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 quarterly period ended: June 30, 2021

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

Commission file number: 001-08443

TELOS CORPORATION

(Exact name of registrant as specified in its charter)

Maryland	**52-0880974**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
19886 Ashburn Road, Ashburn, Virginia	**20147-2358**
(Address of principal executive offices)	(Zip Code)

(703) 724-3800
(Registrant’s telephone number, including area code)

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

Title of each class	Trading symbol	Name of each exchange on which registered
Common stock, $0.001 par value per share	TLS	The Nasdaq Stock Market LLC

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

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

Large accelerated filer	☐	Accelerated filer	☐
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 transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

As of August 9, 2021, the registrant had outstanding 66,755,230 shares of common stock.

TELOS CORPORATION

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

TELOS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(amounts in thousands, except per share data)

	Three Months Ended June 30, 2021	Three Months Ended June 30, 2020	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020
Revenue				
Services	$ 47,618	$ 45,486	$ 99,676	$ 80,044
Products	4,941	3,124	8,641	7,545
	52,559	48,610	108,317	87,589
Costs and expenses				
Cost of sales - Services	29,501	29,378	69,103	54,243
Cost of sales - Products	2,501	1,659	4,299	3,531
	32,002	31,037	73,402	57,774
Selling, general and administrative expenses				
Sales and marketing	5,043	1,473	8,869	3,065
Research and development	5,327	3,815	9,388	7,472
General and administrative	28,743	7,219	48,708	13,809
	39,113	12,507	66,965	24,346
Operating (loss) income	(18,556)	5,066	(32,050)	5,469
Other income (expense)				
Other income (expense)	32	4	(1,022)	12
Interest expense	(192)	(1,996)	(388)	(4,013)
(Loss) income before income taxes	(18,716)	3,074	(33,460)	1,468
(Provision for) benefit from income taxes	(13)	(2)	(47)	144
Net (loss) income	(18,729)	3,072	(33,507)	1,612
Less: Net income attributable to non-controlling interest	—	(2,806)	—	(3,590)
Net (loss) income attributable to Telos Corporation	$ (18,729)	$ 266	$ (33,507)	$ (1,978)
Net (loss) income per share attributable to Telos Corporation, basic	$ (0.28)	$ 0.01	$ (0.51)	$ (0.05)
Net (loss) income per share attributable to Telos Corporation, diluted	$ (0.28)	$ 0.01	$ (0.51)	$ (0.05)
Weighted-average shares of common stock outstanding, basic	66,616	38,583	65,621	38,328
Weighted-average shares of common stock outstanding, diluted	66,616	39,927	65,621	38,328

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

TELOS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(Unaudited)
(amounts in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	**2020**	**2021**	**2020**
Net (loss) income	$ (18,729)	$ 3,072	$ (33,507)	$ 1,612
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	5	2	(27)	1
Less: Comprehensive income attributable to non-controlling interest	—	(2,806)	—	(3,590)
Comprehensive (loss) income attributable to Telos Corporation	$ (18,724)	$ 268	$ (33,534)	$ (1,977)

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

TELOS CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(amounts in thousands)

	June 30, 2021	December 31, 2020
	(Unaudited)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 130,996	$ 106,045
Accounts receivable, net of reserve of $122 and $308, respectively	39,412	30,913
Inventories, net of obsolescence reserve of $865 and $851, respectively	1,784	3,311
Prepaid expenses	5,451	3,059
Other current assets	760	786
Total current assets	178,403	144,114
Property and equipment, including capitalized software development costs, net of accumulated depreciation and amortization of $38,867 and $36,891, respectively	24,725	22,397
Operating lease right-of-use assets	1,168	1,464
Goodwill	14,916	14,916
Other assets	882	926
Total assets	$ 220,094	$ 183,817
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable and other accrued liabilities	$ 21,036	$ 20,899
Accrued compensation and benefits	7,811	8,474
Contract liabilities	5,925	5,654
Finance lease obligations – short-term	1,399	1,339
Operating lease obligations – short-term	656	677
Other current liabilities	1,831	1,903
Total current liabilities	38,658	38,946
Finance lease obligations – long-term	13,591	14,301
Operating lease liabilities – long-term	642	941
Deferred income taxes	670	652
Other liabilities	1,833	1,873
Total liabilities	55,394	56,713
Commitments and contingencies (Note 8)		
Stockholders' equity		
Common stock, $0.001 par value, 250,000,000 shares authorized, 66,755,230 shares and 64,625,071 shares issued and outstanding as of June 30, 2021 and December 31, 2020, respectively	105	103
Additional paid-in capital	341,928	270,800
Accumulated other comprehensive income	17	44
Accumulated deficit	(177,350)	(143,843)
Total stockholders' equity	164,700	127,104
Total liabilities and stockholders' equity	$ 220,094	$ 183,817

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

TELOS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(amounts in thousands)

	Six Months Ended June 30, 2021	Six Months Ended June 30, 2020
Operating activities:		
Net (loss) income	$ (33,507)	$ 1,612
Adjustments to reconcile net (loss) income to cash (used in) provided by operating activities:		
Stock-based compensation	35,006	—
Dividends from preferred stock recorded as interest expense	—	1,911
Depreciation and amortization	2,764	2,734
Amortization of debt issuance costs	—	453
Deferred income tax provision	18	19
Loss on disposal of fixed assets	5	—
Other noncash items	(2)	(17)
Changes in other operating assets and liabilities	(10,074)	(5,873)
Cash (used in) provided by operating activities	(5,790)	839
Investing activities:		
Capitalized software development costs	(3,663)	(3,159)
Purchases of property and equipment	(1,070)	(332)
Cash used in investing activities	(4,733)	(3,491)
Financing activities:		
Proceeds from issuance of common stock, net of issuance costs	64,269	—
Repurchase of outstanding warrants	(26,894)	—
Repurchase of common stock	(1,251)	—
Payments under finance lease obligations	(650)	(594)
Amendment fee paid to lender	—	(100)
Distributions to Telos ID Class B member - non-controlling interest	—	(1,000)
Cash provided by (used in) financing activities	35,474	(1,694)
Increase (decrease) in cash and cash equivalents	24,951	(4,346)
Cash and cash equivalents, beginning of period	106,045	6,751
Cash and cash equivalents, end of period	$ 130,996	$ 2,405
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 388	$ 1,474
Income taxes	$ 54	$ 50
Noncash:		
Dividends from preferred stock recorded as interest expense	$ —	$ 1,911

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

TELOS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)
(Unaudited)
(amounts in thousands)

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Non-Controlling Interest	Total Stockholders' Equity (Deficit)
For the Three Months Ended June 30, 2021						
Beginning balance	$ 103	$ 284,470	$ 12	$ (158,621)	$ —	$ 125,964
Net loss	—	—	—	(18,729)	—	(18,729)
Issuance of common stock	2	64,267	—	—	—	64,269
Foreign currency translation gain	—	—	5	—	—	5
Stock-based compensation	—	21,336	—	—	—	21,336
Repurchase of outstanding warrants	—	(26,894)	—	—	—	(26,894)
Repurchase of common stock	—	(1,251)	—	—	—	(1,251)
Ending balance	$ 105	$ 341,928	$ 17	$ (177,350)	$ —	$ 164,700
For the Three Months Ended June 30, 2020						
Beginning balance	$ 78	$ 4,310	$ 5	$ (147,774)	$ 5,298	$ (138,083)
Net income	—	—	—	266	2,806	3,072
Foreign currency translation gain	—	—	2	—	—	2
Distributions	—	—	—	—	(1,000)	(1,000)
Ending balance	$ 78	$ 4,310	$ 7	$ (147,508)	$ 7,104	$ (136,009)
For the Six Months Ended June 30, 2021						
Beginning balance	$ 103	$ 270,800	$ 44	$ (143,843)	$ —	$ 127,104
Net loss	—	—	—	(33,507)	—	(33,507)
Issuance of common stock	2	64,267	—	—	—	64,269
Foreign currency translation loss	—	—	(27)	—	—	(27)
Stock-based compensation	—	35,006	—	—	—	35,006
Repurchase of outstanding warrants	—	(26,894)	—	—	—	(26,894)
Repurchase of common stock	—	(1,251)	—	—	—	(1,251)
Ending balance	$ 105	$ 341,928	$ 17	$ (177,350)	$ —	$ 164,700
For the Six Months Ended June 30, 2020						
Beginning balance	$ 78	$ 4,310	$ 6	$ (145,530)	$ 4,514	$ (136,622)
Net (loss) income	—	—	—	(1,978)	3,590	1,612
Foreign currency translation gain	—	—	1	—	—	1
Distributions	—	—	—	—	(1,000)	(1,000)
Ending balance	$ 78	$ 4,310	$ 7	$ (147,508)	$ 7,104	$ (136,009)

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

TELOS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. General and Basis of Presentation

Organization

Telos Corporation, together with its subsidiaries (collectively, the "Company", "we", "our" or "Telos"), a Maryland corporation, is a leading provider of cyber, cloud and enterprise security solutions for the world's most security-conscious organization. We own all of the issued and outstanding share capital of Xacta Corporation, a subsidiary that develops, markets and sells government-validated secure enterprise solutions to government and commercial customers. We also own all of the issued and outstanding share capital of Ubiquity.com, Inc., a holding company for Xacta Corporation. We also have a 100% ownership interest in Telos Identity Management Solutions, LLC (“Telos ID”), Teloworks, Inc. (“Teloworks”) and Telos APAC Pte. Ltd. (“Telos APAC”).

On November 12, 2020, we amended our charter to effect an approximate 0.794-for-1 reverse stock split with respect to our common stock. The par value and the authorized shares of the common stock were not adjusted as a result of the reverse stock split. The accompanying condensed consolidated financial statements and notes to the condensed consolidated financial statements give retroactive effect to the reverse stock split for all periods presented.

In December 2019, an outbreak of COVID-19 was reported in Wuhan, China. On March 11, 2020, the World Health Organization declared COVID-19 a global pandemic and on March 13, 2020, President Donald J. Trump declared the virus a national emergency. This highly contagious disease has spread to most of the countries in the world and throughout the United States, creating a serious impact on customers, workforces, and suppliers, disrupting economies and financial markets, and leading to a world-wide economic downturn. COVID-19, together with subsequently reported variants of this strain, have caused a disruption of the normal operations of many businesses, including the temporary closure or scale-back of business operations and/or the imposition of either quarantine or remote work or meeting requirements for employees, either by government order or on a voluntary basis. The pandemic may adversely affect our customers’ ability to perform their missions and is in many cases disrupting their operations. It may also impact the ability of our subcontractors, partners, and suppliers to operate and fulfill their contractual obligations, and result in an increase in their costs and cause delays in performance. These supply chain effects, and the direct effect of the virus and the disruption on our operations, may negatively impact both our ability to meet customer demand and our revenue and profit margins. Our employees, in some cases, are working remotely due either to safety concerns or to customer imposed limitations and using various technologies to perform their functions. We could see delays or changes in customer demand, particularly if government funding priorities change. Additionally, the disruption and volatility in the global and domestic capital markets may increase the cost of capital and limit our ability to access capital. Both the health and economic aspects of COVID-19 are highly fluid and the future course of each is uncertain.

Public Offerings of Common Stock

On November 19, 2020, we completed our initial public offering ("IPO") of shares of our common stock. We issued 17.2 million shares of our common stock at a price of $17.00 per share, generating net proceeds of approximately $272.8 million. We used approximately $108.9 million of the net proceeds in connection with the conversion of our outstanding shares of Exchangeable Redeemable Preferred Stock into the right to receive cash and shares of our common stock, $30.0 million to fund our acquisition of the outstanding Class B Units of Telos ID, and $21.0 million to repay our outstanding senior term loan and subordinated debt. We intend to use the remaining net proceeds for general corporate purposes. We also may use a portion of the net proceeds to acquire complementary businesses, products, services, or technologies. The amounts and timing of our actual use of the net proceeds will vary depending on numerous factors.

On April 6, 2021, we completed our follow-on offering of 9.1 million shares of our common stock at a price of $33.00 per share, including 7.0 million shares of common stock held by certain existing stockholders of Telos. The offering generated approximately $64.3 million of net proceeds to Telos. We did not receive any proceeds from the shares of common stock sold by the selling stockholders. On April 19, 2021, we used approximately $1.3 million of the net proceeds to repurchase 39,682 shares of our common stock and $26.9 million for the warrants to purchase 900,970 shares of our common stock owned by certain affiliates of Enlightenment Capital Solutions ("EnCap"). We intend to use the remaining net proceeds for general corporate purposes, including working capital, sales and marketing activities, research and development, general and administrative matters and capital expenditures.

Principles of Consolidation and Reporting

The accompanying condensed consolidated financial statements include the accounts of Telos and its wholly-owned subsidiaries. All intercompany transactions have been eliminated in consolidation.

The accompanying condensed consolidated financial statements for the three and six months ended June 30, 2021 and 2020 have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and pursuant to rules and regulations of the Securities and Exchange Commission (“SEC”). The presented interim results are not necessarily indicative of fiscal year performance for a variety of reasons including, but not limited to, the impact of seasonal and short-term variations. We have continued to follow the accounting policies (including the critical accounting policies) set forth in the consolidated financial statements included in our 2020 Annual Report on Form 10-K filed with the SEC. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2020.

In preparing these condensed consolidated financial statements, we have evaluated subsequent events through the date that these condensed consolidated financial statements were issued.

Segment Reporting

Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision maker (“CODM”), or decision making group, in deciding how to allocate resources and assess performance. We currently operate in one operating and reportable business segment for financial reporting purposes. Our Chief Executive Officer is the CODM. The CODM only evaluates profitability based on consolidated results.

Recent Accounting Pronouncements

Recent Accounting Pronouncements Adopted

In December 2019, the Financial Accounting Standard Board (“FASB”) issued Accounting Standards Update ("ASU”) No. 2019-12, “Simplifying the Accounting for Income Taxes (Topic 740)”, which simplifies the accounting for income taxes by removing certain exceptions to the general principles in Topic 740. The ASU also clarifies and amends existing guidance to improve consistent application. This standard is effective for reporting periods beginning after December 15, 2020, which made this standard effective for us on January 1, 2021. The adoption of this ASU did not have a material impact on our condensed consolidated financial position, results of operations and cash flows.

Revenue Recognition

We account for revenue in accordance with ASC Topic 606, “Revenue from Contracts with Customers”. The unit of account in ASC 606 is a performance obligation, which is a promise in a contract with a customer to transfer a good or service to the customer. ASC 606 prescribes a five-step model for recognizing revenue that includes identifying the contract with the customer, determining the performance obligation(s), determining the transaction price, allocating the transaction price to the performance obligation(s), and recognizing revenue as the performance obligations are satisfied. Timing of the satisfaction of performance obligations varies across our businesses due to our diverse product and service mix, customer base, and contractual terms. Significant judgment can be required in determining certain performance obligations, and these determinations could change the amount of revenue and profit recorded in a given period. Our contracts may have a single performance obligation or multiple performance obligations. When there are multiple performance obligations within a contract, we allocate the transaction price to each performance obligation based on our best estimate of standalone selling price.

The majority of our revenue is recognized over time, as control is transferred continuously to our customers who receive and consume benefits as we perform, and is classified as services revenue. All of our business groups earn services revenue under a variety of contract types, including time and materials, firm-fixed price, firm fixed price level of effort, and cost plus fixed fee contract types, which may include variable consideration as discussed further below. 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, and thereby best depicts, the transfer of control to the customer. Contract costs include labor, material, subcontractor costs and indirect expenses. This continuous transfer of control to the customer is supported by clauses in our contracts with U.S. Government customers whereby the customer may terminate a contract for convenience and then pay for costs incurred plus a profit, at which time the customer would take control of any work in process. For non-U.S. Government contracts where we perform as a subcontractor and our order includes similar Federal Acquisition Regulation (the FAR) provisions as the prime contractor’s order from the U.S. Government, continuous transfer of control is likewise supported by such provisions. For other non-U.S. Government customers, continuous transfer of control to such customers is also supported due to general terms in our contracts and rights to recover damages which would include, among other potential damages, the right to payment for our work performed to date plus a reasonable profit.

Due to the transfer of control over time, revenue is recognized based on progress towards completion of the performance obligation. The selection of the method to measure progress towards completion requires judgment and is based on the nature of the performance obligations. We generally use the cost-to-cost measure of progress on a proportional performance basis for our contracts because it best depicts the transfer of control to the customer which occurs as we incur costs on our contracts. Under the cost-to-cost measure of progress, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the total estimated costs at completion of the performance obligation. Revenues are recorded proportionally as costs are incurred. Due to the nature of the work required to be performed on certain of our performance obligations, the estimation of total revenue and cost at completion is complex, subject to many variables and requires significant judgment. Contract estimates are based on various assumptions including labor and subcontractor costs, materials and other direct costs and the complexity of the work to be performed. A significant change in one or more of these estimates could affect the profitability of our contracts. We review and update our contract-related estimates regularly and recognize adjustments in estimated profit on contracts on a cumulative catch-up basis, which may result in an adjustment increasing or decreasing revenue to date on a contract in a particular period that the adjustment is identified. Revenue and profit in future periods of contract performance are recognized using the adjusted estimate.

Revenue that is recognized at a point in time is for the sale of software licenses in our Information Assurance / Xacta® (previously referred to as Cyber & Cloud Solutions) and Secure Communications (previously referred to as Secure Communications Cyber and Enterprise Solutions) business groups and for the sale of resold products in Telos ID (previously referred to as Telos ID Enterprise Solutions) and Secure Networks (previously referred to as Secure Mobility and Network Management/Defense Enterprise Solutions), and is classified as product revenue. Revenue on these contracts is recognized when the customer obtains control of the transferred product or service, which is generally upon delivery of the product to the customer for their use, due to us maintaining control of the product until that point. Orders for the sale of software licenses may contain multiple performance obligations, such as maintenance, training, or consulting services, which are typically delivered over time, consistent with the transfer of control disclosed above for the provision of services. When an order contains multiple performance obligations, we allocate the transaction price to the performance obligations using our best estimate of standalone selling price.

Contracts are routinely and often modified to account for changes in contract requirements, specifications, quantities, or price. Depending on the nature of the modification, we determine whether to account for the modification as an adjustment to the existing contract or as a new contract. Generally, modifications are not distinct from the existing contract due to the significant interrelatedness of the performance obligations and are therefore accounted for as an adjustment to the existing contract, and recognized as a cumulative adjustment to revenue (as either an increase or reduction of revenue) based on the modification’s effect on progress toward completion of a performance obligation.

Our contracts may include various types of variable consideration, such as claims (for instance, indirect rate or other equitable adjustments) or incentive fees. We include estimated amounts in the transaction price based on all of the information available to us, including historical information and future estimations, and to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when any uncertainty associated with the variable consideration is resolved.

Historically, most of our contracts do not include award or incentive fees. For incentive fees, we would include such fees in the transaction price to the extent we could reasonably estimate the amount of the fee. With limited historical experience, we have not included any revenue related to incentive fees in our estimated transaction prices. We may include in our contract estimates additional revenue for submitted contract modifications or claims against the customer when we believe we have an enforceable right to the modification or claim, the amount can be estimated reliably and its realization is probable. We consider the contractual/legal basis for the claim (in particular FAR provisions), the facts and circumstances around any additional costs incurred, the reasonableness of those costs and the objective evidence available to support such claims.

For our contracts that have an original duration of one year or less, we use the practical expedient applicable to such contracts and do not consider the time value of money. We capitalize sales commissions related to proprietary software and related services that are directly tied to sales. We do not elect the practical expedient to expense as incurred the incremental costs of obtaining a contract if the amortization period would have been one year or less. For the sales commissions that are capitalized, we amortize the asset over the expected customer life, which is based on recent and historical data.

Contract assets are amounts that are invoiced as work progresses in accordance with agreed-upon contractual terms, either at periodic intervals or upon achievement of contractual milestones. Generally, revenue recognition occurs before billing, resulting in contract assets. These contract assets are referred to as unbilled receivables and are reported within accounts receivable, net of reserve on our condensed consolidated balance sheets.

Billed receivables are amounts billed and due from our customers and are reported within accounts receivable, net of reserve on the condensed consolidated balance sheets. The portion of the payments retained by the customer until final contract settlement is not considered a significant financing component due to the intent of the retainage being the customer's protection with respect to full and final performance under the contract.

Contract liabilities are payments received in advance and milestone payments from our customers on selected contracts that exceed revenue earned to date, resulting in contract liabilities. Contract liabilities typically are not considered a significant financing component because they are generally satisfied within one year and are used to meet working capital demands that can be higher in the early stages of a contract. Contract liabilities are reported on our condensed consolidated balance sheets on a net contract basis at the end of each reporting period.

We have one reportable segment. We treat sales to U.S. customers as sales within the U.S. regardless of where the services are performed. Substantially all of our revenues are from U.S. customers as revenue derived from international customers is not currently meaningful. The following tables disclose revenue (in thousands) by customer type and contract type for the three and six months ended June 30, 2021 and 2020.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Federal	$ 50,047	$ 46,877	$ 103,395	$ 82,968
State & Local, and Commercial	2,512	1,733	4,922	4,621
Total	$ 52,559	$ 48,610	$ 108,317	$ 87,589

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Firm fixed-price	$ 45,257	$ 41,935	$ 94,398	$ 73,596
Time-and-materials	3,059	3,637	6,089	7,462
Cost plus fixed fee	4,243	3,038	7,830	6,531
Total	$ 52,559	$ 48,610	$ 108,317	$ 87,589

The following table discloses accounts receivable and contract assets (in thousands):

	June 30, 2021	December 31, 2020
Billed accounts receivable	$ 12,088	$ 12,060
Unbilled receivables	27,446	19,161
Allowance for doubtful accounts	(122)	(308)
Receivables – net	$ 39,412	$ 30,913

As of June 30, 2021 and December 31, 2020, we had $152.7 million and $127.7 million of remaining performance obligations, respectively, which we also refer to as funded backlog. We expect to recognize approximately 68.9% of our remaining performance obligations as revenue in 2021, an additional 26.6% in 2022, and the balance thereafter. Revenue recognized for the three and six months ended June 30, 2021 that was included in the contract liabilities balance at the beginning of each reporting period was $1.2 million and $3.2 million, respectively. Revenue recognized for the three and six months ended June 30, 2020 that was included in the contract liabilities balance at the beginning of each reporting period was $1.1 million and $3.5 million, respectively. Contract liabilities were $5.9 million and $5.7 million as of June 30, 2021 and December 31, 2020, respectively.

Accounts Receivable

Accounts receivable are stated at the invoiced amount, less an allowance for doubtful accounts. Collectability of accounts receivable is regularly reviewed based upon management's knowledge of the specific circumstances related to overdue balances. The allowance for doubtful accounts is adjusted based on such evaluation. Accounts receivable balances are written off against the allowance when management deems the balances uncollectible.

Inventories

Inventories are stated at the lower of cost or net realizable value, where cost is determined using the weighted average method. Substantially all inventories consist of purchased off-the-shelf hardware and software, and component computer parts used in connection with system integration services that we perform. An allowance for obsolete, slow-moving or nonsaleable inventory is provided for all other inventories. This allowance is based on our overall obsolescence experience and our assessment of future inventory requirements. This charge is taken primarily due to the age of the specific inventory and the significant additional costs that would be necessary to upgrade to current standards as well as the lack of forecasted sales for such inventory in the near future. Gross inventory was $2.6 million and $4.2 million as of June 30, 2021 and December 31, 2020, respectively. As of June 30, 2021, it is management's judgment that we have fully provided for any potential inventory obsolescence, which was $0.9 million as of June 30, 2021 and December 31, 2020.

Software Development Costs

Our policy on accounting for development costs of software to be sold is in accordance with ASC Topic 985-20, "Software – Costs of Software to be Sold, Leased, or Marketed" and ASC Topic 350-40 "Internal Use Software" in so far as our Xacta products being available in various deployment modalities including on premises licenses and cloud-based Software as a Service ("SaaS"). Under both standards, software development costs are expensed as incurred until technological feasibility is reached, at which time additional costs are capitalized until the product is available for general release to customers or is ready for its intended use, as appropriate. Technological feasibility is established when all planning, designing, coding and testing activities have been completed, and all risks have been identified. Software development costs are capitalized and amortized over the estimated product life of 2 years on a straight-line basis. As of June 30, 2021 and December 31, 2020, we capitalized $16.0 million and $12.3 million of software development costs, respectively, which are included as a part of property and equipment. Amortization expense was $0.5 million and $0.9 million for the three and six months ended June 30, 2021, respectively, and $0.4 million and $0.9 million for the three and six months ended June 30, 2020, respectively. Accumulated amortization was $5.7 million and $4.8 million as of June 30, 2021 and December 31, 2020, respectively. The Company analyzes the net realizable value of capitalized software development costs on at least an annual basis and has determined that there is no indication of impairment of the capitalized software development costs as forecasted future sales are adequate to support the carrying values.

Income Taxes

We account for income taxes in accordance with ASC 740, “Income Taxes”. Under ASC 740, deferred tax assets and liabilities are recognized for the estimated future tax consequences of temporary differences and income tax credits. Deferred tax assets and liabilities are measured by applying enacted statutory tax rates that are applicable to the future years in which deferred tax assets or liabilities are expected to be settled or realized for differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. Any change in tax rates on deferred tax assets and liabilities is recognized in net income in the period in which the tax rate change is enacted. We record a valuation allowance that reduces deferred tax assets when it is "more likely than not" that deferred tax assets will not be realized. We are required to establish a valuation allowance for deferred tax assets if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based on available evidence, realization of deferred tax assets is dependent upon the generation of future taxable income. We considered projected future taxable income, tax planning strategies, and reversal of taxable temporary differences in making this assessment.

We follow the provisions of ASC 740 related to accounting for uncertainty in income taxes. The accounting estimates related to liabilities for uncertain tax positions require us to make judgments regarding the sustainability of each uncertain tax position based on its technical merits. If we determine it is more likely than not that a tax position will be sustained based on its technical merits, we record the impact of the position in our condensed consolidated financial statements at the largest amount that is greater than fifty percent likely of being realized upon ultimate settlement. These estimates are updated at each reporting date based on the facts, circumstances and information available. We are also required to assess at each reporting date whether it is reasonably possible that any significant increases or decreases to our unrecognized tax benefits will occur during the next 12 months.

The provision for income taxes in interim periods is computed by applying the estimated annual effective tax rate against earnings before income tax expense for the period. In addition, non-recurring or discrete items are recorded during the period in which they occur.

Goodwill

We evaluate the impairment of goodwill in accordance with ASC 350, “Intangibles - Goodwill and Other,” which requires goodwill and indefinite-lived intangible assets to be assessed on at least an annual basis for impairment using a fair value basis. Between annual evaluations, if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount, then impairment must be evaluated. Such circumstances could include, but are not limited to: (1) a significant adverse change in legal factors or business climate, or (2) a loss of key contracts or customers.

As the result of an acquisition, we record any excess purchase price over the net tangible and identifiable intangible assets acquired as goodwill. An allocation of the purchase price to tangible and intangible net assets acquired is based upon our valuation of the acquired assets. Goodwill is not amortized, but is subject to annual impairment tests. We complete our goodwill impairment test as of December 31st each year. Additionally, we make evaluations between annual tests if events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

Goodwill is amortized and deducted over a 15-year period for tax purposes.

Stock-Based Compensation

Under our 2016 Omnibus Long-Term Incentive Plan, as amended (the “2016 LTIP”), we have the ability to award restricted stock units with time-based vesting (“Service-Based RSUs”), and restricted stock units with performance-based vesting (“Performance-Based RSUs”) to senior executives, directors, employees and other eligible service providers. Under the 2016 LTIP, our Board of Directors or, by designation of authority, the Compensation Committee of our Board of Directors has the discretion to establish the terms, conditions and criteria of the various awards, including the weighing and vesting schedule of Service-Based RSU and the performance conditions applicable to the Performance-Based RSUs, including the achievement of certain financial performance criteria or price targets for our common stock. Upon vesting, Service-Based RSUs and Performance-Based RSUs will be settled in the Company’s common stock.

- *Service-Based RSUs* granted to eligible employees as an incentive generally vest in equal installments over two to three years from the date of grant. Service-Based RSUs granted to senior executives in 2021 vest in three annual installments from the date of grant, with 30% vesting on the first and second anniversaries and 40% vesting on the third anniversary. The grant date fair value per share is equal to the closing stock price on the date of grant.

- *Performance-Based RSUs* may vest upon the achievement of a defined performance target or at the end of the defined performance period from the date of grant, whichever initially occurs. The grant date fair value per share of these Performance-Based RSUs is equal to the closing stock price on the date of the grant. Performance-Based RSUs may vest upon the achievement of certain price targets for the Company's common stock anytime over a three-year period from the date of grant. In order to reflect the substantive characteristics of these market condition awards, the Company employs a Monte Carlo simulation valuation model to calculate the grant date fair value and corresponding requisite service period of the award. Monte Carlo approaches are a class of computational algorithms that rely on repeated random sampling to compute their results. This approach allows the calculation of the value of such awards based on a large number of possible stock price path scenarios.

We recognize these share-based payment transactions when services from the employees are received and recognize a corresponding increase in additional paid-in capital in our condensed consolidated balance sheets. The measurement objective for these equity awards is the estimated fair value at the date of grant of the equity instruments that we are obligated to issue when employees have rendered the requisite service and satisfied any other conditions necessary to earn the right to benefit from the instruments. The compensation expense for an award is recognized ratably over the requisite service period for the entire award, which is the period during which an employee is required to provide service in exchange for an award. Compensation expense for awards with performance conditions is recognized over the requisite service period if it is probable that the performance condition will be satisfied. If such performance conditions are not or are no longer considered probable, no compensation expense for these awards is recognized, and any previously recognized expense is reversed. Compensation expense for awards with performance conditions capable of being earned for satisfying the performance condition or as a result of completing a service requirement will be recognized ratably over the requisite service period for the entire award. If the performance condition is achieved prior to the completion of the requisite service period, any unrecognized compensation expense will be recognized in the period the performance condition is achieved. Compensation expense for awards with market conditions is recognized over the derived service period, or sooner, if the market condition is achieved. Previously recognized expense for awards with market conditions will never be reversed even if the market conditions is never achieved. We recognize forfeitures of share-based compensation awards as they occur. Share-based compensation expense is recognized as part of cost of sales and general and administrative expenses in our condensed consolidated statements of operations.

Net Income (Loss) per Share

Basic net earnings (loss) per share is computed by dividing the net earnings (loss) by the weighted-average number of common shares outstanding for the period, without consideration for potentially dilutive securities. Diluted net earnings (loss) per share is computed by dividing the net earnings (loss) by the weighted-average number of shares of common stock and dilutive common stock equivalents outstanding for the period determined using the treasury-stock and if-converted methods. Dilutive common stock equivalents are comprised of unvested restricted common stock, restricted common stock units and common stock warrants.

For the period of net loss, potentially dilutive securities are not included in the calculation of diluted net earnings (loss) per share because to do so would be anti-dilutive. Potentially dilutive securities are as follows (in common stock equivalent shares, in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Unvested restricted stock and restricted stock units	1,030	60	239	60
Common stock warrants, exercisable at $1.665/sh.	856	901	857	901
Total	1,886	961	1,096	961

Other Comprehensive Income (Loss)

Our functional currency is the U.S. Dollar. For one of our wholly owned subsidiaries, the functional currency is the local currency. For this subsidiary, the translation of its foreign currency into U.S. Dollars is performed for assets and liabilities using current foreign currency exchange rates in effect at the balance sheet date and for revenue and expense accounts using average foreign currency exchange rates during the periods presented. Translation gains and losses are included in stockholders' equity (deficit) as a component of accumulated other comprehensive income (loss).

Accumulated other comprehensive income included within stockholders' equity (deficit) consists of the following (in thousands):

	June 30, 2021	December 31, 2020
Cumulative foreign currency translation loss	$ (90)	$ (63)
Cumulative actuarial gain on pension liability adjustment	107	107
Accumulated other comprehensive income	$ 17	$ 44

Note 2. Non-controlling Interests / Purchase of Telos ID

On April 11, 2007, Telos ID was formed as a limited liability company under the Delaware Limited Liability Company Act. We contributed substantially all of the assets of our Telos ID Enterprise business line and assigned our rights to perform under our U.S. Government contract with the Defense Manpower Data Center ("DMDC") to Telos ID at their stated book values. The net book value of assets we contributed totaled $17,000. Until April 19, 2007, we owned 99.999% of the membership interests of Telos ID and Hoya ID Funds A, LLC ("Hoya") owned 0.001% of the membership interests of Telos ID. On April 20, 2007, we sold an additional 39.999% of the membership interests to Hoya in exchange for $6 million in cash consideration. As a result, we owned 60% of Telos ID, and therefore continued to account for the investment in Telos ID using the consolidation method.

On December 24, 2014, Hoya acquired from the Company an additional ten percent (10%) membership interest in Telos ID in exchange for $5 million (the "2014 Transaction"). In connection with the 2014 Transaction, the Company and Hoya entered into the Second Amended and Restated Operating Agreement (the "Operating Agreement") governing the business, allocation of profits and losses and management of Telos ID. Under the Operating Agreement, Telos ID was managed by a board of directors comprised of five (5) members (the "Telos ID Board"). The Company owned 50% of Telos ID, was entitled to receive 50% of the profits of Telos ID, and could appoint three (3) members of the Telos ID Board. Hoya owned 50% of Telos ID, was entitled to receive 50% of the profits of Telos ID, and could appoint two (2) members of the Telos ID Board.

As a result of the 2014 Transaction, each of the members owned 50% of Telos ID, as mentioned above, and as such each was allocated 50% of the profits, which was $2.8 million and $3.6 million for the three and six months ended June 30, 2020, respectively. Hoya held the non-controlling interest.

On October 5, 2020, we entered into a Membership Interest Purchase Agreement between the Company and Hoya to purchase all of the Class B Units of Telos ID owned by Hoya (the "Telos ID Purchase"). Upon the closing of the Telos ID Purchase, Telos ID became our wholly owned subsidiary. On November 23, 2020, the Telos ID Purchase was consummated with the Company transferring $30.0 million in cash and issuing 7,278,040 shares of our common stock at $20.39 per share (which totals approximately $148.4 million); the total consideration transferred to Hoya was $178.4 million. As part of the common stock issuance, the Company recognized an increase to additional paid-in capital ("APIC") of $148.4 million. The Company further recognized a reduction to APIC of $173.9 million as part of the elimination of Hoya's non-controlling interest in Telos ID. The net impact to APIC associated with the acquisition of the additional 50% interest in Telos ID was a reduction of $25.5 million.

Distributions were made to the members only when and to the extent determined by Telos ID's Board of Directors, in accordance with the Operating Agreement. Hoya received a final distribution of $2.4 million in January 2021, which was accrued and presented in accounts payable and other accrued liabilities in the condensed consolidated balance sheets as of December 31, 2020. Hoya received a total distribution of $1.0 million during the three and six months ended June 30, 2020.

Note 3. Goodwill

The goodwill balance was $14.9 million as of June 30, 2021 and December 31, 2020. Goodwill is subject to annual impairment tests and if triggering events are present in the interim before the annual tests, we will assess impairment. For the three and six months ended June 30, 2021 and 2020, no impairment charges were taken.

Note 4. Fair Value Measurements

The accounting standard for fair value measurements provides a framework for measuring fair value and expands disclosures about fair value measurements. The framework requires the valuation of financial instruments using a three-tiered approach. The statement requires fair value measurement to be classified and disclosed in one of the following categories:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets and liabilities;

Level 2: Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability; or

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e. supported by little or no market activity).

As of June 30, 2021 and December 31, 2020, we did not have any financial instruments with significant Level 3 inputs and we did not have any financial instruments that are measured at fair value on a recurring basis.

For certain of our non-derivative financial instruments, including receivables, accounts payable and other accrued liabilities, the carrying amount approximates fair value due to the short-term maturities of these instruments.

Note 5. Current Liabilities and Debt Obligations

Accounts Payable and Other Accrued Liabilities

Accounts payable and other accrued liabilities consisted of trade accounts payable and accrued liabilities. As of June 30, 2021 and December 31, 2020, the trade accounts payable were $17.8 million and $14.7 million, respectively; while accrued liabilities were $3.2 million and $6.2 million, respectively.

Contract Liabilities

Contract liabilities are payments received in advance and milestone payments from our customers on selected contracts that exceed revenue earned to date, resulting in contract liabilities. Contract liabilities typically are not considered a significant financing component because they are generally satisfied within one year and are used to meet working capital demands that can be higher in the early stages of a contract. Contract liabilities are reported on our condensed consolidated balance sheets on a net contract basis at the end of each reporting period. As of June 30, 2021 and December 31, 2020, the contract liabilities primarily related to product support services.

Enlightenment Capital Credit Agreement

On January 25, 2017, we entered into a Credit Agreement (the "Credit Agreement") with Enlightenment Capital Solutions Fund II, L.P., as agent (the "Agent") and the lenders party thereto (the "Lenders"), (together referenced as “EnCap”). The Credit Agreement provides for an $11 million senior term loan (the "Loan") with a maturity date of January 25, 2022, subject to acceleration in the event of customary events of default. All borrowings under the Credit Agreement accrue interest at the rate of 13.0% per annum (the "Accrual Rate").

In connection with the Credit Agreement, on January 25, 2017, the Company issued warrants (each, a "Warrant") to the Agent and certain of the Lenders representing in the aggregate the right to purchase in accordance with their terms 900,970 shares of the Class A Common Stock of the Company, no par value per share, which is equivalent to approximately 2.5% of the common equity interests of the Company on a fully diluted basis on the date of grant. The exercise price was $1.665 per share. The value of the warrants was determined to be de minimis and no value was allocated to them on a relative fair value basis in accounting for the debt instrument.

The Credit Agreement also included an $825,000 exit fee, which was payable upon any repayment or prepayment of the loan. This amount had been included in the total principal due and treated as an unamortized discount on the debt, which would be amortized over the term of the loan, using the effective interest method at a rate of 15.0% at the time of the original loan. We incurred fees and transaction costs of approximately $374,000 related to the issuance of the Credit Agreement, which were amortized over the life of the Credit Agreement.

On March 30, 2018, the Credit Agreement was amended (the “Third Amendment”) to add a minimum revenue covenant and a net working capital covenant were added. In consideration of these amendments, the interest rate on the loan was increased by 1% which will revert back to the original rate upon achievement of two consecutive quarters of a specified fixed charge coverage ratio as defined in the agreement. The increase in interest expense has been paid in cash. Contemporaneously with the Third Amendment, Mr. John B. Wood agreed to transfer 50,000 shares of the Company’s Class A Common Stock owned by him to EnCap.

On July 19, 2019, we entered into the Fourth Amendment to Credit Agreement and Waiver; First Amendment to Fee Letter (“Fourth Amendment”) to amend the Credit Agreement. As a result of the Fourth Amendment, several terms of the Credit Agreement were amended, including the following:

- The Company borrowed an additional $5 million from the Lenders, increasing the total amount of the principal to $16 million.
- The maturity date of the Credit Agreement was amended from January 25, 2022 to January 15, 2021.
- The prepayment price was amended as follows: (a) from January 26, 2019 through January 25, 2020, the prepayment price is 102% of the principal amount, (b) from January 26, 2020 through October 14, 2020, the prepayment price is 101% of the principal amount, and (c) from October 15, 2020 to the maturity date, the prepayment price will be at par. However, the prepayment price for the additional $5 million loan attributable to the Fourth Amendment will be at par.
- The following financial covenants, as defined in the Credit Agreement, were amended and updated: Consolidated Leverage Ratio, Consolidated Senior Leverage Ratio, Consolidated Capital Expenditures, Minimum Fixed Charge Coverage Ratio, and Minimum Consolidated Net Working Capital.
- Any actual or potential non-compliance with the applicable provisions of the Credit Agreement were waived.
- The Company paid the Agent a fee of $110,000 in connection with the Fourth Amendment. We incurred immaterial third party transaction costs which were expensed during the current period.
- The exit fee was increased from $825,000 to $1,200,000.

The exit fee had been included in the total principal due and treated as an unamortized discount on the debt, which was amortized over the term of the loan using the effective interest method at a rate of 17.3% over the remaining term of the loan.

On March 26, 2020, the Credit Agreement was amended (the “Fifth Amendment”) to modify the financial covenants for 2020 through the maturity of the Credit Agreement to establish that the covenants will remain at the December 31, 2020 levels and to update the previously agreed-upon definition of certain financial covenants, specifically the amount of Capital Expenditures to be included in the measurement of the covenants. The Fifth Amendment also provides for the right for the Company to elect to extend the maturity date of the Credit Agreement which is currently scheduled to mature on January 15, 2021. The Fifth Amendment provides for four quarterly maturity date extensions, which would increase the Exit Fee payable under the Credit Agreement by $250,000 for each quarterly maturity date extension elected, for a total of $1 million increase to the Exit Fee were all four of the maturity date extensions to be elected. The Company paid EnCap an amendment fee of $100,000 and out-of-pocket costs and expenses in consideration for the Fifth Amendment.

We incurred interest expense in the amount of $0.7 million and $1.5 million for the three and six months ended June 30, 2020, respectively, under the Credit Agreement.

On November 24, 2020, upon the closing of the IPO, the Company paid a total of $17.4 million to satisfy its obligations under the Credit Agreement in full including an exit fee of $1.2 million, accrued interest of $138,000, and legal fees of $13,000.

On April 19, 2021, the Company entered into multiple Redemption Agreements and Warrant Redemption and Cancellation Agreements (collectively the "Repurchase Agreement") with EnCap and certain related funds that held the warrants to purchase 900,970 shares of the Company's common stock in addition to 39,682 shares of the Company's common stock. Under the Repurchase Agreement, the Company agreed to repurchase the outstanding warrants for $26.9 million and common stock for $1.3 million; The average price of the warrants and common stock repurchased were $29.85 per share and $31.51 per share, respectively. Upon settlement, the repurchased warrants were retired. The Company reduced common stock for the $0.001 par value of the shares repurchased, with the excess purchase price over par value recorded as a reduction of additional paid-in-capital ("APIC"). As a result of the repurchases, the Company recognized these amounts as a reduction to APIC.

Subordinated Debt

On March 31, 2015, the Company entered into Subordinated Loan Agreements and Subordinated Promissory Notes (“Porter Notes”) with affiliated entities of Mr. John R. C. Porter (together referenced as “Porter”). At the time, Mr. Porter and Toxford Corporation, of which Mr. Porter controls as the co-trustee of the trust that is the sole stockholder of Toxford, owned 35.0% of our Class A Common Stock. Under the terms of the Porter Notes, Porter lent the Company $2.5 million on or about March 31, 2015. Telos also entered into Subordination and Intercreditor Agreements with Porter and a prior senior lender, in which the Porter Notes were fully subordinated to the financing provided by that senior lender, and payments under the Porter Notes were permitted only if certain conditions were met. According to the original terms of the Porter Notes, the outstanding principal sum bore interest at the fixed rate of twelve percent (12%) per annum which would be payable in arrears in cash on the 20th day of each May, August, November and February, with the first interest payment date due on August 20, 2015. The Porter Notes did not call for amortization payments and were unsecured. The Porter Notes, in whole or in part, may be repaid at any time without premium or penalty. The unpaid principal, together with interest, was originally due and payable in full on July 1, 2017.

On April 18, 2017, we amended and restated the Porter Notes to reduce the interest rate from twelve percent (12%) to six percent (6%) per annum, to be accrued, and extended the maturity date from July 1, 2017 to July 25, 2022. Telos also entered into Intercreditor Agreements with Porter and EnCap, in which the Porter Notes were fully subordinated to the Credit Agreement and any subsequent senior lenders, and payments under the Porter Notes were permitted only if certain conditions were met. All other terms remained in full force and effect.

We incurred interest expense in the amount of $88,000 and $175,000 for the three and six months ended June 30, 2020, respectively, on the Porter Notes. As of June 30, 2020, approximately $1.2 million of accrued interest was payable according to the stated interest rate of the Porter Notes.

On November 23, 2020, upon the closing of the IPO, the Porter Notes were paid in full.

Note 6. Exchangeable Redeemable Preferred Stock Conversion

Public Preferred Stock

A maximum of 6,000,000 shares of Exchangeable Redeemable Preferred Stock (the "Public Preferred Stock"), par value $.01 per share, has been authorized for issuance. We initially issued 2,858,723 shares of the Public Preferred Stock pursuant to the acquisition of the Company during fiscal year 1990. The Public Preferred Stock was recorded at fair value on the date of original issue, November 21, 1989, and we made periodic accretions under the interest method of the excess of the redemption value over the recorded value. We adjusted our estimate of accrued accretion in the amount of $1.5 million in the second quarter of 2006. The Public Preferred Stock was fully accreted as of December 2008. We declared stock dividends totaling 736,863 shares in 1990 and 1991. Since 1991, no other dividends, in stock or cash, had been declared. In November 1998, we retired 410,000 shares of the Public Preferred Stock.

We paid dividends on the Public Preferred Stock when and if declared by the Board of Directors. The Public Preferred Stock accrued a semi-annual dividend at the annual rate of 12% ($1.20) per share, based on the liquidation preference of $10 per share, and was fully cumulative. Dividends in additional shares of the Public Preferred Stock for 1990 and 1991 were paid at the rate of 6% per share for each $.60 of such dividends not paid in cash. We accrued dividends on the Public Preferred Stock of $1.0 million and $1.9 million for the three and six months ended June 30, 2020, respectively, which was recorded as interest expense. Prior to the effective date of ASC 480 on July 1, 2003, such dividends were charged to stockholders’ accumulated deficit.

Upon the closing of the IPO, which constituted a qualified initial public offering for the purposes of the terms of the Public Preferred Stock, each issued and outstanding share of Public Preferred Stock automatically was converted (the “ERPS Conversion”) into the right to receive (i) an amount of cash equal to (I) the ERPS Liquidation Value; multiplied by (II) 0.90; multiplied by (III) 0.85 and (ii) that number of shares of common stock (valued at the initial offering price to the public) equal to (I) the ERPS Liquidation Value; multiplied by (II) 0.90; multiplied by (III) 0.15. No fractional shares of common stock, however, were issued upon the ERPS Conversion but, in lieu thereof, the holder was entitled to receive an amount of cash equal to the fair market value of a share of common stock (valued at the initial offering price to the public) at the time of the ERPS Conversion multiplied by such fractional amount (rounded to the nearest cent). “ERPS Liquidation Value” means, per each share of Public Preferred Stock, $10 together with all accrued and unpaid dividends (whether or not earned or declared) thereon calculated as of the actual date of the ERPS Conversion without interest, which, was approximately $142.3 million as of November 19, 2020. All shares of common stock issued upon an ERPS Conversion were validly issued, fully paid and non-assessable.

On November 23, 2020, holders of the Public Preferred Stock received $108.9 million in cash and 1.1 million shares of our common stock at $17 per share for a total value of $19.2 million in connection with the ERPS Conversion. The difference in the redemption value of the ERPS and the carrying value has been accounted for as a gain on extinguishment of debt in accordance with ASC 470 and ASC 480. Approximately $0.2 million of costs directly attributable to this redemption were applied against the gain, resulting in a net gain of $14.0 million.

Note 7. Income Taxes

The income tax provision for interim periods is determined using an estimated annual effective tax rate adjusted for discrete items, if any, which are taken into account in the quarterly period in which they occur. We review and update our estimated annual effective tax rate each quarter. For the three months ended June 30, 2021 and 2020, we recorded an income tax provision of $13,000 and $2,000 respectively. For the six months ended June 30, 2021 and 2020, we recorded an income tax provision of $47,000 and income tax benefit of $144,000, respectively. For the three and six months ended June 30, 2021 and 2020, our estimated effective rate was primarily impacted by the overall valuation allowance position which reduced the net tax impact from taxable income or loss for all periods.

We are required to establish a valuation allowance for deferred tax assets if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based on the available evidence, realization of deferred tax assets is dependent upon the generation of future taxable income. There has been no change in the established valuation allowance as of June 30, 2021. As of June 30, 2021 and December 31, 2020, we have recorded a net deferred tax liability of approximately $670,000 and $652,000, respectively.

Under the provisions of ASC 740, we determined that there were approximately $869,000 and $763,000 of gross unrecognized tax benefits as of June 30, 2021 and December 31, 2020, respectively. Included in the balance of unrecognized tax benefits as of June 30, 2021 and December 31, 2020 were $241,000 and $278,000, respectively, of tax benefits that, if recognized, would impact the effective tax rate. Also included in the balance of unrecognized tax benefits as of June 30, 2021 and December 31, 2020 were $628,000 and $485,000, respectively, of tax benefits that, if recognized, would not impact the effective tax rate due to the Company’s valuation allowance. The Company had accrued interest and penalties related to the unrecognized tax benefits of $233,000 and $241,000, which were recorded in other liabilities as of June 30, 2021 and December 31, 2020, respectively. We believe that the total amounts of unrecognized tax benefits will not significantly increase or decrease within the next 12 months.

Note 8. Commitments, Contingencies and Subsequent Events

Financial Condition and Liquidity

Upon the closing of the IPO, we issued 17.2 million shares of our common stock at a price of $17.00 per share, generating net proceeds of approximately $272.8 million. We used approximately $108.9 million of the net proceeds in connection with the ERPS Conversion (see Note 6 – Exchangeable Redeemable Preferred Stock Conversion), $30.0 million to fund our acquisition of the outstanding Class B Units of Telos ID (see Note 2 – Non-controlling Interests / Purchase of Telos ID), and $21.0 million to repay our outstanding senior term loan and subordinated debt (see Note 5 – Current Liabilities and Debt Obligations).

On April 6, 2021, we completed our follow-on offering of 9.1 million shares of our common stock at a price of $33.00 per share, including 7.0 million shares of common stock by certain existing stockholders of Telos. The offering generated approximately $64.3 million of net proceeds to Telos. We did not receive any proceeds from the shares of common stock sold by the selling stockholders. On April 19, 2021, we used approximately $1.3 million of the net proceeds to repurchase 39,682 shares of our common stock and $26.9 million for the warrants to purchase 900,970 shares our common stock owned by affiliated funds of Enlightenment Capital Solutions (see Note 5 - Current Liabilities and Debt Obligations).

We intend to use the remaining net proceeds of the IPO and the follow-on offering for general corporate purposes. We also may use a portion of the net proceeds to acquire complementary businesses, products, services, or technologies. The amounts and timing of our actual use of the net proceeds will vary depending on numerous factors. Proceeds held by us is invested in short-term investments until needed for the uses described above. We currently anticipate that we will retain all available funds for use in the operation and expansion of our business, and we do not anticipate paying any cash dividends on our common stock in the foreseeable future.

Our working capital was $139.7 million and $105.2 million as of June 30, 2021 and December 31, 2020, respectively.

Legal Proceedings

Hamot et al. v. Telos Corporation

As previously reported in Note 8 of the Form 10-Q for the quarter ended March 31, 2021 filed on May 17, 2021, beginning on August 2, 2007, Messrs. Seth W. Hamot ("Hamot") and Andrew R. Siegel ("Siegel"), principals of Costa Brava Partnership III, L.P. ("Costa Brava"), were involved in litigation against the Company as Plaintiffs and Counter-defendants in the Circuit Court for Baltimore City, Maryland (the "Circuit Court"). Mr. Siegel was a Class D Director of the Company until the closing of the IPO on November 23, 2020, and Mr. Hamot was a Class D Director of the Company until his resignation on March 9, 2018. The Plaintiffs initially alleged that certain documents and records had not been provided to them promptly and were necessary to fulfill their duties as directors of the Company. Subsequently, Hamot and Siegel further alleged that the Company had failed to follow certain provisions concerning the noticing of Board committee meetings and the recording of Board meeting minutes and, additionally, that Mr. John Wood's service as both CEO and Chairman of the Board was improper and impermissible under the Company's Bylaws. On April 23, 2008, the Company filed a counterclaim against Hamot and Siegel for money damages and preliminary and injunctive relief based upon Hamot and Siegel's interference with, and improper influence of, the Company's independent auditors regarding, among other things, a specific accounting treatment. On June 27, 2008, the Circuit Court granted the Company's motion for preliminary injunction and enjoined Hamot and Siegel from contacting the Company's auditors until the completion of the Company's Form 10-K for the preceding year, which injunction later expired by its own terms. As previously disclosed, trial on Hamot and Siegel's claims and the Company's counterclaims took place in July through September 2013, and the Court subsequently issued decisions on the various claims by way of memorandum opinions and orders dated September 11, 2017. Among other rulings, the Court found Hamot and Siegel liable for the intentional tort of tortious interference with the Company's contractual relationship with one of its auditors and entered a monetary judgment in favor of the Company and against Hamot and Siegel for approximately $278,000. The Company's subsequent appeal of the amount of damages awarded to it for Hamot and Siegel's intentional interference was ultimately dismissed by way of the Mandate issued by the Court of Appeals of Maryland on October 11, 2019.

Hamot (and later, his Estate) and Siegel on multiple occasions during this litigation sought to be indemnified or to be awarded advancement of various attorney's fees and expenses incurred by them in this litigation. On October 20, 2020, Hamot's Estate and Siegel (together the "Plaintiffs") filed a Motion for Indemnification of Legal Fees and Expenses against the Company in the Circuit Court for Baltimore City and a Request for a Hearing and on January 28, 2021, Plaintiffs amended their motion by the filing of a Motion for Leave to File Amended Motion for Indemnification of Legal Fees and Expenses ("Amended Motion"). The Amended Motion demanded that the Company indemnify the Plaintiffs for legal fees and expenses incurred in the sum of $2,540,000 plus the costs incurred in obtaining indemnification. The Company opposed the motions, and a hearing on the Amended Motion was scheduled for May 18, 2021.

On May 5, 2021, the Company, Plaintiffs and Costa Brava entered into a settlement agreement, which included a mutual general release, fully and finally settling the indemnification claim in exchange for a $1.0 million payment on or before May 19, 2021. The $1.0 million was paid on May 12, 2021. This settlement concludes all open matters or disputes between the Company and Messrs. Hamot (or his estate) and Siegel, as well as the previously disposed of claims of Costa Brava.

Other Litigation

In addition, the Company may be a party to litigation arising in the ordinary course of business. In the opinion of management, while the results of such litigation cannot be predicted with any reasonable degree of certainty, the final outcome of such known matters will not, based upon all available information, have a material adverse effect on the Company's condensed consolidated financial position, results of operations or cash flows.

Subsequent Events

On July 30, 2021, the Company acquired the assets of Diamond Fortress Technologies ("DFT"), including all patents and digital intellectual property for an undisclosed amount of cash consideration. The acquisition adds several new patents to the Company's library of biometric and digital identity intellectual property. Simultaneously with closing, the Company hired seven current DFT employees to maintain and expand the acquired technology. The addition of contactless biometrics technology will enable the Company to better serve the needs of organizations in existing and new markets. We are currently in the process of finalizing the accounting for this transaction and expect it to be complete by the end of the third quarter of 2021.

Note 9. **Related Party Transactions**

Emmett J. Wood, the brother of our Chairman and CEO, has been an employee of the Company since 1996. The amounts paid to this individual as compensation were $83,000 and $301,000 for the three and six months ended June 30, 2021, respectively, and $151,000 and $324,000 for the three and six months ended June 30, 2020, respectively. Additionally, Mr. Wood owned 682,502 shares of the Company's common stock as of June 30, 2021 and December 31, 2020.

On March 31, 2015, the Company entered into the Porter Notes. At that time, Mr. Porter and Toxford Corporation, of which Mr. Porter controls as the co-trustee of the trust that is the sole stockholder of Toxford, owned 35.0% of our Class A Common Stock. Under the terms of the Porter Notes, Porter lent the Company $2.5 million on or about March 31, 2015. According to the original terms of the Porter Notes, the outstanding principal sum bore interest at the fixed rate of twelve percent (12%) per annum which would be payable in arrears in cash on the 20th day of each May, August, November and February, with the first interest payment date due on August 20, 2015. The Porter Notes did not call for amortization payments and were unsecured. The Porter Notes, in whole or in part, may be repaid at any time without premium or penalty. The unpaid principal, together with interest, was originally due and payable in full on July 1, 2017.

On April 18, 2017, we amended and restated the Porter Notes to reduce the interest rate from twelve percent (12%) to six percent (6%) per annum, to be accrued, and extended the maturity date from July 1, 2017 to July 25, 2022. Telos also entered into Intercreditor Agreements with Porter and EnCap, in which the Porter Notes were fully subordinated to the Credit Agreement and any subsequent senior lenders, and payments under the Porter Notes were permitted only if certain conditions were met. All other terms remained in full force and effect. We incurred interest expense in the amount of $88,000 and $175,000 for the three and six months ended June 30, 2020, respectively, on the Porter Notes. As of June 30, 2020, approximately $1.2 million of accrued interest was payable according to the stated interest rate of the Porter Notes.

On November 23, 2020, upon the closing of the IPO, the Porter Notes were paid in full.

On February 8, 2021, we hired Ms. Donna Hill, as Director, Human Resources, reporting directly to Ms. Nakazawa, EVP of the Company. Ms. Hill is the sister of Mr. Edward Williams, COO of the Company.

Note 10. Leases

We account for leases in accordance with ASC Topic 842, “Leases,” which requires lessees to recognize a right-of-use (“ROU”) asset and lease liability on the balance sheet and expands disclosures about leasing arrangements for both lessees and lessors, among other items, for most lease arrangements.

In accordance with the adoption of ASC 842 on January 1, 2019, we recorded operating lease ROU assets, which represent our right to use an underlying asset for the lease term, and operating lease liabilities which represent our obligation to make lease payments. Generally, we enter into operating lease agreements for facilities. Finance lease assets are recorded within property and equipment, net of accumulated depreciation. The amount of operating lease liabilities due within 12 months are recorded in other current liabilities, with the remaining operating lease liabilities recorded as non-current liabilities in our condensed consolidated balance sheets based on their contractual due dates. Finance lease liabilities are classified according to contractual due dates.

The operating lease ROU assets and liabilities are recognized as of the lease commencement date at the present value of the lease payments over the lease term. Most of our leases do not provide an implicit rate that can readily be determined. Therefore, we use a discount rate based on our incremental borrowing rate which was 5.75% for all operating leases. Our operating lease agreements may include options to extend the lease term or terminate it early. We have included options to extend in the operating lease ROU assets and liabilities when we are reasonably certain that we will exercise such options. The weighted average remaining lease terms and discount rates for our operating leases were approximately 2.1 years and 5.75% and for our finance leases were approximately 7.8 years and 5.04% at June 30, 2021. Operating lease expense is recognized as rent expense on a straight-line basis over the lease term. Some of our operating leases contain lease and non-lease components, which we account for as a single component. We evaluate ROU assets for impairment consistent with our property and equipment policy disclosure included in our Annual Report on Form 10-K for the year ended December 31, 2020.

Future minimum lease commitments at June 30, 2021 were as follows (in thousands):

Year Ending December 31,	Operating Leases	Finance Leases
2021 (excluding the six months ended June 30, 2021)	$ 379	$ 1,059
2022	603	2,149
2023	373	2,202
2024	27	2,258
2025	—	2,314
After 2025	—	8,344
Total lease payments	1,382	18,326
Less imputed interest	(84)	(3,336)
Total	1,298	14,990
Short-term portion	656	1,399
Total, net of short-term portion	$ 642	$ 13,591

The components of lease expense were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Operating lease cost	$ 182	$ 182	$ 364	$ 360
Short-term lease cost[(1)]	4	30	8	57
Finance lease cost				
Amortization of right-of-use assets	305	305	610	610
Interest on lease liabilities	192	208	387	419
Total finance lease cost	497	513	997	1,029
Total lease costs	$ 683	$ 725	$ 1,369	$ 1,446

(1) Leases that have terms of 12 months or less

Supplemental cash flow information related to leases was as follows (in thousands):

	Six Months Ended June 30,	
	2021	2020
Cash paid for amounts included in the measurement of lease liabilities:		
Cash flows from operating activities - operating leases	$ 389	$ 375
Cash flows from operating activities - finance leases	387	418
Cash flows from financing activities - finance leases	650	594
Operating lease right-of-use assets obtained in exchange for lease obligations	322	300

Note 11 – Stock-Based Compensation

During October 2020, the Company amended the 2016 LTIP increasing the total number of shares available for issuance to 9,400,000 from 4,500,000 and extended the term to September 30, 2030. Our 2016 LTIP provides for the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, unrestricted stock and dividend equivalent rights to our senior executives, directors, employees, and other service providers. Awards granted under the 2016 LTIP vest over the periods determined by the Board of Directors or the Compensation Committee of the Board of Directors, generally two to three years and stock options granted under the 2016 LTIP expire no more than ten years after the date of grant. Approximately 6.2 million shares of our common stock were reserved for future grants as of June 30, 2021 under the 2016 LTIP.

The following are the stock-based compensation expense incurred for the three and six months ended June 30, 2021 (in thousands). We recorded immaterial share-based compensation expense for the comparative periods ended June 30, 2020.

	Three Months Ended June 30, 2021	Six Months Ended June 30, 2021
Cost of sales - services	$ 795	$ 1,532
Sales and marketing	2,233	3,780
Research and development	648	1,109
General and administrative	17,660	28,585
Total	$ 21,336	$ 35,006

Restricted Stock Awards and Restricted Stock Unit (collectively "RSU") Activity

During the first quarter of 2021, a number of RSUs were granted to our senior executives, directors and employees.

Service-Based RSU Awards

A summary of the awards of Service-Based RSUs that vest upon the completion of a service requirement are presented below:

	Number of Shares	Weighted-Average Grant Date Fair Value (per share)	Weighted-Average Contractual Life (years)	Aggregate Intrinsic Value (in thousands)
Unvested Balance - December 31, 2020	59,521	$ 0.18	2.4	$ 2,000
Granted	2,731,963	36.52	—	—
Vested	(119,800)	36.17	—	—
Forfeited	(74,776)	36.63	—	—
Unvested Balance - June 30, 2021	2,596,908	$ 35.97	1.7	$ 88,300

We recognized an expense of $14.3 million and $22.0 million related to share-based compensation expense for Service-Based RSUs capable of being earned for completing a service requirement during the three and six months ended June 30, 2021, respectively. As of June 30, 2021, there was approximately $75.0 million of unrecognized stock-based compensation expense related to Service-Based RSUs, and this unrecognized expense is expected to be recognized over a weighted-average period of 1.7 years on a straight-line basis.

Performance-Based RSU Awards

A summary of the awards of Performance-Based RSUs that vest upon the attainment of certain price targets of the Company's common stock are presented below:

	Number of Shares	Weighted-Average Grant Date Fair Value (per share)	Weighted-Average Contractual Life (years)	Aggregate Intrinsic Value (in thousands)
Unvested Balance - December 31, 2020	—	$ —	—	$ —
Granted	438,403	30.84	—	—
Vested	—	—	—	—
Forfeited	(16,176)	30.84	—	—
Unvested Balance - June 30, 2021	422,227	$ 30.84	2.6	$ 14,400

On January 28, 2021 the Company granted certain senior executives awards of Performance-Based RSUs that could settle in 438,403 shares of our common stock. The awards will vest only if, during the three-year period from the date of grant, (a) the Company's common stock, as listed on the Nasdaq Global Market, trades at or above $42.40 per share (the "Target Price") for 20 of 30 consecutive trading days or (b) the weighted average of the per share price of the Company's common stock over any 30 consecutive trading days is at least equal to the Target Price.

For these Performance-Based RSUs containing market conditions, the conditions are required to be considered when calculating the grant date fair value. In order to reflect the substantive characteristics of these awards, a Monte Carlo simulation valuation model was used to calculate the grant date fair value of such awards. Monte Carlo approaches are a class of computational algorithms that rely on repeated random sampling to compute their results. This approach allows the calculation of the value of such Performance-Based RSUs based on a large number of possible stock price path scenarios. Our key assumptions include a performance period of 2.92 years, expected volatility of 57.4%, and a risk-free rate of 0.18%. As the Company recently completed its IPO in November 2020, expected volatility was based on the average historical stock price volatility of comparable publicly-traded companies over the performance period. The risk-free rate is based on the U.S. treasury zero-coupon issues in effect at the time of grant over the performance period. Expense for these awards is recognized over the derived service period as determined through the Monte Carlo simulation model. The fair value at grant date and derived service periods calculated for these market condition Performance-Based RSUs were $30.84 and 0.38 years, respectively.

We recognized an expense of $7.0 million and $13.0 million related to share-based compensation expense for these awards of Performance-Based RSUs during the three and six months ended June 30, 2021, respectively. As of June 30, 2021, all of the stock-based compensation expense related to these Performance-Based RSUs was recognized.

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

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects" and similar expressions are intended to identify forward-looking statements. There are a number of important factors that could cause the Company's actual results to differ materially from those indicated by such forward-looking statements. These factors include, without limitation, those set forth in the risk factors section included in the Company's Form 10-K for the year ended December 31, 2020, as filed with the SEC.

General

We offer technologically advanced, software-based security solutions that empower and protect the world's most security-conscious organizations against rapidly evolving, sophisticated and pervasive threats. Our portfolio of security products, services and expertise empower our customers with capabilities to reach new markets, serve their stakeholders more effectively, and successfully defend the nation or their enterprise. We protect our customers' people, information, and digital assets so they can pursue their corporate goals and conduct their global missions with confidence in their security and privacy.

Our mission is to protect our customers' people, systems, and vital information assets with offerings for cybersecurity, cloud security, and enterprise security. In the current global environment, our mission is more critical than ever. The emergence of each new ICT introduces new vulnerabilities, as security is still too often overlooked in solution development. Networks and applications meant to enhance productivity and profitability often jeopardize an organization due to poor planning, misconfiguration, or an unknown gap in security. Ransomware, insider threats, cybercrime, and advanced persistent threats continue to menace public and private enterprises across all industries.

Cybersecurity, cloud security, and enterprise security of the modern organization share much in common, yet also call for a diverse range of skills, capabilities, and experience in order to meet the requirements of security-conscious customers. Decades of experience in developing, orchestrating, and delivering solutions across these three domains gives us the vision and the confidence to provide solutions that empower and protect the enterprise at an integrated, holistic level. Our experience in addressing challenges in one area of an enterprise helps us meet requirements in others. We understand that a range of complementary capabilities may be needed to solve a single challenge, and we also recognize when a single solution might address multiple challenges.

Our security solutions span across the following domains:

- *Cybersecurity* – We help our customers ensure the ongoing security, integrity, and compliance of their on-premises and related cloud-based systems, reducing threats and vulnerabilities to foil cyber adversaries before they can attack. Our consultants assess our customers' security environments and design, engineer, and operate the systems they need to strengthen their cybersecurity posture.

- *Cloud Security* – The cloud as an organizational resource is more than two decades old, yet the needs of cloud users are constantly changing. Telos offers the specialized skills and experience needed to help our customers plan, engineer, and execute secure cloud migration strategies and then assure ongoing management and security in keeping with the leading standards for cloud-based systems and workloads.

- *Enterprise Security* – Securing the enterprise means protecting the essential and timeless elements common to every organization: its people and processes, its supply chain and inventories, its finances and facilities, and its information and communications. As ICT and operational technology ("OT") have become part of the organizational make-up, we have offered solutions that ensure personnel can work securely and productively across and beyond the enterprise.

We refer to our cyber and cloud applications as Security Solutions, which includes Information Assurance / Xacta® (previously referred to as Cyber & Cloud Solutions), Secure Communications (previously referred to as Secure Communications Cyber and Enterprise Solutions), and Telos ID (previously referred to as Telos ID Enterprise Solutions). We refer to our offerings for enterprise security as Secure Networks (previously referred to as Secure Mobility and Network Management/Defense Enterprise Solutions).

Security Solutions

- **Information Assurance / Xacta:** a premier platform for enterprise cyber risk management and security compliance automation, delivering security awareness for systems in the cloud, on-premises, and in hybrid and multi-cloud environments. Xacta delivers automated cyber risk and compliance management solutions to large commercial and government enterprises. Across the U.S. federal government, Xacta is the de facto commercial cyber risk and compliance management solution.

- **Secure Communications:**
  - **Telos Ghost:** a virtual obfuscation network-as-a-service with encryption and managed attribution capabilities to ensure the safety and privacy of people, information, and resources on the network. Telos Ghost seeks to eliminate cyber-attack surfaces by obfuscating and encrypting data, masking user identity and location, and hiding network resources. It provides the additional layers of security and privacy needed for intelligence gathering, cyber threat protection, securing critical infrastructure, and protecting communications and applications when operations, property, and even lives can be jeopardized by a single error in security.

  - **Telos Automated Message Handling System ("AMHS"):** web-based organizational message distribution and management for mission-critical communications; the recognized gold standard for organizational messaging in the U.S. government. Telos AMHS is used by military field operatives for critical communications on the battlefield and is the only web-based solution for assured messaging and directory services using the DISA Organizational Messaging Service and its specialized communications protocols.

- **Telos ID:** offering Identity Trust and Digital Services through IDTrust360® – an enterprise-class digital identity risk platform for extending SaaS and custom digital identity services that mitigate threats through the integration of advanced technologies that fuse biometrics, credentials, and other identity-centric data used to continuously monitor trust. We maintain government certifications and designations that distinguish Telos ID, including TSA PreCheck® enrollment provider, Designated Aviation Channeling provider, FBI-approved Channeler, and FINRA Electronic Fingerprint Submission provider. We are the only commercial entity in our industry designated as a Secure Flight Services provider for terrorist watchlist checks.

Secure Networks

- **Secure Mobility:** solutions for business and government that enable remote work and minimize concern across and beyond the enterprise. Our secure mobility team brings credentials to every engagement, supplying deep expertise and experience as well as highly desirable clearances and industry recognized certifications for network engineering, mobility, and security.

- **Network Management and Defense:** services for operating, administrating, and defending complex enterprise networks and defensive cyber operations. Our diverse portfolio of capabilities addresses common and uncommon requirements in many industries and disciplines, ranging from the military and government agencies to Fortune 500 companies.

Backlog

We develop our annual budgeted revenue by estimating for the upcoming year our continuing business from existing customers and active contracts. We consider backlog, both funded and unfunded (as explained below), other expected annual renewals, and expansion planned by our current customers. In the context of our current customer portfolio, we view "recurring revenue" as revenue that occurs often and repeatedly. In each of the last three years, recurring revenue has exceeded 85% of our annual revenue. Our total budgeted revenue is the combination of recurring revenue and a forecast of new business.

Total backlog, a component of recurring revenue, consists of the aggregate contract revenues remaining to be earned by us at a given time over the life of our contracts, whether funded or unfunded. Funded backlog consists of the aggregate contract revenues remaining to be earned at a given time, which, in the case of U.S. government contracts, means that they have been funded by the procuring agency. Unfunded backlog is the difference between total backlog and funded backlog and includes potential revenues that may be earned if customers exercise delivery orders and/or renewal options to continue these contracts. Based on historical experience, we generally assume option year renewals to be exercised. Most of our customers fund contracts on a basis of one year or less and, as a result, funded backlog is generally expected to be earned within one year from any point in time, whereas unfunded backlog is expected to be earned over a longer period.

Consolidated Results of Operations (Unaudited)

The accompanying condensed consolidated financial statements include the accounts of Telos Corporation and its subsidiaries including Ubiquity.com, Inc., Xacta Corporation, Telos Identity Management Solutions, LLC, Teloworks, Inc., and Telos APAC Pte. Ltd., all of whose issued and outstanding share capital is owned by Telos Corporation (collectively, the "Company" or "Telos" or "We"). All intercompany transactions have been eliminated in consolidation.

We provide different solutions and are party to contracts of varying revenue types under the NETCENTS (Network-Centric Solutions) and NETCENTS-2 contracts to the U.S. Air Force. NETCENTS and NETCENTS-2 are IDIQ and GWAC, therefore any government customer may utilize the NETCENTS and NETCENTS-2 vehicles to meet its purchasing needs. Consequently, revenue earned on the underlying NETCENTS and NETCENTS-2 delivery orders varies from period to period according to the customer and solution mix for the products and services delivered during a particular period, unlike a standalone contract with one separately identified customer. The contracts themselves do not fund any orders and they state that the contracts are for an indefinite delivery and indefinite quantity. The majority of our task/delivery orders have periods of performance of less than 12 months, which contributes to the variances between interim and annual reporting periods. We have also been awarded other IDIQ/GWACs, including the Department of Homeland Security's EAGLE II, GSA Alliant 2, and blanket purchase agreements under our GSA schedule.

We refer to our cyber and cloud applications as Security Solutions, which includes Information Assurance /Xacta® (previously referred to as Cyber & Cloud Solutions), Secure Communications (previously referred to as Secure Communications Cyber and Enterprise Solutions), and Telos ID (previously referred to as Telos ID Enterprise Solutions). We refer to our offerings for enterprise security as Secure Networks (previously referred to as Secure Mobility and Network Management/Defense Enterprise Solutions).

U.S. Government appropriations have been and continue to be affected by larger U.S. Government budgetary issues and related legislation.

According to the Office of Management and Budget, since enactment of the Budget Control Act of 2011 (the "BCA"), which imposed statutory annual spending caps on federal discretionary spending for ten years, federal outlays devoted to all national defense programs (which includes Energy Department and other non-DoD defense programs) fell from 4.6 percent as a share of Gross Domestic Product ("GDP") in FY 2011 to as low as 3.1 percent of GDP in each of FYs 2017-18, before rising slightly the past two years to a level of 3.5 percent in FY 2020. Moreover, OMB reports that total national defense program outlays (in current, non-adjusted dollars) shrank from $705.6 billion in FY 2011 to as low as $589.7 billion in FY 2015, and did not again exceed their FY 2011 level until FY 2020, when outlays were $724.6 billion, approximately 2.7 percent above their level a decade previously. (By comparison, inflation, as measured by the Consumer Price Index, rose by approximately 15 percent over the same period.)

In fiscal years 2020 and 2021, the COVID-19 pandemic and associated economic dislocation in the United States has resulted in an overwhelming federal response, including enactment of multiple massive and comprehensive emergency appropriations and economic stimulus measures. These were in addition to annual appropriations legislation for FY 2021, which was not enacted into law until late December 2020, nearly three months after the beginning of the fiscal year, during which time the government once again operated under a series of Continuing Resolutions which strictly limited new spending initiatives. These enormous emergency spending packages, possibly coupled with new massive infrastructure and other economic recovery and stimulus proposals being actively considered by Congress, and their resulting increases in the budget deficit will necessarily factor into future federal budget planning and spending decisions, affecting to an unknown degree the government contracts that we hold and the federal procurements that we would otherwise compete for.

President Biden's budget request for FY 2022, submitted to Congress in late May, called for $715 billion in base spending for the Department of Defense ("DoD") in FY 2022, which the Office of Management and Budget described as an $11.3 billion (1.6 percent) increase above the FY 2021 enacted level of $703.7 billion. This requested base defense budget for FY 2022 also now includes wartime spending, which in previous fiscal years was provided for in a separate account for Overseas Contingency Operations.

Congressional support for the President's proposed level of defense spending is uncertain, as there are some in Congress who are advocating large cuts to the defense budget, while others are calling for greater increases in military spending. Additionally, Congress must take action shortly to raise or suspend the debt ceiling, and there are some in Congress who have said they want to block such action unless it is coupled with statutory requirements to limit future federal discretionary and/or entitlement spending. With the expiration of the BCA at the end of FY 2021, there are currently no statutory limits in place to guide federal discretionary spending negotiations and decisions, and action on the annual defense authorization and appropriations bills has been significantly delayed this year.

As a result, and assuming Congress is able to reach agreement on such a measure and avoid a government shutdown, FY 2022 is expected to begin on October 1, 2021 with DoD and other federal departments and agencies again funded for an unknown period of time under a Continuing Resolution, which would restrict new spending initiatives.

Despite the pandemic's resultant massive shift to teleworking by federal employees and contractors, the government has successfully maintained continuity of services as has Telos. More recently, as the government has proceeded to develop and implement its reopening process, officials have said they will seek to continue to maximize use of teleworking by federal employees. As such, with much of the business of government still being conducted by federal employees working remotely through use of information technology systems, we believe there will continue to be a need on the part of the government for the types of solutions and services provided by Telos.

Over the past year, continued and increasingly impactful ransomware and other cyberattacks against government entities at the federal, state and local levels, and against private sector organizations in the critical infrastructure and other sectors, have resulted in intensified efforts to better defend against such attacks.

President Biden's May 12 Executive Order on "Improving the Nation's Cybersecurity" acknowledged the severity and scope of the cybersecurity challenges facing the public and private sectors, the American people and our economy. It gave direction for federal departments and agencies to modernize government cybersecurity by: moving more rapidly to adopt secure cloud services; adopt multifactor authentication; push for increased use in government of such practices as zero trust architecture; and improve the security and integrity of the software supply chain, with a priority on addressing critical software. The executive order also called for improving communications with Cloud Service Providers through automation and standardization of messages at each stage of the Federal Risk and Authorization Management Program (FedRAMP) process, and for other changes in an effort to accelerate and improve the process.

Subsequently, federal agencies, including the Cybersecurity & Infrastructure Security Agency (CISA) and the Transportation Security Administration (TSA), which have specific responsibilities for various aspects of government and private sector cybersecurity, have taken steps to enhance public sector and critical infrastructure cybersecurity. Finally, Congress is working on a massive infrastructure package which contains a number of provisions dealing with cybersecurity and would provide considerable funding for infrastructure-related cybersecurity. We believe many of these actions could ultimately result in increased need for solutions and services provided by Telos.

Finally, as a whole the COVID-19 pandemic has resulted in acceleration of digital transformation and cloud adoption within the government and beyond, which will likely increase demand for Telos solutions Xacta and Ghost.

The principal elements of the Company's operating expenses as a percentage of sales for the three and six months ended June 30, 2021 and 2020 are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
	(unaudited)		(unaudited)	
Revenue	100.0 %	100.0%	100.0%	100.0%
Cost of sales	60.9	63.8	67.8	66.0
Selling, general and administrative expenses	74.4	25.8	61.8	27.8
Operating (loss) income	(35.3)	10.4	(29.6)	6.2
Other income (expense)	0.1	—	(0.9)	—
Interest expense	(0.4)	(4.1)	(0.4)	(4.6)
(Loss) income before income taxes	(35.6)	6.3	(30.9)	1.6
Benefit from income taxes	—	—	—	0.2
Net (loss) income	(35.6)	6.3	(30.9)	1.8
Less: Net income attributable to non-controlling interest	—	(5.8)	—	(4.1)
Net (loss) income attributable to Telos Corporation	(35.6)%	0.5 %	(30.9)%	(2.3)%

Three Months Ended June 30, 2021 Compared with Three Months Ended June 30, 2020

Revenue increased by 8.1% to $52.6 million for the second quarter of 2021, from $48.6 million for the same period in 2020. Security Solutions revenue was $31.2 million and $34.2 million for the second quarter of 2021 and 2020, respectively. This decrease of approximately 8.8% was driven primarily by a decrease of $4.6 million in sales of offerings in Telos ID on the contract with the U.S. Census Bureau as the contract ramps down, offset by various increases in Information Assurance and Secure Communications offerings. Secure Networks revenue was $21.4 million and $14.4 million for the second quarter of 2021 and 2020, respectively. This increase of approximately 48.6% resulted from various contracts with the DoD, primarily in our Secure Mobility Solutions offerings. Due to the various solutions offerings within the business groups, sales may vary from period to period according to the solution mix and timing of deliverables for a particular period.

Cost of sales increased by 3.1% to $32.0 million for the second quarter of 2021, from $31.0 million for the same period in 2020 as a result of increases in revenue. Cost of sales for Security Solutions decreased to $15.7 million (inclusive of $0.7 million of stock-based compensation) for the second quarter of 2021 from $19.5 million for the same period in 2020 (which had no stock-based compensation), which translates as a decrease in the cost of sales as a percentage of revenue to 50.3% from 57.0%, due to a change in the mix and nature of the programs. Cost of sales for Secure Networks increased to $16.3 million (inclusive of $0.1 million of stock-based compensation) for the second quarter of 2021 from $11.5 million for the same period in 2020 (which had no stock-based compensation). While the cost of sales increased between periods, the sales mix improved, which translates to a decrease in the cost of sales as a percentage of revenue to 76.2% from 79.9%.

Gross profit increased by 17.0% to $20.6 million for the second quarter of 2021 from $17.6 million for the same period in 2020. Gross profit for Security Solutions increased to $15.5 million for the second quarter of 2021 from $14.7 million for the same period in 2020. Gross profit for Secure Networks increased to $5.1 million for the second quarter of 2021 from $2.9 million for the same period in 2020. Gross margin increased to 39.1% for the second quarter of 2021 from 36.2% for the same period in 2020, due to various changes in the mix of higher profit margin contracts in all business lines as discussed above. Gross margin for Security Solutions increased to 49.7% for the second quarter of 2021 from 43.0% for the same period in 2020. Gross margin for Secure Networks increased to 23.8% for the second quarter of 2021 from 20.1% for the same period in 2020.

Selling, general, and administrative (“SG&A”) expense increased by 212.7% to $39.1 million for the second quarter of 2021, from $12.5 million for the same period in 2020, primarily attributable to increases in stock-based compensation of $20.5 million, labor costs of $4.1 million, outside services of $1.1 million, and trade shows costs of $0.5 million, offset by a decrease in bonus costs of $1.1 million.

Operating loss was $18.6 million for the second quarter of 2021, compared to $5.1 million operating income for the same period in 2020, primarily due to the stock-based compensation expense related to the RSUs granted in the first quarter of 2021.

Interest expense decreased by 90.4% to $0.2 million for the second quarter of 2021, from $2.0 million for the same period in 2020, primarily due to the repayment of the EnCap loan, subordinated debt, and redemption of public preferred stock upon the closing of our IPO in November 2020.

Income tax provision was $13,000 for the second quarter of 2021, compared to $2,000 for the same period in 2020, which is based on the estimated annual effective tax rate applied to the pretax loss incurred for the quarter plus discreet tax items, based on our expectation of pretax loss for the fiscal year.

Net loss attributable to Telos Corporation was $18.7 million for the second quarter of 2021, compared to $0.3 million of net income attributable to Telos Corporation for the same period in 2020, primarily due to the stock-based compensation recorded in the second quarter of 2021 as mentioned above.

Six Months Ended June 30, 2021 Compared with Six Months Ended June 30, 2020

Revenue increased by 23.7% to $108.3 million for the six months ended June 30, 2021, from $87.6 million for the same period in 2020. Security Solutions revenue was $54.0 million and $61.5 million for the six months ended June 30, 2021 and 2020, respectively. This decrease of approximately 12.2% was driven primarily by a decrease of $9.5 million in sales of offerings in Telos ID on the contract with the U.S. Census Bureau as the contract ramps down, offset by various increases in Information Assurance and Secure Communications offerings. Secure Networks revenue was $54.3 million and $26.1 million for the six months ended June 30, 2021 and 2020, respectively. This increase of approximately 108.0% resulted from various contracts with the DoD, primarily in our Secure Mobility Solutions offerings. Due to the various solutions offerings within the business groups, sales may vary from period to period according to the solution mix and timing of deliverables for a particular period.

Cost of sales increased by 27.1% to $73.4 million for the six months ended June 30, 2021, from $57.8 million for the same period in 2020 as a result of increases in revenue. Cost of sales for Security Solutions decreased to $29.3 million (inclusive of $1.3 million of stock-based compensation) for the six months ended June 30, 2021 from $36.8 million for the same period in 2020 (which had no stock-based compensation), which translates as a decrease in the cost of sales as a percentage of revenue to 54.3% from 59.8%, due to a change in the mix and nature of the programs. Cost of sales for Secure Networks increased to $44.1 million (inclusive of $0.2 million of stock-based compensation) for the six months ended June 30, 2021 from $21.0 million for the same period in 2020 (which had no stock-based compensation), which translates as an increase in the cost of sales as a percentage of revenue to 81.2% from 80.5%.

Gross profit increased by 17.1% to $34.9 million for the six months ended June 30, 2021 from $29.8 million for the same period in 2020. Gross profit for Security Solutions was $24.7 million for the six months ended June 30, 2021 and for the same period 2020. Gross profit for Secure Networks increased to $10.2 million for the six months ended June 30, 2021 from $5.1 million for the six months ended June 30, 2020. Gross margin decreased to 32.2% for the second quarter of 2021 from 34.0% for the same period in 2020, due to stock-based compensation and various changes in the mix of contracts in all business lines as discussed above. Gross margin for Security Solutions increased to 45.7% for the second quarter of 2021 from 40.2% for the same period in 2020. Gross margin for Secure Networks decreased to 18.8% for the second quarter of 2021 from 19.5% for the same period in 2020.

SG&A expense increased by 175.1% to $67.0 million for the six months ended June 30, 2021, from $24.3 million for the same period in 2020, primarily attributable to increases in stock-based compensation of $33.5 million, labor costs of $6.3 million, outside services of $2.0 million, insurance costs of $0.7 million, and trade shows costs of $0.7 million, offset by the capitalization of software development costs of $0.5 million and a decrease in bonus costs of $1.5 million.

Operating loss was $32.1 million for the six months ended June 30, 2021, compared to $5.5 million of operating income for the same period in 2020, primarily due to the stock-based compensation recorded as of the second quarter of 2021 as mentioned above.

Other expense of $1.0 million for the six months ended June 30, 2021 was as a result of the settlement of outstanding litigation.

Interest expense decreased by 90.3% to $0.4 million for the six months ended June 30, 2021, from $4.0 million for the same period in 2020, primarily due to the repayment of the EnCap loan, subordinated debt, and redemption of public preferred stock upon the closing of our IPO in November 2020.

Income tax provision was $47,000 for the six months ended June 30, 2021, compared to $144,000 income tax benefit for the same period in 2020, which is based on the estimated annual effective tax rate applied to the pretax loss incurred for the six months period plus discreet tax items, based on our expectation of pretax loss for the fiscal year.

Net loss attributable to Telos Corporation was $33.5 million for the six months ended June 30, 2021, compared to $2.0 million for the same period in 2020, primarily attributable to the stock-based compensation recorded in 2021 as mentioned above.

Balance Sheet Review

Assets

The Company's total assets as of June 30, 2021 were $220.1 million compared to $183.8 million as of December 31, 2020. The increase in total assets was primarily attributable to an increase in cash and cash equivalents provided by the follow-on offering and an increase in accounts receivables due to higher revenue generation during the three months ended June 30, 2021.

Liabilities

The Company's total liabilities as of June 30, 2021 were $55.4 million compared to $56.7 million as of December 31, 2020. The decrease in total liabilities was primarily attributable to payments made under our finance lease obligations.

Equity

As of June 30, 2021, the Company had a total equity of $164.7 million compared to $127.1 million as of December 31, 2020. The increase in equity is primarily driven by the follow-on offering that raised $64.3 million and stock-based compensation of $35.0 million; offset by the repurchase of the common stock and outstanding warrants held by the EnCap fund holders for $1.3 million and $26.9 million, respectively. The Company reported a net loss of $33.5 million for the six months ended June 30, 2021.

Non-GAAP Financial Measures

In addition to our results determined in accordance with GAAP, we believe the non-GAAP financial measures of Enterprise EBITDA, Adjusted EBITDA, Adjusted Net Income (Loss) and Adjusted EPS are useful in evaluating our operating performance. We believe that this non-GAAP financial information, when taken collectively with our GAAP results, may be helpful to readers of our financial statements because it provides consistency and comparability with past financial performance and assists in comparisons with other companies, some of which use similar non-GAAP financial information to supplement their GAAP results. The non-GAAP financial information is presented for supplemental informational purposes only, should not be considered a substitute for financial information presented in accordance with GAAP, and may be different from similarly-titled non-GAAP measures used by other companies. A reconciliation is provided below for each of these non-GAAP financial measures to the most directly comparable financial measure stated in accordance with GAAP.

We use the following non-GAAP financial measures to understand and evaluate our core operating performance and trends, to prepare and approve our annual budget, to develop short-term and long-term operating plans, and to evaluate the performance of certain management personnel when determining incentive compensation. We believe these non-GAAP financial measures facilitate comparison of our operating performance on a consistent basis between periods by excluding certain items that may, or could, have a disproportionate positive or negative impact on our results of operations in any particular period. When viewed in combination with our results prepared in accordance with GAAP, these non-GAAP financial measures help provide a broader picture of factors and trends affecting our results of operations.

Enterprise EBITDA and Adjusted EBITDA

Both Enterprise EBITDA and Adjusted EBITDA are supplemental measures of operating performance that are not made under GAAP and that does not represent, and should not be considered as, an alternative to net (loss) income as determined by GAAP. We define Enterprise EBITDA as net (loss) income attributable to Telos Corporation, adjusted for net income attributable to non-controlling interest, non-operating expense (income), interest expense, provision for (benefit from) income taxes, and depreciation and amortization. We define Adjusted EBITDA as Enterprise EBITDA, adjusted for transaction gains/losses/expenses related to our IPO and stock-based compensation expense.

A reconciliation of Enterprise EBITDA and Adjusted EBITDA to net (loss) income attributable to Telos Corporation, the most directly comparable GAAP measure, is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Net (loss) income attributable to Telos Corporation	$ (18,729)	$ 266	$ (33,507)	$ (1,978)
Adjustments:				
Net income attributable to non-controlling interest	—	2,806	—	3,590
Non-operating (income) expense	(32)	(4)	1,022	(12)
Interest expense	192	1,996	388	4,013
Provision for (benefit from) income taxes	13	2	47	(144)
Depreciation and amortization	1,404	1,345	2,764	2,734
Enterprise EBITDA	(17,152)	6,411	(29,286)	8,203
Stock-based compensation expense	21,336	—	35,006	—
Adjusted EBITDA	$ 4,184	$ 6,411	$ 5,720	$ 8,203

Adjusted Net Income (Loss) and Adjusted EPS

The adjusted measures of Net Income (Loss) and Adjusted EPS, (defined as “Adjusted Net Income (Loss)” and “Adjusted EPS”, respectively) are supplemental measures of operating performance that are not made under GAAP and that does not represent, and should not be considered as, alternatives to net income (loss) as determined by GAAP. We define Adjusted Net Income (Loss) as net income (loss) attributable to Telos Corporation, adjusted for non-operating expense (income) and stock-based compensation expense. We define Adjusted EPS as Adjusted Net Income (Loss) divided by the weighted-average number of common shares outstanding for the period.

A reconciliation of Adjusted Net Loss and Adjusted EPS to net (loss) income attributable to Telos Corporation, the most directly comparable GAAP measure, is as follows:

Three Months Ended June 30,	**2021**		**2020**	
	Adjusted Net Income (Loss)	**Adjusted Earnings Per Share**	**Adjusted Net Income (Loss)**	**Adjusted Earnings Per Share**
	(in thousands)		(in thousands)	
Reported GAAP measure	$ (18,729)	$ (0.28)	$ 266	$ 0.01
Adjustments:				
Non-operating income	(32)	—	(4)	$ —
Stock-based compensation expense	21,336	0.32	—	$ —
Adjusted non-GAAP measure	$ 2,575	$ 0.04	$ 262	$ 0.01
Weighted-average shares of common stock outstanding	66,616		38,583	

Six Months Ended June 30,	**2021**		**2020**	
	Adjusted Net Income (Loss)	**Adjusted Earnings Per Share**	**Adjusted Net Income (Loss)**	**Adjusted Earnings Per Share**
	(in thousands)		(in thousands)	
Reported GAAP measure	$ (33,507)	$ (0.51)	$ (1,978)	$ (0.05)
Adjustments:				
Non-operating expense (income)	1,022	0.02	(12)	$ —
Stock-based compensation expense	35,006	0.53	—	$ —
Adjusted non-GAAP measure	$ 2,521	$ 0.04	$ (1,990)	$ (0.05)
Weighted-average shares of common stock outstanding	65,621		38,328	

Each of Enterprise EBITDA, Adjusted EBITDA, Adjusted Net Income (Loss) and Adjusted EPS has limitations as an analytical tool, and you should not consider any of them in isolation, or as a substitute for analysis of our results as reported under GAAP. Among other limitations, each of Enterprise EBITDA, Adjusted EBITDA, Adjusted Net Income (Loss) and Adjusted EPS does not reflect our cash expenditures, or future requirements, for capital expenditures or contractual commitments, does not reflect the impact of certain cash charges resulting from matters we consider not to be indicative of our ongoing operations, and does not reflect income tax expense or benefit. Other companies in our industry may calculate Adjusted EBITDA, Adjusted Net Income (Loss) and Adjusted EPS differently than we do, which limits its usefulness as a comparative measure. Because of these limitations, neither Enterprise EBITDA, Adjusted EBITDA, Adjusted Net Income (Loss) nor Adjusted EPS should be considered as a replacement for net income (loss) or earnings per share, as determined by GAAP, or as a measure of our profitability. We compensate for these limitations by relying primarily on our GAAP results and using non-GAAP measures only for supplemental purposes.

Liquidity and Capital Resources

Upon the closing of our IPO, we issued 17.2 million shares of our common stock at a price of $17.00 per share, generating net proceeds of approximately $272.8 million. We used approximately $108.9 million of the net proceeds in connection with the ERPS Conversion (see Note 6 – Exchangeable Redeemable Preferred Stock Conversion), $30.0 million to fund our acquisition of the outstanding Class B Units of Telos ID (see Note 2 – Non-controlling Interest / Purchase of Telos ID), $21.0 million to repay our outstanding senior term loan and subordinated debt (see Note 5 – Current Liabilities and Debt Obligations).

On April 6, 2021, we completed our follow-on offering of 9.1 million shares of our common stock at a price of $33.00 per share, including 7.0 million shares of common stock by certain existing stockholders of Telos. The offering generated approximately $64.3 million of net proceeds to Telos. We did not receive any proceeds from the shares of common stock sold by the selling stockholders. On April 19, 2021, we used approximately $1.3 million of the net proceeds to repurchase 39,682 shares of our common stock and $26.9 million to repurchase 900,970 outstanding warrants for our common stock held by EnCap fund holders (see Note 5 - Current Liabilities and Debt Obligations).

We intend to use the remaining net proceeds from the IPO and the follow-on offering for general corporate purposes. We also may use a portion of the net proceeds to acquire complementary businesses, products, services, or technologies. The amounts and timing of our actual use of the net proceeds will vary depending on numerous factors. Proceeds held by us are invested in short-term investments until needed for the uses described above. We currently anticipate that we will retain all available funds for use in the operation and expansion of our business, and we do not anticipate paying any cash dividends on our common stock in the foreseeable future.

Our working capital was $139.7 million and $105.2 million as of June 30, 2021 and December 31, 2020, respectively. Although no assurances can be given, we expect that funds generated from operations are sufficient to maintain the liquidity we require to meet our operating, investing and financing needs for the next 12 months.

Cash used in operating activities was $5.8 million for the six months ended June 30, 2021, compared to cash provided by operating activities of $0.8 million for the same period in 2020. Cash provided by or used in operating activities is primarily driven by the Company’s operating income, the timing of receipt of customer payments, the timing of its payments to vendors and employees, and the timing of inventory turnover, adjusted for certain non-cash items that do not impact cash flows from operating activities.

Cash used in investing activities was approximately $4.7 million and $3.5 million for the six months ended June 30, 2021 and 2020, respectively, primarily due to software development costs of $3.7 million and $3.2 million for the six months ended June 30, 2021 and 2020, respectively.

Cash provided by financing activities was $35.5 million for the six months ended June 30, 2021 compared to cash used in financing activities of $1.7 million for the same period in 2020, primarily attributable to the proceeds from the follow-on offering that generated $64.3 million of net proceeds, reduced by $26.9 million used to repurchase the outstanding warrants and $1.3 million to repurchase the common stock held by EnCap fund holders.

Recent Accounting Pronouncements

See Note 1 of the Condensed Consolidated Financial Statements for a discussion of recently issued accounting pronouncements.

Critical Accounting Policies

During the three months ended June 30, 2021, there were no material changes to our critical accounting policies as reported in our Annual Report on Form 10-K for the year ended December 31, 2020 as filed with the SEC on March 25, 2021.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

None.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

An evaluation of the effectiveness of our disclosure controls and procedures as of June 30, 2021 was performed under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in its reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and that information required to be disclosed by the Company in the reports the Company files or submits under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during the quarter ended June 30, 2021 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

Information regarding legal proceedings may be found in Note 8 – Commitments, Contingencies and Subsequent Events to the condensed consolidated financial statements.

Item 1A. Risk Factors

There were no material changes in the period ended June 30, 2021 in our risk factors as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2020.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Unregistered Sales of Securities

None.

(b) Use of Proceeds

None.

(c) Issuer Purchases of Equity Securities

The following table summarizes the Company's common share repurchases during the three months ended June 30, 2021:

	Total number of shares purchased	Average price paid per share
April 19, 2021[(1)]	39,682	$ 31.51
Total	39,682	$ 31.51

(1) On April 19, 2021, the Company repurchased 39,682 shares of common stock for an aggregate purchase price of $1.3 million from EnCap in a privately negotiated transaction.

Item 3. Defaults upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Description of Exhibit
10.1*+	Executive Employment Agreement between Mark Bendza and the Company, dated as of July 19, 2021 (Incorporated by reference to Exhibit 10.1 filed with the Company's Current Report on Form 8-K on July 19, 2021)
31.1+	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2+	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32+	Certification pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS**	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document
101.SCH**	XBRL Taxonomy Extension Schema
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase
101.DEF**	XBRL Taxonomy Extension Definition Linkbase
101.LAB**	XBRL Taxonomy Extension Label Linkbase
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase
104**	Cover Page Interactive Data File - the cover page XBRL tags are embedded within the Inline XBRL document contained in Exhibit 101

* constitutes a management contract or compensatory plan or arrangement
+ filed herewith
** in accordance with Regulation S-T, the XBRL-related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall be deemed to be "furnished" and not "filed"

SIGNATURES

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

Date: August 16, 2021

TELOS CORPORATION

/s/ John B. Wood

John B. Wood
Chief Executive Officer (Principal Executive Officer)

/s/ Mark Bendza

Mark Bendza
Chief Financial Officer (Principal Financial and Accounting Officer)

EMPLOYMENT AGREEMENT

THIS **EMPLOYMENT AGREEMENT** (“Agreement”) is made and entered into as of this 19th day of July, 2021 by and between Telos Corporation, a Maryland corporation, for itself and its subsidiary companies, divisions, affiliates and operating entities (the “Company”) and **Mark Bendza** (the “Executive”).

WHEREAS, the Company and the Executive desire to enter into this Agreement pertaining to the employment of the Executive by the Company.

NOW, THEREFORE, in consideration of the mutual covenants and agreements set forth below and other good and valuable consideration, the receipt of which is hereby acknowledged, the Executive and the Company hereby agree as follows:

1. Performance of Services. The Executive’s employment with the Company shall be subject to the following:

(a) Subject to the terms of this Agreement, the Company hereby agrees to employ the Executive as its Chief Financial Officer, during the Agreement Term (as defined below).

(b) During the Agreement Term, the Executive shall devote full time (paid time off and other authorized leave excepted) and best efforts, energies and talents to serving the Company as an employee.

(c) The Executive agrees to perform his duties faithfully, efficiently and with integrity subject to the direction of the Company. The Executive will have such authority, power, responsibilities and duties as are inherent in such position and necessary to carry out such responsibilities and the duties required hereunder, as well as any additional duties and authority granted to him by the Company’s Chief Executive Officer and/or Board of Directors (the “Board of Directors”).

(d) Notwithstanding the foregoing, during the Agreement Term, the Executive may devote reasonable time to activities other than those required under this Agreement, including activities involving professional, charitable, educational, religious and similar types of organizations, speaking engagements, membership on the boards of directors of other profit or not-for-profit organizations, and similar activities, to the extent that such other activities do not, in the judgment of the Company, inhibit or prohibit the performance of the Executive’s duties under this Agreement or conflict in any material way with the Company’s business.

(e) The Executive shall not be required to perform services under this Agreement during any period in which Executive is determined to be Disabled (as defined below).

(f) The “Agreement Term” shall be the period beginning on July 19, 2021 for a one year period, and thereafter automatically renewing for consecutive one year periods unless terminated in accordance with the provisions hereof.

2. Compensation and Benefits. While the Executive is employed by the Company pursuant to this Agreement, the Company shall compensate him for his services as follows:

(a) Base Salary. The Executive shall receive an annual base salary of Four Hundred Ten Thousand Dollars ($410,000), effective as of the commencement of employment (the "Salary"), plus any salary increases authorized during the Agreement Term, if any, payable in accordance with the Company's payroll cycle.

(b) Annual Bonus. The Executive shall have the opportunity to participate in the Company's annual incentive (or bonus) plan or plans, under the terms and conditions as defined by the Company and in those plans as they may exist from time to time. Any bonus for the Executive shall be subject to the then-existing requirements of the Company governing internal recommendation and approval of such a bonus. Any such annual bonus shall be paid to the Executive as soon as practicable following achievement of the requirements for the bonus, in accordance with the terms of the annual incentive plan or plans.

(c) Equity Awards. The Executive shall be eligible to receive equity awards under the Company's long-term equity incentive plans under the terms and conditions as defined by the Company and in those plans as they may exist from time to time, and in an amount determined by the Management Development and Compensation Committee, subject to any approval required by the Board of Directors.

(d) Expense Reimbursement. While the Agreement is in effect, the Company will reimburse the Executive for all reasonable and necessary expenses incurred by the Executive in connection with the performance of his duties for the Company. Such reimbursement is subject to the submission to the Company by the Executive of appropriate documentation and/or vouchers, and will be made in accordance with the customary procedures of the Company for expense reimbursement, as may from time to time be established.

(e) Other Benefits. The Executive shall be eligible to participate in any and all plans maintained by the Company to provide benefits for its salaried senior executives, and, including, without limitation, any vacation plan, pension, profit sharing or other retirement plan, any life, accident, disability, medical, hospital or similar group insurance program and any other benefit plan, subject to the normal terms and conditions of such plans.

(f) Clawback. All payments made to the Executive pursuant to this Agreement are subject to clawback by the Company to the extent required by applicable law or the policies of the Company as in effect from time to time.

3. Termination. The Executive's employment with the Company pursuant to this Agreement may terminate under the following circumstances (hereinafter referred to as a "Termination").

(a) Death. The Executive's employment hereunder shall terminate upon his death (referred to hereafter as "Death").

(b) Disability. If the Executive becomes Disabled, the Company may terminate Executive's employment. For purposes of this Agreement, the Executive shall be deemed to be "Disabled" if (i) eligible for disability benefits under the Company's long-term disability plan, or (ii) has a physical or mental disability which renders Executive incapable, after reasonable accommodation, of performing substantially all of Executive's duties hereunder for a period of 180 days (which need not be consecutive) in any 12-month period. In the event of a dispute as to whether the Executive is Disabled, the Company may, at its expense, refer Executive to a licensed practicing physician of the Company's choice and the Executive agrees to submit to such tests and examination as such physician shall deem customary and appropriate.

(c) Cause. The Company may terminate the Executive's employment hereunder immediately and at any time for Cause by written notice to the Executive detailing the basis for the Cause Termination. For purposes of this Agreement, "Cause" means (i) gross negligence or willful and continued failure by the Executive to substantially perform his duties as an employee of the Company (other than any such failure resulting from incapacity due to physical or mental illness); (ii) Executive's dishonesty, fraudulent misrepresentation, willful misconduct, malfeasance, violation of fiduciary duty relating to the business of the Company; or (iii) conviction of a felony.

(d) Without Cause. The Company may terminate the Executive's employment hereunder immediately and at any time without Cause (referred to hereafter as "Without Cause") by written notice to the Executive.

(e) Termination by Executive. The Executive may terminate his employment hereunder at any time for any reason by giving the Company prior written notice not less than thirty (30) days prior to such Termination.

(f) Mutual Agreement. This Agreement may be terminated at any time by mutual written agreement of the parties.

(g) Termination within Twelve (12) Months of Change in Control. Termination because of a Change in Control (as defined in paragraph 4(d) below) occurs when the Executive's employment is terminated by the Company or its successor Without Cause within twelve (12) months after a Change in Control.

(h) Date of Termination. "Date of Termination" means the last day that the Executive is employed by the Company under the terms of this Agreement, provided that Executive's employment is terminated in accordance with one of the foregoing provisions.

4. Rights Upon Termination. The Executive's right to payments and benefits under this Agreement for periods after Termination shall be determined in accordance with the following:

(a) If the Executive's Termination occurs for Cause, if the Executive terminates the Agreement in accordance with paragraph 3(e) above, if the Executive's Termination occurs by mutual agreement, or if the Executive's Termination by the Company Without Cause (as defined below) occurs on or before the date that is six (6) months from the date of the beginning of the Agreement Term as referenced in paragraph 1(f), the Company shall pay to the Executive:

(i) A lump-sum payment equivalent to the remaining unpaid portion of the Executive's Salary for the period ending on the Date of Termination.

(ii) A lump-sum payment for all accrued and unused vacation days.

(iii) Any other payments or benefits to be provided to the Executive by the Company pursuant to any employee benefit plans or arrangements adopted by the Company, to the extent such payments and benefits are earned and vested as of the Date of Termination, or are required by law to be offered for periods following the Executive's Date of Termination. In addition, any bonus which has been earned by Executive and approved by the appropriate corporate authorities but which remains unpaid as of the date of Executive's Termination, shall be paid to Executive at such time and in such manner as if Executive had continued to be employed by the Company.

(b) If, subsequent to the date that is six (6) months from the date of the beginning of the Agreement Term as referenced in paragraph 1(f), the Company terminates the Executive's employment Without Cause as referenced in paragraph 3(d) above, or Termination occurs due to Disability in accordance with paragraph 3(b) above, the Company shall pay or provide to the Executive the following: The amounts payable under paragraph 4(a), and in addition, the Executive shall be entitled to monthly payments over a 12-month period of an amount equal to the monthly salary which the Executive was being paid as of the Date of Termination. Such payments will commence as of the month following the date that the Executive incurs a separation from service, as such term is defined in the context of Section 409A of the Code (as defined below). Such payments will continue over the 12-month period in accordance with the Company's normal payroll cycle. In the event that the Executive dies prior to the completion of the 12-month payment cycle, any amounts remaining unpaid as of the date of Executive's death will be paid to Executive's estate in lump sum.

(c) If, subsequent to the date that is six (6) months from the date of the beginning of the Agreement Term as referenced in paragraph 1(f), the Executive's employment is terminated due to Death in accordance with paragraph 3(a), the Executive's estate shall be entitled to the amounts payable under paragraph 4(a), and in addition, the Executive's estate shall be entitled to a lump-sum payment of an amount equal to the amount of monthly salary which the Executive was being paid as of the Date of Termination times 12 months.

(d) Upon Termination of the Executive's employment within 12 months after a Change in Control in accordance with paragraph 3(g) (regardless of whether six (6) months has elapsed since the beginning of the Agreement Term as referenced in paragraph 1(f)), Executive shall be entitled to the amounts payable under paragraph 4(a), and in addition, the Executive shall be entitled to a lump-sum payment of amounts equal to the following: (i) the amount of monthly salary which the Executive was being paid as of the Date of Termination times 12 months; plus (ii) one (1) times the Average Bonus Amount (as defined below). For purposes of this Agreement, "Average Bonus Amount" shall equal (x) if, at the time of the Date of Termination, the Executive has been employed by the Company for two calendar years or more, the average amount of the bonus to be earned for the then-current year (i.e., the year in which the Change in Control occurs) and the bonuses received for the two immediately prior years; (y) if, at the time of the Date of Termination, the Executive has been employed by the Company for more than one calendar year but less than two calendar years, the average amount of the bonus to be earned for the then-current year and the bonus received for the prior year; and (z) if, at the time of the Date of Termination, the Executive has been employed by the Company for less than one calendar year, the amount of the bonus to be earned for the then-current year. For purposes of calculating the Average Bonus Amount, the amount of the bonus for the then-current year shall equal the amount earned or scheduled to be earned by the Executive as if the bonus targets set in the bonus plan have been met. The Average Bonus Amount, which is payable in lump sum, shall be paid contemporaneously with the Date of Termination. "Change in Control" means an occasion upon which (i) any one person, or more than one person acting as a group (as defined in Treasury Regulation Section 1.409A-3(i)(5)(v)(B)), other than a member of the Board of Directors or fiduciary holding securities under an employee benefit plan of the Company or a corporation controlled by the Company, acquires (either directly and/or through becoming the "beneficial owner" (as defined in Rule 13d-3 under the Securities Exchange Act)), directly or indirectly, securities of the Company representing 50% or more of the combined voting power of the Company's then outstanding securities (or has acquired securities representing 50% or more of the combined voting power of the Company's then outstanding securities during the 12-month period ending on the date of the most recent acquisition of Company securities by such person); or (ii) during any period of twelve (12) consecutive months , a majority of the members of the Board of Directors is replaced by directors whose appointment or election is not endorsed by a majority of the members of the Board of Directors before the date of the appointment or election; or (iii) any one person, or more than one person acting as a group (as defined in Treasury Regulation Section 1.409A-3(i)(5)(v)(B)) acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) all, or substantially all, of the Company's assets. Each Change in Control event described in this paragraph is intended to constitute a change in ownership or effective control of the Company or in the ownership of a substantial portion of the Company's assets within the meaning of Section 409A(a)(2)(A)(v) of the Internal Revenue Code of 1986, as amended ("Code"), and the IRS guidance issued thereunder and this Agreement shall be interpreted accordingly. For the sake of clarity, and notwithstanding anything to the contrary set forth in this Agreement, the Executive shall not be entitled to any payments under paragraphs 4(b) or 4(c) upon Termination if the Executive receives the payments under this paragraph 4(d) upon a Change in Control.

(e) In the event that the Executive’s employment is terminated for any reason discussed in paragraphs 4(b), 4(c) or 4(d), in addition to the amounts payable under paragraphs 4(b), 4(c) or 4(d) as applicable, the Executive or the Executive’s estate shall be entitled to the following:

(i) Executive’s equity and equity-based awards will continue to be subject to the terms of the applicable grant notice and award agreement, which may provide for immediate vesting of the unvested portion of the award under certain circumstances. In addition, if the Company terminates the Executive’s employment due to Death as referenced in paragraph 3(a) above, Disability as referenced in paragraph 3(b) above, or Without Cause as referenced in paragraph 3(d) above subsequent to the date that is six (6) months after the beginning of the Agreement Term as referenced in paragraph 1(f), all equity and equity-based awards, including but not limited to, Restricted Shares and/or Restricted Share Units, that have not yet vested shall vest immediately on the Date of Termination.

(ii) Cash payments equal to twelve (12) months of premium payments for medical and dental coverage. The amount of the monthly payments shall be equal to the amount of the “applicable premium” as determined pursuant to the terms of the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended (“COBRA”) (without regard to whether or not the Executive elects COBRA continuation coverage) based on the Executive’s choices under the Company’s plan as of the Date of Termination and further based upon the current premiums as of the Date of Termination, less the amount that the Executive was contributing for coverage. The Company benefits package in which the Executive participated will cease as of the Date of Termination.

(iii) Cash payments equal to twelve (12) months of benefit premiums based upon the premium rate at the Date of Termination under the terms of the Company’s Group Life Policy which allows the option to convert to an individual policy for basic life and accidental death and dismemberment (AD&D) coverage. However, the cash payments shall be no more than the amount of the premiums that the Company was paying as if the Executive was still employed. This paragraph shall not apply if the Executive’s employment is terminated per paragraph 4(c).

(iv) Cash payments equal to the employer matching contribution, as if the Executive was still a plan participant that would otherwise have been contributed on Executive's behalf to the Code Section 401(k) program maintained by the Company with respect to the 12-month period commencing on the Date of Termination under the following assumptions:

(a) Executive would have made a voluntary salary reduction contribution to the Code Section 401(k) program with respect to the 12-month period based upon the salary reduction election in effect on behalf of the Executive as of the Date of Termination.

(b) No additional "constructive matching" payments will be made under this provision with respect to a calendar year once the combination of the actual matching contributions made on behalf of Executive to the Code Section 401(k) program for such calendar year plus the "constructive matching" payments made to Executive pursuant to this provision for such calendar equal the maximum amount of matching contributions that could have been allocated to Executive's account under the terms of the Code Section 401(k) program with respect to such calendar year.

(c) Except as otherwise contemplated by paragraph 4(e)(vi) below, the "constructive matching" payments will be made at such times as the Company remits the actual matching contributions to the Code Section 401(k) program.

(v) If the Executive’s employment is terminated per paragraph 4(b), all payments under paragraph this 4(e) shall be made on a periodic basis on the same schedule as such benefits otherwise would have been payable as if the Executive was still employed at the Company. If the Executive’s employment is terminated per paragraph 4(c) or paragraph 4(d), all payments under this paragraph 4(e) shall be paid in a lump-sum payment at the same time the lump sum payment is paid in accordance with paragraph 4(c) or paragraph 4(d).

(vi) If the Executive was receiving other benefits as of the Date of Termination that are not listed above, and to the extent such payments or benefits are earned and vested or are required by law to be offered to the Executive for the 12-month period following the Date of Termination, then the cash equivalent or arrangements for continuing coverage will be determined at that time. However, the cash payments shall be no more than the amount that the Company was paying as if the Executive was still employed.

(vii) If any of the benefits listed above are no longer available to the Executive as of the Date of Termination, then there will be no such payments made to continue the benefits after the Date of Termination or its cash equivalent. The undertakings of the Company in connection with paragraphs b(i), b(ii) and b(iii), above, are contingent upon Executive's compliance with the non-compete, confidentiality, and non-solicitation provisions of paragraphs 5, 6 and 7. Should the Company determine that the Executive has committed an infraction of any component of paragraph 5, paragraph 6 or paragraph 7, the Company shall notify the Executive of its determination and provide the Executive with 10 business days to cure the infraction or present convincing evidence that no infraction has occurred. Should the infraction not be subject to cure, or should Executive otherwise fail to cure such infraction within 5 business days of such notice, then the Company may discontinue the payment referenced in paragraph b(i) and the continuation of benefits referenced in paragraph b(iii) and any otherwise unexercised stock option will be forfeited.

(f) To the extent required by Section 409A of the Code, if the Executive separates from service with the Company for any reason other than death and the Executive constitutes a "specified employee" as defined in Section 409A(2)(B)(i) of the Code at the time of separation from service, then payment to the Executive of any amounts pursuant to paragraph b(i) and payment of any cash amounts pursuant to paragraph b(iii) shall not commence until a date that is six months following the date of the Executive's separation from service with the Company. Upon the date which is six months following the date of Executive's separation from service, all previously accrued monthly amounts shall be payable in a lump sum and future amounts will continue to be paid pursuant to the remaining term of the 12-month payment cycle. The above-referenced six month delay in payment shall only apply to the extent required by Section 409A of the Code, such that such delay shall not apply to payments made in connection with an involuntary termination of employment provided such payments fall within the dollar threshold described in Treas. Reg. § 1.409A-1(b)(9)(iii).

(g) If the Executive becomes entitled to any amount in the nature of compensation payable by the Company (including benefits under this Agreement) that is contingent on a change in ownership, effective control, or substantial ownership of a substantial portion of the Company's assets within the meaning of Section 280G of the Code, and that is subject to the excise tax imposed by Section 4999 of the Code, then the Company shall reduce the compensation payable to the minimum amount necessary to avoid the excise tax, except as follows. No reduction applies if after accounting for the excise tax and all other income and employment taxes due on the compensation payable by the Company, the net amount that the Executive would retain would be greater than the amount the Executive would receive after reduction under this paragraph 4(g). Any reduction applies in the following order: first, cash payments; second, equity awards; and third, noncash benefits, in each case, in reverse chronological order. The extent to which any reduction is necessary is determined by the Company's independent accountants.

5. Non-Competition. During the Agreement Term and for a period of 12 months subsequent to the Date of Termination, the Executive shall not, without the prior written consent of the Company, directly or indirectly, (i) own or acquire in any manner any interest (other than the ownership solely for investment purposes of not more than five percent of the shares of any corporation, the shares of which are publicly and regularly traded on a national securities exchange or in the over-the-counter market) in any person, firm, partnership, company, association or other entity that competes with the Company in the business of enterprise security solutions and services to customers in the United States government and industry (the “Business”), (ii) be employed by, or serve as an employee, agent, officer, director of, any person, firm, partnership, corporation or provider of services competitive with the Business of the Company, or (iii) provide financial, technical, marketing or other assistance or act as a representative, broker, director, officer, employee, advisor, consultant or agent of any person or entity that is competitive with the Business of the Company.

6. Confidentiality. The Executive promises that he will receive, develop and hold Confidential Information (as defined below) in strict confidence and will not use or disclose Confidential Information, or make copies of any documents containing Confidential Information, except in furtherance of the Business of the Company, unless the Chief Executive Officer provides prior written consent. The Executive further agrees to use reasonable efforts to safeguard the Confidential Information and protect it from disclosure, misuse, loss or theft. The foregoing promises of confidentiality shall not apply if and to the extent that the Executive is ordered by a court or other governmental agency to disclose Confidential Information, provided the Executive has given the Company prompt written notice of the order or subpoena and provides all reasonable cooperation necessary to limit such disclosure and to protect the confidentiality of any Confidential Information so disclosed. “Confidential Information” means all nonpublic information (whether or not specifically labeled or identified as confidential), that has been or is disclosed to, developed or learned by the Executive as a result of employment with the Company and that relates to the business, finances, products, services, customers, research or development of the Company or third parties with whom the Company does business or from whom the Company receives information. The definition of Confidential Information includes, but is not limited to, the following: access codes, security devices and naming conventions used in software and hardware systems; databases of information; other proprietary software; proprietary specifications for hardware and software platforms, the identity and transactions with customers, clients and suppliers; marketing product and service plans, objectives and strategies; tactical objectives, approaches, and competitive advantages; internal financial information; specialized marketing programs related to products and services offered or under development by the Company (or any parent or affiliate of the Company); data and reports related to marketing programs; proprietary systems and operations manuals; proprietary training manuals; proprietary technical and scientific know-how, data and strategies; the Company’s information gathering processes and compilations of information; and information disclosed to the Company by its business partners, licensees, customers and clients in reliance on promises that its confidentiality will be preserved.

7. Non-Solicitation.

(a) The Executive recognizes that the Company incurs significant expense in training employees to provide services in accordance with the Company's Business and that the Company will disclose Confidential Information to each such employee. The Executive promises that, during the Agreement Term and for a period of 12 months after expiration of the Agreement Term, the Executive will not, without the prior written consent of the Company, knowingly hire, directly or indirectly, any person then employed by the Company, or knowingly solicit, directly or indirectly, such a person either to terminate or diminish employment with the Company, or to work for any other person or entity, whether or not a competitor, and the Executive shall not approach any such employee for any such purpose or authorize or knowingly cooperate with the taking of any such actions by any other individual or entity.

(b) The Executive also acknowledges that the Company incurs significant expense in developing business partners, licensees, customers and clients. The Executive promises that, during the Agreement Term and for a period of 18 months after the Agreement Term ends, the Executive will not, without the prior written consent of the Company, knowingly directly or indirectly, solicit any customer, business partner, licensee or client of the Company to terminate or diminish its business relationship with the Company or to purchase any product or service that is or may be used as a substitute for any product or service of the Company, and the Executive shall not knowingly approach any such customer, supplier, lessor or lessee for such purpose or authorize or knowingly cooperate with the taking of any such actions by any other individual or entity.

8. Restrictions Reasonable. Executive agrees that the restrictions set forth in paragraphs 5 (Non-Competition), 6 (Confidentiality), and 7 (Non-Solicitation) are reasonable, proper and necessitated by the legitimate business interests of the Company, and do not constitute an unlawful or unreasonable restraint upon Executive's ability to earn a living. Executive acknowledges that it may be impossible to assess the monetary damages occurred by Executive's violation of paragraphs 6, 7 or 8 of this Agreement, that violations of those paragraphs will be material breaches of this Agreement and will cause irreparable injury to the Company. Accordingly, Executive agrees that Company will be entitled, in addition to all other rights and remedies which may be available, to an injunction enjoining and restraining Executive and any other involved party from committing a violation of this Agreement, and Executive consents to the issuance and entry of such injunction. In addition, Company will be entitled to such damages as it can demonstrate that it sustained by reason of the violation of this Agreement by the Executive and/or others. The parties agree that in the event of any litigation to enforce or interpret this Agreement, the prevailing party will be entitled to recover all costs, including reasonable attorney's fees, from the non-prevailing party. In the event Company enforces this paragraph 8 through a Court Order, Executive agrees that the restriction on Executive following Termination of employment set forth in this Agreement shall remain in effect for a period of one year from the date of the final Court Order enforcing this Agreement.

9. Return of Materials. Upon the Executive's Date of Termination, or at any time upon the Company's request, the Executive (or if deceased, the Executive's personal representative) shall promptly deliver to the Company without retaining copies, all tangible things that are or contain Confidential Information. The Executive or such personal representative shall also promptly deliver to the Company all computer print-outs, books, software manuals and directions, floppy disks and other such media for storing software and information, work papers, files, customer lists, supplier lists, employee lists, telephone and/or address books, Rolodex or equivalent cards, memoranda, appointment books, calendars, employee manuals, sales aides, keys and other tangible things provided to the Executive by the Company, or authored in whole or in part by the Executive within the scope of his employment by the Company, even if they do not contain Confidential Information; provided that the Executive shall not be required to deliver personal files and personal information unrelated to the Company's business. At the time of such deliveries, the Executive shall disclose to the Company any passwords or other knowledge required to access and use any of the foregoing. The Executive acknowledges that he does not have, and will not acquire, any ownership rights in such materials and things.

10. Nonalienation. The interests of the Executive under this Agreement are not subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, attachment, or garnishment by the Executive's creditors or beneficiaries.

11. Successors. This Agreement shall be binding upon, and inure to the benefit of, the Company and its successors and assigns and upon any person acquiring, whether by merger, consolidation, purchase of assets or otherwise, all or substantially all of the Company's assets and business.

12. Notices. Notices and all other communications provided for in this Agreement shall be in writing and shall be delivered personally or sent by registered or certified mail, return receipt requested, postage prepaid, or sent by facsimile or prepaid overnight courier to the parties at the addresses set forth below (or such other addresses as shall be specified by the parties by like notice):

To the Company:
Telos Corporation
19886 Ashburn Road
Ashburn, VA 20147
Attn.: General Counsel

To the Executive:
Mr. Mark Bendza
1904 Ballycor Drive
Vienna, VA 22182

13. Severability. The invalidity or unenforceability of any provision of this Agreement will not affect the validity or enforceability of any other provision of this Agreement, and this Agreement will be construed as if such invalid or unenforceable provision were omitted (but only to the extent that such provision cannot be appropriately reformed or modified).

14. Waiver of Breach. No waiver of either party hereto of a breach of any provision of this Agreement by the other party will operate or be construed as a waiver of any subsequent breach by such other party. The failure of either party to take any action by reason of such breach will not deprive such party of the right to take action at any time while such breach continues.

15. Amendment. This Agreement may be amended or canceled only by mutual agreement of the parties in writing without the consent of any other person. So long as the Executive lives, no person, other than the Executive and the Company, shall have any rights under or interest in this Agreement or the subject matter hereof.

16. Choice of Law and Forum Selection. This Agreement shall be governed by the laws of the Commonwealth of Virginia as to its validity, interpretation and enforcement. Should it be necessary for the Company to file suit, exclusive jurisdiction will lie in the courts of the Commonwealth of Virginia.

17. Survival of Agreement. Except as otherwise expressly provided in this Agreement, the rights and obligations of the parties to this Agreement shall survive the Termination of the Executive’s employment with the Company.

18. Entire Agreement. This Agreement constitutes the entire agreement between the parties concerning the subject matter hereof and supersedes all prior and contemporaneous agreements, if any, between the parties relating to the subject matter hereof.

19. Acknowledgement by Executive. The Executive represents to the Company that he is knowledgeable and sophisticated as to business matters, including the subject matter of this Agreement, that he has read this Agreement and that he understands its terms. The Executive acknowledges that, prior to assenting to the terms of this Agreement, he has been given a reasonable time to review it, to consult with counsel of his choice, and to negotiate at arm’s-length with the Company as to the contents. The Executive and the Company agree that the language used in this Agreement is the language chosen by the parties to express their mutual intent, and that no rule of strict construction is to be applied against either party hereto.

20. Section 409A. Regardless of intent, neither party is required to prevent, minimize, or offset any negative consequences to the other party because a payment or benefit due under this Agreement is subject to Section 409A. To the extent that any payment or benefit is subject to Section 409A, the following terms apply:

(a) The parties hereby designate that any right to a series of installment payments be treated as the right to a series of separate payments.

(b) If payment under this agreement is conditioned on termination of employment, termination of employment (however referred to) means a “separation from service” (as defined under Section 409A).

(c) Any payment or benefit due upon separation from service is payable after the Executive’s release of claims becomes irrevocable. If a new calendar year begins during the period when the Executive may sign a release of claims, payment will be made or begin in the new calendar year, regardless of when the release becomes irrevocable.

IN WITNESS WHEREOF, the Executive has hereunto set his hand, and the Company has caused these presents to be executed in its name and on its behalf, as of the date above first written.

EXECUTIVE	TELOS CORPORATION, a Maryland corporation
/s/ Mark Bendza	/s/ John B. Wood
Mark Bendza Chief Financial Officer	John B. Wood Chairman & CEO

Exhibit 31.1

CERTIFICATION

I, John B. Wood, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Telos Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and to the audit committee of registrant's board of directors:

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 16, 2021

/s/ John B. Wood
John B. Wood
Chief Executive Officer (Principal Executive Officer)

Exhibit 31.2

CERTIFICATION

I, Mark Bendza, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Telos Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and to the audit committee of registrant's board of directors:

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 16, 2021

/s/ Mark Bendza

Mark Bendza
Chief Financial Officer (Principal Financial and Accounting Officer)

Exhibit 32

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Telos Corporation (the "Company") on Form 10-Q for the period ended June 30, 2021, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, John B. Wood and Mark Bendza, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to our knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 16, 2021

/s/ John B. Wood
John B. Wood
Chief Executive Officer (Principal Executive Officer)

Date: August 16, 2021

/s/ Mark Bendza
Mark Bendza
Chief Financial Officer (Principal Financial and Accounting Officer)