whole, in part, or at all. If these claims are not approved, our revenue may be reduced in future periods.

An impairment charge of goodwill could have a material adverse impact on our financial condition and results of operations.

Because we have grown in part through acquisitions, goodwill and intangible assets-net represent a substantial portion of our assets. Goodwill and intangible assets-net were $7.2 million as of July 1, 2016. Under accounting principles generally accepted in the United States, we are required to test goodwill carried in our Consolidated Balance Sheets for possible impairment on an annual basis based upon a fair value approach and whenever events occur that indicate impairment could exist. These events or circumstances could include a significant change in the business climate, including a significant sustained decline in a reporting unit's market value, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of our business, a significant sustained decline in our market capitalization and other factors. In connection with our annual goodwill impairment testing for fiscal 2016, we recorded impairment charges of $20.3 million related to goodwill and $3.8 million related to intangible assets due to market conditions and business trends within the ECM, ESG, and PSG reporting units.

Maintaining adequate bonding capacity is necessary for us to successfully bid on and win fixed-price contracts. Failing to maintain adequate bonding capacity could have a material adverse impact on our ability to pursue new construction services contracts.

In line with industry practice, we are often required to provide bid, performance or payment bonds to clients under certain fixed-price contracts. These bonds indemnify the customer should we fail to perform our obligations under the relevant contract. If a bond is required for a particular project and we are unable to obtain an appropriate bond, we cannot pursue that project. We have bonding capacity but, as is typically the case, the issuance of a bond is at the surety's sole discretion. Moreover, due to events that affect the insurance and bonding markets generally, bonding may be more difficult to obtain in the future or may only be available at significantly higher costs. There can be no assurance that our bonding capacity will continue to be available to us on reasonable terms. Our inability to obtain adequate bonding and, as a result, to bid on new fixed-price contracts could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Our operating margins may decline under our fixed-price contracts if we fail to estimate accurately the time and resources necessary to satisfy our obligations.

Some of our contracts are fixed-price contracts, under which we bear the risk of any cost overruns. Our profits are adversely affected if our costs under these contracts exceed the assumptions that we used in bidding for the contract. Often, we are required to fix the price for a contract before we finalize the project specifications, increasing the risk that we may misprice these contracts. The complexity of many of our engagements makes accurately estimating our time and resources more difficult. In the event we fail to estimate our time and resources accurately, our expenses will increase and our profitability, if any, under such contracts will decrease.

Item 2. Properties

Our corporate executive office is located in Springfield, Virginia, which is a suburb of Washington, D.C. Versar currently leases 40,507 square feet from Springfield Realty Investors, LLC. The rent is subject to a two percent escalation per year through December 31, 2021.

As of July 1, 2016, we had under lease an aggregate of approximately 213,000 square feet of office and manufacturing space in the following locations (parenthetical reference of business segments using space): Dulles (ECM), Springfield (all segments), Hampton, VA (ESG); Chandler, AZ (ESG); Westminster, CO (all segments); Atlanta, GA (ESG and PSG); Aiea, HI (ECM); Boise, ID (ESG); Columbia (ESG), and Germantown, MD (ECM and ESG); Charleston, SC (ESG); San Antonio and El Paso, TX (ESG); Clark Air Force Base, the Republic of Philippines (ECM); Milton Keynes, U.K. (ECM); and Abu Dhabi (ECM and ESG), United Arab Emirates. The lease terms primarily range from two to six years.

Item 3. Legal Proceedings

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

PART II

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

Our common stock is traded on the NYSE MKT under the symbol VSR. At March 1, 2017, the Company had 825 stockholders of record, excluding stockholders whose shares were held in nominee name. The quarterly high and low sales prices as reported on the NYSE MKT during fiscal years 2016 and 2015 are presented below.

Fiscal Year 2017	High	Low
2nd Quarter	1.56	1.19
1st Quarter	1.87	1.15

Fiscal Year 2016	High	Low
4th Quarter	3.25	1.01
3rd Quarter	3.07	1.93
2nd Quarter	3.55	2.67
1st Quarter	4.38	2.86

Fiscal Year 2015	High	Low
4th Quarter	4.45	3.06
3rd Quarter	3.60	2.96
2nd Quarter	7.84	2.69
1st Quarter	4.10	3.06

No cash dividends have been paid by Versar since it began public trading of its stock in 1986. The Board of Directors intends to retain any future earnings for use in our business and does not anticipate paying cash dividends in the foreseeable future. Under the terms of our revolving line of credit, approval would be required from our Lender for the payment of any dividends. We have established equity compensation plans to attract, motivate and reward good performance of high caliber employees, directors and service providers serving Versar and its affiliates. Currently, there is one stock incentive plan, which was previously approved by the stockholders: the 2010 Stock Incentive Plan. We do not maintain any equity compensation plans not approved by our stockholders. Through July 1, 2016, 551,369 restricted stock units have been granted under this plan.

Equity Compensation Plan Information

Plan Category	Number of Securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans, excluding securities reflected in column (a) (c)
Equity compensation plans approved by security holders	-	-	539,935

The graph below matches Versar, Inc.'s cumulative 5-Year total shareholder return on common stock with the cumulative total returns of (i) the S&P 500 index and (ii) a customized peer group of five companies comprised of AECOM Technology Corp., Arcadis, NV, Ecology & Environment Inc., TRC Companies Inc. and URS Corp. The graph tracks the performance of a $100 investment in our common stock, in each of the peer groups, and the index (with the reinvestment of all dividends) from 6/30/2011 to 6/30/2016.

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

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

The following discussion and analysis of our financial condition and results of operations is provided to enhance the understanding of, and should be read together with, our consolidated financial statements and the notes to those statements that appear elsewhere in this Annual Report on Form 10-K. This discussion contains forward-looking statements that involve risks and uncertainties. Unless otherwise specifically noted, all years refer to our fiscal years which ended on July 1, 2016, June 26, 2015 and June 27, 2014.

Financial Trends

Our business performance is affected by the overall level of U.S. Government spending and the alignment of our offerings and capabilities with the budget priorities of the U.S. Government. Adverse changes in fiscal and economic conditions, such as the manner in which spending reductions are implemented, including sequestration, future government shutdowns, and issues related to the nation's debt ceiling, could have a material adverse effect on our business.

In this challenging economic environment, our focus is on those opportunities where the U.S. Government continues funding and which clearly align with Versar's capabilities. These opportunities include construction management, security system integration, performance-based remediation, and hazardous materials management. We also continue to focus on areas that we believe offer attractive enough returns to our clients, such as construction type services both in the U. S. and internationally, improvements in energy efficiency, and assisting with facility upgrades. We continue to see a decline in some of our PSG contract positions largely due to the continued shift to more contract solicitations being targeted to small business and similar such programs. If we are unable to seek new ways to develop our relationships with firms qualified for these programs to increase our ability to capture more of this work and maintain current projects this may result in a material impact of future periods. Overall, our pipeline remains robust, but longer timelines for contract awards and project start dates have slowed the transition from pipeline to backlog and then to revenue generating projects.

We believe that Versar has the expertise to identify and respond to the challenges raised by the issues we face and that we are positioned in the coming year to address these concerns. Our business operates through the following three business segments: ECM, ESG, and PSG. These segments are segregated based on the nature of the work, business processes, customer bases and the business environment in which each of the segments operates.

The initial award for the DAFB project was $98.3 million. Seven modifications have raised the contract ceiling to $109.5 million. DAFB project contributed $50.2 million of revenue for fiscal 2016 as compared to $43.2 million for fiscal 2015, an increase of $6.9 million. Versar is the prime contractor on the DAFB project, with a significant portion of the work performed by sub-contractors, resulting in positive smaller gross margin on the project than our self-performing projects. During January 2017, the DAFB customer, issued the Company a Notice of Forbearance stating we had not met our contractual obligation to complete the DAFB project by December 31, 2016. We submitted several change order requests to the DAFB customer during fiscal 2016, which are still pending resolution. The requested change orders impacted our timeline for completion of the project, and were outside the original scope of services to be performed, but did not impact the project's profitability. We continue to work and perform tasks on the DAFB project, while under the Notice of Forbearance, in order to deliver the completed runway project as soon as possible. We anticipate the acceptance of the change orders and resolution of the construction related issues by the DAFB customer that will resolve the current Notice of Forbearance and allow the Company to complete the construction project by June 28, 2017.

There are risk factors or uncertainties that could significantly impact our future financial performance. A sample of these risks is listed below. For a complete discussion of these risk factors and uncertainties, refer to Item 1A. Risk Factors, herein.

Factors Affecting Fiscal 2016 Performance

During fiscal 2016, the Company recognized many onetime project losses and charges to our Income Statement and Balance Sheet as follows:

Loss Contingency Accruals in the ESG Segment

In June 2016, a class action lawsuit was filed against the Company by former employees alleging violations of several provisions of California's labor law relating to paid lunch time and breaks for the years 2012 through 2015. The Company has reviewed the supporting files and documentation regarding this notice and has engaged outside counsel with experience with these matters to assist the Company in the defense of this matter. Given that this matter is in a very early stage it is difficult to predict the likely outcome; however, management has determined a reasonably possible loss in a range of $0.5 to $1.0 million, including the expenses of outside counsel. The Company performed an initial financial review of the number of employees, days worked, and hours per day worked by employees on this project over the course of the years noted in the lawsuit. As a result of this analysis, the Company has recorded a loss contingency accrual of $0.5 million related to this event. On October 11, 2016, the mediation resulted in a Confidential Memorandum Of Understanding (MOU) for settlement of this claim. The estimated contingency accrual of $0.5 million remains consistent with this MOU.

In May 2016, during a routine audit by the General Services Administration ("GSA") concerning authorized GSA schedule rates compared to the invoicing of a federal customer, the GSA discovered that the Company had been charging its customer several billing rates that were not supported by the contractual listed billing rates for the fiscal 2015 and 2016. The outcome of this audit finding has not yet been resolved. The Company has performed a preliminary financial analysis of the number of employees working, labor categories billed to the customer, the contractual billing rates that should have been billed, days worked, and hours per day worked on this project over the course of the years noted in the audit finding. This preliminary analysis is the basis for the Company's probable loss and provided the basis for the accrual made. Therefore, the Company determined the audit finding to be estimateable and recorded a loss contingency accrual of $0.3 million related to this event during the fiscal year ended July 1, 2016. Subsequently, the outstanding audit issues were resolved and the Company made a payment of $0.3 million to the GSA in November 2016.

During April 2016, a project under one of the Company's PBR Task Orders involving a ground water extraction well system at a site in Ohio failing to meet minimum performance requirements required rehabilitation/replacement. This work was completed under the Company's 2009 United States Air Force Worldwide Environmental Restoration and Construction contract with the Air Force Civil Engineer Center ("AFCEC"). This extraction well system failure was not included in the Company's original budget for the performance of this work. In accordance with the performance basis of our contract with the customer, the Company must repair and or replace all equipment located on the site that fails to meet performance requirements. The Company has performed a review of the materials and labor required to rehabilitate or replace the extraction well system and used this review as the basis of the estimate for the accrual. The Company recorded a loss contingency accrual of $0.3 million to rehabilitate or replace the extraction well system. The corrective action will occur during the first three quarters of fiscal 2017.

Lease Loss Accruals

In March 2016, the Company abandoned its field office facilities in Charleston, SC and Lynchburg, VA, both within the ESG segment. Although the Company remains obligated under the terms of these leases for the rent and other costs associated with these leases, the Company decided to cease using these spaces effective April 1, 2016, and does not plan to occupy them in the future. Therefore, the Company recorded a charge to selling, general and administrative expenses of approximately $0.4 million to recognize the costs of exiting these spaces. This liability is equal to the total amount of rent and other direct costs for the period of time that the space is expected to remain unoccupied. In addition, this liability includes, the present value of the amount by which the rent paid by the Company to the landlord exceeds any rent paid to the Company by a tenant under a sublease over the remainder of the lease terms, which expire in April 2019 for Charleston, SC, and June 2020 for Lynchburg, VA. The Company also recognized $0.1 million of costs for the associated leasehold improvements related to the Lynchburg, VA office.

In June 2016, the Company abandoned an office in San Antonio, TX, which is within the ECM segment. The Company will, however, continue to use a smaller office in San Antonio. Although the Company remains obligated under the terms of this lease for the rent and other costs associated with this lease, the Company made the decision to cease using this space on July 1, 2016, and has no foreseeable plans to occupy it in the future. Therefore, the Company recorded a charge to selling, general and administrative expenses of approximately $0.2 million to recognize the costs of exiting this space. This liability is equal to the total amount of rent and other direct costs for the period of time that the space is expected to remain unoccupied. In addition, this liability includes the present value of the amount by which the rent paid by the Company to the landlord exceeds any rent paid to the Company by a tenant under a sublease over the remainder of the lease term, which expires in February 2019. The Company also recognized $0.2 million of costs for the associated leasehold improvements related to the San Antonio, TX office.

Other Nonrecurring Expenses

On September 30, 2015, the Company, together with certain of its domestic subsidiaries acting as guarantors, entered into a loan agreement with the Lender and letter of credit issuer for a revolving credit facility in the amount of $25.0 million and a term facility in the amount of $5.0 million. The proceeds of the term facility and borrowings under the revolving credit facility were used to repay amounts outstanding under the Company's Third Amended and Restated Loan and Security Agreement with United Bank and to pay a portion of the purchase price for the acquisition of VSS.

During the third and fourth quarters of fiscal 2016, as has previously been disclosed, following discussion with the Lender, the Company determined that it was not in compliance with the covenants regarding its Consolidated Total Leverage Ratio, Consolidated Senior Leverage Ratio and Asset Coverage Ratio under the loan agreement. Each failure to comply with these covenants constitutes a default under the Loan Agreement. On May 12, 2016, the Company, certain of its subsidiaries, and the Lender entered into a Forbearance Agreement pursuant to which the Lender agreed to forbear from exercising any and all rights or remedies available to it under the Loan Agreement and applicable law related to these defaults for a period ending on the earliest to occur of: (a) a breach by the Company of any obligation or covenant under the Forbearance Agreement, (b) any other default or event of default under the Loan Agreement or (c) June 1, 2016 (the Forbearance Period). During the Forbearance Period, the Company continued to have the right to borrow funds pursuant to the terms of the Loan Agreement. The Lender engaged an advisor to review the Company's financial condition on the Lender's behalf. The Company accrued $0.1 million at July 1, 2016 related to the costs of services provided by the Lenders' advisor.

Subsequent to the end of fiscal year 2016, the Company, certain of its subsidiaries and the Lender entered into forbearance agreements, which allowed the Company to borrow funds pursuant to the Loan Agreement, consistent with current Company needs as set forth in a 13-week cash flow forecast subject to certain caps on revolving borrowings initially of $15.5 million and reducing to $13.5 million through December 9, 2016. In addition, from and after June 30, 2016 outstanding amounts under the credit facility bear interest at the default interest rate set forth in the credit facility equal to the LIBOR Daily Floating Rate (as defined in the credit facility) plus 3.95%. The Company was required to provide a 13 week cash flow forecast updated on a weekly basis to the Lender and the Lender waived any provisions prohibiting the financing of insurance premiums for policies covering the period of July 1, 2016 to June 30, 2017 in the ordinary course of the Company's business and in amounts consistent with past practices. The forbearance agreement also required the Company to pursue alternative sources of funding for its ongoing business operations. In connection with the forbearance agreement, the Company recorded a charge to selling, general and administrative expenses of approximately $0.2 million for fiscal year 2016 related to the remaining deferred expenses associated with the loan agreement entered into in September 2015.

On December 9, 2016, Versar, together with certain of its domestic subsidiaries acting as guarantors (collectively, the Guarantors), entered into a First Amendment and Waiver (the Amendment) to the loan agreement (the Loan Agreement) dated September 30, 2015 with the Lender.

Under the Amendment, the Lender waived all existing events of default, and reduced the revolving facility to $13,000,000 from $25,000,000. The interest rate on borrowings under the revolving facility and the term facility accrue at the LIBOR Daily Floating Rate plus 5.00% from LIBOR plus 1.87%. The Amendment amended the Loan Agreement to add a covenant requiring Versar to maintain certain minimum quarterly consolidated EBITDA amounts. The Amendment also eliminated the Loan Agreement covenants requiring maintenance of a required consolidated total leverage ratio, consolidated fixed charge coverage ratio, consolidated senior leverage ratio and consolidated asset coverage ratio.

The Company, entered into negotiations with Applied Research Associates (ARA) regarding the fiscal 2014 acquisition of GMI, and the related price agreement dated September 2, 2013 between Versar and ARA. Per the price agreement, after the closing date of the acquisition, Versar was to calculate the net working capital adjustment and then make a payment to, or receive a payment from, ARA for the adjusted amount. As the Company continues to negotiate a payment settlement to ARA, a reasonably possible payment calculation is within a range of $0.7 million to $2.2 million. The Company has recorded a loss contingency accrual of $1.2 million which represents management's best estimate of the ultimate cost to resolve this matter. The contracts acquired related to this acquisition are reported within the ECM and ESG segments on a 58.6% and 41.4% allocation with the segments receiving their proportional share of the loss contingency accrual.

During the fourth quarter of fiscal 2016, the Company recorded a $9.5 million charge to record a full valuation allowance against its deferred tax assets. ASC 740-10-30-4 requires deferred taxes to be determined separately for each taxpaying component in each tax jurisdiction. Furthermore, the deferred tax assets must be reduced by a valuation allowance if, based on the weight of available positive and negative evidence, it is "more likely than not" that some portion or all of the deferred tax assets will not be realized. The Company has determined to reduce the deferred tax asset to the amount that is more likely than not to be realized.

Additionally, during the fourth quarter of fiscal 2016, the Company recorded a $1.9 million charge to recognize a loss on the sale of PPS, which is scheduled to be sold in March 2017. This amount is recorded as Other Expense (Income) in the financial statements.

Goodwill and Intangible Expense Impairments

During the third quarter of fiscal 2016, sustained delays in contract awards and contract funding and the direct impact on the Company's results of operations, coupled with the continued decrease in the Company's stock price, and were deemed to be triggering events that led to an interim period test for goodwill impairment. As a result of our analysis, we recorded an impairment charge of $15.9 million. The carrying value of goodwill after impairment at April 1, 2016 was $4.4 million. The Company's remaining goodwill balance, after impairment, was derived from the acquisition of JMWA in fiscal 2015. Based on the results of the impairment testing, the Company concluded that the value of definite-lived intangible assets with a carrying value of $2.9 million was not recoverable. The Company has recorded a charge of $1.5 million for the partial impairment of definite-lived intangible assets acquired from JMWA, a charge of $0.8 million for the impairment of definite-lived intangible assets acquired from GMI, and a charge of $0.7 million for the impairment of definite-lived intangible assets of PPS, acquired in fiscal 2010, and Charon Consulting, acquired in fiscal 2012. As a result of these charges, the carrying amount of intangible assets acquired from Charon and PPS has been reduced to zero, and the carrying amount of intangible assets in the Company's PSG segment have been reduced to zero.

During the fourth quarter of fiscal 2016, continued delays in contract awards and contract funding and the direct impact on the Company's results of operations, coupled with the continued decrease in the Company's stock price, and were deemed to be triggering events that led to an updated test for goodwill impairment. As a result of our analysis, we recorded an additional impairment charge of $4.4 million. The carrying value of goodwill after impairment at July 1, 2016 was zero. Based on the results of the impairment testing, the Company concluded that the value of definite-lived assets with a carrying value of $0.9 million was not recoverable. The Company has recorded a charge of $0.3 million for the impairment of definite-lived intangible assets acquired from JMWA, a charge of $0.6 million for the impairment of definite-lived intangible assets acquired from GMI. As a result of these charges, the carrying amount of intangible assets acquired from JMWA and GMI has been reduced to zero.

Consolidated Results of Operations

The table below sets forth our consolidated results of continuing operations for the fiscal years ended July 1, 2016, June 26, 2015, and June 27, 2014.

	For the Fiscal Year Ended		
	July 1, 2016	June 26, 2015	June 27, 2014
	(dollars in thousands)		
GROSS REVENUE	$167,917	$159,877	$110,280
Purchased services and materials, at cost	107,199	90,289	55,108
Direct costs of services and overhead	57,544	55,797	46,653
GROSS PROFIT	$3,174	$13,791	$8,519
Gross Profit percentage	2%	9%	8%
Selling general and administrative expenses	13,031	11,003	10,175
Other operating expense (income)	1,937	-	(1,596)
Goodwill Impairment	20,332	-	1,381
Intangible impairment	3,812	-	-
OPERATING (LOSS) INCOME	(35,937)	2,788	(1,441)
OTHER (INCOME) EXPENSE			
Interest income	(19)	(2)	(15)
Interest expense	702	447	133
(LOSS) INCOME BEFORE INCOME TAXES, FROM CONTINUING OPERATIONS	$(36,619)	$2,343	$(1,559)

Fiscal Year 2016 Compared to Fiscal Year 2015

Gross revenue for fiscal 2016 was $167.9 million, an increase of 5% compared to $159.9 million during fiscal 2015. VSS contributed $17.6 million to the increase and our DAFB project contributed an additional $6.9 million off-set by decreases in revenue of approximately (i) $3.0 million related to reduced sales from PPS, (ii) $1.9 million related to decreased levels of Title II work in Iraq and Afghanistan within ECM, (iii) $2.3 million related to PBR projects, (iv) $4.0 million related to the expiration of the Ft. Irwin contract within ESG, and a (v) $3.8 million from PSG's historical business line as a result of the continued shift of contract solicitations to businesses that qualify for small business programs.

Purchased services and materials for fiscal 2016 were $107.2 million, an increase of 19% compared to $90.3 million during fiscal 2015. VSS, acquired during fiscal 2016, contributed $10.0 million to the increase and the DAFB project contributed an additional $6.0 million. We are the prime contractor at DAFB, and as such, a significant portion of the work is performed by sub-contractors.

Direct costs of services and overhead for fiscal 2016 were $57.5 million, an increase of 3% compared to $55.8 million during the fiscal 2015.

Gross profit from operations for fiscal 2016 was $3.2 million, a decrease of 77% compared to gross profit of $13.8 million for fiscal 2015. Gross profit contributions from VSS were $2.1 million, offset by a project mix shift, such as the decline in our Title II work in Iraq and Afghanistan, ncreased costs associated with the DAFB project, and a loss of $2.1 million in our PPS subsidiary, which we are in the process of divesting. In addition, we incurred losses of $900,000 to complete a firm-fixed price project at Homestead AFB we obtained as a result of the GMI acquisition. This decrease was magnified by the expiration of the Ft. Irwin contract In addition, the Company recognized $1.3 million of loss contingency accruals in connection with (i) a class action lawsuit from a group of former employees at Ft. Irwin, (ii) a probable loss relate within our ESG segment due to the audit finding by GSA within the ESG segment, and (iii) the loss accrual for the removal and installation of the new well pump for the PBR task orders (see "Factors Affecting Fiscal 2016 Performance--Loss Contingency Accruals" above for more information). Primarily because we are the prime contractor on the DAFB project, with a significant portion of the work performed by sub-contractors, our consolidated gross margin decreased from 9% to 3%. As the DAFB project becomes a smaller percentage of our overall revenue mix we expect to see margins improve. However, our higher margin Title II work in Iraq and Afghanistan has declined during fiscal 2016, so to sustain improved margins we will need to continue to secure additional higher margin work under new contracts. A charge for $1.2 million for the ARA net working capital adjustments also contributed to the decline in the gross profit (see Non Recurring Expenses above).

Selling, general and administrative expenses for fiscal 2016 were $13.0 million, or 8% of gross revenue, compared to $11.0 million, or 7% of gross revenue, during fiscal 2015. The increase in fiscal 2016 included approximately $0.6 million in integration costs and approximately $0.65 million in transaction costs associated with the acquisition of VSS, approximately $0.6 million to record the costs of impairing exiting lease spaces, and approximately $0.15 million in restructuring costs and fees associated with our forbearance agreements with Bank of America, including legal fees arising from our efforts to obtain alternative financing.

We recorded a Goodwill and Intangible impairments charge of $ 24.1 million due to a decline in the estimated fair value in the ECM, ESG, and PSG reporting units, attributable to goodwill acquired in certain acquisitions. (For additional information on these goodwill and intangible impairments, see Note 7 to our Consolidated Financial Statements included herein).

Other operating expense for fiscal 2016 was a $1.9 million charge for the loss on the sale of PPS subsidiary.

Operating loss, before income taxes, for fiscal 2016 was $36.6 million compared to operating income of $2.3 million during fiscal 2015. The decline in operating income was the result of the items discussed above.

Fiscal Year 2015 Compared to Fiscal Year 2014

Gross revenue for fiscal 2015 was $159.9 million, an increase of 45% compared to $110.3 million during fiscal 2014. JMWA, acquired in fiscal 2015, contributed $29.2 million to the increase and the DAFB project contributed an additional $32.0 million. These increases were off-set by a $6.2 million decrease in revenue related to PBR projects within ESG and a $5.5 million decrease in revenue from PSG’s historical business line as a result of the continued shift of contract solicitations to businesses that qualify for small business programs. Additionally, we continue to see declines in revenue from our international operations in Afghanistan and Iraq as the Title II work in that region winds down.

Purchased services and materials for fiscal 2015 was $90.3 million, an increase of 64% compared to $55.1 million during fiscal 2014. We are the prime contractor on the DAFB project, and, as such, a significant portion of the work is performed by sub-contractors.

Direct costs of services and overhead for fiscal 2015 were $55.8 million, an increase of 20% compared to $46.7 million during fiscal 2014. Additional costs associated with JMWA were partially offset by the cost savings associated with our internal re-alignment within ESG.

Gross profit from continuing operations for fiscal 2015 was $13.8 million, an increase of 62% compared to $8.5 million for fiscal 2014. Gross profit contributions from JMWA were $7.1 million. Although we are the prime contractor on the DAFB project, with a significant portion of the work performed by sub-contractors, we were still able to improve our gross margin from 8% to 9%. Additionally, we saw margin improvement in our ESG group due to the reduction in contract related overhead expenses as a result of our internal realignment of the ESG organization.

Selling, general and administrative expenses for fiscal 2015 were $11.0 million, or 7% of gross revenue, compared to $10.2 million, or 9% of gross revenue, during fiscal 2014. Fiscal 2015 included approximately $1.0 million related to integration costs associated with the acquisition of JMWA. Management was able to realize cost savings as the result of internal re-organizations within our business segments.

Operating income from continuing operations for fiscal 2015 was $2.8 million compared to operating loss of $1.4 million during fiscal 2014. The improvement in operating income was the result of the items discussed above.

Results of Operations by Business Segment

The tables below set forth the operating results for our three business segments for the fiscal years ended July 1, 2016, June 26, 2015, and June 27, 2014.

ECM

	For the Fiscal Year Ended		
	July 1, 2016	June 26, 2015	June 27, 2014
GROSS REVENUE	$110,533	$91,111	$52,012
Purchased services and materials, at cost	86,927	68,159	32,991
Direct costs of services and overhead	20,498	14,922	13,733
GROSS PROFIT, from continuing operations	3,108	8,030	5,288
Income (Loss) from discontinued operations	-	-	317
GROSS PROFIT	$3,108	$8,030	$5,605
Gross profit (loss) percentage	3%	9%	10%

Fiscal 2016 Compared to Fiscal 2015

Gross revenue for fiscal 2016 was $110.5 million, an increase of 21% compared to $91.1 million during fiscal 2015. VSS, acquired during fiscal 2016, contributed $17.6 million to the increase, and revenue from the DAFB project contributed approximately $6.9 million to the increase, offset by a decrease in revenue from PPS of approximately $3.0 million. Our Title II work in Iraq and Afghanistan continued to wind down during fiscal 2016, so to sustain improved margins we will need to continue to secure additional higher margin work under new contracts.

Gross profit from continuing operations for fiscal 2016 was $3.1 million, a decrease of 61% compared to $8.0 million during the fiscal 2015. Gross profit margin decreased from 9% to 3% for fiscal 2016. VSS contributed $2.1 million to gross profit offset by the decline of our higher margin Title II, a $0.9 million loss on our Homestead AFB project, and a $2.1 million loss associated with PPS. A charge for $0.7 million for the ARA net working capital adjustments also contributed to the decline in the gross profit (see Non Recurring Expenses above).

Fiscal 2015 Compared to Fiscal 2014

Gross revenue for fiscal 2015 was $91.1 million, an increase of 75% compared to $52.0 million during fiscal 2014. JMWA contributed $7.0 million, revenue from the DAFB project contributed approximately $28.0 million, and revenue from PPS contributed approximately $2.0 million to this increase.

Gross profit from continuing operations for fiscal 2015 was $8.0 million, an increase of 52% compared to $5.3 million during fiscal 2014. JMWA contributed $2.3 million to this increase and the remaining increase is directly attributable to DAFB project. Although we are the prime contractor on the DAFB project, with a significant portion of the work performed by sub-contractors, we were able to achieve a gross margin of 9% as the result of efficient project management compared to 10% for fiscal 2014. Lastly, during the first quarter of fiscal 2015, we recognized a loss of approximately $0.7 million related to a project managed out of our Knoxville office that was inherited through the acquisition of GMI in fiscal 2014.

ESG

	For the Fiscal Year Ended		
	July 1, 2016	June 26, 2015	June 27, 2014
GROSS REVENUE	$38,688	$46,620	$46,848
Purchased services and materials, at cost	17,628	19,666	21,438
Direct costs of services and overhead	20,170	23,287	23,294
GROSS (LOSS) PROFIT	$890	$3,667	$2,116
Gross (loss) profit percentage	2%	8%	5%

Fiscal 2016 Compared to Fiscal 2015

Gross revenue for fiscal 2016 was $38.7 million, a decrease of 17% compared to $46.6 million during fiscal 2015. The decrease in revenue was due to the expiration of the significant contract with Ft. Irwin and anticipated revenue decreases associated with the maturing of the PBR program.

Gross profit for fiscal 2016 was $0.9 million, a decrease of 76% compared to $3.7 million during fiscal 2015. This decrease is due to a total of $1.3 million of project loss contingency accruals in connection with (i) Ft. Irwin class action lawsuit brought by a number of former employees, (ii) a probable loss from the audit finding by GSA, and (iii) the loss accrual for the removal and installation of the new well pump for the PBR task orders, as described above. Additionally, several projects experienced decreased gross profit related to no cost work extensions due to demobilization expenses and higher overtime requirements to finish projects within the required period of performance. These decreases were offset by costs savings in the reduction of the amount of work performed by subcontractors, and by a reduction in contract related overhead expenses following the internal realignment of ESG's organization in early fiscal 2016. A charge for $0.5 million for the ARA net working capital adjustments also contributed to the decline in the gross profit (see Non Recurring Expenses above).

Fiscal 2015 Compared to Fiscal 2014

Gross revenue for fiscal 2015 was $46.6 million, a slight decrease compared to $46.8 million during fiscal 2014. JMWA contributed $6.0 million in revenue, however this increase was off-set by decreases in revenue due to the timing of our PBR projects.

Gross profit for fiscal 2015 was $3.7 million, an increase of 76% compared to $2.1 million during fiscal 2014. Although revenue was slightly down from the prior fiscal year, we were able to realize a 3% increase in gross margins to 8%, compared to 5% in the prior fiscal year. We were able to achieve higher margins as the result of a decrease in the amount of work that was performed by subcontractors, 42% compared to 46% in the prior fiscal year, and by a reduction in contract related overhead expenses.

PSG

For the Fiscal Year Ended

	July 1, 2016	June 26, 2015	June 27, 2014
GROSS REVENUE	$18,696	$22,146	$11,420
Purchased services and materials, at cost	2,644	2,464	679
Direct costs of services and overhead	16,876	17,588	9,626
GROSS (LOSS) PROFIT	$(824)	$2,094	$1,115
Gross (loss) profit percentage	-4%	9%	10%

Fiscal 2016 Compared to Fiscal 2015

Gross revenue for fiscal 2016 was $18.7 million, a decrease of 16 % compared to $22.1 million during fiscal 2015. We continue to see a decline in our contract positions largely due to the continued shift to more contract solicitations being targeted to small business and similar such programs. We continue to seek new ways to develop our relationships with firms qualified for these programs to increase our ability to capture more of this work and maintain current projects. We continue to experience profit pressures in this segment.

Gross loss for fiscal 2016 was $0.8 million, a decrease of 139% compared to gross profit of $2.1 million during fiscal 2015. This decrease is a direct result of the decline in revenue due to the loss of task orders and the allocation of significant indirect costs due to their high level of direct labor.

Fiscal 2015 Compared to Fiscal 2014

Gross revenue for fiscal 2015 was $22.1 million, an increase of 94% compared to $11.4 million during fiscal 2014. This increase was directly attributable to the $16.2 million contributed by JMWA, off-set by a $5.5 million decrease in revenue from historical business lines. We continued to experience a decline in our contract positions largely due to the continued shift to more contract solicitations being targeted to small business and similar such programs.

Gross profit for fiscal 2015 was $2.1 million, an increase of 88% compared to $1.1 million during fiscal 2014. This increase was the direct result of the contribution of JMWA.

Gross Revenue by Client Base

Our business segments provide services to various industries, serving government and commercial clients. A summary of gross revenue from continuing operations generated from our client base is as follows:

	Years Ended					
	July 1, 2016		June 26, 2015		June 27, 2014	
			(in thousands)			
Government						
DoD	116,062	69%	129,305	81%	86,039	78%
State and Local	6,899	4%	7,249	5%	8,573	8%
EPA	4,583	3%	6,457	4%	1,593	1%
Other	38,416	23%	11,552	7%	6,314	6%
Commercial	1,957	1%	5,314	3%	7,761	7%
Gross Revenue	167,917	100%	159,877	100%	110,280	100%

Liquidity and Capital Resources

Our working capital as of July 1, 2016 was approximately a negative $2.2 million, compared to positive working capital at June 26, 2015 of $23.1 million. A significant factor contributing to this change in working capital is the $14.9 million increase in the outstanding line of credit balance with Bank of America, the $9.5 million decrease in the ending accounts receivable balance, the $1.9 million for the loss on the sale of PPS, and $1.4 million decrease in deferred income taxes as compared to fiscal 2015. Our current ratio at July 1, 2016 was 0.96 compared to 1.54 from the prior fiscal year.

On July 1, 2014, we acquired JMWA. The acquisition price of $13 million was paid in cash and with seller notes in the principal amount of $6 million. On July 1, 2016, the outstanding aggregate principal balance of the notes was $3.9 million. On September 30, 2015, the Company successfully completed the acquisition of JCSS, now known as VSS. The Company paid a cash purchase price of $10.5 million and agreed to pay contingent consideration of up to a maximum of $9.5 million based on the occurrence of certain events within the earn-out period of 3 years from September 30, 2015. As of July 1, 2016, management believes the amount of the contingent consideration that will be earned within the earn-out period is $3.2 million, including probability weighing of future cash flows. All payment related to the VSS contingent consideration over the next 2.5 years will also be funded through existing working capital (See Note 3 – Acquisitions).

On September 30, 2015, the Company, together with certain of its domestic subsidiaries acting as guarantors, entered into a loan with Bank of America, N.A. as the lender and letter of credit issuer for a revolving credit facility in the amount of $25.0 million and a term facility in the amount of $5.0 million. The proceeds of the term facility and borrowings under the revolving credit facility were used to repay amounts outstanding under the Company's Third Amended and Restated Loan and Security Agreement with United Bank and to pay a portion of the purchase price for the acquisition of VSS.

The maturity date of the revolving credit facility is September 30, 2018 and the maturity date of the term facility is March 31, 2017. The principal amount of the term facility amortizes in quarterly installments equal to $0.8 million with no penalty for prepayment. Interest initially accrued on the revolving credit facility and the term facility at a rate per year equal to the LIBOR Daily Floating Rate (as defined in the Loan Agreement) plus 1.95% and was payable in arrears on December 31, 2015 and on the last day of each quarter thereafter. Obligations under the loan agreement are guaranteed unconditionally and on a joint and several basis by the guarantors and secured by substantially all of the assets of Versar and the guarantors. The loan agreement contains customary affirmative and negative covenants and during fiscal year 2016 contained financial covenants related to the maintenance of a Consolidated Total Leverage Ratio (which requires that the Company maintain a Consolidated Total Leverage Ratio, as defined, of not greater than 3.25:1.0), Consolidated Senior Leverage Ratio (which requires the Company to maintain a Consolidated Senior Leverage Ratio, as defined, of not greater than 2.75:1.0), Consolidated Fixed Charge Coverage Ratio(which requires the Company maintain an Fixed Charge Coverage Ration greater than 1.25:1.0 and Consolidated Asset Coverage Ratio (which requires the Company maintain an Asset Coverage Ratio, as defined, of greater than 1.25:1.0).

During the third and fourth quarters of fiscal 2016, following discussion with the Lender, the Company determined that it was not in compliance with the Consolidated Total Leverage Ratio, Consolidated Senior Leverage Ratio, and Asset Coverage Ratio covenants for the fiscal quarters ended January 1, 2016, April 1, 2016, and July 1, 2016. Each failure to comply with these covenants constitutes a default under the loan agreement. On May 12, 2016, the Company, with certain of its subsidiaries and the Lender entered into a forbearance agreement pursuant to which the Lender agreed to forbear from exercising any and all rights or remedies available to it under the loan agreement and applicable law related to these defaults for a period ending on the earliest to occur of: (a) a breach by the Company of any obligation or covenant under the forbearance agreement, (b) any other default or event of default under the loan agreement or (c) June 1, 2016 (the Forbearance Period). Subsequently, the Company and the Lender entered into additional forbearance agreements to extend the Forbearance Period through December 9, 2016, and to allow the Company to borrow funds pursuant to the terms of the loan agreement, consistent with current Company needs as set forth in a 13-week cash flow forecast and subject to certain caps on revolving borrowings initially of $15.5 million and reducing to $13.5 million. In addition, from and after June 30, 2016, outstanding amounts under the credit facility bore interest at the default interest rate equal to the LIBOR Daily Floating Rate (as defined in the Loan Agreement) plus 3.95%. The Company is required to provide a 13-week cash flow forecast updated on a weekly basis to the Lender, and the Lender waived any provisions prohibiting the financing of insurance premiums for policies covering the period of July 1, 2016 to June 30, 2017 in the ordinary course of the Company's business and in amounts consistent with past practices. The Lender has engaged an advisor to review the Company's financial condition on the Lender's behalf, and also required the Company to pursue alternative sources of funding for its ongoing business operations.

As of July 1, 2016, the available balance on the Company's revolving credit facility was approximately $9.7 million. As of December 30, 2016 the available balance on the Company's revolving credit facility was approximately $2.7 million.

On December 9, 2016 (the Closing Date), Versar, Inc. (Versar), together with certain of its domestic subsidiaries acting as guarantors (collectively, the Guarantors), entered into a First Amendment and Waiver (the Amendment) to the loan agreement (the Loan Agreement) dated September 30, 2015 with Bank of America, N.A. (the Lender).

Under the Amendment, the Lender waived all existing events of default, and reduced the revolving facility to $13,000,000 from $25,000,000. The interest rate on borrowings under the revolving facility and the term facility will accrue at the LIBOR Daily Floating Rate plus 5.00% from LIBOR plus 1.87%. The Amendment added a covenant requiring Versar to maintain certain minimum quarterly consolidated EBITDA amounts. The Amendment also eliminated the Loan Agreement covenants requiring maintenance of a required consolidated total leverage ratio, consolidated fixed charge coverage ratio, consolidated senior leverage ratio and asset coverage ratio.

In addition to the foregoing, and subject to certain conditions regarding the use of cash collateral and other cash received to satisfy outstanding obligations under the Loan Agreement, the Amendment suspended all amortization payments under the term facility such that the entire amount of the term facility shall be due and payable on September 30, 2017. The original maturity date under the Loan Agreement was September 30, 2018. As consideration for the Amendment and the waiver of the existing events of default, Versar agrees to pay an amendment fee of .5% of the aggregate principal amount of the term facility outstanding as of November 30, 2016 plus the commitments under the revolving facility in effect as of the same date, which fee is due and payable on the earlier of a subsequent event of default or August 30, 2017. The Company paid $0.3 million in amendment fees in December 2016.

Finally, the Amendment continued the requirement for Versar to retain a CRO and recognized Versar's ongoing efforts to work with the Lender and continues the requirements to engage with a strategic financial advisor to assist with the structuring and consummation of a transaction, the purpose of which will be the replacement or repayment in full of all obligations under the Loan Agreement.

Our capital requirements for fiscal 2016 were approximately $0.7 million, used primarily for annual hardware and software purchases to maintain our existing information technology systems. We anticipate that our discretionary capital requirements for fiscal 2017 will be approximately $0.5 million. Also, the Company has made certain cost cutting measures during fiscal 2016 so that we can continue to operate within existing cash resources. We believe that our cash balance of $1.1 million at the end of fiscal 2016, along with anticipated cash flows from ongoing operations and the funds available from our line of credit facility, will be sufficient to meet our working capital and liquidity needs during fiscal 2017. Going forward, the Company will continue to aggressively manage our cash flows and costs as needed based on the performance of the Company. Additionally, the surety broker has informed the Company that bonding for new work may be limited due to our accumulated deficit. The surety broker has requested that for all new bonds issued: i) a portion of the required bonds for future work be placed in a collateral account, and ii) establish a funds control account for each new project. A funds control account essentially eliminates the payment risk for the surety. The surety establishes a separate bank account in the contractor's name, oversees all of the payment disbursements from the Company, and delivers checks from each payment for the Company to distribute to their vendors working on the project. The surety essentially becomes the contractor's accounts payable back office. We continue to work with our surety broker and bonding companies to find ways to issue bonds. As we commit to obtaining new financing our bonding capacity's availability is also expected to increase.

Contractual Obligations

At July 1, 2016, we had total contractual obligations of approximately $21.6 million, including short-term obligations of approximately $6.9 million. The short-term obligations will become due over the next twelve months (fiscal 2017). Our contractual obligations are primarily related to lease commitments. Additionally, we have principal and interest obligations related to the notes payable from our acquisition of JMWA. The table below specifies the total contractual payment obligations as of July 1, 2016.

Contractual Obligations	Total	Within 1 Year	2-3 Years	4-5 Years	After 5 Years
Lease obligations	$13,986	$2,948	$5,668	$3,816	$1,554
Notes Payable to sellers	3,825	1,331	2,494	-	-
Notes Payable to Bank of America	2,500	2,500	-	-	-
Deferred Compensation obligations	1,019	107	214	201	497
Estimated interest obligations	293	167	126	-	-
Total contractual obligations	$21,623	$7,053	$8,502	$4,017	$2,051

On October 3, 2016 the Company did not make the quarterly principal payments to three individuals who were the former owners of JMWA. However, the Company continued to make monthly interest payments through the end of calendar year 2016 at an increased interest rate (seven percent per annum, rather than five percent per annum). On November 21, 2016, two of the former JMWA shareholders filed an action against the Company in Fairfax County District Court, VA for failure to make such payments and to enforce their rights to such payments. Consequently, in the second quarter of fiscal 2017, the Company has moved the long-term portion of the debt to short term notes payable for a total of $3.8 million. Starting in January 2017 the Company stopped making the interest-only payments to two of the former owners and continues to make the monthly interest only payment at seven percent per annum to one owner. The discovery process is currently underway. A trial date is set for July 2017.

On January 1, 2017 the Company did not make $0.1 million in periodic payment to three individuals who participate in a Deferred Compensation Agreement plan established by the Company in 1988. The Company continues to negotiate with the individuals to reschedule the payments for a future period.

Critical Accounting Policies and Related Estimates That Could Have a Material Effect on Our Consolidated Financial Statements

Critical Accounting Policies and Estimates

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

Revenue recognition: On cost-plus fee contracts, revenue is recognized to the extent of costs incurred plus a proportionate amount of fee earned, and on time-and-material contracts, revenue is recognized to the extent of billable rates times hours delivered plus material and other reimbursable costs incurred. We record income from fixed-price contracts, extending over more than one accounting period, using the percentage-of-completion method. During the performance of such contracts, estimated final contract prices and costs are periodically reviewed and revisions are made as required. Fixed price contracts can be significantly impacted by changes in contract performance, contract delays, liquidated damages and penalty provisions, and contract change orders, which may affect the revenue recognition on a project. Revisions to such estimates are made when they become known. Detailed quarterly project reviews are conducted with project managers to review all project progress accruals and revenue recognition. There is the possibility that there will be future and currently unforeseeable adjustments to our estimated contract revenues, costs and margins for fixed price contracts, particularly in the later stages of these contracts. Such adjustments are common in the construction industry given the nature of the contracts. These adjustments could either positively or negatively impact our estimates due to the circumstances surrounding the negotiations of change orders, the impact of schedule slippage, subcontractor claims and contract disputes which are normally resolved at the end of the contract.

Allowance for doubtful accounts: Disputes arise in the normal course of our business on projects where we are contesting with customers for collection of funds because of events such as delays, changes in contract specifications and questions of cost allowability and collectability. Such disputes, whether claims or unapproved change orders in process of negotiation, are recorded at the lesser of their estimated net realizable value or actual costs incurred and only when realization is probable and can be reliably estimated. Management reviews outstanding receivables on a quarterly basis and assesses the need for reserves, taking into consideration past collection history and other events that bear on the collectability of such receivables. All receivables over 60 days old are reviewed as part of this process.

Share-based compensation: Share-based compensation is measured at the grant date, based on the fair value of the award. All of the Company's equity awards granted to employees in fiscal 2016, 2015, and 2014 were restricted stock unit awards. Share-based compensation cost for restricted stock unit awards is based on the fair market value of the Company’s stock on the date of grant. Stock-based compensation cost for stock options is calculated on the date of grant using the fair value of stock options, as calculated using the Black-Scholes pricing model.

Net deferred tax asset: The Company established a full valuation allowance against its U.S net deferred tax assets during the year and maintained the full valuation allowance from our Philippine branch. Therefore, the net balance of deferred taxes as of July 1, 2016 is zero.

Long-lived assets: We review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset might not be recoverable. An impairment loss is recognized if the carrying value exceeds the fair value. We review the cash flows of the operating units to ensure the carrying values do not exceed the cash flows that they support. Any write-downs are treated as permanent reductions. We believe the carrying value of our long-lived assets as of July 1, 2016 are fully recoverable.

Goodwill: During fiscal 2015, the Company changed the annual goodwill impairment assessment date from the last day of the fiscal year to the first day of the fourth quarter of the fiscal year. Management determined that performing the assessment prior to the close of the fiscal year provided the external valuation firm, the independent external auditors, and the Company with sufficient time to generate, review, and conclude on the valuation analysis results. At the close of fiscal year 2015, management assessed whether there were any conditions present during the fourth quarter that would indicate impairment subsequent to the initial assessment date and concluded that no such conditions were present.

During the third quarter of fiscal 2016, sustained delays in contract awards and contract funding and the direct impact on the Company’s results of operations, coupled with the continued decrease in the Company’s stock price, were deemed to be triggering events that led to an updated test for goodwill impairment. As a result of our analysis, we recorded an impairment charge of $15.9 million. The carrying value of goodwill after impairment at April 1, 2016 was $4.4 million.

During the fourth quarter of fiscal 2016, sustained delays in contract awards and contract funding and the direct impact on the Company’s results of operations, coupled with the continued decrease in the Company’s stock price, and were deemed to be triggering events that led to an interim period test for goodwill impairment. As a result of our analysis, we recorded an impairment charge of $4.4 million. The carrying value of goodwill after impairment atJuly 1, 2016 was zero. . Based on the results of the impairment testing, the Company concluded that the value of definite-lived intangible assets with a carrying value of $2.9 million was not recoverable. The Company has recorded a charge of $1.8 million for the impairment of definite-lived intangible assets acquired from JMWA, a charge of $1.1 million for the impairment of definite-lived intangible assets acquired from GMI, and a charge of $0.7 million for the impairment of definite-lived intangible assets of PPS, acquired in fiscal 2010, and Charron Consulting, acquired in fiscal 2012. As a result of these charges, the carrying amount of intangible assets acquired from Charron and PPS has been reduced to zero, and the carrying amount of intangible assets in the Company’s PSG and ESG segments have been reduced to zero. The carrying value of goodwill at July 1, 2016 and June 26, 2015 was zero million and $16.1 million, respectively. The goodwill balances were principally generated from our acquisition of JMWA during fiscal 2015, GMI during fiscal 2014, Charron during fiscal 2012, and the acquisitions of PPS and Advent Environmental, Inc. (Advent) during fiscal 2010. To conduct the annual goodwill impairment analysis, management, with the assistance of an external valuation firm, estimated the fair value of each reporting unit using a market-based valuation approach based on guideline public company data.

The first step of the goodwill impairment analysis identifies potential impairment and the second step measures the amount of impairment loss to be recognized, if any. Step 2 is only performed if Step 1 indicates potential impairment. Potential impairment is identified by comparing the fair value of the reporting unit with its carrying amount, including goodwill. The carrying amount of a reporting unit equals assets (including goodwill) less liabilities assigned to that reporting unit. The fair value of a reporting unit is the price that would be received if the reporting unit was sold. Value is based on the assumptions of market participants. Market participants may be strategic acquirers, financial buyers, or both. The assumptions of market participants do not include assumed synergies which are unique to the parent company. Our external valuation firm has estimated the fair value of each reporting unit using both a discounted cash flow analysis and the Guideline Public Company (GPC) method under the market approach. Each of the GPC’s is assumed to be a market participant. The valuation analysis methodology adjusted the value of the reporting units by including a premium for control, or market participant acquisition premium (MPAP). The MPAP reflects the capitalized benefit of reducing a company’s operating costs. These costs are associated with a company’s public reporting requirements. The adjustment assumes an acquirer could take the company private and eliminate these costs.

For the year ended July 1, 2016, we concluded that there was an indication of impairment to the Company’s recorded remaining goodwill balance which are now zero.

Intangible assets: The net carrying value of our intangible assets at July 1, 2016 and June 26, 2015 was $7.2 million and $4.6 million, respectively. The intangible assets include customer related assets, marketing related assets, and technology-based assets. These intangible assets are amortized over a 5 - 15 year useful life. We review our intangible assets for impairment whenever events or changes in circumstances indicate that the carrying value of the asset might not be recoverable. An impairment loss is recognized if the carrying value exceeds the fair value. Any impairments of the asset are treated as permanent reductions. In connection with our annual goodwill impairment testing for fiscal 2016, we recorded an intangible impairment charge of $3.7 million due to market conditions and business trends within the ECM, ESG, and PSG reporting units.

Impact of Inflation

We protect ourselves from the effects of inflation. The majority of contracts we perform are for a period of a year or less and are firm fixed price contracts. Multi-year contracts provide for projected increases in labor and other costs.

Business Segments

We have the following three business segments: ECM, ESG, and PSG. Additional details regarding these segments are contained in Note 2 - Business Segments, of the Notes to the Consolidated Financial Statements included elsewhere in this annual report on Form 10-K.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

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

Item 8. Financial Statements and Supplementary Data Report of Independent Registered Public Accounting Firm

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders Versar, Inc.

We have audited the accompanying consolidated balance sheet of Versar, Inc. (a Delaware corporation) and subsidiaries (the “Company”) as of July 1, 2016 the related consolidated statements of operations, comprehensive (loss) income, changes in stockholders’ equity, and cash flows for the year ended. Our audit also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements and financial statement schedule of Versar, Inc. and subsidiaries as of June 26, 2015 and June 27, 2014 and for each of the two years then ended were audited by other auditors whose report dated September 15, 2015, expressed an unqualified opinion on those statements.

We conducted our audit 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. We were not engaged to perform an audit of the Company’s internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the fiscal year 2016 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Versar, Inc. and subsidiaries as of July 1, 2016, and the results of its operations and its cash flows for the year ended July 1, 2016, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As described in Note 2 to the consolidated financial statements, the Company generated a net loss of $37.9 million for the fiscal year ended July 1, 2016, expects losses to continue in the future and had an accumulated deficit of $27.4 million at that date. These conditions raise substantial doubt about its ability to continue as a going concern. Management’s plans in regard to these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Urish Popeck & Co., LLC

Pittsburgh, PA
March 27, 2017

VERSAR, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(In thousands, except share amounts)

	As of	
	July 1,2016	June 26,2015
ASSETS		
Current assets		
Cash and cash equivalents	$1,549	$2,109
Accounts receivable, net	47,675	57,171
Inventory, net	221	1,188
Prepaid expenses and other current assets	1,007	1,540
Deferred income taxes	-	1,366
Income tax receivable	1,513	2,373
Total current assets	51,965	65,747
Property and equipment, net	1,328	2,084
Deferred income taxes, non-current	-	414
Goodwill	-	16,066
Intangible assets, net	7,248	4,643
Other assets	775	252
Total assets	$61,316	$89,206
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$18,156	$35,852
Billings in excess of revenue	7,156	-
Accrued salaries and vacation	2,478	3,332
Bank line of credit	14,854	-
Notes payable, current	3,831	2,313
Other current liabilities	7,724	1,114
Total current liabilities	54,199	42,611
Notes payable, non-current	2,494	5,835
Other long-term liabilities	3,555	1,390
Total liabilities	60,248	49,836

COMMITMENTS AND CONTINGENCIES		
Stockholders' equity		
Common stock $.01 par value; 30,000,000 shares authorized;10,217,227 shares issued and 9,982,778 shares outstanding as of July 1 2016; 10,128,923 shares issued and 9,805,082 shares outstanding as of June 26, 2015 (10,217,277 shares issued and 9,950,958 shares outstanding as of March 1, 2017)	102	101
Capital in excess of par value	31,128	30,798
(Accumulated deficit) Retained earnings	(27,448)	10,439
Treasury stock, at cost	(1,480)	(1,460)
Accumulated other comprehensive loss; foreign currency translation	(1,234)	(508)
Total stockholders' equity	1,068	39,370
Total liabilities and stockholders' equity	$61,316	$89,206

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

VERSAR, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

(In thousands, except per share amounts)

	For the Fiscal Year Ended		
	July 1, 2016	June 26, 2015	June 27, 2014
GROSS REVENUE	$167,917	$159,877	$110,280
Purchased services and materials, at cost	107,199	90,289	55,108
Direct costs of services and overhead	57,544	55,797	46,653
GROSS (LOSS) PROFIT	3,174	13,791	8,519
Selling, general and administrative expenses	13,031	11,003	10,175
Other operating expense (income)	1,937	-	(1,596)
Goodwill impairment	20,331	-	1,381
Intangible impairment	3,812	-	-
OPERATING (LOSS) INCOME	(35,937)	2,788	(1,441)
OTHER (INCOME) EXPENSE			
Interest income	(19)	(2)	(15)
Interest expense	702	447	133
(LOSS) INCOME BEFORE INCOME TAXES, FROM CONTINUING OPERATIONS	(36,620)	2,343	(1,559)
Income tax expense (benefit)	1,267	936	(1,043)
NET (LOSS) INCOME FROM CONTINUING OPERATIONS	(37,887)	1,407	(516)
Income (Loss) from discontinued operations, net of tax	-	-	182
NET (LOSS) INCOME	$(37,887)	$1,407	$(334)
NET (LOSS) INCOME PER SHARE-BASIC and DILUTED			
Continuing operations	$(3.84)	0.14	$(0.05)
Discontinued operations	-	-	0.02
NET (LOSS) INCOME PER SHARE-BASIC and DILUTED	$(3.84)	$0.14	$(0.03)
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING-BASIC	9,857	9,771	9,663

WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING-DILUTED	9,857	9,771	9,663

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

VERSAR, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive (Loss) Income
Fiscal Years Ended July 1, 2016, June 26, 2015, and June 27, 2014

	For the Fiscal Year Ended		
	July 1, 2016	June 26, 2015	June 27, 2014
COMPREHENSIVE (LOSS) INCOME			
Net (loss) income	$(37,887)	$1,407	$(334)
Foreign currency translation adjustments	(726)	(164)	31
TOTAL COMPREHENSIVE (LOSS) INCOME	$(38,613)	$1,243	$(303)

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

VERSAR, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
Fiscal Years Ended July 1, 2016, June 26, 2015, and June 27, 2014 (in thousands)

	Common Stock		Capital in Excess of	Retained Earnings / (Accumulated)	Treasury		Other Comprehensive	Stockholders'
	Shares	Amount	Par Value	Deficit)	Shares	Amount	Loss	Equity
Balance at June 27, 2014	10,013	$100	$30,393	$9,032	(305)	$(1,396)	$(344)	$37,785
Restricted stock units	116	1	405	-	-	-	-	406
Treasury stock	-	-	-	-	(19)	(64)	-	(64)
Net income	-	-	-	1,407	-	-	-	1,407
Foreign Currency Translation Adjustment	-	-	-	-	-	-	(164)	(164)
Balance at June 26, 2015	10,129	101	30,798	10,439	(324)	(1,460)	(508)	39,370
Restricted stock units	88	1	330	-	-	-	-	331
Treasury stock	-	-	-	-	(7)	(20)	-	(20)
Net loss	-	-	-	(37,887)	-	-	-	(37,887)
Foreign Currency Translation Adjustment	-	-	-	-	-	-	(726)	(726)
Balance at July 1, 2016	10,217	$102	$31,128	$(27,448)	(331)	$(1,480)	$(1,234)	$1,068

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

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

	For the Fiscal Year Ended		
	July 1, 2016	June 26, 2015	June 27, 2014
Cash flows from operating activities:			
Net income (loss)	$(37,887)	$1,407	$(334)
Adjustments to reconcile net income (loss) from continuing operations to net cash provided by operating activities:			
Depreciation and amortization	5,756	2,566	1,973
(Gain) loss on sale of property and equipment	(79)	59	34
Change in contingent notes	-	-	(1,590)
Provision for (recovery of) doubtful accounts receivable	1,001	(27)	(886)
Loss on life insurance policy cash surrender value	-	(35)	(63)
Provision (benefit) for income taxes expense	1,779	1,008	(913)
Share based compensation	329	405	502
Goodwill impairment	20,331	-	1,381
Intangible impairment	3,812	-	-
Changes in assets and liabilities:			
Decrease (increase) in accounts receivable	15,191	(26,239)	10,682
Decrease (increase) in prepaid and other assets	1,148	(344)	356
(Increase) decrease in inventories	(96)	7	64
(Decrease) increase in accounts payable	(19,635)	23,013	(2,190)
Decrease in accrued salaries and vacation	(1,055)	(938)	(130)
Decrease in income tax payable	829	(15)	(141)
Decrease (increase) in other assets and liabilities	6,503	(705)	(1,998)
Net cash provided by operating activities	(2,072)	162	6,747
Cash flows from investing activities:			
Purchase of property and equipment	(686)	(839)	(971)
Payment for VSS acquisition, net of cash acquired	(11,080)	-	-
Payment for JMWA acquisition, net of cash acquired	-	(7,164)	-
Payment for GMI acquisiton, net of cash acquired	-	-	(2,788)
Proceeds from sale of office equipment	270	-	-
Premiums paid on life insurance policies	-	(23)	(23)
Proceeds received on life insurance policies	-	835	-
Net cash used in investing activities	(11,496)	(7,191)	(3,782)

Cash flows from financing activities:			
Borrowings on line of credit	73,464	19,943	-
Repayments on line of credit	(58,611)	(19,943)	-
Loan for JMWA Purchase	-	4,000	-
Repayment of Loan for JMWA Purchase	(1,266)	(1,189)	-
Loan for VSS Purchase	5,000	-	-
Repayment of Loan for VSS Purchase	(2,500)	-	-
Proceeds from exercise of stock options	-	-	99
Repayments of notes payable	(3,058)	(3,559)	(2,045)
Purchase of treasury stock	(20)	(64)	(171)
Net cash provided by financing activities	13,009	(812)	(2,117)
Effect of exchange rate changes on cash and cash equivalents	(1)	276	98
Net decrease in cash and cash equivalents	(560)	(7,565)	946
Cash and cash equivalents at the beginning of the period	2,109	9,674	8,728
Cash and cash equivalents at the end of the period	$1,549	$2,109	$9,674
Supplemental disclosure of cash and non-cash activities:			
Promissory notes-payable issued in connection with JMWA acquisition	$-	$6,000	$-
Promissory notes-payable issued in connection with GMI acquisition	$-	$-	$1,250
Contingent consideration payable related to VSS acquisition	$3,154	$-	$-
Cash paid for interest	$133	$429	$133
Cash paid for income taxes	$254	$48	$254

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

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

NOTE 1 - Significant Accounting Policies

Principles of consolidation and business operations: Versar, Inc., a Delaware corporation organized in 1969, is a global project management firm that provides value oriented solutions to government and commercial clients. We also provide tailored and secure engineering solutions in extreme environments and offers specialized abilities in construction management, security system integration, performance-based remediation, and hazardous materials management. The accompanying consolidated financial statements include the accounts of Versar, Inc. and its wholly-owned subsidiaries (“Versar” or the “Company”). All intercompany balances and transactions have been eliminated in consolidation. The Company operates within three business segments ECM, ESG and PSG. Refer to Note 3 - Business Segments for additional information. The Company’s fiscal year end is based upon 52 or 53 weeks per year ending on the last Friday of the fiscal period and therefore does not close on a calendar month end. The Company’s fiscal year 2016 included 53 weeks and its fiscal years 2015 and 2014 included 52 weeks.

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

Contract accounting and revenue recognition: Contracts in process are stated at the lower of actual cost incurred plus accrued profits or incurred costs reduced by progress billings. The Company records income from major fixed-price contracts, extending over more than one accounting period, using the percentage-of-completion method. During performance of such contracts, estimated final contract prices and costs are periodically reviewed and revisions are made as required. The effects of these revisions are included in the periods in which the revisions are made. On cost-plus-fee type contracts, revenue is recognized to the extent of costs incurred plus a proportionate amount of fee earned, and on time-and material contracts, revenue is recognized to the extent of billable rates times hours delivered plus material and other reimbursable costs incurred. Losses on contracts are recognized when they become known.

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

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

Depreciation and amortization: Property and equipment are carried at cost net of accumulated depreciation and amortization. Depreciation and amortization are computed on a straight-line basis over the estimated useful lives of the assets. Repairs and maintenance that do not add significant value or significantly lengthen an asset’s useful life are charged to current operations.

Allowance for doubtful accounts receivable: Disputes arise in the normal course of our business on projects where we are contesting with customers for collection of funds because of events such as delays, changes in contract specifications and questions of cost allowability and collectability. Such disputes, whether claims or unapproved change orders in process of negotiation, are recorded at the lesser of their estimated net realizable value or actual costs incurred and only when realization is probable and can be reliably estimated. Management reviews outstanding receivables on a quarterly basis and assesses the need for reserves, taking into consideration past collection history and other events that bear on the collectability of such receivables. All receivables over 60 days old are reviewed as part of this process.

Share-based compensation: Share-based compensation expense is measured at the grant date, based on the fair value of the award. The Company's recent equity awards have been restricted stock unit awards. Share-based compensation cost for restricted stock unit awards is based on the fair market value of the Company’s stock on the date of grant. Share-based compensation expense for stock options is calculated on the date of grant using the Black-Scholes pricing model to determine the fair value of stock options. Compensation expense is then recognized ratably over the requisite service period of the grants.

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

The following is a reconciliation of weighted average outstanding shares for purposes of calculating basic net (loss) income per share compared to diluted net (loss) income per share:

	For the Fiscal Year End		
	July 1, 2016	June 26, 2015	June 27,2014
	(in thousands)		
Weighted average common shares outstanding-basic	9,857	9,771	9,663
Effect of assumed exercise of options and vesting of restricted stock unit awards, using the treasury stock method	-	-	-
Weighted average common shares outstanding-diluted	9,857	9,771	9,663

For fiscal 2014, there were outstanding options to purchase approximately 43,000 shares of common stock, however, due to the net loss, there was no impact to dilution. We had no outstanding options in fiscal years 2015 and 2016.

Cash and cash equivalents: All investments with an original maturity of three months or less when purchased are considered to be cash equivalents. Cash and cash equivalents are maintained at financial institutions and, at times, balances may exceed federally insured limits. The Company has never experienced any losses related to these balances.

Inventory: The Company's inventory is valued at the lower of cost or market and is accounted for on a first-in first-out basis.

Long-lived assets: The Company is required to review long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying value of an asset might not be recoverable. An impairment loss is recognized if the carrying value exceeds the fair value. Any write-downs are treated as permanent reductions. The Company believes the long-lived assets as of July 1, 2016 are fully recoverable.

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

Goodwill: The carrying value of goodwill at July 1, 2016 and June 26, 2015 was zero and $16.1 million, respectively. To conduct the annual goodwill impairment analysis, management, with the assistance of an external valuation firm, estimated the fair value of each reporting unit using a market-based valuation approach based on comparable public company data (see Note 7 for results). As of July 1, 2016, the Company has recognized impairment expense of $11.5 million for the ECM reporting unit, $4.4 million for the ESG reporting unit, and $4.4 million for the PSG reporting unit. These charges are associated with impairment of goodwill acquired from JCSS, Advent, PPS, Charron, GMI, and JMWA.

Other intangible assets: The net carrying value of intangible assets at July 1, 2016 and June 26, 2015 was $7.2 million and $4.6 million, respectively. The intangible assets accumulated from acquisitions include customer related assets, marketing related assets, technology-based assets, contractual related assets, and non-competition related assets. These intangible assets are amortized over a 1.75 - 15 year useful life. The Company is required to review its amortized intangible assets for impairment whenever events or changes in circumstances indicate that the carrying value of the asset might not be recoverable. An impairment loss is recognized if the carrying value exceeds the fair value. Any impairment of the assets would be treated as permanent reductions. Based on the results of the impairment testing during the third and fourth quarters of fiscal 2016, the Company concluded that the value of intangible assets with a carrying amount of $3.7 million was not recoverable. As a result of these charges, the carrying amount of intangible assets acquired from GMI, Charron, Advent, JMWA, and PPS has been reduced to zero. The carrying amount of intangible assets in the Company's PSG and ESG segments have been reduced to zero.

Treasury stock: The Company accounts for treasury stock using the cost method. There were 330,742 and 323,841 shares of treasury stock at historical cost of approximately $1.5 million at July 1, 2016 and June 26, 2015, respectively.

Foreign Currency Translation and Transactions: The financial position and results of operations of the Company's foreign affiliates are translated using the local currency as the functional currency. Assets and liabilities of the affiliates are translated at the exchange rate in effect at year-end. Statement of Operations accounts are translated at the average rate of exchange prevailing during the year. Translation adjustments arising from the use of differing exchange rates from period to period are included in Other Comprehensive Income (Loss) within the Company's Consolidated Statements of Comprehensive Income (Loss). Gains and losses resulting from foreign currency transactions are included in operations and are not material for the fiscal years presented. At July 1, 2016 and June 26, 2015, the Company had cash held in foreign banks of approximately \$0.5 million and \$0.8 million, respectively. At July 1, 2016 and June 26, 2015, the Company had net assets held in the United Kingdom of approximately \$0.3 million.

Fair value of Financial Instruments: The fair values of the Company's cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximate their carrying values because of the short-term nature of those instruments. The carrying value of the Company's debt approximates its fair value based upon the quoted market price offered to the Company for debt of the same maturity and quality.

Commitments and Contingencies: Liabilities for loss contingencies arising from claims, assessments, litigation, fines, and penalties and other sources are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated.

Recent Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-08, "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity" ("ASU 2014-08"), which amends the requirements for reporting discontinued operations and requires additional disclosures about discontinued operations. Under the new guidance, a discontinued operation is defined as a disposal of a component or group of components that is disposed of or is classified as held for sale and represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. This new accounting guidance is effective for annual periods beginning after December 15, 2014. The Company adopted this guidance for the fiscal year ended July 1, 2016 and had no impact on the fiscal 2016 financial statements.

In April 2015, the FASB issued Accounting Standards Update No. 2015-03, Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which simplifies the presentation of debt issuance costs as a deduction from the carrying amount of the related debt liability instead of a deferred charge. For public business entities, the amendments of the update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption of the amendments in this update are permitted for financial statements that have not been previously issued. The Company has elected to adopt this standard for the fiscal year ended July 1, 2016. The Company reclassified \$0.2 million of the Lenders debt issuance costs from Prepaid expenses within the other current assets to the Bank line of credit section within current liabilities on the Company consolidated balance sheets.

In September 2015, the FASB issued Accounting Standards Update No. 2015-16 – "Simplifying the Accounting for Measurement-Period Adjustments (Topic 805): Business Combinations" ("ASU 2015-16"), which replaces the requirement that an acquirer in a business combination account for measurement period adjustments retrospectively with a requirement that an acquirer recognize adjustments to the provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. ASU 2015-16 requires that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. For public business entities, ASU 2015-16 is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The guidance is to be applied prospectively to adjustments to provisional amounts that occur after the effective date of the guidance, with earlier application permitted for financial statements that have not been issued. The Company will adopt the guidance for fiscal 2017 and does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In November 2015, the FASB issued Accounting Standards Update NO. 2015-17 – "Balance Sheet Classifications of Deferred Taxes" ("ASU 2015-17"). To simplify the presentation of deferred income taxes, ASU 2015-17 require that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. ASU 2015-17 eliminate the guidance in Topic 740 that requires an entity to separate deferred tax liabilities and assets into a current amount and a noncurrent amount in a classified statement of financial position. ASU 2017 -17 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The guidance is to be applied prospectively to adjustments to provisional amounts that occur after the effective date of the guidance, with earlier application permitted for financial statements that have not been issued. The Company adopted this guidance for the fiscal year ended July 1, 2016 and had no impact on the fiscal 2016 financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842) ("ASU 2016-02"), which requires the recognition of lease rights and obligations as assets and liabilities on the balance sheet. Previously, lessees were not required to recognize on the balance sheet assets and liabilities arising from operating leases. The ASU also requires disclosure of key information about leasing arrangements. ASU 2016-02 is effective on January 1, 2019, using the modified retrospective method of adoption, with early adoption permitted. We have not yet determined the effect of the adoption of ASU 2016-02 on our consolidated financial statements nor have we selected a transition date.

In March 2016, the FASB issued ASU 2016-07 (Topic 323), Investments – Equity Method and Joint Ventures. The new guidance eliminates the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods that the investment had been held. The guidance is effective for fiscal years, beginning after December 15, 2016. Early adoption is permitted. The Company does not anticipate the adoption of this guidance to have a material impact on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 provides a single comprehensive revenue recognition framework and supersedes almost all existing revenue recognition guidance. Included in the new principles-based revenue recognition model are changes to the basis for deciding on the timing for revenue recognition. In addition, the standard expands and improves revenue disclosures. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of Effective Date, to amend ASU 2014-09 to defer the effective date of the new revenue recognition standard. As a result, ASU 2014-09 is effective for the Company for fiscal 2018 and can be adopted either retrospectively to each prior reporting period presented or as a cumulative effect adjustment as of the date of adoption.

In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net) to amend ASU 2014-09, clarifying the implementation guidance on principal versus agent considerations in the new revenue recognition standard. Specifically, ASU 2016-08 clarifies how an entity should identify the unit of accounting (i.e., the specified good or service) for the principal versus agent evaluation and how it should apply the control principle to certain types of arrangements.

In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing to amend ASU 2014-09, reducing the complexity when applying the guidance for identifying performance obligations and improving the operability and understandability of the license implementation guidance.

In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients. The improvements address completed contracts and contract modifications at transition, noncash consideration, the presentation of sales taxes and other taxes collected from customers, and assessment of collectability when determining whether a transaction represents a valid contract. Specifically, ASU 2016-12 clarifies how an entity should evaluate the collectability threshold and when an entity can recognize nonrefundable consideration received as revenue if an arrangement does not meet the standard's contract criteria. The pronouncement is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The Company is evaluating the impact all the foregoing Topic 606 amendments will have on its consolidated financial statements.

In August 27, 2014, the FASB (the "board") issued Accounting Standards Update No. 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, which requires management to assess a company’s ability to continue as a going concern and to provide related footnote disclosures in certain circumstances. Before this new standard, there was minimal guidance in U.S. GAAP specific to going concern. Under the new standard, disclosures are required when conditions give rise to substantial doubt about a company’s ability to continue as a going concern within one year from the financial statement issuance date. The new standard applies to all companies and is effective for the annual period ending after December 15, 2016, and all annual and interim periods thereafter. The Company will adopt the guidance for fiscal 2017 and does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment: These amendments eliminate Step 2 from the goodwill impairment test. The annual, or interim, goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. In addition, income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit should be considered when measuring the goodwill impairment loss, if applicable. The Company will adopt the guidance for fiscal 2017 and does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

NOTE 2 – GOING CONCERN

The accompanying financial statements and notes have been prepared assuming that the Company will continue as a going concern. For the fiscal year ended July 1, 2016, the Company generated a net loss of $37.9 million and had an accumulated deficits of $27.4 million with limited sources of operating cash flows, and further losses are anticipated in the development of its business. Further, the Company was in default under its loan agreement as of July 1, 2016. On December 9, 2016 Versar, together with certain of its domestic subsidiaries acting as guarantors, entered into an Amendment and to the Loan Agreement dated September 30, 2015 with the Lender (see Note 13 – Debt). The Company’s ability to continue as a going concern is dependent upon the Company’s ability to generate profitable operations and/or raise additional capital through equity or debt financing to meet its obligations and repay its liabilities when they come due.

The Company intends to continue funding its business operations and its working capital needs by way of private placements financing, obtaining additional term loans or borrowings from other financial institutions, until such time profitable operations can be achieved. As much as management believes that this plan provides an opportunity for the Company to continue as a going concern, there are no written agreements in place for such funding or issuance of securities and there can be no assurance that sufficient funding will be available in the future. These and other factors raise substantial doubt about the Company’s ability to continue as a going concern.

These financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts, or amounts and classification of liabilities that might result from the outcome of this uncertainty.

NOTE 3 - BUSINESS SEGMENTS

The Company’s ECM business segment provides facility planning and programming, engineering design, construction, construction management and security systems installation and support services. ESG provides full service environmental consulting including compliance, cultural resources. Natural resources, remediation and UXO/MMRP services. PSG provides onsite environmental, engineering, construction and logistics services.

Summary financial information for the Company’s business segments from continuing operations is as follows:

	For the Fiscal Year Ended		
	July 1, 2016	June 26, 2015	June 27, 2014
	(in thousands)		
GROSS REVENUE			
ECM	$110,533	$91,111	$52,012
ESG	38,688	46,620	46,848
PSG	18,696	22,146	11,420
	$167,917	$159,877	$110,280
GROSS PROFIT (LOSS) (a)			

ECM	$3,108	$8,030	$5,288
ESG	890	3,667	2,116
PSG	(824)	2,094	1,115
	$3,174	$13,791	$8,519
Selling, general and administrative expenses	13,031	11,003	10,175
Other operating expense (income)	1,937	-	(1,596)
Goodwill impairment	20,332	-	1,381
Intangible impairment	3,812	-	-
OPERATING (LOSS) INCOME	$(35,937)	$2,788	$(1,441)

a) - Gross profit is defined as gross revenues less purchased services and materials, at cost, less direct costs of services and overhead allocated on a proportional basis. During fiscal 2015, the Company's management changed the method of allocating business development (BD) costs to the reportable segments in order to refine the information used by our Chief Operating Decision Maker (CODM). The new methodology allocates BD costs to the selling, general, and administrative expense line, while the old methodology allocated BD costs to contract costs. The presentation for fiscal 2014 has been reclassified to conform to fiscal 2015 presentation. Approximately $1.8 million has been recast from contract costs to selling, general, and administrative expenses for the year ended June 27, 2014.

	As of	
	July 1, 2016	June 26, 2015
ASSETS	(in thousands)	
ECM	$21,842	$35,925
ESG	21,492	47,347
PSG	17,982	5,934
Total Assets	$61,316	$89,206

NOTE 4 - ACQUISITIONS

On September 30, 2015, the Company completed the acquisition of a specialized federal security integration business from Johnson Controls, Inc., which is now known as Versar Security Systems (VSS). This group is headquartered in Germantown, Maryland and generated approximately $34 million in trailing twelve month revenues prior to the acquisition date from key long term customers such as FAA and FEMA. The results of operations of VSS have been included in the Company's consolidated results from the date of acquisition. VSS has contributed approximately $17.6 million in revenue and $15.4 million in expenses from the date of the acquisition through July 1, 2016. Additionally, the Company has incurred approximately $0.6 million of acquisition and integration costs through July 1, 2016, recorded in selling, general, and administrative expenses.

VSS expands the Company's service offerings to include higher margin classified construction, enables Versar to generate more work with existing clients and positions the Company to more effectively compete for new opportunities. At closing, the Company paid a cash purchase price of $10.5 million. In addition, the Company agreed to pay contingent consideration of up to a maximum of $9.5 million (undiscounted) based on certain events within the earn out period of 3 years from September 30, 2015. Based on the facts and circumstances as of April 1, 2016, management believes that the amount of the contingent consideration that will be earned within the earn out period is $3.2 million, including probability weighing of future cash flows. This anticipated contingent consideration is recognized as consideration and as a liability, of which $1.6 million is presented within other current liabilities and $1.6 million is presented within other long-term liabilities on the condensed consolidated balance sheet as of July 1, 2016. The potential undiscounted amount of all future payments that the Company could be required to make under the contingent consideration agreement ranges from $0 to a maximum payout of $9.5 million, with the amount recorded being the most probable.

The final purchase price allocation in the table below reflects the Company's estimate of the fair value of the assets acquired and liabilities assumed as of the September 30, 2015 acquisition date. Goodwill was allocated to the ECM segment. Goodwill represents the value in excess of fair market value that the Company paid to acquire JCSS. The allocation of intangibles has been completed by an independent third party and recorded on the Company's consolidated balance sheet as of July 1, 2016.

Description	Amount (in thousands)
Accounts receivable	$6,979
Prepaid and other	15
Property and equipment	29
Goodwill	4,266
Intangibles	8,129
Assets Acquired	19,418
Account payable	1,675
Other liabilities	3,509
Liabilities Assumed	5,184
Acquisition Purchase Price	$14,234

The table below summarizes the unaudited pro forma statements of operations for the fiscal year ended July 1, 2016, June 26, 2015 and June 27, 2014, assuming that the VSS acquisition had been completed as of the first day of each of the three fiscal years, respectively. These pro forma statements do not include any adjustments that may have resulted from synergies derived from the acquisition or for amortization of intangibles other than during the period the acquired entity was part of the Company.

VERSAR, INC. AND SUBSIDIARIES

Pro forma Consolidated Statements of Operations

(In thousands, except per share amounts)

	For the Fiscal Year EndedJuly 1, 2016(in thousands)			For the Fiscal Year EndedJune 26, 2015(in thousands)			For the Fiscal Year EndedJun 27, 2014(in thousands)		
	Versar	VSS	Pro Forma Combined	Versar	VSS	Pro Forma Combined	Versar	VSS	Pro For Combin
GROSS REVENUE	$167,917	6,497	174,414	$159,877	31,438	191,315	$110,280	41,526	151,80
Purchased services and materials, at cost	107,199	3,816	111,015	90,289	20,956	111,245	55,108	27,886	82,994
Direct costs of services and overhead	57,544	1,043	58,587	55,797	5,570	61,368	46,653	7,413	54,066
GROSS PROFIT	3,174	1,638	4,812	13,791	4,912	18,702	8,519	6,227	14,745
Selling, general and administrative expenses	13,031	450	13,481	11,003	1,207	12,209	10,175	2,021	12,196
Other operating expense (income)	1,937	-	1,937	-	(2)	(2)	(1,596)	(2)	(1,598
Goodwill impairment	20,332	-	20,332	-	-	-	1,381	-	1,381
Intangible impairment	3,812	-	3,812	-	-	-	-	-	-
OPERATING (LOSS) INCOME	(35,937)	1,188	(34,749)	2,788	3,707	6,494	(1,441)	4,208	2,767
OTHER EXPENSE									
Interest income	(19)	-	(19)	(2)	-	(2)	(15)	-	(15)
Interest expense	702	-	702	447	-	447	133	-	133
(LOSS) INCOME BEFORE INCOME TAXES, FROM CONTINUING OPERATIONS	(36,620)	1,188	(35,432)	2,343	3,707	6,051	(1,559)	4,208	2,649
	1,267	457	1,724	936	1,394	2,330	(1,043)	1,520	477

Income tax (benefit) expense									
NET (LOSS) INCOME FROM CONTINUING OPERATIONS	(37,887)	731	(37,156)	1,407	2,313	3,720	(516)	2,688	2,172
Income (Loss) from discontinued operations, net of tax	-	-	-	-	-	-	182	-	182
NET (LOSS) INCOME	$(37,887)	731	(37,156)	$1,407	2,313	3,720	$(334)	2,688	2,354
NET (LOSS) INCOME PER SHARE-BASIC and DILUTED									
Continuing operations	$(3.84)	-	(3.84)	$0.14	-	0.14	$(0.05)	-	(0.05)
Discontinued operations	-	-		-	-	-	0.02	-	0.02
NET (LOSS) INCOME PER SHARE-BASIC and DILUTED	$(3.84)	-	(3.84)	$0.14	-	0.14	$(0.03)	-	(0.03)
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING-BASIC	9,857	-	9,857	9,771	-	9,771	9,663	-	9,663
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING-DILUTED	9,857	-	9,857	9,771	-	9,771	9,663	-	9,663

On July 1, 2014, Versar acquired all of the issued and outstanding capital stock of JMWA. JMWA was a service disabled veteran owned small business providing architectural, design, planning, construction management, environmental, facilities, and logistical consulting services to federal, state, municipal and commercial clients. The outstanding capital stock of JMWA was acquired by Versar pursuant to a Stock Purchase Agreement by and among Versar, JMWA, and the stockholders of JMWA and entered into on June 30, 2014. The aggregate purchase price for the outstanding capital stock of JMWA was $13.0 million, which was comprised of: (i) cash in the amount of $7.0 million paid pro rata in accordance with each stockholder’s ownership interest in JMWA at closing; and (ii) three seller notes with an aggregate principal amount of $6.0 million issued by Versar to the JMWA stockholders, pro rata in accordance with each stockholders’ ownership interest in JMWA at closing. The seller notes bear interest at a rate of 5.00% per annum and mature on the third business day of January 2019. The purchase price is subject to a post-closing adjustment based on an agreed target net working capital of JMWA as of the date of closing. The Stock Purchase Agreement contains customary representations and warranties and requires the JMWA stockholders to indemnify Versar for certain liabilities arising under the agreement, subject to certain limitations and conditions.

The final purchase price allocation in the table below reflects the Company's estimate of the fair value of the assets acquired and liabilities assumed on the July 1, 2014 acquisition date. Goodwill has been allocated between our ECM, ESG, and PSG segments based on a percentage of segment specific JMWA revenue dollars for fiscal 2015. Goodwill, which in certain circumstances, may be deductible for tax purposes, represents the value in excess of fair market value that the Company paid to acquire JMWA, less identified intangible assets. The Company incurred approximately $0.1 million in transaction costs related to the JMWA acquisition. During fiscal 2015, the Company recorded measurement period adjustments totaling approximately $1.1 million related to accounts receivable, intangible assets, goodwill, accounts payable, and other liabilities.

Description	Amount (in thousands)
Cash	$456
Accounts receivable	4,996
Property and equipment	382
Other assets	147
Intangibles	2,833
Goodwill	8,355
Assets Acquired	17,169
Account payable	1,603
Other liabilities	2,566
Liabilities Assumed	4,169
Purchase Price	$13,000

NOTE 5 – FAIR VALUE MEASUREMENT

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

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

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

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

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

As a result of the acquisition of JMWA, the Company is required to report at fair value the assets and liabilities it acquired as a result of the acquisition. The significant valuation technique utilized in the fair value measurement of the assets and liabilities acquired was primarily an income approach used to determine fair value of the acquired intangible assets. Additionally, a market approach and an asset-based approach were used as secondary methodologies. This valuation technique is considered to be Level 3 fair value estimate, and required the estimate of appropriate royalty and discount rates and forecasted future revenues generated by each identifiable intangible asset.

NOTE 6 – DISCONTINUED OPERATIONS

The consolidated financial statements and related footnote disclosures reflect fiscal 2013 discontinuation of the Lab, Telecom, and Domestic Products business components in the ECM segment. Income and losses associated with these components, net of applicable income taxes, is shown as income or loss from discontinued operations for the fiscal year ended June 27, 2014 (excluding quarterly financial data in Note 18). For the year ended July 1, 2016, there was no activity associated with discontinued operations.

Operating results for the discontinued operations for the years ended July 1, 2016, June 26, 2015, and June 27, 2014, were as follows;

	For the Fiscal Years Ended		
	July 1, 2016	June 26, 2015	June 27, 2014
	(in thousands)		
Gross Revenues	$-	$-	$-
Income (Loss) from discontinued operations	-	-	317
Provision for income taxes	-	-	(135)
Income (Loss) from discontinued operations, net of taxes	$-	$-	$182

NOTE 7 - GOODWILL AND INTANGIBLE ASSETS

Goodwill

The carrying value of goodwill at July 1, 2016 and June 26, 2015 was zero million and $16.1million, respectively. The goodwill balances were principally generated from our acquisition of VSS during fiscal 2016 (see Note 4), JMWA during fiscal 2015, GMI during fiscal 2014, Charon during fiscal 2012, and PPS and Advent during fiscal 2010. We had three reporting units at July 1, 2016. The aggregate balance of goodwill decreased by $20.3 million at July 1, 2016 and increased by 8.0 million at June 26, 2015, respectively. In connection with the preparation of fiscal 2016 financial statements, management conducted a test of the Company's goodwill as of April 2, 2016 and July 1, 2016. A roll forward of the carrying value of the Company's goodwill balance, by business segment, for fiscal 2016 and 2015 is as follows (in thousands):

	Goodwill Balances			
	ECM	ESG	PSG	Total
Balance, June 27, 2014	$5,302	$2,771	$-	$8,073
JMWA Acquisition	1,920	1,631	4,442	7,993

Balance, June 26, 2015	$7,222	$4,402	$4,442	$16,066
VSS Acquisition	4,266	-	-	4,266
Impairment	(11,488)	(4,401)	(4,442)	(20,332)
Balance, July 1, 2016	$-	$-	$-	$-

The Company records goodwill in connection with the acquisition of businesses when the purchase price exceeds the fair values of the assets acquired and liabilities assumed. Generally, the most significant intangible assets from the businesses that the Company acquires are the assembled workforces, which includes the human capital of the management, administrative, marketing and business development, engineering and technical employees of the acquired businesses. Since intangible assets for assembled workforces are part of goodwill in accordance with the accounting standards for business combinations, the substantial majority of the intangible assets for recent business acquisitions are recognized as goodwill.

During fiscal 2015, the Company changed the goodwill impairment assessment date from the last day of the fiscal year to the first day of the fourth quarter of the fiscal year, or March 28, 2015. Management determined that performing the assessment prior to the close of the fiscal year provided the external valuation firm, the independent registered public accountants, and the Company with sufficient time to generate, review, and conclude on the valuation analysis results. At the close of each fiscal year, management assessed whether there were any conditions present during the fourth quarter that would indicate impairment subsequent to the initial assessment date and concluded that no such conditions were present.

The first step of the goodwill impairment analysis identifies potential impairment and the second step measures the amount of impairment loss to be recognized, if any. Step 2 is only performed if Step 1 indicates potential impairment. Potential impairment is identified by comparing the fair value of the reporting unit with its carrying amount, including goodwill. The carrying amount of a reporting unit equals assets (including goodwill) less liabilities assigned to that reporting unit. The fair value of a reporting unit is the price that would be received if the reporting unit was sold. Value is based on the assumptions of market participants. Market participants may be strategic acquirers, financial buyers, or both. The assumptions of market participants do not include assumed synergies which are unique to the parent company. Management, with the assistance of an external valuation firm has estimated the fair value of each reporting unit using the Guideline Public Company (GPC) method under the market approach. Each of the GPC's is assumed to be a market participant. The valuation analysis methodology adjusted the value of the reporting units by including a premium for control, or MPAP. The MPAP reflects the capitalized benefit of reducing the Company's operating costs. These costs are associated with a company's public reporting requirements. The adjustment assumes an acquirer could take a company private and eliminate these costs. Based upon fiscal 2015 analysis, the estimated fair value of a company's reporting units exceeded the carrying value of their net assets and therefore, management concluded that the goodwill was not impaired.

During the third quarter of fiscal 2016, sustained delays in contract awards and contract funding and the direct impact on the Company's results of operations, coupled with the continued decrease in the Company's stock price, and were deemed to be triggering events that led to an interim period test for goodwill impairment. As a result of our analysis, we recorded an impairment charge of $15.9 million. The carrying value of goodwill after impairment at April 1, 2016 was $4.4 million. The Company's remaining goodwill balance, after impairment, was derived from a partial impairment the acquisition of JMWA acquired in fiscal 2015. As a result of these charges, the carrying amount of goodwill assets acquired from VSS, JMWA, GMI, Charron Consulting and PPS has been reduced to zero, and the carrying amount of goodwill assets in the Company's ECM and PSG segment have been reduced to zero.

During the fourth quarter of fiscal 2016, sustained delays in contract awards and contract funding and the direct impact on the Company's results of operations, coupled with the continued decrease in the Company's stock price, and were deemed to be triggering events that led to an updated test for goodwill impairment. As a result of our analysis, we recorded an additional impairment charge of $4.4 million. The carrying value of goodwill after impairment at July 1, 2016 was zero. Based on the results of the impairment testing, the Company concluded that the value of definite-lived assets with a carrying value of $0.9 million was not recoverable. The Company has recorded a charge of $0.3 million for the impairment of definite-lived intangible assets acquired from JMWA, a charge of $0.6 million for the impairment of definite-lived intangible assets acquired from GMI. As a result of these charges, the carrying amount of intangible assets acquired from JMWA and GMI has been reduced to zero.

The carrying value of goodwill at June 26, 2015 was $16.1 million. The goodwill balance was principally generated from the acquisition of GMI during fiscal 2014, the fiscal 2012 acquisition of Charron, and the fiscal 2010 acquisitions of PPS and Advent. The Company had three reporting units at June 26, 2015. The aggregate balance of goodwill declined by $1.4 million at June 26, 2015. In connection with the preparation of the fiscal 2014 financial statements, the Company conducted a test of our goodwill as of June 26, 2015. The June 26, 2015 decline was due to an impairment charge of $1.4 million as a result of a decline in the estimated fair value of the ECM reporting unit. The June 26, 2015 impairment is attributable to goodwill acquired from acquisitions prior to 2011.

Intangible Assets

In connection with the acquisitions of VSS, JMWA, GMI, Charron, PPS, and Advent, the Company identified certain intangible assets. These intangible assets were customer-related, marketing-related and technology-related. A summary of the Company's intangible asset balances as of July 1, 2016 and June 26, 2015, as well as their respective amortization periods, is as follows (in thousands):

	Gross Carrying Amount	Accumulated Amortization	Impairment Expense	Net Carrying Amount	Amortization Period
As of July 1, 2016					
Customer-related	$12,409	$(2,407)	$(3,618)	$6,384	5-15 yrs
Marketing-related	1,084	(980)	(104)	-	2-7 yrs
Technology-related	841	(751)	(90)	-	7 yrs
Contractual-related	1,199	(514)	-	685	1.75 yrs
Non-competition-related	211	(32)	-	179	5 yrs
Total	$15,744	(4,684)	(3,812)	$7,248	

	Gross Carrying Amount	Accumulated Amortization	Impairment Expense	Net Carrying Amount	Amortization Period
As of June 26, 2015					
Customer-related	$5,689	$(1,613)	$-	$4,076	5-15 yrs
Marketing-related	1,084	(698)	-	386	5-7 yrs
Technology-related	841	(660)	-	181	7 yrs
Total	$7,614	$(2,971)	$-	$4,643	

Amortization expense for intangible assets was approximately $1.7 million, $1.1 million and $0.6 million for fiscal 2016, 2015, and 2014, respectively. The Company concluded that the value of definite-lived intangible assets with a carrying value of $3.8 million was not recoverable. The Company has recorded a charge of $3.8 million for the full impairment of definite-lived intangible assets. As a result of these charges, the carrying amount of intangible assets acquired from JMWA, GMI, Charron and PPS has been reduced to zero, and the carrying amount of intangible assets in the Company's PSG and ESG segment have been reduced to zero.

No intangible asset impairment charges were recorded during fiscal 2015 or 2014.

Expected future amortization expense in the fiscal years subsequent to July 1, 2016 is as follows:

Years	Amounts
	(in thousands)
2017	1,265
2018	579
2019	579
2020	579
2021	548
Thereafter	3,698
Total	$7,248

NOTE 8 - ACCOUNTS RECEIVABLE

Unbilled receivables represent amounts earned which have not yet been billed and other amounts which can be invoiced upon completion of fixed-price contract milestones, attainment of certain contract objectives, or completion of federal and state governments' incurred cost audits. Management anticipates that such unbilled receivables will be substantially billed and collected in fiscal 2017; therefore, they have been presented as current assets in accordance with industry practice. As part of concentration risk, management continues to assess the impact of having the PBR contracts within the ESG segment represent a significant portion the outstanding receivable balance.

	As of	
	July 1, 2016	June 26, 2015
	(in thousands)	
Billed receivables		
U.S. Government	$7,531	$8,787
Commercial	11,159	8,074
Unbilled receivables		
U.S. Government	20,883	40,769
Commercial	9,103	157
Total receivables	48,676	57,787
Allowance for doubtful accounts	(1,001)	(616)
Accounts receivable, net	$47,675	$57,171

NOTE 9 - CUSTOMER INFORMATION

A substantial portion of the Company's revenue from continuing operations is derived from contracts with the U.S. Government as follows:

	As of		
	July 1, 2016	June 26, 2015	June 27, 2014
		(in thousands)	
DoD	$116,062	$129,305	$86,039
U.S. EPA	4,583	6,457	1,593
Other US Government agencies	38,415	11,552	6,314
Total US Government	$159,060	$147,314	$93,946

A majority of the DOD work is related to the Company's runway repair project at DAFB, support of the reconstruction efforts in Iraq and Afghanistan with the USAF and U.S. Army, and our PBR contracts with AFCEC. Revenue of approximately $ 16.6 million for fiscal 2016, $29 million for fiscal 2015, and $33 million for fiscal 2014, was derived from the Company's international work for the U.S. Government, respectively.

NOTE 10 - PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets include the following:

	As of	
	July 1, 2016	June 26, 2015
	(in thousands)	
Prepaid insurance	$18	$295
Prepaid rent	48	113
Other prepaid expenses	457	474
Collateralized Cash	472	-
Miscellaneous receivables	12	658

Total	$1,007	$1,540

Other prepaid expenses include maintenance agreements, licensing, subscriptions, and miscellaneous receivables from employees and a service provider. The collateralized cash amount is related to a bid bond the Company issued.

NOTE 11 – INVENTORY

The Company’s inventory balance includes the following:

	As of	
	July 1, 2016	June 26, 2015
	(in thousands)	
Raw Materials	$132	$722
Finished Goods	94	400
Work-in-process	7	152
Reserve	(12)	(86)
Total	$221	$1,188

During the fourth quarter of fiscal 2016, the Company recorded a $0.6 million charge to write-down certain PPS assets, primarily inventory, to their estimated net realizable value as of July 1, 2016. This amount is recorded as Other Expense (Income) in the financial statements.

NOTE 12 - PROPERTY AND EQUIPMENT

Description	Useful life	As of July 1, 2016	As of June 26, 2015
		(in thousands)	
Furniture and fixtures	8	$640	$1,274
Equipment	3 to 10	4,446	6,330
Capital leases	Life of lease	565	565
Leasehold improvements	(a)	684	1,435
Property and equipment, gross		$6,335	$9,604
Accumulated depreciation		(5,007)	(7,520)
Property and equipment, net		$1,328	$2,084

(a) The useful life is the shorter of lease term or the life of the asset.

Depreciation of property and equipment was approximately $1.3 million and $1.5 million, for the fiscal years 2016 and 2015, respectively.

Maintenance and repair expense approximated $0.1 million for the fiscal years 2016, 2015, and 2014 respectively.

NOTE 13 - DEBT

Notes Payable

As part of the purchase price for JMWA in July 2014, the Company agreed to pay the three JMWA stockholders with an aggregate principal balance of up to $6.0 million, which are payable quarterly over a four and a half-year period with interest accruing at a rate of 5% per year. Accrued interest is recorded within the note payable line item in the consolidated balance sheet. As of July 1, 2016, the outstanding principal balance of the JMWA shareholders was $3.9 million.

On October 3, 2016 the Company did not make the quarterly principal payments to three individuals who were the former owners of JMWA. However, the Company continued to make monthly interest payments through the end of calendar year 2016 at an increased interest rate (seven percent per annum, rather than five percent per annum). On November 21, 2016, two of the former JMWA shareholders filed an action against the Company in Fairfax County District Court, VA for failure to make such payments and to enforce their rights to such payments. During the second quarter of fiscal 2017, the Company has moved the long term portion of the debt to short term notes payable for a total of $3.5 million. The Company is defending the lawsuit on legal grounds. Starting January 2017 the Company stopped making the interest only payments to two of the former owners and continues to make the monthly interest only payment at seven percent per annum to one owner.

On September 30, 2015, the Company, together with certain of its domestic subsidiaries acting as guarantors, entered into a Loan Agreement with the Lender and letter of credit issuer for a revolving credit facility in the amount of $25.0 million, $14.6 million of which was drawn on the date of closing, and a term facility in the amount of $5.0 million, which was fully drawn on the date of closing.

The maturity date of the revolving credit facility is September 30, 2018 and the maturity date of the term facility is March 31, 2017. The principal amount of the term facility amortizes in quarterly installments equal to $0.8 million with no penalty for prepayment. Interest accrues on the revolving credit facility and the term facility at a rate per year equal to the LIBOR Daily Floating Rate (as defined in the Loan Agreement) plus 1.95% and was payable in arrears on December 31, 2015 and on the last day of each quarter thereafter. Obligations under the Loan Agreement are guaranteed unconditionally and on a joint and several basis by the Guarantors and secured by substantially all of the assets of Versar and the Guarantors. The Loan Agreement contains customary affirmative and negative covenants and during fiscal year 2016 contained financial covenants related to the maintenance of a Consolidated Total Leverage Ratio, Consolidated Senior Leverage Ratio, Consolidated Fixed Charge Coverage Ratio and a Consolidated Asset Coverage Ratio. On December 9, 2016 Versar, together with certain of its domestic subsidiaries acting as guarantors, entered into an Amendment to the Loan Agreement dated September 30, 2015 with the Lender removing these covenants and adding a covenant requiring Versar to maintain certain minimum quarterly consolidated EBITDA amounts.

The proceeds of the term facility and borrowings under the revolving credit facility were used to repay amounts outstanding under the Company's Third Amended and Restated Loan and Security Agreement with United Bank and to pay a portion the purchase price for the acquisition of VSS.

As of July 1, 2016, the Company's outstanding principal debt balance was $6.4 million comprised of the Bank of America facility term loan balance of $2.5 million, and JMWA Note balance of $3.8 million. The following maturity schedule presents all outstanding debt as of July 1, 2016.

Fiscal Years	Amounts
	(in thousands)
2017	$3,831
2018	1,399
2019	1,095
Total	$6,325

On January 1, 2017 the Company did not make $0.1 million in periodic payment to three individuals who participate in a Deferred Compensation Agreement plan established by the Company in 1988. The Company continues to negotiate with the individuals to reschedule the payments for a future period.

Line of Credit

As noted above, the Company had a $25.0 million revolving line of credit facility pursuant to the Loan Agreement with the Lender. The revolving credit facility is scheduled to mature on September 30, 2018. The Company had $14.8 million outstanding under its line of credit for the fiscal year ended July 1, 2016. On December 9, 2016 Versar, together with certain of its domestic subsidiaries acting as guarantors, entered into an Amendment to the Loan Agreement dated September 30, 2015 with the Lender. The Company now has a $13.0 million revolving line of credit facility. The Company has $10.3 million outstanding under its line of credit for the six months ended December 30, 2016.

The Company has elected to adopt ASU No. 2015-13 to simplify the presentation of debt issuance costs for the fiscal year ended July 1, 2016. $0.2 million of remaining unamortized cost associated with the Loan Agreement as of July 1, 2016 is therefore no longer presented as a separate asset - deferred charge on the consolidated balance sheet, and instead reclassified as a direct deduction from the carrying value of the line of credit.

Debt Covenants

During the third and fourth quarters of fiscal 2016, following discussion with the Lender, the Company determined that it was not in compliance with the Consolidated Total Leverage Ratio covenant for the fiscal quarters ended January 1, 2016, and April 1, 2016, the Consolidated Total Leverage Ratio covenant, Consolidated Senior Leverage Ratio covenant and the Asset Coverage Ratio covenant for the fiscal quarter ended April 1, 2016, which defaults continued as of July 1, 2016. Each failure to comply with these covenants constitutes a default under the Loan Agreement. On May 12, 2016, the Company, certain of its subsidiaries and the Lender entered into a Forbearance Agreement pursuant to which the Lender agreed to forbear from exercising any and all rights or remedies available to it under the Loan Agreement and applicable law related to these defaults for a period ending on the earliest to occur of: (a) a breach by the Company of any obligation or covenant under the Forbearance Agreement, (b) any other default or event of default under the Loan Agreement or (c) June 1, 2016 (the Forbearance Period).

The Forbearance Period was subsequently extended by additional Forbearance Agreements between the Company and the Lender, through December 9, 2016. During the Forbearance Period, the Company was allowed to borrow funds pursuant to the terms of the Loan Agreement, consistent with current Company needs as set forth in a required 13-week cash flow forecast and subject to certain caps on revolving borrowings initially of $15.5 million and reducing to $13.5 million. In addition, the Forbearance Agreements provided that from and after June 30, 2016 outstanding amounts under the credit facility will bear interest at the default interest rate equal to the LIBOR Daily Floating Rate (as defined in the Loan Agreement) plus 3.95%, required that the Company provide a 13 week cash flow forecast updated on a weekly basis to the Lender, and waives any provisions prohibiting the financing of insurance premiums for policies covering the period of July 1, 2016 to June 30, 2017 in the ordinary course of the Company’s business and in amounts consistent with past practices. On December 9, 2016 Versar, together with certain of its domestic subsidiaries acting as guarantors, entered into an Amendment to the Loan Agreement dated September 30, 2015 with the Lender, among other things, eliminating the events of default and amending the due date of the loan agreement to September 30, 2017. The Lender has engaged an advisor to review the Company’s financial condition on the Lender’s behalf, and pursuant to the Forbearance Agreements and the Amendment, requires the Company to pursue alternative sources of funding for its ongoing business operations. If the Company is unable to raise additional financing, the Company will need to adjust its operational plans so that the Company can continue to operate with its existing cash resources. The actual amount of funds that the Company will need will be determined by many factors, some of which are beyond its control and the Company may need funds sooner than currently anticipated.

As of the fiscal 2017 quarter ended December 30, 2016, we are in compliance with all covenants under the Amendment to the Loan Agreement.

NOTE 14 - OTHER CURRENT LIABILITIES

Other current liabilities include the following:

	As of	
	July 1, 2016	June 26, 2015
Project related reserves	$867	$57
Payroll related	110	221
Deferred rent	330	63
Earn-out obligations	1,577	-
Severance accrual	96	16
Acquired capital lease liability	97	176
Warranty Reserve	302	-
ARA Reserve	1,200	-
PPS Reserve	1,314	-
Other	1,831	581
Total	$7,724	$1,114

Other accrued and miscellaneous liabilities include accrued legal, audit, VAT tax liability, foreign entity obligations, and other miscellaneous items.

NOTE 15 – LEASE LOSS LIABILITIES

In March 2016, the Company abandoned its field office facilities in Charleston, SC and Lynchburg, VA, within the ESG and ECM segments, respectively. Although the Company remains obligated under the terms of these leases for the rent and other costs associated with these leases, the Company made the decision to cease using these spaces on April 1, 2016, and has no foreseeable plans to occupy them in the future. Therefore, the Company recorded a charge to selling, general and administrative expenses of approximately $0.4 million to recognize the costs of exiting these spaces. The liability is equal to the total amount of rent and other direct costs for the period of time the space is expected to remain unoccupied plus the present value of the amount by which the rent paid by the Company to the landlord exceeds any rent paid to the Company by a tenant under a sublease over the remainder of the lease terms, which expire in April 2019 for Charleston, SC, and June 2020 for Lynchburg, VA. The Company also recognized $0.1 million of costs for the associated leasehold improvements related to the Lynchburg, VA office.

In June 2016, the Company abandoned its field office facilities in San Antonio, TX within the ECM segment. Although the Company remains obligated under the terms of the lease for the rent and other costs associated with the lease, the Company made the decision to cease using this space on July 1, 2016, and has no foreseeable plans to occupy it in the future. Therefore, the Company recorded a charge to selling, general and administrative expenses of approximately $0.2 million to recognize the costs of exiting this space. The liability is equal to the total amount of rent and other direct costs for the period of time the space is expected to remain unoccupied plus the present value of the amount by which the rent paid by the Company to the landlord exceeds any rent paid to the Company by a tenant under a sublease over the remainder of the lease terms, which expires in February 2019. The Company also recognized $0.2 million of costs for the associated leasehold improvements related to the San Antonio, TX office.

The following table summarizes information related to our accrued lease loss liabilities at July 1, 2016 and June 26, 2015.

	As of July 1, 2016 (in thousands)	As of June 26, 2015 (in thousands)
Lease loss accruals	$718	$-
Rent payments	(20)	-
Balance	$698	$-

NOTE 16 – SHARE-BASED COMPENSATION

In November 2010, the stockholders approved the Versar, Inc. 2010 Stock Incentive Plan (the “2010 Plan”), under which the Company may grant incentive awards to directors, officers, and employees of the Company and its affiliates and to service providers to the Company and its affiliates. One million shares of Versar common stock were reserved for issuance under the 2010 Plan. The 2010 Plan is administered by the Compensation Committee of the Board of Directors. Through July 1, 2016, a total of 551,369 restricted stock units have been issued under the 2010 Plan. As of July 1, 2016, there are 448,631 shares remaining available for future issuance of awards (including restricted stock units) under the 2010 Plan.

During the twelve month period ended July 1, 2016, the Company awarded 209,500 restricted stock units to certain employees, which generally vest over a two-year period following the date of grant. The grant date fair value of these awards is approximately $0.6 million. The total unrecognized compensation cost, measured on the grant date, that relates to 130,948 non-vested restricted stock awards at July 1, 2016, was approximately $0.4 million, which if earned, will be recognized over the weighted average remaining service period of two years. Share-based compensation expense relating to all outstanding restricted stock unit awards totaled approximately $0.4 million and $0.4 million for the year ended July 1, 2016 and June 26, 2015, respectively. These expenses were included in the direct costs of services and overhead and general and administrative lines of the Company’s Condensed Consolidated Statements of Operations. There were no stock options outstanding and exercisable as of July 1, 2016. 20,000 stock options were exercised during fiscal year 2014, with an intrinsic value of approximately $0.1 million.

Exercisable qualified stock options outstanding at July 1, 2016 are as follows:

	Option Shares	Weighted Average Option Price Per Share	Total
	(in thousands, except share price)		
Outstanding at June 27, 2014	14	$3.99	$57
Exercised	-	-	-
Cancelled	(14)	3.99	(57)
Outstanding at June 26, 2015	-	-	-
Exercised	-	-	-
Cancelled	-	-	-
Outstanding at July 1, 2016	-	$-	$-

NOTE 17 - INCOME TAXES

The Company regularly reviews the recoverability of its deferred tax assets and establishes a valuation allowance as deemed appropriate. The Company established a full valuation allowance against its U.S. deferred tax assets at July 1, 2016 of $12.9 million as it determined they were not more likely than not to realize the deferred tax assets due to current year losses and projections for the near future. The company also maintained full valuation allowances on the Philippine and UK branches of $0.1 million and $0.9 million, respectively. The deferred tax assets in the foreign jurisdictions are related primarily to net operating loss carryforwards, as these jurisdictions have a history of losses and it is not more likely than not that the deferred tax assets will be realized. The valuation allowance at the end of fiscal 2015 was $0.8 million to offset the deferred tax asset from the Philippine branch operations, PPS, and for the U.S capital losses not more likely than not to be realized in the future.

At July 1, 2016, the Company has net operating loss carryforwards in the Philippines branch of approximately $0.1 million ($0.2 million gross), PPS $1.0 million ($5.4 million gross) and $0.4 million ($1.1 million gross) from the acquisition of Geo-Marine, Inc. In addition, they had $0.1 million of R&D credits carry forward.

Pretax income (loss) is comprised of the following:

	For the Fiscal Year Ended		
	July 1, 2016	June 26, 2015	June 27, 2014
	(in thousands)		
US Entities	$(39,395)	1,675	150
Foreign Entities	2,775	669	(1,709)
Total continuing operations	(36,620)	2,343	(1,559)
Discontinued operations	-	-	317
Total pretax (loss) income	$(36,620)	2,343	(1,244)

Income tax expense (benefit) for continuing operations is as follows:

	For the Fiscal Year Ended		
	July 1, 2016	June 26, 2015	June 27, 2014
	(in thousands)		
Current			

Federal	$(459)	$(254)	$(130)
State	2	182	(86)
Foreign	-	-	1
Deferred			
Federal	(10,033)	873	(819)
State	(1,981)	133	(9)
Foreign	-	(159)	(429)
Change in Valuation allowance	13,738	-	429
Income tax (benefit) expenses, continued operations	$1,267	$936	$(1,043)
Income tax benefit, current from discontinued operations	-	-	(189)
Income tax benefit, deferred from discontinued operations	-	-	324
Income tax (benefit) expenses	$1,267	$936	$(908)

Deferred tax assets (liabilities) are comprised of the following as of the dates indicated below:

	For the Fiscal Year Ended	
	July 1, 2016	June 26, 2015
	(in thousands)	
Deferred Tax Assets		
Employee benefits	$283	$329
Bad debt reserves	382	229
All other reserves	1,174	653
Net operating losses and tax credit	4,969	1,222
Capital loss carryforward	-	108
Accrued expenses	435	446
Depreciation and amortization	7,430	831