VSE CORP
Form 10-Q
July 27, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarter Ended June 30, 2018 Commission File Number: 0 3676

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

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

| | | |
|---|---|---|
| 6348 Walker Lane<br>Alexandria, Virginia | 22310 | www.vsecorp.com |
| (Address of Principal Executive Offices) | (Zip Code) | (Webpage) |

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

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

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Stock, par value $0.05 per share | The NASDAQ Global Select Market |

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [x] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [x] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

| | |
|---|---|
| Large accelerated filer [ ] | Accelerated filer [x] |
| Non-accelerated filer [ ] | Smaller reporting company [ ] |
| | Emerging growth company [ ] |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transaction period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
Yes [ ]    No [ ]

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

Number of shares of Common Stock outstanding as of July 20, 2018: 10,881,106

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VSE Corporation and Subsidiaries

Forward Looking Statements

This report contains statements that, to the extent they are not recitations of historical fact, constitute "forward looking statements" under federal securities laws. All such statements are intended to be subject to the safe harbor protection provided by applicable securities laws. For discussions identifying some important factors that could cause actual results of VSE Corporation ("VSE," the "Company," "us," "our," or "we") to differ materially from those anticipated in the forward looking statements contained in this report, see VSE's discussions captioned "Business," "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Notes to Consolidated Financial Statements" contained in VSE's Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed with the U.S. Securities and Exchange Commission ("SEC") on March 7, 2018 ("2017 Form 10-K").

Readers are cautioned not to place undue reliance on these forward looking statements, which reflect management's analysis only as of the date hereof. We undertake no obligation to revise publicly these forward looking statements to reflect events or circumstances that arise after the date hereof. Readers should carefully review the risk factors described in our 2017 Form 10-K and in the reports and other documents the Company files from time to time with the SEC, including this and other Quarterly Reports on Form 10-Q and any Current Reports on Form 8-K that we have filed or will file with the SEC subsequent to our 2017 Form 10-K.

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PART I. Financial Information

Item 1. Financial Statements

VSE Corporation and Subsidiaries

Unaudited Consolidated Balance Sheets
(in thousands except share and per share amounts)

| | June 30, 2018 | December 31, 2017 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $624 | $ 624 |
| Receivables, net | 54,629 | 55,760 |
| Unbilled receivables, net | 37,955 | 42,577 |
| Inventories, net | 164,390 | 132,591 |
| Other current assets | 13,551 | 16,988 |
| Total current assets | 271,149 | 248,540 |
| | | |
| Property and equipment, net | 52,670 | 55,146 |
| Intangible assets, net | 102,901 | 110,909 |
| Goodwill | 198,622 | 198,622 |
| Other assets | 15,401 | 15,796 |
| Total assets | $640,743 | $ 629,013 |
| | | |
| Liabilities and Stockholders' equity | | |
| Current liabilities: | | |
| Current portion of long-term debt | $9,468 | $ 6,960 |
| Accounts payable | 57,648 | 66,015 |
| Accrued expenses and other current liabilities | 32,619 | 40,243 |
| Dividends payable | 870 | 759 |
| Total current liabilities | 100,605 | 113,977 |
| | | |
| Long-term debt, less current portion | 171,857 | 165,614 |
| Deferred compensation | 18,028 | 16,323 |
| Long-term lease obligations, less current portion | 19,765 | 20,581 |
| Deferred tax liabilities | 19,172 | 19,423 |
| Total liabilities | 329,427 | 335,918 |
| | | |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common stock, par value $0.05 per share, authorized 15,000,000 shares; issued and outstanding 10,881,106 and 10,838,747, respectively | 544 | 542 |
| Additional paid-in capital | 26,490 | 24,470 |
| Retained earnings | 283,767 | 267,902 |
| Accumulated other comprehensive income | 515 | 181 |
| Total stockholders' equity | 311,316 | 293,095 |
| Total liabilities and stockholders' equity | $640,743 | $ 629,013 |

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

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VSE Corporation and Subsidiaries

Unaudited Consolidated Statements of Income
(in thousands except share and per share amounts)

| | For the three months ended June 30, | | For the six months ended June 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Revenues: | | | | |
| Products | $90,119 | $ 89,254 | $178,792 | $ 178,271 |
| Services | 80,275 | 104,606 | 168,499 | 212,883 |
| Total revenues | 170,394 | 193,860 | 347,291 | 391,154 |
| Costs and operating expenses: | | | | |
| Products | 75,834 | 74,222 | 150,560 | 148,928 |
| Services | 75,971 | 100,150 | 161,726 | 204,094 |
| Selling, general and administrative expenses | 730 | 479 | 1,549 | 923 |
| Amortization of intangible assets | 4,004 | 4,004 | 8,008 | 8,008 |
| Total costs and operating expenses | 156,539 | 178,855 | 321,843 | 361,953 |
| Operating income | 13,855 | 15,005 | 25,448 | 29,201 |
| Interest expense, net | 2,182 | 2,376 | 4,357 | 4,811 |
| Income before income taxes | 11,673 | 12,629 | 21,091 | 24,390 |
| Provision for income taxes | 2,922 | 4,822 | 5,288 | 9,290 |
| Net income | $8,751 | $ 7,807 | $15,803 | $ 15,100 |
| Basic earnings per share | $0.80 | $ 0.72 | $1.45 | $ 1.39 |
| Basic weighted average shares outstanding | 10,881,106 | 10,838,435 | 10,870,887 | 10,830,595 |
| Diluted earnings per share | $0.80 | $ 0.72 | $1.45 | $ 1.39 |
| Diluted weighted average shares outstanding | 10,918,927 | 10,861,769 | 10,907,777 | 10,855,632 |
| Dividends declared per share | $0.08 | $ 0.07 | $0.15 | $ 0.13 |

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

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VSE Corporation and Subsidiaries

Unaudited Consolidated Statements of Comprehensive Income
(in thousands)

| | For the three months ended June 30, | | For the six months ended June 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Net income | $8,751 | $7,807 | $15,803 | $15,100 |
| Change in fair value of interest rate swap agreements, net of tax | 123 | (24) | 334 | 69 |
| Other comprehensive income (loss), net of tax | 123 | (24) | 334 | 69 |
| Comprehensive income | $8,874 | $7,783 | $16,137 | $15,169 |

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

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VSE Corporation and Subsidiaries

Unaudited Consolidated Statements of Cash Flows
(in thousands)

| | For the six months ended June 30, 2018 | 2017 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $15,803 | $15,100 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 12,723 | 13,204 |
| Deferred taxes | (888) | (974) |
| Stock-based compensation | 1,676 | 1,464 |
| Changes in operating assets and liabilities: | | |
| Receivables, net | 1,131 | 6,412 |
| Unbilled receivables, net | 9,604 | 13,861 |
| Inventories, net | (34,352) | 528 |
| Other current assets and noncurrent assets | 4,227 | 9,725 |
| Accounts payable and deferred compensation | (6,164) | (39,511) |
| Accrued expenses and other current liabilities | (6,568) | (105) |
| Long-term lease obligations | (816) | (667) |
| Net cash (used in) provided by operating activities | (3,624) | 19,037 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (1,880) | (1,252) |
| Proceeds from the sale of property and equipment | 46 | 400 |
| Net cash used in investing activities | (1,834) | (852) |
| Cash flows from financing activities: | | |
| Borrowings on loan agreement | 359,554 | 181,673 |
| Repayments on loan agreement | (349,534) | (197,142) |
| Payment of debt financing costs | (1,692) | — |
| Payments on capital lease obligations | (707) | (627) |
| Payments of taxes for equity transactions | (641) | (500) |
| Dividends paid | (1,522) | (1,300) |
| Net cash provided by (used in) financing activities | 5,458 | (17,896) |
| Net (decrease) increase in cash and cash equivalents | — | 289 |
| Cash and cash equivalents at beginning of period | 624 | 428 |
| Cash and cash equivalents at end of period | $624 | $717 |

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

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VSE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2018

(1) Nature of Business and Basis of Presentation

Our accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the instructions to SEC Form 10-Q and Article 10 of SEC Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In our opinion, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2018. For further information refer to the consolidated financial statements and footnotes thereto included in our 2017 Form 10-K.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates affecting the financial statements include accruals for contract disallowance reserves, award fee revenues, costs to complete on fixed price contracts, and recoverability of goodwill and intangible assets.

Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASC 606"), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. ASC 606 is based on the principle that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for the goods or services. ASC 606 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to fulfill a contract.

On January 1, 2018, we adopted ASC 606 using the modified retrospective method applied to those contracts which were not completed as of January 1, 2018, including the aggregate effect of modifications to such contracts through January 1, 2018. We recognized the cumulative effect of initially applying the new standard through an increase to the opening balance of retained earnings of $1.7 million. The primary effects of adopting ASC 606 are: (1) the timing of when we recognize revenue on our contracts with award fees, which previously was based on when we received customer authorization, changed to recognition of the award fees to the extent that it is probable that a significant reversal will not occur as the related performance obligation is satisfied, resulting in revenue being recognized earlier in the contract period, (2) the timing of when we recognize revenues and costs on maintenance, repair and overhaul ("MRO") services for aviation clients and certain fixed price delivery contracts, which changed from the date of delivery to recognition over time as control of the good or service transfers to the customer and progress is made to satisfy the performance obligation, and (3) the pattern in which we recognize revenue on certain fixed price services contracts changed from a straight-line basis over the contract period to measuring progress using input measures, such as costs incurred. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods.

The adoption of ASC 606 also resulted in the establishment of “Unbilled receivables, net” as a separate line item on our unaudited consolidated balance sheets and reclassification of balances to this new line item from “Receivables, net”. Certain prior year amounts have been reclassified to conform to the current year presentation. These reclassifications have no effect on our reported financial condition, results of operations, or cash flows.

The cumulative effect of the changes made to our January 1, 2018 unaudited consolidated balance sheet for the adoption of the ASC 606 update was as follows (in thousands):

| | Balance at December 31, 2017 | Adjustment for ASC 606 | Adjusted balance at January 1, 2018 |
|---|---|---|---|
| Assets: | | | |
| Unbilled receivables, net | $42,577 | $ 4,982 | $47,559 |
| Inventories, net | $132,591 | $ (2,553) | $130,038 |
| Liabilities: | | | |
| Accounts payable | $66,015 | $ (498) | $65,517 |
| Accrued expenses and other current liabilities | $40,243 | $ 655 | $40,898 |
| Deferred tax liabilities | $19,423 | $ 577 | $20,000 |
| Stockholders' equity: | | | |
| Retained earnings | $267,902 | $ 1,695 | $269,597 |

In accordance with the new revenue standard requirements for entities adopting ASC 606 using the modified retrospective method, the disclosure of the impact of adoption on our unaudited consolidated balance sheet as of June 30, 2018 and statement of income for the three months and six months ended June 30, 2018 was as follows (in thousands):

Balance Sheet

| | As Reported | Without Adoption of ASC 606 |
|---|---|---|
| Assets: | | |
| Unbilled receivables, net | $37,955 | $31,294 |
| Inventories, net | $164,390 | $167,958 |
| Other current assets | $13,551 | $13,551 |
| Liabilities: | | |
| Accrued expenses and other current liabilities | $32,619 | $32,619 |
| Deferred tax liabilities | $19,172 | $18,386 |
| Stockholders' equity: | | |
| Retained earnings | $283,767 | $281,460 |

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2018

Statement of Income

| | For the three months ended June 30, 2018 | | For the six months ended June 30, 2018 | |
|---|---|---|---|---|
| | As Reported | Without Adoption of ASC 606 | As Reported | Without Adoption of ASC 606 |
| Revenues: | | | | |
| Products | $90,119 | $ 88,785 | $178,792 | $177,470 |
| Services | $80,275 | $ 80,120 | $168,499 | $167,986 |
| Costs and operating expenses: | | | | |
| Products | $75,834 | $ 74,841 | $150,560 | $149,545 |
| Services | $75,971 | $ 75,971 | $161,726 | $161,726 |
| Provision for income taxes | $2,922 | $ 2,796 | $5,288 | $5,080 |
| Net income | $8,751 | $ 8,381 | $15,803 | $15,191 |

Significant Accounting Policies Update

Our significant accounting policies are discussed in "Note 1: Nature of Business and Significant Accounting Policies" of our 2017 Form 10-K. Significant changes to our policies related to revenue recognition as a result of adopting ASC 606 are discussed below:

We account for revenue in accordance with ASC 606. The unit of account in ASC 606 is a performance obligation. At the inception of each contract with a customer, we determine our performance obligations within the contract and the contract's transaction price. A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is defined as the unit of account. A contract’s transaction price is allocated to each distinct performance obligation and recognized as revenue when the performance obligation is satisfied. The majority of our contracts have a single performance obligation as the promise to transfer the individual goods or services is not separately identifiable from other promises in the contracts and is, therefore, not distinct. For product sales, each product sold to a customer typically represents a distinct performance obligation. Our performance obligations are satisfied over time as work progresses or at a point in time based on transfer of control of products and services to our customers.

Contract modifications are routine in the performance of our contracts. Contracts are often modified to account for changes in contract specifications or requirements. In most instances, contract modifications are for goods or services that are not distinct, and therefore are accounted for as part of the existing contract.

Substantially all of our Supply Chain Management Group revenue from the sale of vehicle parts to customers is recognized at the point in time of the transfer of control to the customer. Sales returns and allowances for vehicle parts are not significant.

Our Aviation Group revenues result from the sale of aircraft parts and performance of MRO services for private and commercial aircraft owners, other aviation MRO providers, and aviation original equipment manufacturers. Our Aviation Group recognizes revenues at a point in time for the sale of aircraft parts when control is transferred to the customer, which usually occurs when the parts are shipped. Our Aviation Group recognizes revenues for MRO services over time as the services are transferred to the customer. MRO services revenue recognized is measured based on the cost-to-cost input method, as costs incurred reflect the work completed, and therefore the services transferred to date. Sales returns and allowances are not significant

Our Federal Services Group revenues result from professional and technical services, which we perform for customers on a contract basis. Revenue is recognized for performance obligations over time as we transfer the services to the customer. The three primary types of contracts used are cost-type, fixed-price and time and materials. Revenues result from work performed on these contracts by our employees and our subcontractors and from costs for materials and other work related costs allowed under our contracts.

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Revenues on cost-type contracts are recorded as contract allowable costs are incurred and fees are earned. Variable consideration, typically in the form of an award fees, is included in the estimated transaction price, to the extent that it is probable that a significant reversal will not occur, when there is a basis to reasonably estimate the amount of the fee. These estimates are based on historical award experience, anticipated performance and our best judgment based on current facts and circumstances.

Revenues on fixed-price contracts are recorded as work is performed over the period. Revenue is recognized over time using costs incurred to date relative to total estimated costs at completion to measure progress toward satisfying our performance obligations. Incurred cost represents work performed, which corresponds with the transfer of control to the customer. For such contracts, we estimate total costs at the inception of the contract based on our assumptions of the cost elements required to complete the associated tasks of the contract and assess the affects of the risks on our estimates of total costs to complete the contract. Our cost estimates are based on assumptions that include the complexity of the work, our employee labor costs, the cost of materials, and the performance of our subcontractors. These cost estimates are subject to change as we perform under the contract and as a result, the timing of revenues and amount of profit on a contract may change as there are changes in estimated costs to complete the contract. Such adjustments are recognized on a cumulative catch-up basis in the period we identify the changes.

Revenues for time and materials contracts are recorded based on the amount for which we have the right to invoice our customers, because the amount directly reflects the value of our work performed for the customer. Time and materials contracts are recorded on the basis of contract allowable labor hours worked multiplied by the contract defined billing rates, plus the direct costs and indirect cost burdens associated with materials and subcontract work used in performance on the contract. Generally, profits on time and materials contracts result from the difference between the cost of services performed and the contract defined billing rates for these services.

(2) Revenue

Disaggregated Revenue
Our revenues are derived from contract services performed for United States Department of Defense ("DoD") agencies or federal civilian agencies and from the delivery of products to our clients. Our customers also include various other government agencies and commercial entities.

A summary of revenues for our operating groups by customer for the three and six months ended June 30, 2018 is as follows (in thousands):

| | Three months ended June 30, 2018 | | | |
|---|---|---|---|---|
| Customer | Supply Chain Management | Aviation | Federal Services | Total |
| U.S. Postal Services | $43,089 | $— | $— | $43,089 |
| DoD | 7,525 | 1,025 | 73,637 | 82,187 |
| Commercial | 3,413 | 34,037 | 31 | 37,481 |
| Other Government | 236 | 742 | 6,659 | 7,637 |
| | $54,263 | $35,804 | $80,327 | $170,394 |

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June 30, 2018

| | Six months ended June 30, 2018 | | | |
|---|---|---|---|---|
| Customer | Supply Chain Management | Aviation | Federal Services | Total |
| U.S. Postal Services | $87,120 | $— | $— | $87,120 |
| DoD | 15,701 | 2,240 | 151,899 | 169,840 |
| Commercial | 6,799 | 65,572 | 233 | 72,604 |
| Other Government | 507 | 742 | 16,478 | 17,727 |
| | $110,127 | $68,554 | $168,610 | $347,291 |

A summary of revenues for our operating groups by contract type for the three and six months ended June 30, 2018 is as follows (in thousands):

| | Three months ended June 30, 2018 | | | |
|---|---|---|---|---|
| Contract Type | Supply Chain Management | Aviation | Federal Services | Total |
| Cost-type | $— | $701 | $41,801 | $42,502 |
| Fixed-price | 54,263 | 19,869 | 17,204 | 91,336 |
| Time and materials | — | 15,234 | 21,322 | 36,556 |
| Total revenues | $54,263 | $35,804 | $80,327 | $170,394 |

| | Six months ended June 30, 2018 | | | |
|---|---|---|---|---|
| Contract Type | Supply Chain Management | Aviation | Federal Services | Total |
| Cost-type | $— | $1,098 | $92,922 | $94,020 |
| Fixed-price | 110,127 | 39,373 | 32,343 | 181,843 |
| Time and materials | — | 28,083 | 43,345 | 71,428 |
| Total revenues | $110,127 | $68,554 | $168,610 | $347,291 |

Contract Balances

Billed receivables, unbilled receivables (contract assets), and contract liabilities are the results of revenue recognition, customer billing, and timing of payment receipts. Billed receivables, net, represent unconditional rights to consideration under the terms of the contract and include amounts billed and currently due from our customers. Unbilled receivables represent our right to consideration in exchange for goods or services that we have transferred to the customer prior to us having the right to payment for such goods or services. Contract liabilities are recorded when customers remit contractual cash payments in advance of us satisfying performance obligations under contractual arrangements, including those with performance obligations to be satisfied over a period of time.

We present our unbilled receivables and contract liabilities on a contract-by-contract basis. If a contract liability exists, it is netted against the unbilled receivables balance for that contract. Unbilled receivables decreased from $47.6 million at adoption of ASC 606 on January 1, 2018 to $38.0 million at June 30, 2018, primarily due to billings in excess of revenue recognized. Contract liabilities, which are included in accrued expenses and other current liabilities in our consolidated balance sheet, decreased from $9.8 million at adoption of ASC 606 on January 1, 2018 to $3.9 million at June 30, 2018, primarily due to revenue recognized in excess of advance payments received. For the three and six months ended June 30, 2018, we recognized revenue of $1.2 million and $7.7 million that was previously included in the beginning balance of contract liabilities.

Performance Obligations

Our performance obligations are satisfied over time as work progresses or at a point in time. Revenues from products and services transferred to customers over time accounted for approximately 57% of our revenues for the three and six months ended June 30, 2018, primarily related to revenues in our Federal Services Group and for MRO services in our Aviation Group. Revenues from products and services transferred to customers at a point in time accounted for approximately 43% of our revenues for the three and six months ended June 30, 2018. The majority of our revenue recognized at a point in time is for the sale of vehicle and aircraft parts in our Supply Chain Management and Aviation groups.

As of June 30, 2018, the aggregate amount of transaction prices allocated to unsatisfied or partially unsatisfied performance obligations was $339 million. Performance obligations expected to be satisfied within one year and greater than one year are 96% and 4%, respectively. We have applied the practical expedient for certain parts sales and MRO services to exclude the amount of remaining performance obligations for (i) contracts with an original expected term of one year or less or (ii) contracts for which we recognize revenue in proportion to the amount we have the right to invoice for services performed.

During the six months ended June 30, 2018, revenue recognized from performance obligations related to prior periods was not material.

(3) Debt

We have a loan agreement with a group of banks to provide working capital support, letters of credit and finance acquisitions. The loan agreement, which was amended in January 2018 and expires in January 2023, has a term loan facility and a revolving loan facility. The revolving loan facility provides for revolving loans and letters of credit. Financing costs associated with the inception of the amended loan agreement of approximately $1.7 million were capitalized and are being amortized over the five-year life of the loan.

Our required term loan payments after June 30, 2018 are approximately $5.0 million in 2018, $10.0 million in 2019, $11.9 million in 2020, $14.4 million in 2021, $15 million in 2022, and $41.2 million in 2023. The amount of term loan borrowings outstanding as of June 30, 2018 was $97.5 million.

The maximum amount of credit available to us under the loan agreement for revolving loans and letters of credit as of June 30, 2018 was $300 million. Subject to the terms of the loan agreement, we may borrow and repay the revolving loan borrowings as our cash flows require or permit. We pay an unused commitment fee and fees on letters of credit that are issued. We had $86.2 million in revolving loan amounts outstanding and $22 thousand in letters of credit outstanding as of June 30, 2018. We had approximately $79.3 million in revolving loan amounts outstanding and no letters of credit outstanding as of December 31, 2017.

Under the loan agreement we may elect to increase the maximum availability of the term loan facility, the revolving loan facility, or both facilities, up to an aggregate additional amount of $100 million.

Total bank loan borrowed funds outstanding, including term loan borrowings and revolving loan borrowings, were $183.7 million and $173.7 million, as of June 30, 2018 and December 31, 2017, respectively. These amounts exclude unamortized deferred financing costs of approximately $2.4 million and $1.1 million as of June 30, 2018 and December 31, 2017. The fair value of outstanding debt as of June 30, 2018 under our bank loan facilities approximates its carrying value using Level 2 inputs based on market data on companies with a corporate rating similar to ours that have recently priced credit facilities.

We pay interest on the term loan borrowings and revolving loan borrowings at LIBOR plus a base margin or at a base rate (typically the prime rate) plus a base margin. As of June 30, 2018, the LIBOR base margin was 1.75% and the base rate base margin was 0.50%. The base margins increase or decrease in increments as our Total Funded Debt/EBITDA Ratio increases or decreases.

The loan agreement requires us to have interest rate hedges on a portion of the outstanding term loan for the first three years after the January 2018 amendment date of the agreement. We executed interest rate swap agreements in February 2015 and February 2018. The notional amount of the interest rate swap agreements was $50 million and $85 million as of June 30, 2018 and December 31, 2017, respectively.

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After taking into account the impact of interest rate swap agreements, as of June 30, 2018, interest rates on portions of our outstanding debt ranged from 3.00% to 5.50%, and the effective interest rate on our aggregate outstanding debt was 3.77%.

Interest expense incurred on bank loan borrowings and interest rate hedges was approximately $1.7 million and $1.9 million for the three months ended June 30, 2018 and 2017, respectively. Interest expense incurred on bank loan borrowings and interest rate hedges was approximately $3.2 million and $3.8 million for the six months ended June 30, 2018 and 2017, respectively.

The loan agreement contains collateral requirements to secure our loan agreement obligations, restrictive covenants, a limit on annual dividends, and other affirmative and negative covenants, conditions, and limitations. Restrictive covenants include a maximum Total Funded Debt/EBITDA Ratio, which decreases over time, and a minimum Fixed Charge Coverage Ratio. We were in compliance with required ratios and other terms and conditions at June 30, 2018.

(4) Earnings Per Share

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

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Basic weighted average common shares outstanding | 10,881,106 | 10,838,435 | 10,870,887 | 10,830,595 |
| Effect of dilutive shares | 37,821 | 23,334 | 36,890 | 25,037 |
| Diluted weighted average common shares outstanding | 10,918,927 | 10,861,769 | 10,907,777 | 10,855,632 |

(5) Commitments and Contingencies

Contingencies

In November 2016, a lawsuit, Arrieta et al vs. Prime Turbines LLC et al, was filed in the District Court of Texas in Dallas County, by Edgar Arrieta, and four other plaintiffs against VSE subsidiaries, Kansas Aviation of Independence, L.L.C. and Prime Turbines LLC, and three other unrelated defendants. The other named defendants are Pratt & Whitney of Canada Corporation, Cessna Aircraft Company and Woodward Inc. The plaintiffs allege that on April 1, 2016, a plane crashed resulting in the death of three plaintiffs and serious injuries to six other plaintiffs and that VSE's subsidiaries were negligent in providing maintenance, service and inspection of the airplane engine prior to the crash. Plaintiffs are seeking monetary relief over $1.0 million from the defendants. Trial is scheduled for November 2018. VSE together with its insurance carrier, will aggressively defend the proceedings. While the results of legal proceedings cannot be predicted with certainty and the amount of loss, if any, cannot be reasonably estimated at this time, we believe the likelihood that this lawsuit will have a material adverse effect on our results of operation, financial condition, or cash flows is remote.

On or about April 19, 2018 Joseph Waggoner and Clifford Tefteller, on behalf of themselves and all similarly situated individuals, filed a lawsuit against VSE Corporation, XOTECH Solutions, LLC (Tefteller's employer) and White's Paint and Blast (Waggoner's employer) in the United State District Court, Eastern District of Texas, Texarkana Division, alleging overtime compensation entitlement at a rate of one and on-half times their regular rate of pay for all hours worked over 40 hours in a workweek. The plaintiffs are seeking to certify the case as a collective action for similarly situated individuals. The plaintiffs work under a contract between defendants and the United States Army at the Red River Army Depot in Texas. The plaintiffs assert that employees' fifteen minute unpaid work breaks should have been included as "working hours" for the purposes of calculating overtime. While the results of legal proceedings cannot be predicted with certainty and the amount of loss, if any, cannot be reasonably estimated at this time, we believe the likelihood that this lawsuit will have a material adverse effect on our results of operation, financial condition, or cash flows is remote.

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In a letter dated May 21, 2018, Dyncorp International ("Dyncorp") notified VSE's subsidiary Prime Turbines LLC that the U.S. Air Force ("USAF") had filed a claim against Dyncorp for approximately $27 million in respect of work performed by Dyncorp and Prime Turbines in support of the USAF program for servicing fuel nozzle tips on aircraft engines. Dyncorp's notification also asserts that Dyncorp believes any liability arising from the USAF claim will be borne by Prime Turbines under its agreement dated August 21, 2013, with Dyncorp. As the events leading to the USAF claim against Dyncorp, including the work performed by Prime Turbines as a subcontractor, occurred prior to VSE's acquisition of Prime Turbines in January 2015, VSE notified the sellers of Prime Turbines of the Dyncorp and USAF claims and VSE's intention to seek restitution from the sellers for any damages arising from such claims. While the sellers have not acknowledged any liability in respect of Dyncorp's claim against Prime Turbines, they have assumed the defense of such claim under the acquisition agreement between the sellers and VSE. VSE believes that Dyncorp and Prime Turbines together with its insurance carrier, will appeal the USAF claim against Dyncorp and will otherwise aggressively defend against such claim. While the results of any resulting legal proceedings cannot be predicted with certainty and the amount of loss, if any, cannot be reasonably estimated at this time, we believe the likelihood that this claim will have a material adverse effect on our results of operation, financial condition, or cash flows is remote.

Other Matters

In addition to the above-referenced legal proceedings and Dyncorp claim, we may have certain claims in the normal course of business, including legal proceedings, against us and against other parties. In our opinion, the resolution of these other claims will not have a material adverse effect on our results of operations, financial position, or cash flows. However, because the results of any legal proceedings cannot be predicted with certainty, the amount of loss, if any, cannot be reasonably estimated.

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

(6) Business Segments and Customer Information

Business Segments

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

Supply Chain Management Group – Our Supply Chain Management Group supplies vehicle parts primarily through a Managed Inventory Program ("MIP") and direct sa