

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

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d)
The Securities Exchange Act of 1934

For the fiscal year ended December 31, 1998

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

Commission file number: 1-8443

TELOS CORPORATION
(Exact name of registrant as specified in its charter)

Maryland 52-0880974
(State of Incorporation) (I.R.S. Employer Identification No.)

19886 Ashburn Road, Ashburn, Virginia 20147
(Address of principal executive offices) (Zip Code)

Registrant's Telephone Number,
including area code: (703) 724-3800

Securities registered pursuant to Section 12(b) of the Act: NONE

Securities registered pursuant to Section 12(g) of the Act:
12% Cumulative Exchangeable Redeemable Preferred Stock, par value \$.01 per share

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

No public market exists for the registrant's Common Stock.

As of March 28, 1999, the registrant had 21,238,980 shares of Class A
Common Stock, no par value; 4,037,628 shares of Class B Common Stock, no par
value; and 3,185,586 shares of 12% Cumulative Exchangeable Redeemable Preferred
Stock, par value \$.01 per share, outstanding.

Incorporation by Reference: None
Number of pages in this report (excluding exhibits): 57

PART 1

Item 1. Business

History and Introduction

Founded in 1968, Telos Corporation ("Telos" or the "Company") delivers
enterprise integration solutions and services to customers in the U.S. federal
government and industry. Telos' product and service offerings span the entire
systems life cycle, including network and systems design, software development,
systems integration, hardware and software maintenance, and solutions for
emerging needs for enterprise network infrastructure management, data
integration, and information security. The Company headquarters is in Ashburn,
Virginia, part of Northern Virginia's growing Netplex region of high technology
companies. There are approximately 60 other offices throughout the United States
and around the world.

In today's dynamic business environment, timely and accurate information
flow is critical for success. Telos' specialized approach to this information
challenge is based on leveraging customers' IT infrastructure, delivering user
centric information, and enabling customers to achieve a fast return on
investment. Many customers are turning to the virtual enterprise as a model for
improving business performance through enhanced communications and business
processes. The virtual enterprise is a demand driven partnership of customers,
employees, partners and suppliers to deliver solutions. Telos' solutions are
aimed at overcoming the critical barriers that face the virtual enterprise: (1)
the difficulty in accessing disparate data without extensive programming, (2)
the inability to quickly integrate data to ensure customer responsiveness,
manufacturing and distribution efficiency and overall competitive strength, (3)
the problem of effectively distributing information quickly and securely and (4)

the challenge of making the organizational and technological complexity invisible to end users.

Over each of the past three years, Telos has made significant investments in the development of software and service solutions to facilitate the transition of its business toward a larger mix of fixed price commerce solutions. As part of this strategy, the Company has discontinued or divested itself of those elements of its traditional business which were not consistent with this strategy. In December 1996, Telos sold Telos Consulting Services ("TCS"), one of its contract labor divisions, for \$31.6 million. In February 1998, Telos sold Telos Information Systems ("TIS"), another contract labor division, for \$14.7 million.

Reportable Operating Segments

During 1998, the Company provided its business solutions through three operating segments: Systems and Support Services, its Products Group, and its Enterworks subsidiary.

Systems and Support Services

The Company's Systems and Support Services Group provides software development and support services for software and hardware including technology insertion, system redesign, software re-engineering, Help Desk, and third party maintenance. Key customers of this segment include: The U.S. Army at Ft. Sill in Lawton, Oklahoma; the U.S. Army at Ft. Monmouth in Red Bank, New Jersey; and the U.S. Army's Redstone Arsenal in Huntsville, Alabama. Telos is the largest provider of software engineering services to the U.S. Army, maintaining over 50 million lines of software code for fire support systems. In addition, the Company has supported seventy-nine tactical land and satellite communications systems for the Communications-Electronics Command's Research, Development, and Engineering Center. The Company's largest hardware services contract is for the Redstone Arsenal where the Telos Call Center responds to support the Army's Aviation and Missile Command. In addition to these traditional Telos customers and services, the Company has information assurance, data integration and enterprise management practices which generate higher margins and represent a growing component of this segment.

For 1998, the Systems and Support Services Group generated revenue of \$98.3 million, or 47.5%, of the Company's consolidated revenue. Both the TIS and TCS divisions were part of the Systems and Support Services Group prior to their respective sales in 1998 and 1996, respectively.

Products Group

The Products Group delivers product-based solutions for networking environments. This group sells commercial products from most major original equipment manufacturers. The Company is capable of staging, installing, and deploying large network infrastructures with little disruption to the customer's ongoing operations.

This operating segment also holds the largest network integration contract ever awarded by the U.S. federal government. The Small Multi-user Computer ("SMC-II") contract has a three-year term that commenced with award in September 1995, and was extended through April 1999. The Products Group was awarded the follow-on to the SMC II Contract, Infrastructure Solutions 1, in February 1999. For 1998, the Products Group had revenues of \$101.7 million, or 49.1%, of the Company's consolidated revenues.

Enterworks, Inc.

Enterworks, Inc. ("Enterworks") develops, markets, licenses and supports Web-enabled software products that integrate data, applications and business processes throughout an enterprise. The Company's primary product is Virtual DB(TM), which delivers single, integrated views of data across multiple, disparate databases and platforms. These real-time views can easily be tailored to a company's business model, and the cleansed, integrated data can be stored in a data warehouse or forwarded to an enterprise software application. At the end of 1998, the Company released Enterworks(TM) Process Manager ("EPM") for Deployment, an innovative solution for reducing the cost, time and complexity of implementing enterprise software packages. The technology underlying EPM for Deployment uses intelligent agents that interact with existing databases and business applications to automate data exchange and coordinate the execution of tasks across any system using proven "best practices" models.

Enterworks' advanced solutions are targeted at companies with complex data environments and a strong need to build competitive strengths by increasing their speed, agility, and business intelligence. The Company focuses primarily in government markets, manufacturing, and healthcare, offering specialized consulting, training and support services as part of a total solution for its customers.

For 1998, Enterworks had revenues of \$7.1 million, or 3.4%, of the Company's consolidated revenues.

Revenue by Major Market and Significant Customers

Revenue by major market for the Company are as follows:

	Percentage of total consolidated revenue for		
	1998	1997	1996(1)
	----	----	-----
Federal government	92.9%	94.6%	84.8%
Commercial	5.1	3.9	13.6
State and local governments	2.0	1.5	1.6
	----	----	----
Total	100.0%	100.0%	100.0%
	=====	=====	=====

(1) 1996 major market revenue percentages exclude TCS revenues. TCS was sold in 1996.

Total consolidated revenue derived from the federal government for 1998 includes 68.9% of revenue from contracts with the Department of Defense, 21.7% of revenue from contracts with other Departments of the federal government, and 2.3% of revenue from subcontracts with U.S. government prime contractors.

Competition

The segments of the information services industry in which the Company operates are highly fragmented with no single company or small group of companies in a dominant position. Some of the Company's competitors also operate in international markets, along with other entities, which operate exclusively or primarily outside the United States. Some of the large competitors offer services in a number of markets which overlap many of the same areas in which the Company offers services, while certain companies are focused on only one or a few of these markets. The firms which compete with the Company are computer services firms, applications software companies and accounting firms, as well as the computer service arms of computer manufacturing companies and defense and aerospace firms. Thousands of firms fall into these categories. As the Company becomes more focused on network-enabled enterprise computing, the competition shifts to include companies that perform enterprise integration for large and complex information technology environments. In addition, the internal staffs of client organizations, non-profit federal contract research centers and universities are competitors of the Company.

The Company believes that the principal competitive factors in the segments of the information and network technology market in which it competes include project management capability, technical expertise, reputation for providing quality service, and price. The Company believes its technical competence in computer engineering, systems software, engineering, system and network integration, and hardware maintenance will enable it to compete favorably in the information and network technology market.

Employees

The Company employed 1,155 persons as of December 31, 1998. The services the Company provides require proficiency in many fields, such as computer science, mathematics, physics, engineering, operations research, economics, and business administration.

Of the total Company personnel, 807 provide Systems and Support Services, 105 are employed by Enterworks and 105 provide System Integration (Products) Services. An additional 138 employees provide corporate and business services functions.

Backlog

Many of the Company's contracts with the U.S. Government are funded by the procuring government agency from year to year, primarily based upon the government's fiscal requirements. This results in two different categories of backlog: funded and unfunded. Total backlog consists of the aggregate contract revenues remaining to be earned by the Company at a given time over the life of its contracts, whether or not funded. Funded backlog consists of the aggregate contract revenues remaining to be earned by the Company at a given time, but only to the extent, in the case of government contracts, funded by a procuring government agency and allotted to the contracts. Unfunded backlog is the difference between total backlog and funded backlog. Included in unfunded backlog are revenues which may be earned only if customers exercise delivery orders and/or renewal options to continue existing contracts.

A number of contracts undertaken by the Company extend beyond one year, and accordingly, portions of contracts are carried forward from one year to the next as part of the backlog. Because many factors affect the scheduling and continuation of projects, no assurance can be given as to when revenue will be realized on projects included in the Company's backlog.

At December 31, 1998 and 1997, the Company had total backlog from existing contracts of approximately \$923.3 million and \$1.0 billion, respectively. This is the maximum value of additional future orders for systems, products, maintenance and other support services presently allowable under those contracts, including renewal options available on the contracts if exercised by the client, over periods extending up to seven years. Included in the backlog at December 31, 1998 is \$786 million from the Company's SMC-II contract, which is due to expire in April 1999 and is therefore unlikely to be converted to orders and revenue of this magnitude in 1999. The Company has been awarded the follow-on contract to SMC II, Infrastructure Solutions-1 ("IS1"), in the first quarter of 1999. This contract has a five year term with an award amount not to exceed \$380 million. The backlog totals at December 31, 1998 do not include this award. Approximately \$56 million and \$104 million of the total was funded backlog at December 31, 1998 and 1997, respectively.

While backlog remains a useful measurement consideration, in recent years the Company, as well as other federal contractors, experienced a change in the manner in which the federal government procures equipment and services. These procurement changes include the growth in the use of General Services Administration ("GSA") schedules which allow agencies of the federal government to purchase significant amounts of equipment and services. The use of the GSA schedules results in a significantly shorter and much more flexible procurement cycle, as well as increased competition as many companies hold such schedules. Along with the GSA schedules, the federal government is awarding a large number of omnibus contracts with multiple awardees. These contracts generally require extensive marketing efforts by the awardees to procure business. The use of GSA schedules and omnibus contracts, while generally not providing immediate backlog, provide areas of potential growth that the Company continues to aggressively pursue.

Overview of 1998

During 1998, Telos continued to make investments in order to execute its strategy of transitioning its business toward a larger mix of fixed price commerce solutions.

These investments included the continued development of Enterworks' enterprise application integration software solutions, Virtual Database ("Virtual DB") and Enterworks Process Manager ("EPM"). Virtual DB 3.0 was released in March 1999, and EPM 1.0 was released in December 1998. Enterworks' revenue grew to \$7.1 million in 1998, more than double 1997 revenue. The Company expects Enterworks revenue to continue to increase in 1999 based on the status of its products and its continuing investment in its sales and marketing infrastructure to support those products. However, the Company does not expect the Enterworks business to be profitable until after 1999, consistent with the experience of comparable software companies at this stage of development.

The Company's 1998 investments were also focused on its higher margin information assurance, data integration, advanced messaging and wireless networking practices. Revenue for these practices approximated \$7.0 million for 1998, which also represents a more than doubling of 1997 revenue. In December 1998, Telos announced a strategic partnership with Tivoli Systems, a subsidiary of IBM, whereby Telos plans to provide professional services to support Tivoli Products. This enterprise management practice will be an additional area of emphasis for Telos in 1999 and beyond. As with Enterworks, the Company expects total revenue for these practices will continue to grow in 1999 based in part on its continuing investments in sales and marketing to support these practices.

The Company's 1998 activities also focused on reducing or eliminating certain of its least profitable contracts. These reductions or eliminations were principally within the Products Group, although there were also some targeted reductions in the Systems and Support Services Group. With these business reductions came decreases in related corporate infrastructure costs, including sales, general and administrative ("SG&A") expenses. However, on a total company basis, these cost reductions were more than offset by increases in SG&A costs to support Enterworks and the other higher margin businesses noted above.

In February 1998, Telos sold substantially all of the net assets of its TIS division for \$14.7 million in cash. In connection with this sale, the Company recorded a gain of \$5.7 million in its consolidated statement of operations for 1998.

In May 1998, the Company entered into an agreement with one of its shareholders, Union de Banques Suisses (Luxembourg) S.A. ("UBS"), to retire all of UBS's equity holdings in the Company. These equity holdings included all of the 7,500 shares of the Company's Class B Preferred Stock, 1,837,773 shares of the Company's Class A Common Stock, and 1,312,695 of the Company's Class A Common Stock warrants. The \$5.9 million excess of the carrying amount of the Class B Redeemable Preferred Stock over the redemption price was recorded as an increase in capital in excess of par; there was no impact on income from this transaction.

In November 1998, the Company retired 410,000 shares of the Public Preferred Stock held by certain shareholders. The Company repurchased the stock at \$4.00 per share. The carrying value of these shares was determined to be \$3.8 million, and the \$2.2 million excess of the carrying amount of these shares of Public Preferred Stock over the redemption price of \$1.6 million was recorded as an increase in capital in excess of par; there was no impact on income from this transaction.

Item 2. Properties

The Company leases 191,700 square feet of space in Ashburn, Virginia for its corporate headquarters, integration facility, and primary service depot. This lease expires in March 2016, with a ten year extension available at the Company's option. This facility supports all three of the Company's operating segments.

The Company leases additional space for regional field engineering, contract work sites, training, and sales offices in 56 separate facilities located in 19 states and Europe under various leases, which expire on various dates through February 2006. At December 31, 1998, the Company also owned two buildings in Amery, Wisconsin. One of these buildings was sold in early 1999. These facilities principally support the Company's Systems and Support Services operating segment.

Item 3. Legal Proceedings

The Company is a party to various lawsuits arising in the ordinary course of business. In the opinion of management, while the results of litigation cannot be predicted with certainty, the final outcome of such matters will not have a material adverse effect on the Company's consolidated financial position, results of operations or of cash flows.

Item 4. Submission of Matters to a Vote of Security Holders

During the fourth quarter of 1998, no matters were submitted to a vote of security holders.

PART II

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters

No public market exists for the Company's Class A or Class B Common Stock. As of March 1, 1999, there were 85 holders of the Company's Class A Common Stock and 3 holders of the Company's Class B Common Stock.

Item 6. Selected Financial Data

The following should be read in connection with the accompanying information presented in Item 7 and Item 8 of this document.

OPERATING RESULTS

Year Ended December 31,

	1998	1997	1996	1995	1994
(amounts in thousands)					
Sales (5)	\$207,086	\$253,787	\$188,895	\$175,759	\$150,676
(Loss) income from continuing operations	(9,171)	1,412	(9,816)	592	(11,838)
Discontinued Operations: (1)					
Income (loss) from discontinued operations	--	--	500	423	(583)
Gain on sale of Consulting Services	--	--	11,524	--	--
(Loss) income before extraordinary items	(9,171)	1,412	2,208	1,015	(12,421)
Extraordinary items	--	--	--	--	(196)
Net (loss) income	(9,171)	1,412	2,208	1,015	(12,617)

FINANCIAL CONDITION

As of December 31,

	1998	1997	1996	1995	1994
(amounts in thousands)					
Total assets(5)	\$ 95,251	\$109,718	\$110,064	\$94,492	\$86,872
Long-term debt (2)	54,651	56,875	32,857	47,316	40,414
Capital lease obligations, long-term (3)	11,710	12,085	12,537	--	--
Senior redeemable preferred stock (4)	5,631	5,207	4,828	4,494	4,192
Class B redeemable preferred stock (4)	--	12,035	11,087	10,252	9,497
Redeemable preferred Stock (4)	31,729	29,951	24,230	18,647	14,263

- (1) See Note 3 to the Consolidated Financial Statements in Item 8 regarding the sale of TCS.
- (2) See Note 5 to the Consolidated Financial Statements in Item 8 regarding long-term debt obligations of the Company. Total long-term debt obligations include amounts due under the Senior Credit Facility and subordinated notes.
- (3) See Note 9 to the Consolidated Financial Statements in Item 8 regarding the capital lease obligations of the Company.
- (4) See Note 6 to the Consolidated Financial Statements in Item 8 regarding redeemable preferred stock of the Company.
- (5) See Note 2 to the Consolidated Financial Statements in Item 8 regarding the sale of TIS.

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

General

Over the last three years, the Company has made significant investments in the development of software and hardware products, operational infrastructure to support contracts awarded to the Company, and sales and marketing. The Company's investments in new software products provide the Company with an expanded product line that, the Company believes, offers its customers unique value added solutions for their computing and information gathering analysis problems. The investment in software products is primarily through Enterworks and is focused on the enterprise application integration market, through data integration and information processing products. Additionally, the Company has established a comprehensive offering of products and services on its GSA schedule. These investments have enabled the Company to win most of its significant contract rebids, and continue to provide significant new business opportunities.

During 1998, the Company experienced decreases in revenue and profitability. Revenue decreased \$46.7 million, or 18.4%, as compared to 1997. Approximately \$39.5 million of this decrease was attributable to the expiration of two large contracts in 1997, which are discussed further below, and approximately \$20.7 million of the decrease was due to the sale of the TIS division in February 1998. The operating loss for 1998 was \$7.3 million, as compared to operating income of \$7.4 million in 1997. Operating profitability declined principally as a result of the decreases in revenue and the Company's continued investment in its majority-owned subsidiary, Enterworks, Inc. Exclusive of Enterworks, the Company's earnings before interest and taxes for 1998 was \$4.2 million. Profitability was also impacted by unfavorable changes in the product mix of the Products Group and the under absorption of certain infrastructure costs. These operating losses were partially offset by a \$5.7 million gain on the sale of the TIS division in February 1998.

During 1997, the Company's revenue and profitability increased as compared to 1996. Revenue increased \$64.9 million, or 34.4%, primarily due to three large projects awarded in 1997 which are discussed further below. Operating income for 1997 was \$7.4 million, as compared to an operating loss of \$9.4 million in 1996. Operating profitability improved principally as a result of the increases in revenue, as well as cost cutting measures initiated in 1996 and continued into 1997, which included staff reductions and branch consolidation.

The year ended December 31, 1996 was difficult from an operational perspective due to the federal government budget impasse early in the year. However, during 1996 the Company continued to invest in its contract and support services infrastructure to accommodate a number of contracts awarded in late 1995. The Company also moved to a larger headquarters and systems integration facility in 1996, which resulted in increased costs associated with the relocation.

Revenue by Contract Type

Approximately 95% of the Company's total revenues in 1998 were attributable to contracts with federal, state, and local governments, including 93% attributable to the federal government. This represents a decrease of 2% from 1997 and relates primarily to the increase in commercial revenue generated from Enterworks, Inc. in 1998. The Company's revenues are generated from a number of contract vehicles. In general, the Company believes its contract portfolio is characterized as having low to moderate financial risk as the Company has limited long-term fixed price development contracts. The Company's firm fixed price contracts consist principally of contracts for the purchase of computer equipment at established contract prices or contracts for maintenance of computer hardware. A significant portion of the Company's revenue is from time and material and cost reimbursable contracts, which generally allow the pass-through of allowable costs plus a profit margin. For 1998, revenue by contract type was as follows: time and materials, 24.6%; firm fixed price, 56.8%; cost reimbursable, 13.7%; fixed monthly rate, 4.7%; and other, 0.2%. While the Company has not experienced any significant recent terminations or renegotiations, government contracts may be terminated or renegotiated at any time at the convenience of the government.

Statement of Operations Data

The following table sets forth certain consolidated financial data and related percentages for the periods indicated:

	Year Ended December 31,					
	1998		1997		1996	
	(dollar amounts in thousands)					
Sales	\$207,086	100.0%	\$253,787	100.0%	\$188,895	100.0%
Cost of sales	182,915	88.3	218,430	86.1	168,281	89.1
Selling, general and administrative expenses	30,842	14.9	27,054	10.7	29,055	15.4
Goodwill amortization	589	0.3	892	0.3	1,001	0.5
Operating (loss) income	(7,260)	(3.5)	7,411	2.9	(9,442)	(5.0)
Interest expense	(6,555)	(3.1)	(7,455)	(2.9)	(5,668)	(3.0)
Gain on Sale of Assets	5,683	2.7	--	--	--	--
Other income (expense)	64	--	124	--	(445)	(0.2)
(Loss) income before taxes	(8,068)	(3.9)	80	--	(15,555)	(8.2)
Income tax (provision) benefit	(1,103)	(0.5)	1,332	0.6	5,739	3.0
(Loss) income from continuing operations	(9,171)	(4.4)	1,412	0.6	(9,816)	(5.2)
Discontinued Operations:						
Income from discontinued operations, net of tax	--	--	--	--	500	0.2
Gain on sale of TCS, net of tax	--	--	--	--	11,524	6.1
Net (loss) income	\$ (9,171)	(4.4)%	\$1,412	0.6%	\$ 2,208	1.1%

Financial Data by Operating Segment

The Company has three reportable operating segments: Enterworks, Inc., Systems and Support Services, and Products.

Sales, gross profit and gross margin by market segment for the periods designated below are as follows:

	Year Ended December 31,		
	1998	1997	1996
	(dollar amounts in thousands)		
Revenue:			
Enterworks, Inc.	\$ 7,073	\$ 3,398	\$ 2,140
Systems and Support Services	98,277	121,052	101,535
Products	101,736	129,337	85,220
Total	\$207,086	\$253,787	\$188,895
Gross Profit:			
Enterworks, Inc.	\$ 1,542	\$ (132)	\$ 955
Systems and Support Services	14,046	20,614	11,237
Products	8,583	14,875	8,422
Total	\$ 24,171	\$ 35,357	\$ 20,614
Gross Margin:			
Enterworks, Inc.	21.8 %	(3.9)%	44.6 %
Systems and Support Services	14.3 %	17.0 %	11.1 %
Products	8.4 %	11.5 %	9.9 %
Total	11.7 %	13.9 %	10.9 %

Results of Operations

Years ended December 31, 1998 and 1997

Revenue for 1998 was \$207.1 million, a \$46.7 million or 18.4% decrease from 1997. Approximately \$27.6 million of this decrease was attributable to the Products Group, which experienced lower revenue primarily due to the completion of the Immigration and Naturalization Services Contract ("INS Contract") in the third quarter of 1997. The INS contract contributed revenue of \$27.8 million in 1997. In addition, the Systems and Support Services Group experienced a \$22.8 million decrease in revenue for the year ended December 31, 1998 compared to the same period of 1997. This decrease was primarily due to the sale of TIS in February 1998 and the expiration of its Immigration and Naturalization Services Blanket Purchase Agreement for Field Operation Support Contract ("INS BPA") in the fourth quarter of 1997. TIS and INS BPA contributed revenue of \$24.7 million and \$12.2 million, respectively, during 1997 with corresponding 1998 revenues of \$4.0 million and \$100,000, respectively. The declines in Products and Systems and Support Services revenue were partially offset by an increase of \$3.7 million, or 108%, in Enterworks revenue for the year ended December 31, 1998 compared to the same period of 1997.

Cost of revenue was 88.3% of revenue for 1998, as compared to 86.1% for 1997. The increase in cost of revenue as a percentage of revenue is primarily attributable to unfavorable changes in product mix and the under absorption of infrastructure costs. On a dollar basis, the decrease in cost of revenue for the year is primarily attributable to the decreases in revenue.

Gross profit decreased by \$11.2 million or 31.6% from 1997 to 1998. The decrease is primarily attributable to the revenue declines discussed above, as well as the unfavorable changes in product mix and under absorption of infrastructure costs.

Selling, general and administrative expenses ("SG&A") were \$30.8 million in 1998 and \$27.1 million in 1997. During 1998, the Company increased expenditures for Enterworks research and development and sales and marketing by \$5.1 million and \$1.2 million, respectively, as compared to the same 1997 period. Research and development expense for 1998 included a net realizable value adjustment of \$1.7 million to capitalized software costs. However, these increases were partially offset by reductions in other SG&A expenditures, relating principally to the consolidation of certain administrative support functions.

Goodwill amortization expense decreased \$303,000 to \$589,000 for 1998, as compared to \$892,000 in 1997. This reduction is primarily due to a decrease in the goodwill balance associated with the sale of the TIS division in early 1998.

Telos sold substantially all of the net assets of TIS in the first quarter of 1998. The transaction generated \$14.7 million in cash proceeds and a gain of \$5.7 million.

Interest expense decreased \$900,000 to \$6.6 million in 1998, from \$7.5 million in 1997. This decrease is due principally to a decrease in the average balance of the Senior Credit Facility for most of 1998 compared to 1997, as well as a reduction in the bank's base rate due to changing economic conditions.

The income tax provision was \$1.1 million for 1998. The tax provision was primarily attributable to state income taxes, and increases in allowances relating to the recoverability of deferred tax assets. An income tax benefit of \$1.3 million was recorded for 1997, principally because the Company reduced its valuation allowance relating to net operating loss carryforwards expected to be utilized as a result of the gain on the TIS sale.

Years ended December 31, 1997 and 1996

Revenue increased \$64.9 million, or 34.4%, from \$188.9 million in 1996 to \$253.8 million in 1997. This increase was attributable both to the Products Group which reported an increase in sales of \$44.1 million and the Systems and Support Services Group with an increase in sales of \$19.5 million.

The increase in the Systems Integration Group's revenue was primarily due to orders under its Joint Recruiting Information Support System ("JRIS") Blanket Purchase Agreement (\$15.1 million) as well as its U.S. Courts Systems Data Communication Network contract (\$10.6 million) which were both awarded in 1997. In general, those 1996 contracts that continued into 1997 experienced reduced order volume, except for the Small Multi-User Computer II ("SMC-II") contract which had an increase in order volume of \$25.7 million from 1996 to 1997.

The increase in the Systems and Support Services Group's revenue is primarily attributable to the effect of a Blanket Purchase Agreement won and completed in 1997 for the Immigration and Naturalization Service (\$12.2 million). The TIS division, which held Jet Propulsion Laboratory contracts, experienced an increase in revenue of \$6.1 million in 1997, compared to 1996. Hardware support revenues remained consistent between 1997 and 1996.

Cost of sales increased by \$50.1 million, or 29.8%, to \$218.4 million in 1997 from \$168.3 million in 1996. This increase is the result of increased sales during the year, and changes in the revenue product mix. The Systems and Support Services Group benefited significantly as a result of new contract revenues described above. The cost of labor required to support these new contracts, as a percentage of revenue, was much less than to support traditional services contracts, on a per hour basis. Additionally, the Systems and Support Services Group implemented a cost reduction program to reduce labor and material costs in the hardware support area. The Products Group benefited from the insertion of new technology with lower cost components as part of the solutions provided in its larger contracts. However, in the second half of 1997, certain additional reserves for the write-off of inventory of approximately \$1.8 million were recorded.

Gross profit increased by \$14.8 million for the year to \$35.4 million in 1997, from \$20.6 million in 1996. The increase is primarily attributable to the changes in cost of sales discussed above and reflects the result of cost cutting measures initiated in 1996 and continued in 1997, including staff reductions and branch consolidation.

Selling, general and administrative (SG&A) expenses decreased for the year by approximately \$2.0 million, from \$29.1 million in 1996 to \$27.1 million in 1997. A reduction in SG&A costs in 1997 resulted from the Company's relocation to a new headquarters facility. The lease for the new facility is considered a capital lease rather than the previous operating lease. The Company also realized a reduction in facility and operating costs as a result of the sale of TCS in late 1996. Additionally, aggressive cost reduction programs implemented in late 1996, reduced bid and proposal and sales and marketing expenses as well as other discretionary expenses contributed to the decrease in SG&A expenses. SG&A as a percentage of sales decreased to 10.7% for 1997 from 15.4% in 1996.

Goodwill amortization expense was \$892,000 for 1997 compared to \$1.0 million for 1996. The reduction in goodwill amortization is attributable to reductions in the goodwill balance as a result of the sale of TCS which reduced goodwill by approximately \$6.9 million in 1996.

The change from an operating loss of \$9.4 million in 1996 to operating income of \$7.4 million in 1997 is a result of the increases in gross profit and the decreases in SG&A discussed above.

Other non-operating income of \$124,000 for 1997 is compared to an expense of \$445,000 in 1996. The income in 1997 is attributable to non-operating refunds and other miscellaneous charges. The expense in 1996 was attributable to costs required to settle a previous non-operating related lawsuit.

Interest expense increased approximately \$1.8 million to \$7.5 million for 1997, as compared to \$5.7 million in 1996. The increase is a result of the significant increase in the average outstanding balance of the Senior Credit Facility for most of 1997, as well as an increase in interest recorded for capital lease obligations associated with the mid-1996 move by the Company to its new manufacturing and support facility in Ashburn, Virginia.

The deferred tax benefit recognized for 1997 of \$1.3 million represents the reduction of the valuation allowance related to net operating loss carryforwards which are expected to be utilized to offset the taxable gain of approximately \$11 million were recognized related to the sale of TIS in February 1998.

Liquidity and Capital Resources

The Company's capital structure consists of a revolving credit facility, subordinated notes, and redeemable preferred stock and common stock.

At December 31, 1998, the Company had an outstanding balance of \$36.2 million on its \$45 million Senior Credit Facility (the "Facility"). The Facility matures on July 1, 2000 and is collateralized by certain assets of the Company (primarily inventory and accounts receivable). The amount of borrowings fluctuates based on the underlying asset borrowing base as well as the Company's working capital requirements. At December 31, 1998, the Company, under its borrowing base formula, had \$6.7 million of unused availability. The Facility has various covenants which may, among other things, restrict the ability of the Company to merge with another entity, sell or transfer certain assets, pay dividends and make other distributions beyond certain limitations. The Facility also requires the Company to meet certain leverage, net worth interest coverage and operating goals. At December 31, 1998, the Company was not in compliance with several covenants contained in the Facility; however, the bank has waived this non-compliance. In addition, the bank has amended the covenants to conform to the Company's 1999 budget expectations.

The Company's subordinated notes are held principally by shareholders and management, and totaled \$18.5 million at December 31, 1998. These notes bear interest at rates between 8% and 17% and become payable in 2000 through 2001.

The Company currently has two primary classes of redeemable preferred stock - Senior Redeemable Preferred Stock and Public Preferred Stock. Each class carries cumulative dividend rates of 12% to 14.125%. At December 31, 1998 the total carrying value of redeemable preferred stock, including accumulated and unpaid dividends, was \$37.4 million. The Company accrues dividends and provides for accretion related to the redeemable preferred stock. Mandatory redemption for the Senior Redeemable Preferred Stock including all dividends payable, is required on December 31, 2001, subject to the legal availability of funds. Mandatory redemption for the Public Preferred Stock is required from 2005 through 2009, subject to the legal availability of funds.

Cash used by operating activities was \$2.7 million in 1998, due primarily to the year's net loss and an increase in accounts receivable as a result of sales growth in the fourth quarter compared to the prior year's fourth quarter. Cash provided by investing activities was \$11.4 million in 1998, reflecting capital expenditures of \$1.3 million and \$2.0 million in continued investments in software development costs related to Enterworks, offset by the proceeds from the sale of TIS of \$14.7 million. The Company used cash from financing activities of \$8.9 million in 1998, reflecting principally the payment of \$6.5 million for the retirement of the UBS equity holdings, the repurchase of 410,000 shares of Redeemable Preferred Stock for \$1.6 million, and net payments on the Facility.

In February 1998, the Company sold its TIS division for approximately \$15 million. The net proceeds from the sale were used to pay down amounts outstanding under the Facility.

In May 1998, the Company retired all of the equity holdings of Union de Banques Suisses (Luxembourg) S.A. for \$6.5 million, of which \$5 million was paid in cash in May 1998, and the remaining \$1.5 million was funded by two separate letters of credit. UBS was paid \$1.0 million in September 1998 using the first letter of credit secured by the Company's lender and \$500,000 in November 1998 using the second letter of credit.

In November 1998, the Company retired 410,000 shares of the Public Preferred Stock held by certain shareholders. The Company repurchased the stock at \$4.00 per share. The carrying value of these shares was \$3.8 million, and the \$2.2 million excess of the carrying amount of these shares of Public Preferred Stock over the redemption price of \$1.6 million was recorded as an increase in capital in excess of par; there was no impact on income from this transaction.

In November 1998, the Company issued additional Senior Subordinated Notes to certain shareholders which are classified as Series D. The Series D Notes total \$1.8 million and are unsecured. The Series D Notes have a maturity date of October 1, 2000 and bear interest at 14% per annum. Interest is paid quarterly on January 1, April 1, July 1, and October 1 of each year. The notes can be prepaid at the Company's option. These Notes contain the same payment premium provisions as the Series B and Series C Notes (see above). In connection with the debt, the Company issued 1,500,000 warrants to purchase shares of the Company's Class A Common Stock. The warrants have an exercise price of \$.01 and an exercise period of 22 months. The Company has assigned a value to the warrants of \$420,000 which has been included in capital in excess of par. The amount outstanding of the subordinated debt was approximately \$1,396,000 at December 31, 1998.

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. However, as reflected in the accompanying financial statements, the Company incurred a net loss of \$9.2 million in 1998. This loss included the effect of a \$5.7 million non-recurring gain from the sale of its TIS division. In addition, the Company was not in compliance with several covenants of its Senior Credit Facility, although the lender has provided waivers for the violations and has amended the covenants to conform to the Company's 1999 budget expectations. Based on its budget, the Company anticipates a need for approximately \$10 million of additional financing for 1999. These factors, including the uncertainty surrounding whether and when the additional financing will be secured and whether the Company will meet its budget expectations and bank covenants in 1999, indicate that the Company may be unable to continue as a going concern for a reasonable period of time. The financial statements do not include any adjustments relating to the recoverability of assets and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. The Company's continuation as a going concern is dependent on its ability to obtain the additional financing required, meet its 1999 budgeted cash flow objectives, and comply with the terms of its Senior Credit Facility.

The Company believes that the necessary additional financing will be secured through one or more of the following sources: the sale of a division or asset which is not critical to its strategic goals; additional financing from its lender; or additional equity financing. Alternatives are currently being pursued under each of these sources; however, the required financing has not yet been secured. The Company believes the required funding will be arranged in a timely manner that does not have a significant adverse impact on its operations. However, there can be no assurance that the Company will be able to secure financing sufficient for its needs and at terms favorable to the Company. Additionally, there can be no assurance that the Company will be successful in meeting budget expectations and bank covenants in 1999. Failure by the Company to obtain sufficient financing, meet its budget expectations, or meet its bank covenants may have a material adverse effect on the Company's financial position, results of operations or cash flows. See also Note 1 to the Consolidated Financial Statements.

Capital Expenditures

The Company believes that its business is generally not capital intensive. Capital expenditures for property and equipment were \$1.2 million in 1998 and \$2.6 million in each of 1997 and 1996. The Company incurred capital expenditures in 1996 as a result of moving to a new headquarters and integration facility. In 1996, the Company entered into a twenty year lease for a building that provides significantly more integration and warehouse space. The Company anticipates capital expenditures of approximately \$2.6 million in 1999, however, there can be no assurance that this level of capital expenditures will occur.

Inflation

The rate of inflation has been moderate over the past five years and, accordingly, has not had a significant impact on the Company. The Company has generally been able to pass through increased costs to customers through higher prices to the extent permitted by competitive pressures. The Company's cost reduction efforts have offset the effects of inflation, if any, on the Company's performance.

Year 2000

Year 2000 issues refer generally to the problems that some software may have in determining the correct century for the year. For example, software with date-sensitive functions that is not Year 2000 compliant may not be able to distinguish whether "00" means 1900 or 2000, which may result in failures or the creation of erroneous results.

The Company, like most owners of computer software, is modifying significant portions of its internal use software so that it will function properly in the Year 2000. Accordingly, the Company has incurred and expects to continue to incur internal staff costs as well as consulting and other expenses related to software and infrastructure enhancements necessary to prepare the systems for the Year 2000. Total expenditures for such costs were not material to the Company's consolidated financial statement in 1998 or 1999. The Company expects to complete its internal use software compliance efforts during 1999. Maintenance, modification costs and software purchased with the express purpose of fixing the Year 2000 problem are expensed as incurred.

The Company has queried its key suppliers and vendors to assess their Year 2000 readiness and has been informed that software licensed to the Company for resale will be compliant by the Year 2000. Therefore, the Company is not aware of any problems that would have a material adverse impact on its financial position, results of operations or cash flows. However, the Company has no means of ensuring compliance by its suppliers or vendors. If its suppliers and vendors are not Year 2000 compliant, there could be a material adverse effect on the Company.

As is the case with other similarly situated computer companies, if Telos' current or future customers fail to achieve Year 2000 compliance or if they divert technology expenditures to address Year 2000 compliance problems, Telos' business, results of operations or financial condition could be materially adversely affected. For example, agencies of the United States Government are principal customers of the Company. If such agencies experience significant Year 2000 system failures, under terms of typical government contracts, the Company's performance and/or receipt of payments due could be delayed or contracts could be terminated for convenience, which could have a material adverse effect on the Company. If similar failures are experienced by other customers or potential customers of the Company, this could also have a material adverse impact on the Company.

Based on its internal review and the compliance information received from its suppliers and vendors, the Company does not believe that there is a need for a contingency plan for Year 2000 system non-compliance. Such a plan will be developed if the Company becomes aware of any Year 2000 non-compliance that would impact its critical operations. The cost of developing and implementing such a plan, if required, may in itself be material.

Although the Company does not believe that it will incur any material unanticipated costs or experience material disruptions in its business associated with preparing its internal systems for the Year 2000, there can be no assurances that the Company will not experience serious unanticipated consequences and/or material costs caused by undetermined errors or defects in the technology used in its systems, which are composed of third party software, third party hardware that contains embedded software and the Company's own software products. A worst case scenario could include: (i) corruption of data contained in the Company's internal information systems, (ii) interruptions, delays or terminations in the Company's business with government agencies or other customers associated with their own Year 2000 problems, and (iii) the failure of infrastructure services provided by government agencies and other third parties (e.g., electricity, phone service, water transport, internet services, etc.). Any of these unexpected outcomes could have a material adverse effect on the Company.

Management believes that computer systems and software created and sold by the Company is compliant or will be compliant by the Year 2000. However, because the Company is in the business of selling computer systems, the Company's risk of being subjected to lawsuits relating to Year 2000 issues is likely to be greater than that of other industries. Computer systems may involve different hardware and software components from different manufacturers; therefore, it may be difficult to determine which component in a computer system may cause a Year 2000 issue. As a result, the Company may be subjected to Year 2000 related lawsuits independent of whether its products and services are Year 2000 compliant. The outcomes of such lawsuits and the impact on the Company cannot be determined at this time.

Recent Accounting Pronouncements

In March 1998, the American Institute of Certified Public Accountants issued Statement of Position 98-1 ("SOP 98-1"), "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." This standard requires companies to capitalize qualifying computer software costs which are incurred during the application development stage and amortize them over the software's estimated useful life. SOP 98-1 is effective for fiscal years beginning after December 15, 1998. The Company is currently evaluating the impact of SOP 98-1 on its financial statements and related disclosures.

In November 1998, the American Institute of Certified Public Accountants issued Statement of Position 98-9 ("SOP 98-9"), "Modification of SOP 97-2, "Software Revenue Recognition", with Respect to Certain Transactions". The Company is currently evaluating the impact of SOP 98-9 on its financial statements and related disclosures.

Forward-Looking Statements

This Annual Report on Form 10-K 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 below under the caption "Certain Factors That May Affect Future Results."

Certain Factors That May Affect Future Results

The following important factors, among others, could cause actual results to differ materially from those indicated by forward-looking statements made in this Annual Report on Form 10-K and presented elsewhere by management from time to time.

A number of uncertainties exist that could affect the Company's future operating results, including, without limitation, general economic conditions, the timing and approval of the federal government's fiscal year budget, business growth through obtaining new business and, once obtained, the Company's ability to successfully perform at a profit, the Company's ability to convert contract backlog to revenue, the Company's ability to secure adequate capital and financing to support its business, the success of the Company's investments in Enterworks, and the risk of the federal government terminating contracts with the Company. While the Company has not experienced contract terminations with the federal government, the federal government can terminate at its convenience. Should this occur, the Company's operating results could be adversely impacted.

As a high percentage of the Company's revenue is derived from business with the federal government, the Company's operating results could be adversely impacted should the federal government not approve and implement its annual budget in a timely fashion.

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. However, as reflected in the accompanying financial statements, the Company incurred a net loss of \$9.2 million in 1998. This loss included the effect of a \$5.7 million non-recurring gain from the sale of its TIS division. In addition, the Company was not in compliance with several covenants of its Senior Credit Facility, although the lender has provided waivers for the violations and has amended the covenants to conform to the Company's 1999 budget expectations. Based on its budget, the Company anticipates a need for approximately \$10 million of additional financing for 1999. These factors, including the uncertainty surrounding whether and when the additional financing will be secured and whether the Company will meet its budget expectations and bank covenants in 1999, indicate that the Company may be unable to continue as a going concern for a reasonable period of time. The financial statements do not include any adjustments relating to the recoverability of assets and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. The Company's continuation as a going concern is dependent on its ability to obtain the additional financing required, meet its 1999 budgeted cash flow objectives, and comply with the terms of its Senior Credit Facility.

The Company believes that the necessary additional financing will be secured through one or more of the following sources: the sale of a division or asset which is not critical to its strategic goals; additional financing from its lender; or additional equity financing. Alternatives are currently being pursued under each of these sources; however, the required financing has not yet been secured. The Company believes the required funding will be arranged in a timely manner that does not have a significant adverse impact on its operations. However, there can be no assurance that the Company will be able to secure financing sufficient for its needs and at terms favorable to the Company. Additionally, there can be no assurance that the Company will be successful in meeting budget expectations and bank covenants in 1999. Failure by the Company to obtain sufficient financing, meet its budget expectations, or meet its bank covenants may have a material adverse effect on the Company's financial position, results of operations or cash flows.

Item 7a. Quantitative and Qualitative Disclosures About Market Risk

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's long-term debt obligations.

The Company is exposed to interest rate volatility with regard to its variable rate debt obligations under its Senior Credit Facility. This facility bears interest at 1.00%, subject to certain adjustments, over the bank's base rate. The weighted average interest rate in 1998 was 9.95%. This facility expires on July 1, 2000 and has outstanding balance of \$36.2 million at December 31, 1998.

The Company's other long-term debt at December 31, 1998 consists of Senior Subordinated Notes B, C, and D which bear interest at fixed rates ranging from 14% to 17%. The Senior Subordinated Notes mature as to principal in the aggregate amount of \$16,173,000 on October 1, 2000. Additionally, the Company has subordinated debt issued by their majority owned subsidiary, Enterworks, which bears interest at a fixed rate of 8%. The Enterworks Notes mature as to principal in the aggregate amount of \$3,277,960 on January 1, 2000. The Company has no cash flow exposure due to rate changes for its Senior Subordinated or Enterworks Notes.

Item 8. Financial Statements and Supplementary Data

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
Report of Independent Accountants - PricewaterhouseCoopers LLP.....	19
Consolidated Statements of Operations for the Years Ended December 31, 1998, December 31, 1997, and December 31, 1996.....	20
Consolidated Balance Sheets as of December 31, 1998 and December 31, 1997.....	21-22
Consolidated Statements of Cash Flows for the Years Ended December 31, 1998, December 31, 1997, and December 31, 1996.....	23
Consolidated Statements of Changes In Stockholders' Investment (Deficit) for the Years Ended December 31, 1998, December 31, 1997, and December 31, 1996.....	24
Notes to Consolidated Financial Statements.....	25-43

INDEX TO SCHEDULES

All schedules are omitted because they are not applicable or the required information is included in the consolidated financial statements or notes thereto.

Report of Independent Accountants

To the Board of Directors and Stockholders
of Telos Corporation

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of cash flows and of changes in stockholders' investment (deficit) present fairly, in all material respects, the financial position of Telos Corporation and its subsidiaries at December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company has suffered losses from operations and has not yet been able to obtain sufficient financing for 1999 working capital purposes. These conditions raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

PRICEWATERHOUSECOOPERS LLP

McLean, VA
April 1, 1999

TELOS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(amounts in thousands)

	Year Ended December 31,		
	1998	1997	1996
<hr style="border-top: 1px dashed black;"/>			
Sales			
Enterworks, Inc.	\$ 7,073	\$ 3,398	\$ 2,140
Systems and Support Services	98,277	121,052	101,535
Products	101,736	129,337	85,220
	-----	-----	-----
	207,086	253,787	188,895
	-----	-----	-----
Costs and expenses			
Cost of Enterworks, Inc.	5,531	3,530	1,185
Cost of Systems and Support Services	84,231	100,438	90,298
Cost of Products	93,153	114,462	76,798
Selling, general and administrative expenses	30,842	27,054	29,055
Goodwill amortization	589	892	1,001
	-----	-----	-----
	214,346	246,376	198,337
	-----	-----	-----
Operating (loss) income	(7,260)	7,411	(9,442)
Other income (expenses)			
Non-operating income (expense)	64	124	(445)
Gain on sale of assets	5,683	--	--
Interest expense	(6,555)	(7,455)	(5,668)
	-----	-----	-----
(Loss) income before income taxes	(8,068)	80	(15,555)
(Provision) benefit for income taxes	(1,103)	1,332	5,739
	-----	-----	-----
(Loss) income from continuing operations	(9,171)	1,412	(9,816)
Discontinued operations:			
Income from discontinued operations (net of income tax provision of \$566)	--	--	500
Gain on sale of Consulting Services, (net of income tax provision of \$6,327)	--	--	11,524
	-----	-----	-----
Net (loss) income	\$ (9,171)	\$ 1,412	\$ 2,208
	=====	=====	=====

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

TELOS CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(amounts in thousands)

ASSETS

	December 31,	
	----- 1998 -----	----- 1997 -----
Current assets		
Cash and cash equivalents (includes restricted cash of \$160 at December 31, 1998)	\$ 408	\$ 587
Accounts receivable, net	56,783	57,972
Inventories, net	8,662	12,390
Deferred income taxes	4,164	4,632
Prepaid income taxes	220	268
Other current assets	487	408
	-----	-----
Total current assets	70,724	76,257
	-----	-----
Property and equipment		
Land and building	346	346
Furniture and equipment	21,677	21,469
Leasehold improvements	2,683	2,750
Property and equipment under capital leases	13,774	13,774
	-----	-----
	38,480	38,339
Accumulated depreciation and amortization	(24,159)	(22,609)
	-----	-----
	14,321	15,730
	-----	-----
Goodwill, net	6,896	12,466
Deferred income taxes	442	385
Other assets	2,868	4,880
	-----	-----
	\$ 95,251	\$109,718
	=====	=====

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

TELOS CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(amounts in thousands, except share data)

LIABILITIES AND STOCKHOLDERS' INVESTMENT (DEFICIT)

	December 31,	
	----- 1998	----- 1997
	-----	-----
Current liabilities		
Accounts payable	\$ 25,206	\$16,912
Accrued compensation and benefits	7,400	8,553
Unearned warranty revenue	1,349	1,135
Current portion, capital lease obligations	379	430
Other current liabilities	3,117	5,401
	-----	-----
Total current liabilities	37,451	32,431
Senior credit facility	36,159	39,945
Senior subordinated notes	18,492	16,930
Capital lease obligations	11,710	12,085
	-----	-----
Total liabilities	103,812	101,391
	-----	-----
Commitments and contingencies (Note 9)		
Redeemable preferred stock		
Senior redeemable preferred stock	5,631	5,207
Class B redeemable preferred stock	--	12,035
Redeemable preferred stock	31,729	29,951
	-----	-----
	37,360	47,193
	-----	-----
Stockholders' investment		
Class A common stock, no par value, 50,000,000 shares authorized, 21,238,980 and 23,076,753 shares issued and outstanding at 1998 and 1997, respectively	65	65
Class B common stock, no par value, 50,000,000 shares authorized, 4,037,628 shares issued and outstanding	13	13
Capital in excess of par	2,116	--
Accumulated deficit	(48,115)	(38,944)
	-----	-----
Total stockholders' investment (deficit)	(45,921)	(38,866)
	-----	-----
	\$ 95,251	\$109,718
	=====	=====

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

TELOS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(amounts in thousands)

	Year Ended December 31,		
	1998	1997	1996
Operating activities:			
Net (loss) income	\$(9,171)	\$ 1,412	\$ 2,208
Adjustments to reconcile net income to cash used in operating activities:			
Depreciation and amortization	4,266	4,098	3,058
Gain on sale of TCS	--	--	(17,176)
Loss on disposal of fixed assets	--	715	--
Goodwill amortization	589	892	1,418
Amortization of debt issuance costs	243	243	243
Accretion of subordinated notes	181	143	78
Provision for inventory obsolescence	1,254	2,150	1,008
Provision for doubtful accounts receivable	39	490	647
Gain on sale of assets	(5,683)	--	--
Provision for net realizable value of other assets	1,743	887	--
Deferred income tax provision (benefit)	434	(1,719)	900
Changes in assets and liabilities			
Increase in accounts receivable	(2,329)	(6,913)	(14,487)
Decrease (increase) in inventories	2,826	2,186	(2,364)
Decrease (increase) decrease in other assets	(76)	795	(2,319)
Increase (decrease) in accounts payable and other liabilities	3,031	(20,559)	11,283
	(2,653)	(15,180)	(15,503)
Cash used in operating activities	(2,653)	(15,180)	(15,503)
Investing activities:			
Proceeds from sale of assets	14,675	--	--
Proceeds from sale of discontinued operations	--	--	31,579
Purchase of property and equipment	(1,250)	(2,589)	(2,558)
Investment in other assets	(2,040)	(3,083)	(1,422)
	11,385	(5,672)	27,599
Cash provided by (used in) investing activities	11,385	(5,672)	27,599
Financing activities:			
(Payments) proceeds from Senior Credit Facility	(3,786)	24,526	(16,894)
Proceeds from debt issuance	1,800	--	3,278
Increase (decrease) in book overdrafts	1,641	(4,838)	3,833
Repayment of long-term debt	--	(651)	--
Retirement of Class B redeemable preferred stock	(6,500)	--	--
Repurchase of 410,000 shares of redeemable preferred stock	(1,640)	--	--
Payments under capital lease obligations	(426)	(379)	(267)
	(8,911)	18,658	(10,050)
Cash (used in) provided by financing activities	(8,911)	18,658	(10,050)
(Decrease) increase in cash and cash equivalents	(179)	(2,194)	2,046
Cash and cash equivalents at beginning of the year	587	2,781	735
	\$ 408	\$ 587	\$ 2,781
	=====	=====	=====
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	\$ 5,228	\$6,872	\$ 5,760
	=====	=====	=====
Income taxes	1,088	\$ 92	\$ 187
	=====	=====	=====
Supplemental schedule of non-cash investing activities:			
Assets under capital lease	\$ --	\$ ---	\$13,154
	=====	=====	=====

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

TELOS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' INVESTMENT (DEFICIT)
(amounts in thousands)

	Class A Common Stock -----	Class B Common Stock -----	Capital In Excess of Par -----	Accumulated Deficit -----	Total Stockholders' Investment (Deficit) -----
Balance December 31, 1995	\$65	\$13	\$7,669	\$(37,356)	\$(29,609)
Senior redeemable preferred stock dividend	--	--	--	(334)	(334)
Class B redeemable preferred stock dividend	--	--	--	(835)	(835)
Redeemable preferred stock dividend	--	--	(3,272)	(1,039)	(4,311)
Redeemable preferred stock accretion	--	--	(1,270)	--	(1,270)
Issuance of Enterworks common stock warrants	--	--	921	--	921
Net income for the year	--	--	--	2,208	2,208
	--	--	-----	-----	-----
Balance December 31, 1996	65	13	4,048	(37,356)	(33,230)
Senior redeemable preferred stock dividend	--	--	(379)	--	(379)
Class B redeemable preferred stock dividend	--	--	(948)	--	(948)
Redeemable preferred stock dividend	--	--	(2,721)	(1,594)	(4,315)
Redeemable preferred stock accretion	--	--	--	(1,406)	(1,406)
Issuance of Net income for the year	--	--	--	1,412	1,412
	--	--	-----	-----	-----
Balance December 31, 1997	65	13	--	(38,944)	(38,866)
Senior redeemable preferred stock dividend	--	--	(423)	--	(423)
Class B redeemable preferred stock dividend	--	--	(347)	--	(347)
Redeemable preferred stock dividend	--	--	(4,068)	--	(4,068)
Redeemable preferred stock accretion	--	--	(1,527)	--	(1,527)
Gain on retirement of Class B redeemable preferred stock	--	--	5,883	--	5,883
Repurchase of 410,000 shares of redeemable preferred stock	--	--	2,178	--	2,178
Issuance of Telos common stock warrants	--	--	420	--	420
Net loss for the year	--	--	--	(9,171)	(9,171)
	--	--	-----	-----	-----
Balance December 31, 1998	\$65	\$13	\$ 2,116	\$(48,115)	\$ (45,921)
	==	==	=====	=====	=====

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

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Business and Organization

Telos Corporation ("Telos" or "the Company") provides enterprise integration services and solutions primarily to the U.S. federal government and industry. In addition to its core competency of software development and systems support services, Telos delivers information security, enterprise integration and networking infrastructure solutions to its customers. The Company, founded in 1968, is incorporated under the laws of the State of Maryland.

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. However, as reflected in the accompanying financial statements, the Company incurred a net loss of \$9.2 million in 1998. This loss included the effect of a \$5.7 million non-recurring gain from the sale of its TIS division. In addition, the Company was not in compliance with several covenants of its Senior Credit Facility, although the lender has provided waivers for the violations and has amended the covenants to conform to the Company's 1999 budget expectations. Based on its budget, the Company anticipates a need for approximately \$10 million of additional financing for 1999. These factors, including the uncertainty surrounding whether and when the additional financing will be secured and whether the Company will meet its budget expectations and bank covenants in 1999, indicate that the Company may be unable to continue as a going concern for a reasonable period of time. The financial statements do not include any adjustments relating to the recoverability of assets and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. The Company's continuation as a going concern is dependent on its ability to obtain the additional financing required, meet its 1999 budgeted cash flow objectives, and comply with the terms of its Senior Credit Facility.

The Company believes that the necessary additional financing will be secured through one or more of the following sources: the sale of a division or asset which is not critical to its strategic goals; additional financing from its lender; or additional equity financing. Alternatives are currently being pursued under each of these sources; however, the required financing has not yet been secured. The Company believes the required funding will be arranged in a timely manner that does not have a significant adverse impact on its operations. However, there can be no assurance that the Company will be able to secure financing sufficient for its needs and at terms favorable to the Company. Additionally, there can be no assurance that the Company will be successful in meeting budget expectations and bank covenants in 1999. Failure by the Company to obtain sufficient financing, meet its budget expectations, or meet its bank covenants may have a material adverse effect on the Company's financial position, results of operations or cash flows.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Telos Corporation and its wholly-owned subsidiaries, Telos Corporation (California), Telos Field Engineering, Inc., and Telos International Corporation, and its substantially owned subsidiary Enterworks, Inc., formerly, enterWorks.com ("Enterworks") (collectively, the "Company"). Significant intercompany transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions used in the preparation of the Company's consolidated financial statements include contract percentage of completion methodology, allowance for accounts receivable, allowance for inventory obsolescence, valuation of goodwill, the valuation allowance for deferred tax assets, employee benefits and estimated useful lives of goodwill, property and equipment and other noncurrent assets, including software development costs. Actual results could differ from those estimates.

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Revenue Recognition

The majority of the Company's sales are made directly or indirectly to the federal government. A substantial portion of the Company's revenues are derived from time and materials and cost reimbursement contracts, under which revenue is recognized as services are performed and costs are incurred. The Company generally recognizes equipment revenue as products are shipped, although certain revenue recognition practices are dependent upon contract terms. Revenue for maintenance contracts is recognized as such services are performed. The Company records loss provisions for its contracts, if required, at the time such losses are identified.

Revenue from the licensing of software is recognized in accordance with American Institute of Certified Public Accountants (AICPA) Statement of Position 97-2 (SOP 97-2), "Software Revenue Recognition", whereby revenue is recognized when a noncancelable revenue agreement is in force, the product has been shipped and no significant obligations remain. Revenue generated from warranty service contracts is recognized ratably over the warranty service period.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less at the date of purchase to be cash equivalents. The Company's cash management program utilizes zero balance accounts. Accordingly, all book overdraft balances have been reclassified to accounts payable.

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Inventories

Inventories are stated at the lower of cost or market, cost being determined primarily on the first-in, first-out method. Substantially all inventories consist of purchased hardware and component computer parts used in connection with system integration services performed by the Company. Inventories also include spare parts of \$729,000 and \$1,329,000 at December 31, 1998 and 1997, respectively, which are utilized to support maintenance contracts. Spare parts inventory is amortized on a straight line basis over five years. An allowance for obsolete, slow-moving or non-salable inventory is provided for all other inventory. This allowance is based on the Company's overall obsolescence experience and its assessment of future inventory requirements. In addition to the product inventory obsolescence stated below, the Company provided for \$50,000 in spares inventory obsolescence and \$114,000 in software inventory obsolescence.

At December 31, 1998 and 1997, the Company's allowance for product inventory obsolescence was \$3,074,000 and \$3,915,000, respectively. The components of the allowance for inventory obsolescence are set forth below (in thousands):

	Balance, Beginning of Year -----	Additions Charged to Costs and Expense -----	Deductions(1) -----	Balance, End of Year -----
Year Ended December 31, 1998	\$ 3,915	\$ 1,090	\$ 1,931	\$ 3,074
Year Ended December 31, 1997	\$ 2,357	\$ 2,150	\$ 592	\$ 3,915
Year Ended December 31, 1996	\$ 1,385	\$ 1,008	\$ 36	\$ 2,357

(1) Inventories written off.

Property and Equipment

Property and equipment is recorded at cost. Depreciation is provided on the straight-line method at rates based on the estimated useful lives of the individual assets or classes of assets as follows:

Buildings	20	Years
Machinery and equipment	3-7	Years
Office furniture and fixtures	5-7	Years
Leasehold improvements		Life of Lease

Leased property meeting certain criteria is capitalized at the present value of the related minimum lease payments. Amortization of property and equipment under capital leases is computed on the straight-line method over the term of the related lease.

Upon sale or retirement of property and equipment, the costs and related accumulated depreciation are eliminated from the accounts, and any gain or loss on such disposition is reflected in the statement of operations. Expenditures for repairs and maintenance are charged to operations as incurred.

Depreciation and amortization expense related to property and equipment, including property and equipment under capital leases, was \$2,460,000, \$2,630,000 and \$2,255,000 for the years ended December 31, 1998, 1997 and 1996, respectively.

Goodwill

Goodwill arose principally from the acquisition of Telos Corporation (California) in 1992 and has been assigned a useful life of twenty years. The useful life considered a number of factors including the Company's maintenance of long-term significant customer relationships for periods of up to twenty-seven years and its strong positions in the marketplace.

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company assesses the potential impairment and recoverability of goodwill on an annual basis and more frequently if factors dictate. Management forecasts are used to evaluate the recovery of goodwill through determining whether amortization of goodwill can be recovered through projected undiscounted future cash flows. If an impairment of goodwill is indicated, the impairment is measured based on projected discounted cash flows using a discount rate reflecting the Company's cost of funds. In addition, the Company may assess the net carrying amount of goodwill using internal and/or independent valuations of the Company.

Accumulated amortization of goodwill at December 31, 1998 and 1997 was \$8,955,000 and \$8,366,000, respectively.

Other Assets

Other noncurrent assets consist principally of deferred software development costs and debt issuance costs. The Company expenses all research and development costs incurred in connection with software development projects until such software achieves technological feasibility, determined based on the achievement of a working model. All costs thereafter are capitalized. The Company amortizes such capitalized costs on a product-by-product basis over the greater of the amount computed using an estimated product life of two years or the ratio that current gross revenues bears to the total of current and anticipated future gross revenues. The Company periodically evaluates the realizability of these capitalized costs through evaluation of anticipated revenue and gross margin as compared to current revenue and gross margin. At the time a determination is made that capitalized amounts are not recoverable based on the estimated cash flows to be generated from the applicable software product, a loss is recognized.

Unamortized software and product costs at December 31, 1998 and 1997 were \$1.9 million and \$3.6 million, respectively. Amortization expense associated with these capitalized software and product costs was \$2,044,000, \$1,128,000 and \$689,000 in 1998, 1997 and 1996, respectively. Additionally, \$1,743,000 and \$887,000 were written off as net realizable value adjustments in the fourth quarter of 1998 and in the fourth quarter of 1997, respectively.

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Debt issuance costs are amortized over the term of the underlying financial instrument, which amortization method does not differ significantly from the effective interest method. Unamortized costs amounted to \$425,000 and \$668,000 at December 31, 1998 and 1997, respectively.

Income Taxes

The Company accounts for income taxes under Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes". Under this asset and liability method, 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 to the 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. The Company provides a valuation allowance that reduces deferred tax assets when it is "more likely than not" that deferred tax assets will not be realized.

Accounting for Stock Based Compensation

The Company accounts for stock-based compensation using the intrinsic value method provided by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." Pro forma disclosures are made as if the fair value measurement provisions of SFAS No. 123 had been used in determining compensation expense (See Note 7).

Research and Development

The Company charges all research and development costs to expense as incurred, until, as in the case of software, technological feasibility is reached after which time such costs are capitalized. During 1998, 1997 and 1996, the Company incurred \$6.1 million, \$1.0 million and \$1.2 million in research and development costs, respectively.

Earnings per Share

In February 1997, the Financial Accounting Standards Board (FASB) issued SFAS No. 128, "Earnings per Share." This Statement establishes standards for computing and presenting earnings per share (EPS). As the Company does not have publicly held common stock or potential common stock, this Statement is not applicable and, accordingly, no EPS data is reported for any of the years presented.

Financial Instruments

The Company uses various methods and assumptions to estimate the fair value of its financial instruments. Due to their short-term nature, the carrying value of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximates fair value. The fair value of long-term debt is based on the discounted cash flows for similar term borrowings based on market prices for the same or similar issues. The Company has not estimated the fair value of its subordinated debt or its redeemable preferred stock. The Company does not deem such estimation practicable due to the unique features of these instruments.

Fair value estimates are made at a specific point in time, based on relevant market information. These estimates are subjective in nature and involve matters of judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Reclassifications

Certain reclassifications have been made to the 1997 and 1996 financial statements to conform to the current period presentation.

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Recent Accounting Pronouncements

In March 1998, the American Institute of Certified Public Accountants issued Statement of Position 98-1 ("SOP 98-1"), "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." This standard requires companies to capitalize qualifying computer software costs which are incurred during the application development stage and amortize them over the software's estimated useful life. SOP 98-1 is effective for fiscal years beginning after December 15, 1998. The Company is currently evaluating the impact of SOP 98-1 on its financial statements and related disclosures.

In November 1998, the American Institute of Certified Public Accountants issued Statement of Position 98-9 ("SOP 98-9"), "Modification of SOP 97-2, "Software Revenue Recognition", with Respect to Certain Transactions". The Company is currently evaluating the impact of SOP 98-9 on its financial statements and related disclosures.

Note 2. Sale of Assets

In February 1998, Telos sold substantially all of the net assets of one of its support services divisions, Telos Information Systems ("TIS"), to NYMA, Inc., a subsidiary of Federal Data Corporation of Bethesda, Maryland, for approximately \$14.7 million in cash. In connection with this sale, the Company has recorded a gain of \$5.7 million in its consolidated statement of income for the year ended December 31, 1998, which included a write-off of \$4.9 million of goodwill allocated to TIS operations.

Note 3. Discontinued Operations

On December 27, 1996, the Company sold substantially all of the assets of its consulting division, Telos Consulting Services (TCS), to COMSYS Technical Services, Inc., a subsidiary of COREStaff, Inc. for approximately \$31.6 million. The resulting gain from the sale of TCS of \$11.5 million included a write-off of \$6.9 million of goodwill allocated to the TCS operations.

The sale of TCS has been treated as a discontinued operation in accordance with APB Opinion Number 30 ("APB 30"). Pursuant to APB 30, the revenue, costs and expenses of TCS have been excluded from their respective captions in the Company's consolidated statements of operations and the net results of these operations have been reported separately as "Income (loss) from discontinued operations." Included in the results of the discontinued operations is allocated interest expense of \$1.5 million for 1996. Interest has been allocated based on the net assets of the discontinued operations in relation to the Company's consolidated net assets plus non-specific debt. Additionally, goodwill amortization of \$418,000 for 1996 has been included in the results of the discontinued operations. TCS had revenue of \$33.1 million for 1996.

Note 4. Revenue and Accounts Receivable

Revenue resulting from contracts and subcontracts with federal, state, and local governments accounted for 94.9%, 96.1% and 86.4% of consolidated revenue in 1998, 1997 and 1996, respectively. As the Company's primary customer is the federal government, the Company has a concentration of credit risk associated with its accounts receivable. However, the Company does not believe the likelihood of loss arising from such concentration is significant. The Company performs ongoing credit evaluations of its customers and generally does not require collateral from its customers. The Company maintains allowances for potential losses.

The components of accounts receivable are as follows (in thousands):

	December 31,	
	1998	1997
	----	----
Billed accounts receivable	\$48,222	\$ 48,207
	-----	-----
Amounts billable upon acceptance by customer	1,422	4,485
Amounts currently billable	7,878	6,244
	-----	-----
Total unbilled accounts receivable	9,300	10,729
	-----	-----
Allowance for doubtful accounts	(739)	(964)
	-----	-----
	\$56,783	\$ 57,972
	=====	=====

The provision for doubtful accounts receivable was \$39,000, \$490,000 and \$647,000 for 1998, 1997 and 1996, respectively. Reductions to the allowance were primarily due to write-offs of accounts receivable and other adjustments.

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5. Debt Obligations

Senior Revolving Credit Facility

At December 31, 1998, the Company has a \$45 million Senior Revolving Credit Facility (the "Facility") with a bank which expires on July 1, 2000 and has an outstanding balance of \$36.2 million. Borrowings under the facility are collateralized by certain assets of the Company (primarily accounts receivable and inventory), and the amount of the available borrowings fluctuates based on the underlying asset borrowing base and the Company's working capital requirements. The agreement requires payment of a fee of .25% of the unused portion of the Facility. The Facility bears interest at 1.00%, subject to certain adjustments, over the bank's base rate, which was 9.00% at December 31, 1998. The weighted average interest rate on the outstanding borrowings under the Facility was 9.95% for 1998 compared with 9.44% for 1997. At December 31, 1998, the Company had approximately \$6.7 million available under the Facility.

The Facility has various covenants which may, among other things, restrict the ability of the Company to merge with another entity, sell or transfer certain assets, pay dividends and make other distributions beyond certain limitations. The Facility also requires the Company to meet certain leverage, net worth, interest coverage and operating goals. At December 31, 1998, the Company was not in compliance with several covenants contained in the Facility; however, the bank has waived this non-compliance. In addition, the bank has amended the covenants to conform to the Company's 1999 budget expectations.

The carrying value of the Facility at December 31, 1998 and 1997 approximates fair value.

Senior Subordinated Notes

In 1995 the Company issued Senior Subordinated Notes ("Notes") to certain shareholders. The Notes are classified as either Series B or Series C. Series B Notes, which total \$6.5 million at December 31, 1998 and 1997, are collateralized by fixed assets of the Company. Series C Notes, which total \$7.9 million at December 31, 1998 and 1997, are unsecured. Both the Series B and Series C Notes have a maturity date of October 1, 2000 and have interest rates ranging from 14% to 17%. Interest is paid quarterly on January 1, April 1, July 1, and October 1 of each year. The Notes can be prepaid at the Company's option. Additionally, these Notes have a cumulative payment premium of 13.5% per annum payable only upon certain circumstances. These circumstances include an initial public offering of the Company's common stock or a significant refinancing, to the extent that net proceeds from either of the above events are received and are sufficient to pay the premium. Due to the contingent nature of the premium payment, the associated premium expense will only be recorded after the occurrence of a triggering event. At December 31, 1998, the prepayment premium that would be due upon a triggering event is \$7,620,000.

In November 1998, the Company issued additional Senior Subordinated Notes to certain shareholders which are classified as Series D. The Series D Notes total \$1.8 million and are unsecured. The Series D Notes have a maturity date of October 1, 2000 and bear interest at 14% per annum. Interest is paid quarterly on January 1, April 1, July 1, and October 1 of each year. The notes can be prepaid at the Company's option. These Notes contain the same payment premium provisions as the Series B and Series C Notes (see above). In connection with the debt, the Company issued 1,500,000 warrants to purchase shares of the Company's Class A Common Stock. The warrants have an exercise price of \$.01 and an exercise period of 22 months. The Company has assigned a value to the warrants of \$420,000 which has been included in capital in excess of par. The amount outstanding of the subordinated debt was approximately \$1,396,000 at December 31, 1998.

Enterworks Subordinated Notes

During 1996, the Company completed a private financing whereby \$3,277,960 of 8% subordinated debt of Enterworks was issued. Investors included certain members of the Board of Directors and management and certain shareholders of the Company. The subordinated debt has a five year maturity. Interest is paid quarterly, beginning January 1 1998, on the first of January, April, July and October each year. In connection with the debt, the Company issued 2,048,725 warrants to purchase shares of Enterworks common stock. The warrants have an exercise price of one dollar and an exercise period of ten years. The Company has assigned a value to the warrants of \$921,926 which has been included in capital in excess of par. The amount outstanding of this subordinated debt was approximately \$2,723,000 and \$2,557,000 at December 31, 1998 and 1997, respectively.

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6. Redeemable Preferred Stock

Senior Redeemable Preferred Stock

The components of the senior redeemable preferred stock are Series A-1 and Series A-2, each with \$.01 par value and 1,250 and 1,750 shares authorized, issued and outstanding, respectively. The Series A-1 and Series A-2 carry a cumulative per annum dividend rate of 14.125% per annum of their liquidation value of \$1,000 per share. The dividends are payable semi-annually on June 30 and December 31 of each year. The liquidation preference of the preferred stock is the face amount of the Series A-1 and A-2 Stock (\$1,000 per share), plus all accrued and unpaid dividends. The Company is required to redeem all of the outstanding shares of the stock on December 31, 2001, subject to the legal availability of funds. Mandatory redemptions are required from excess cash flows, as defined in the stock agreements. The Series A-1 and A-2 redeemable preferred stock is senior to all other present and future equity of the Company. The Series A-1 is senior to the Series A-2. The Company has not declared dividends on its senior redeemable preferred stock since its issuance. At December 31, 1998 and 1997 undeclared, unpaid dividends relating to Series A-1 and A-2 redeemable preferred stock totaled \$2,631,000 and \$2,207,000, respectively, and have been accrued and are included in the Series A-1 and A-2 redeemable preferred stock balances.

Class B Redeemable Preferred Stock

In May 1998 the Company entered into an agreement, with one of its shareholders, Union de Banques Suisses (Luxemborg) S.A. ("UBS"), to retire all of UBS's equity holdings in the Company. These equity holdings included all of the 7,500 shares of the Company's Class B Preferred Stock with a liquidation preference of \$1,000 per share, and the cumulative unpaid dividends of approximately \$4.8 million, 1,837,773 shares of the Company's Class A Common Stock, and 1,312,695 of the Company's Class A Common Stock warrants. The purchase price to retire these interests was \$6.5 million, of which \$5 million was paid in cash, and the remaining \$1.5 million was funded by two separate letters of credit secured by the Company's lender. UBS was paid these letters of credit in the amount of \$1.0 million in September 1998 and in the amount of \$500,000 in November 1998.

The \$5.9 million excess of the carrying amount of the Class B Redeemable Preferred Stock over the redemption price was recorded as an increase in capital in excess of par; there was no impact on income from this transaction.

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12% Cumulative Exchangeable Redeemable Preferred Stock

A maximum of 6,000,000 shares of 12% Cumulative Exchangeable Redeemable Preferred Stock, par value \$.01 per share, has been authorized for issuance.

The Company initially issued 2,858,723 shares of 12% Cumulative Exchangeable Redeemable Preferred Stock (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 the Company is making periodic accretions under the interest method of the excess of the redemption value over the recorded value. Accretion for the years ended December 31, 1998 and 1997 was \$1,528,000 and \$1,406,000, respectively. The Company declared stock dividends totaling 736,863 shares in 1990 and 1991.

The Public Preferred Stock has a 20 year maturity, however, the Company must redeem, out of funds legally available, 20% of the Public Preferred Stock on the 16th, 17th, 18th and 19th anniversaries of November 21, 1989, leaving 20% to be redeemed at maturity. On any dividend payment date after November 21, 1991, the Company may exchange the Public Preferred Stock, in whole or in part, for 12% Junior Subordinated Debentures that are redeemable upon terms substantially similar to the Public Preferred Stock and subordinated to all indebtedness for borrowed money and like obligations of the Company.

The Public Preferred Stock accrues a semi-annual dividend at an annual rate of 12% (\$1.20) per share, based on the liquidation preference of \$10 per share, and is fully cumulative. Through November 21, 1995, the Company had the option to pay dividends in additional shares of Preferred Stock in lieu of cash. Dividends in additional shares of the Preferred Stock are paid at the rate of 0.06 of a share of the Preferred Stock for each \$.60 of such dividends not paid in cash. Dividends are payable by the Company, provided the Company has legally available funds under Maryland law, when and if declared by the Board of Directors, commencing June 1, 1990, and on each six month anniversary thereof. For the years 1992 through 1994 and for the dividend payable June 1, 1995, the Company has accrued undeclared dividends in additional shares of preferred stock. These accrued dividends are valued at \$3,950,000. Had the Company accrued such dividends on a cash basis, the total amount accrued would have been \$15,101,000. For the cash dividends payable since December 1, 1995, the Company has accrued \$14,855,000.

The Company has not declared or paid dividends since 1991, due to restrictions and ambiguities relating to the payment of dividends contained within its charter, its working capital facility agreement, and under Maryland law.

In November 1998, the Company retired 410,000 shares of the Public Preferred Stock held by certain shareholders. The Company repurchased the stock at \$4.00 per share. The carrying value of these shares was \$3.8 million, and the \$2.2 million excess of the carrying amount of these shares of Public Preferred Stock over the redemption price of \$1.6 million was recorded as an increase in capital in excess of par; there was no impact on income from this transaction.

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7. Stockholders' Investment and Employee Benefit Plans

Common Stock

The relative rights, preferences, and limitations of the Class A common stock and the Class B common stock are in all respects identical. The holders of the common stock have one vote for each share of common stock held. Subject to the prior rights of the Public Preferred Stock or any series of the Series A redeemable preferred stock, holders of Class A and the Class B common stock are entitled to receive such dividends as may be declared.

Stock Warrants

In 1992, the Company issued to the holder of the Class B Redeemable Preferred Stock a common stock warrant to purchase up to 3,150,468 shares of Class A common stock of the Company. The stock warrant was valued at \$1,109,000 and such amount was shown as an increase in capital in excess of par. The warrant was initially exercisable to purchase up to 1,181,425 shares at any time. The warrant increased by 656,348 shares on June 30, 1993 and July 1, 1994 and by 656,347 shares on July 1, 1995. Through December 31, 1997, 1,837,773 shares of Class A Common Stock has been purchased under the warrant. The price per share at which shares have been purchased and are purchasable upon the exercise of the warrant is \$.0025. In May 1998, the Company retired the remaining 1,312,695 Class A common stock warrants held by the holder of the Class B Redeemable preferred stock (See Note 6).

In 1994, Toxford Corporation deposited \$3 million with the Company's bank to provide the Company with increased borrowing capability under its Facility (see Note 5). In exchange, Toxford Corporation was issued 500,000 shares of Class A common stock for which the Company recorded additional interest expense of \$410,000. The Company also granted Toxford Corporation warrants to acquire 7,228,916 shares of the Company's Class A common stock at a purchase price of \$.83 per share which approximated the estimated market value of the Company's common stock at the issuance date. In November 1998, 840,000 of these warrants were transferred to certain other shareholders of the Company. The warrant is fully exercisable and has a term of ten years from the date of issue.

Stock Options

The Company has granted stock options to certain employees of the Company under four plans. The Long-Term Incentive Compensation Plan was adopted in 1990 ("1990 Stock Option Plan") and had option grants under it through 1993. In 1993, stock option plan agreements were reached with certain employees. In 1996, the Board of Directors approved and the shareholders ratified the 1996 Stock Option Plan ("1996 Stock Option Plan"). The Company also approved an Enterworks stock option plan ("1996 Enterworks Option Plan") during 1996.

The Company generally grants options under its respective plans at the estimated fair value at the date of grant. Fair value is determined by the Trustees of the Plan or management based on third party appraisals and information with respect to the business operations.

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1990 Stock Option Plan

Under the terms of the 1990 Stock Option Plan, 2,168,215 shares of the Company's Class A common stock are available for issuance under options to key employees, including officers and directors. The option price of \$1.42 and \$1.07 per share, determined by the Board of Directors, was not less than the fair market value at the date of the grant and the options are generally exercisable over a four year period. Additional information as to these options is as follows:

Stock Option Activity		
	Number of Shares (000's)	Weighted Average Exercise Price
Outstanding at December 31, 1995	598	\$1.42
Granted	--	--
Exercised	--	--
Canceled	(13)	1.42
	-----	-----
Outstanding at December 31, 1996	585	\$1.42
Granted	--	--
Exercised	--	--
Canceled	(55)	1.42
	-----	-----
Outstanding at December 31, 1997	530	\$1.42
Granted	1,495	1.07
Exercised	--	--
Canceled	(85)	1.42
	-----	-----
Outstanding at December 31, 1998	1,940	\$1.27
	=====	=====

1996 Stock Option Plan

The 1996 Stock Option Plan allows for the award of up to 6,644,974 shares of Class A common stock at an exercise price of not lower than fair market value at the date of grant. Vesting of the stock options for key employees is based both upon the passage of time and certain key events occurring including an initial public offering or a change in control. Vesting for options granted to employees is based upon the passage of time, generally four years. The stock options may be exercised over a ten year period subject to the vesting requirements. Additional information as to these options follows:

Stock Option Activity		
	Number of Shares (000's)	Weighted Average Exercise Price
Outstanding at December 31, 1995	--	--
Granted	3,767	0.95
Exercised	--	--
Canceled	(29)	0.97
	-----	-----
Outstanding at December 31, 1996	3,738	\$0.95
Granted	772	1.01
Exercised	--	--
Canceled	(259)	0.97
	-----	-----
Outstanding at December 31, 1997	4,251	\$0.96
Granted	1,447	1.07
Exercised	--	--
Canceled	(143)	0.98
	-----	-----
Outstanding at December 31, 1998	5,555	\$0.99
	=====	=====

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Other Option Plans

In 1993, stock option plan agreements were reached to provide Mr. John Wood, CEO and President, and Mr. Joseph Beninati, former Chairman, with options to each purchase up to 700,459 shares of the Company's Class A common stock from the Company at \$0.50 per share. Under the terms of the agreements, 350,230 shares vested immediately and the remainder vested ratably over the next twelve months. The Company recorded compensation expense related to these options based upon the difference between the exercise price and the estimated fair value of \$0.82 per share at the measurement date of the stock option. Mr. Beninati's agreement was canceled in 1996 and the shares now available will be administered under the same terms as the 1996 Stock Option Plan. Additional information as to these options follows:

	Stock Option Activity	
	Number of Shares (000's)	Weighted Average Exercise Price
Outstanding at December 31, 1995	1,401	\$0.50
Granted	--	--
Exercised	--	--
Canceled	--	--
	-----	-----
Outstanding at December 31, 1996	1,401	\$0.50
Granted	653	1.01
Exercised	--	--
Canceled	(700)	0.50
	-----	-----
Outstanding at December 31, 1997	1,354	\$0.75
Granted	--	--
Exercised	--	--
Canceled	--	--
	-----	-----
Outstanding at December 31, 1998	1,354	\$0.75
	=====	=====

John Wood has the option to cancel the 1993 stock options discussed above or receive an equal number of options under the 1996 plan at an exercise price of \$0.95 per share. Additionally, the effect on the 1996 stock option plan as of December 31, 1998 would be to increase the number of shares outstanding to 6,255,000 with a weighted average exercise price of \$.98 per share.

1996 Enterworks Option Plan

In 1996, Enterworks implemented a stock option plan that allows for the award of up to 5,000,000 shares of common stock at an exercise price of not lower than fair market value at the date of grant. Vesting of the stock options for key employees is based both upon the passage of time and certain key events occurring including an initial public offering or a change in control. Vesting for options granted to employees is based upon the passage of time, generally four years. The stock options may be exercised over a ten year period subject to the vesting requirements.

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The weighted-average fair value of options granted under the 1990 Stock Option Plan, the Other Stock Option Plan, the 1996 Stock Option Plan, and the 1996 Enterworks Option Plan was \$0.26, \$0, \$0.25 and \$0.19 per share, respectively, in 1998 and \$0, \$0.23, \$0.28 and \$0.22 per share, respectively, in 1997. Had the Company determined compensation cost consistent with SFAS No. 123 methodology, net (loss) income would have been (\$9,666,000), \$1,073,000 and \$2,100,000 in 1998, 1997 and 1996, respectively. Significant assumptions used in determining the fair value of each option grant at the date of grant were as follows:

	1990 Stock Option Plan			Other Stock Option Plan		
	1998	1997	1996	1998	1997	1996
Expected dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Expected stock price volatility	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Risk free interest rate	5.54%	--	--	--	6.28%	--
Expected life of options	5.3 yrs	--	--	--	4.0 yrs	--

	1996 Stock Option Plan			1996 Enterworks Option Plan		
	1998	1997	1996	1998	1997	1996
Expected dividend yield	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Expected stock price volatility	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Risk free interest rate	5.54%	6.28%	6.66%	5.18%	6.00%	6.73%
Expected life of options	4.8 yrs	5.5 yrs	6.0 yrs	5.2 yrs	5.5 yrs	6.0 yrs

Because the pro forma disclosures under SFAS No. 123 only apply to stock options granted in or after 1995, pro forma net income for 1996, 1997 and 1998 is not necessarily indicative of future periods.

Telos Shared Savings Plan

The Company sponsors a defined contribution employee savings plan (the "Plan") under which substantially all full-time employees are eligible to participate. The Company matches one-half of voluntary participant contributions to the Plan up to a maximum Company contribution of 3% of a participant's salary. Total Company contributions to this Plan for 1998, 1997 and 1996 were \$835,000, \$1,335,000, and \$1,679,000, respectively.

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8. Income Taxes

The provision (benefit) for income taxes includes the following (in thousands):

	For The Year Ended December 31,		
	----- 1998 -----	----- 1997 -----	----- 1996 -----
Current provision (benefit)			
Federal	\$ --	\$ --	\$ (421)
State	669	387	--
	-----	-----	-----
Total current	669	387	(421)
	-----	-----	-----
Deferred provision (benefit)			
Federal	568	(1,464)	(4,527)
State	(134)	(255)	(791)
	-----	-----	-----
Total deferred	434	(1,719)	(5,318)
	-----	-----	-----
Total provision (benefit)	\$ 1,103	\$(1,332)	\$ (5,739)
	=====	=====	=====

The provision (benefit) for income taxes varies from the amount determined by applying the federal income tax statutory rate to the income or loss before income taxes. The reconciliation of these differences is as follows:

	For the Year Ended December 31,		
	----- 1998 -----	----- 1997 -----	----- 1996 -----
Computed expected income tax provision (benefit)	(34.0)%	34.0 %	(34.0)%
Goodwill amortization	2.4	379.6	2.2
State income taxes, net of federal income tax benefit	(1.8)	5.9	(5.9)
Change in valuation allowance for deferred tax assets	24.9	(2,214.0)	0.2
Meals and entertainment	1.1	111.8	--
Sale of division/other	20.9	17.2	0.6
	-----	-----	-----
	13.5 %	(1,665.5)%	(36.9)%
	=====	=====	=====

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1998 and 1997 are as follows (in thousands):

	December 31,	
	----- 1998 -----	----- 1997 -----
Deferred tax assets:		
Accounts receivable, principally due to allowance for doubtful accounts	\$ 153	\$ 201
Allowance for inventory obsolescence and amortization	1,377	1,728
Accrued liabilities not currently deductible	794	999
Accrued compensation	1,562	2,190
Deferred office rent and accrued sublease liabilities	--	25
Property and equipment, principally due to differences in depreciation methods	396	1,165
Net operating loss carryforwards	5,660	3,140
Alternative minimum tax credit carryforward	703	703
Total gross deferred tax assets	10,645	10,151
Less valuation allowance	(4,987)	(2,974)
Net deferred tax assets	5,658	7,177
Deferred tax liabilities:		
Unbilled accounts receivable, deferred for tax purposes	(317)	(800)
Software development costs	(735)	(1,360)
Total deferred tax liabilities	(1,052)	(2,160)
Net deferred tax assets	\$4,606	\$5,017
	=====	=====

The net change in the valuation allowance was an increase of \$2,013,000 for 1998 and a decrease of \$1,728,000 for 1997. Included in the change in the valuation allowance were decreases of approximately \$23,000 and \$187,000 for 1998 and 1997, respectively, related to the reversal of temporary differences acquired from Telos Corporation (California). The total tax benefits of future deductible temporary differences acquired in connection with the Telos Corporation acquisition were \$6,097,000 at January 14, 1992. As of December 31, 1998, all of the tax benefits acquired have reversed.

At December 31, 1998, for federal income tax purposes the Company had net operating loss carryforwards of \$12,741,000 available to offset future regular taxable income. These net operating loss carryforwards expire in 2011 through 2014. Additionally, \$10,943,000 of alternative minimum tax net operating loss carryforwards are available to offset future alternative minimum taxable income. These alternative minimum tax net operating loss carryforwards also expire from 2011 to 2014. In addition, the Company has \$703,000 of alternative minimum tax credits available to be carried forward indefinitely to reduce future regular tax liabilities.

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 9. Commitments and Contingencies

Leases

The Company leases office space and equipment under non-cancelable operating and capital leases with various expiration dates, some of which contain renewal options.

On March 1, 1996, the Company entered into a twenty year capital lease for a building that serves as its corporate headquarters. The Company has accounted for this transaction as a capital lease and has accordingly recorded assets and a corresponding liability of approximately \$12.3 million. Under the terms of the lease, the landlord furnished the Company with \$1.3 million to fund tenant improvements and other building costs. The Company's former headquarters facility was leased with a lease expiration date of March 31, 1997. In 1996, the Company recorded \$781,000 of additional expense for the remaining lease obligation of its former headquarters facility.

The following is a schedule by years of future minimum payments under capital leases together with the present value of the net minimum lease payments as of December 31, 1998 (in thousands):

	Property -----	Equipment -----	Total -----
1999	\$ 1,447	\$ 140	\$ 1,587
2000	1,447	103	1,550
2001	1,447	54	1,501
2002	1,447	--	1,447
2003	1,447	--	1,447
Remainder	17,655	--	17,655
	-----	-----	-----
Total minimum obligations	24,890	297	25,187
Less amounts representing interest	(13,033)	(65)	(13,098)
	-----	-----	-----
Net present value of minimum obligations	11,857	232	12,089
Less current portion	(274)	(105)	(379)
	-----	-----	-----
Long term capital lease obligations at December 31, 1998	\$11,583	\$127	\$11,710
	=====	===	=====

Accumulated amortization for property and equipment under capital leases at December 31, 1998 and 1997 is \$2,019,000 and \$1,196,000, respectively.

Future minimum lease payments for all non-cancelable operating leases at December 31, 1998 are as follows (in thousands):

1999	\$2,369
2000	1,543
2001	590
2002	304
2003	248
Remainder	677

Total minimum lease payments	\$5,731
	=====

Net rent expense charged to operations for 1998, 1997, and 1996 totaled \$2,001,000, \$2,545,000, and \$4,556,000, respectively.

Legal

The Company is a party to various other lawsuits arising in the ordinary course of business. In the opinion of management, while the results of litigation cannot be predicted with certainty, the final outcome of such matters will not have a material adverse effect on the Company's consolidated financial position or results of operations.

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10. Related Parties

In 1996, the Company paid previously accrued advisory fees of \$525,000 to the firm Beninati and Wood, Inc. Mr. John B. Wood became an employee of the Company in 1992 and serves as President and Chief Executive Officer and a Director of the Company. Mr. Joseph P. Beninati served as Chairman of the Board for the majority of 1994 before resigning January 5, 1995. The Company paid Mr. Beninati \$165,000 annually subject to a three year employment agreement that began in 1995. Mr. Beninati resigned from the Board in 1996 and received his final payment in 1998.

Mr. John R. Porter, a major shareholder, has a consulting agreement with the Company whereby he is compensated for specific services. Expense recorded pursuant to this agreement was \$200,000 in both 1998 and 1997.

Mr. Byers, a Director of the Company, has a consulting agreement with the Company to help the Company expand its business operations into the international marketplace. Under this agreement Mr. Byers receives \$10,500 a month for his services. Mr. Byers was compensated \$125,000, \$130,000 and \$128,000 for 1998, 1997 and 1996, respectively. This consulting agreement was terminated in the fourth quarter of 1998.

Note 11. Reportable Business Segments

The Company adopted SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information", in 1998 which changes the way the Company reports information about its operating segments. The information for 1997 and 1996 has been restated from the prior year's presentation in order to conform to the 1998 presentation.

The Company has three reportable segments:

Systems and Support Services - provides software development and support services for software and hardware including technology insertion, system redesign and software re-engineering. This segment consists of four divisions - solutions, services, international, and systems (systems was sold in February 1998 as discussed in Note 2). The principal market for this segment is the Federal government and its agencies.

Products - delivers information security, enterprise integration and networking infrastructure solutions to its customers. These solutions include providing commercial hardware, software and services to its customers. The Products group is capable of staging, installing and deploying large network infrastructures with virtually no disruption to customer's ongoing operations. The principal market for this segment is the Federal government and its agencies.

Enterworks - this group helps companies build the fast and flexible information infrastructure they need to compete in a global economy. Though web-enabled integration of disparate data and intelligent business process flows, their software links employees, customers and partners in ways that make the virtual enterprise a reality. Their products include Virtual DB and Enterworks Process Manager. Enterworks' advanced solutions serve healthcare, financial services, manufacturing and government customers worldwide.

The accounting policies of the reportable segments are the same as those described in Note 1. The Company evaluates the performance of its operating segments based on revenue, gross profit and income before goodwill amortization, income taxes, non-recurring items and interest income or expense.

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Summarized financial information concerning the Company's reportable segments is shown in the following table. The "other" column includes corporate related items.

The Company has excluded TCS amounts from external and internal revenues, and segment profit (loss) disclosures as this business was sold in December 1996 and has been treated as a disposal of a segment of a business under APB 30 (Note 3).

	Systems and Support Services -----	Products -----	Enterworks -----	Other (1) -----	Total -----
1998					
External Revenues	\$ 98,277	\$101,736	\$ 7,073	\$ --	\$ 207,086
Intersegment Revenues	\$ 970	\$ 2,622	\$ 1	\$ --	\$ 3,593
Gross profit	\$ 14,046	\$ 8,583	\$ 1,542	\$ --	\$ 24,171
Segment profit (loss)(4)	\$ 4,849	\$ 14	\$ (11,534)	\$ --	\$ (6,671)
Total assets	\$ 45,340	\$ 24,206	\$ 6,119	\$19,586	\$ 95,251
Capital Expenditures	\$ 179	\$ 49	\$ 587	\$ 435	\$ 1,250
Depreciation & Amortization(2)	\$ 557	\$ 479	\$ 2,332	\$ 1,487	\$ 4,855
1997					
External Revenues	\$121,052	\$129,337	\$ 3,398	\$ --	\$ 253,787
Intersegment Revenues	\$ 667	\$ 1,387	\$ 4	\$ --	\$ 2,058
Gross profit	\$ 20,614	\$ 14,875	\$ (132)	\$ --	\$ 35,357
Segment profit (loss)(4)	\$ 10,229	\$ 3,977	\$ (5,903)	\$ --	\$ 8,303
Total assets	\$ 55,834	\$ 24,323	\$ 6,374	\$23,187	\$ 109,718
Capital Expenditures	\$ 330	\$ 688	\$ 480	\$ 1,091	\$ 2,589
Depreciation & Amortization(2)	\$ 716	\$ 929	\$ 1,075	\$ 2,270	\$ 4,990
1996					
External Revenues	\$101,535	\$ 85,220	\$ 2,140	\$ --	\$ 188,895
Intersegment Revenues	\$ 946	\$ 968	\$ 69	\$ --	\$ 1,983
Gross profit	\$ 11,237	\$ 8,422	\$ 955	\$ --	\$ 20,614
Segment profit (loss)(4)	\$ 593	\$ (5,362)	\$ (3,672)	\$ --	\$ (8,441)
Total assets	\$ 54,975	\$ 27,885	\$ 3,284	\$23,920	\$ 110,064
Capital Expenditures(3)	\$ 150	\$ 1,087	\$ 554	\$ 656	\$ 2,447
Depreciation & Amortization(2)	\$ 1,417	\$ 949	\$ 502	\$ 1,126	\$ 3,994

- (1) Corporate assets are principally property and equipment, cash and other assets.
- (2) Depreciation and amortization includes amounts relating to property and equipment, goodwill, deferred software costs and spare parts inventory. The depreciation and amortization disclosure above is net of TCS depreciation and amortization of \$482 for 1996.
- (3) The 1996 capital expenditure disclosure is net of TCS capital expenditures of \$111.
- (4) Segment profit (loss) represents operating income (loss) before goodwill amortization.

The Company does not have material international revenues, profit (loss), assets or capital expenditures. The Company's business is not concentrated in a specific geographical area within the United States, as it has 56 separate facilities located in 19 states.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

PART III

Item 10. Directors and Executive Officers of the Registrant

Dr. Fred Charles Ikle, Chairman of the Board

Dr. Ikle (age 74) was elected to the Company's Board of Directors on January 31, 1994 and was elected Chairman of the Board in January 1995. He is Chairman of Conservation Management Corporation and Director of the Zurich-American Insurance Companies. Dr. Ikle is also a Director of the National Endowment for Democracy and a Distinguished Scholar at the Center for Strategic & International Studies. From 1981 to 1988, Dr. Ikle served as Under Secretary of Defense for Policy.

Julio E. Heurtematte, Jr., Director

Mr. Heurtematte (age 62) was elected to the Company's Board of Directors on July 31, 1998. He has been a private consultant since 1989, specializing in international projects, trade and investments. From 1963 to 1989, he held various positions at the InterAmerican Development Bank ("IAD"), most recently as the deputy Manager for Project Analysis. From 1979 to 1989, Mr. Heurtematte was also a member of IAD Bank's Pension Fund Investment Committee. Mr. Heurtematte is also a member of the Board of Directors of Trans World Gaming Corporation.

Malcolm M.B. Sterrett, Director

Mr. Sterrett (age 55) is a private investor and was elected to the Company's Board of Directors on July 31, 1998. From 1989 to 1993, he was a partner at the law firm of Pepper Hamilton & Scheetz in Washington, D.C. From 1988 to 1989, he served as General Counsel to the U.S. Department of Health and Human Services and from 1982 to 1988 he was a Commissioner on the U.S. Interstate Commerce Commission. Prior thereto, he was Vice President and General Counsel to the United States Railway Association and served as Staff Director and Counsel to the U.S. Senate Committee on Commerce, Science and Transportation. Mr. Sterrett is also a member of the Board of Directors of Trans World Gaming Corporation.

John B. Wood, Director, President and Chief Executive Officer

Mr. Wood (age 35) was elected President and Chief Executive Officer on February 16, 1994. Mr. Wood was appointed Chief Operating Officer on October 8, 1993 after serving as Executive Vice President from May of 1992. He was elected to the Board of Directors on May 13, 1992. Mr. Wood joined the Company on February 13, 1992. Prior to joining the Company, Mr. Wood was a founder of Beninati & Wood, Inc., an investment banking firm which had provided services to the Company.

Dr. Stephen D. Bryen, Director

Dr. Stephen Bryen (56) was elected to the Company's Board of Directors on January 31, 1994. He currently serves as a Director in Jefferson Partners, L.L.C., a strategic management consulting and merchant banking firm with offices in Washington, D.C. and New York and as Senior Vice President of L-3 Network Security, LLC, in Denver, Colorado. Dr. Bryen currently serves on the board of C-MAC Industries in Mechanicsburgh, Pennsylvania and is the senior technical advisor to Hollinger Digital Corporation in New York. From 1981 to 1988 Dr. Bryen served as the Deputy Under Secretary of Defense for Trade Security Policy and as the Director of the Defense Technology Security Administration, which he founded.

Norman P. Byers, Director

Mr. Byers (age 52) was elected to the Board of Directors on January 31, 1994. He has been president of Byers Consulting, a Fairfax County, Virginia international business consulting firm since July 1996. Before that appointment, he had served as the President of International Strategies Limited, another local international business consulting firm. From 1968 until his retirement in 1989, Mr. Byers served in a variety of operational and staff positions in the United States Air Force.

David S. Aldrich, Vice President, Chief Operating Officer

Mr. Aldrich (age 39) joined the Company in September 1996 as Vice President, Corporate Development and Strategy. Prior to joining the Company, he was a partner in the Financial Advisory Services Group - Corporate Finance at Coopers & Lybrand L.L.P. Prior to joining Coopers & Lybrand L.L.P. in 1991, Mr. Aldrich was Senior Vice President at Dean Witter Capital Corp., the merchant banking arm of Dean Witter Reynolds, Inc. Mr. Aldrich was appointed to the position of Chief Operating Officer of the Company in January 1999.

William L. Prieur Brownley, Vice President and General Counsel

Mr. Brownley (age 42) joined the Company in April 1991 and is responsible for the management of the Company's legal affairs. For the five years prior to joining the Company, he served as Assistant General Counsel and then as General Counsel at Infotechnology Inc., an investment company whose holdings included various companies in the communications industry.

Gerald D. Calhoun, Vice President, Human Resources, and Corporate Secretary, Telos Corporation and Enterworks, Inc.

Mr. Calhoun (age 49) joined the Company as Vice President, Human Resources, in August 1989. Prior to joining the Company he served as Corporate Director, Risk and Financial Management of BDM International Corp., an information technology consulting services company, Vice President, Human Resources of Halifax Corp. a technical services company, and as Director for the U.S. Department of Labor, Employment Standards Administration.

Mark W. Hester, former Executive Vice President and Chief Operating Officer, Telos Corporation

Mr. Hester (age 46) joined Telos in 1979 and was appointed as Executive Vice President and Chief Operating Officer in 1998. He was responsible for all business activities at Telos. Previously, he has held progressive positions with Telos as President of Telos Systems Solutions, President of Telos Field Engineering, Regional Manager of Operations, and Vice President of Marketing. Mr. Hester resigned from the position of Chief Operating Officer in 1999.

Robert W. Lewis, President, Enterworks, Inc.

Mr. Lewis (age 37) has served as the President of Enterworks, Inc. since its inception in 1996. Mr. Lewis' prior experience has been with Telos Corporation. From 1991 to 1995, he was Director, Business Development with responsibility for major customer development and technology integration.

Robert J. Marino, Chief Sales and Marketing Officer and Executive Vice President

Mr. Marino (age 62) joined the Company in 1988 as Senior Vice President of Sales and Marketing. In 1990, his responsibilities were expanded to include Program Management in addition to Sales and Marketing. On January 1, 1994, Mr. Marino was promoted to President of Telos Systems Integration. With the amalgamation of all Telos divisions, Mr. Marino was selected on January 1, 1998, as Chief Sales & Marketing Officer reporting directly to the CEO and is part of the Office of the President.

Lorenzo Tellez, Chief Financial Officer, Treasurer, and Vice President

Mr. Tellez (age 41) was appointed Chief Financial Officer of the Company in 1993 and Treasurer in 1994. He joined Telos Corporation (California) in 1989 where he was responsible for all financial and regulatory functions. Prior to joining Telos Corporation, Mr. Tellez served as a Senior Manager with Arthur Andersen & Company.

Each of the directors and executive officers of the Company is a United States citizen.

Item. 12. Executive Compensation

Information is set forth in the Summary Compensation Table included on the following page with respect to all forms of compensation for service rendered in all capacities to the Company during the fiscal years ended December 31, 1998, 1997, and 1996, of the Chief Executive Officer and four other most highly paid executive officers during 1998.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Annual Compensation		Other Annual Compensation(2)	Long-Term Compensation (3)	
		Salary	Bonus(1)		Awards	Payouts
					Options/SARs(4)	All Other Compensation (5)
John B. Wood (President, Chief Executive Officer)	1998	\$334,198	\$ --	\$ 8,500	--	\$5,000
	1997	\$299,998	\$382,000	\$32,000	--	\$4,750
	1996	\$291,921	\$ --	\$23,000	2,017,531	\$4,750
Mark W. Hester (Former Executive V. P. and Former Chief Operating Officer)	1998	\$202,425	\$ --	\$ 500	250,000	\$5,000
	1997	\$174,990	\$200,000	\$ 6,000	150,000	\$3,525
	1996	\$184,607	80,000	\$ 6,000	185,000	\$2,850
Lorenzo Tellez (V.P., Treasurer, Chief Financial Officer)	1998	\$218,080	\$ --	\$ 500	200,000	\$5,000
	1997	195,000	\$150,000	\$24,000	150,000	\$4,750
	1996	188,269	\$145,000	\$15,000	465,000	\$4,750
David Aldrich (V.P., Chief Operating Officer)	1998	\$173,850	\$ --	\$ 1,250	210,000	\$1,083
	1997	\$150,010	\$150,000	\$ 6,000	300,000	--
	1996	\$ 45,580	--	\$ --	200,000	--
Robert J. Marino (Chief Sales and Marketing Officer and Executive V.P.)	1998	\$204,734	\$ --	\$ 500	362,000	\$5,000
	1997	\$195,000	\$ 76,000	\$ 6,000	--	\$4,750
	1996	\$182,310	\$ 90,000	\$ 6,000	212,500	\$4,750

- (1) 1997 amounts include bonuses relating to the TIS sale completed in 1998.
- (2) Other annual compensation represents automobile and living allowances provided to executives. Additionally, compensation for John B. Wood includes directors fees.
- (3) There are no restricted stock awards or payouts pursuant to long-term investment plans.
- (4) Options granted are in both the Company's common stock as well as in Enterworks, Inc., common stock.
- (5) All other compensation represents Company contributions made on behalf of the executive officers to the Telos Shared Savings Plan.

Stock Option Grants

The Summary Table of Options/SAR Grants in the Last Fiscal Year is set forth below for the stock option grants in 1998.

Name and Principal Position	Number of Securities Underlying Options/SARS Granted	% of Total Options/SARS Granted	Exercise or Base Price	Expiration Date	Potential Realizable Value at Assumed Rates of Stock Price Appreciation for Option Term	
					5%	10%
John B. Wood (President, Chief Executive Officer)	--	--	--	--	--	--
Mark W. Hester (Former Executive V.P. and Former Chief Operating Officer)	250,000	8.5%	\$1.07	May 2008	\$168,229	\$426,326
Lorenzo Tellez (V.P., Treasurer, Chief Financial Officer)	200,000	6.8%	\$1.07	May 2008	\$134,583	\$341,061
David Aldrich (V.P., Chief Operating Officer)	210,000	7.1%	\$1.07	May 2008	\$141,313	\$358,114
Robert J. Marino (Chief Sales and Marketing Officer and Executive V.P.)	362,000	12.3%	\$1.07	May 2008	\$243,596	\$617,320

Management Stock Options

The following table shows, as to the individuals named in the Summary Compensation table, the number of shares acquired during such period through the exercise of options, and the number of shares subject to and value of all unexercised options held as of December 31, 1998.

AGGREGATED OPTION/SAR EXERCISES IN LAST FISCAL YEAR
AND FY-END OPTION/SAR VALUES

Name	Shares Acquired on Exercise	Value Realized	Number of Securities Underlying Unexercised Options/SARs at FY-End	Value of Unexercised In-the-Money Options/SARs at FY-End (1)(2)
-----	-----	-----	-----	-----
John B. Wood (President, Chief Executive Officer)	--	--	1,507,471/1,210,519	\$924,615/494,887
Mark W. Hester (Former Executive V.P. and Former Chief Operating Officer)	--	--	169,000/416,000	62,400/141,350
Lorenzo Tellez (V.P., Treasurer, Chief Financial Officer)	--	--	271,000/544,000	107,400/201,850
David Aldrich (V.P., Chief Operating Officer)	--	--	212,000/498,000	94,360/196,440
Robert J. Marino (Chief Sales and Marketing Officer and Executive V.P.)	--	--	372,550/534,350	75,857/178,703

(1) Based on an estimated fair market value of the Company's Class A common stock of \$1.35 per share at December 31, 1998.

(2) Based on an estimated fair market value of Enterworks common stock of \$0.77 per share at December 31, 1998.

Compensation of Directors

During the fiscal year ended December 31, 1998, employee directors were paid a fee of \$2,000 for each Board meeting attended. Outside directors Mr. Byers and Dr. Bryen were paid an annual fee of \$25,000, and- further compensated at a rate of \$750 for each meeting in excess of four meetings a year. Chairman of the Board, Dr. Ikle, is paid \$25,000 quarterly for his service on the Board. In addition, Mr. Byers receives \$5,000 per annum for his service as Proxy Chairman. The compensation paid to the outside directors is paid pursuant to a proxy agreement between the Company, the Defense Security Service and certain of the Company shareholders. During the fiscal year ended December 31, 1998, other than Mr. Wood, no directors of the Company were awarded options.

Employment Contracts

The Company is a party to agreements with certain of its executive officers. Mr. David Aldrich, Vice President and Chief Operating Officer, Mr. William Brownley, General Counsel, Mr. Gerald Calhoun, Vice President Human Resources and Corporate Secretary Telos Corporation and Enterworks, Mr. Robert Marino, Chief Sales and Marketing Officer and Executive Vice President, Mr. Lorenzo Tellez, Chief Financial Officer, and Mr. John Wood, Chief Executive Officer, have agreements with the Company which provide for a payment of two year's base salary then in effect if involuntarily terminated. At December 31, 1998, Mr. Aldrich, Brownley, Calhoun, Marino, Tellez and Wood had base salary levels of \$181,000, \$171,000, \$169,000, \$206,000, \$206,000, \$219,000, and \$350,000, respectively. In addition, these executive officers' agreements provide for bonus payments should certain operating results be attained.

Item 12. Security Ownership of Certain Beneficial Owners and Management

(1)	(2)	(3)	(4)
Title of Class	Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership as of March 1, 1999	Percent of Class
Class A Common Stock	John Porter 15 Berners St. London SW1W 9EA England	22,190,718 shares (A)	80.32%
Class A Common Stock	C3, Inc. 401(k) Plan and Telos Corporation Savings Plan c/o C3, Inc. 19886 Ashburn Road Ashburn, Virginia 20147	3,658,536 shares	17.23%
Class B Common Stock	F&C Nominees Limited 11 Devonshire Square London EC 2M 4YR England	3,143,358 shares	77.85%
Class B Common Stock	Hare & Company C/o Bank of New York P.O. Box 11203 New York, NY 10249	815,700 shares	20.20%
Class A Common Stock	David Aldrich	170,392 shares (B)	0.80%
Class A Common Stock	Robert J. Marino	493,352 shares (B)	2.28%
Class A Common Stock	Mark W. Hester	240,778 shares (B)	1.12%
Class A Common Stock	Lorenzo Tellez	412,440 shares (B)	1.92%
Class A Common Stock	John B. Wood	1,491,863 shares (C)	6.57%
Class A Common Stock	All Officers and Directors As A Group (9 persons)	3,124,616 shares (D)	13.03%
12% Cumulative Exchangeable Redeemable Preferred Stock	Value Partners, Ltd. 2200 Ross Avenue, Ste 4660 Dallas, TX 75201	714,317 shares (E)	22.42%
12% Cumulative Exchangeable Redeemable Preferred Stock	Fisher Ewing Partners 2200 Ross Avenue, Ste 4660 Dallas, TX 75201	714,317 shares (E)	22.42%
12% Cumulative Exchangeable Redeemable Preferred Stock	Wynnefield Partners Small Cap Value L.P. Channel Partnership II, L.P. Wynnefield Small Cap Value Offshore Fund, Ltd. One Penn Plaza, Suite 4720 New York, NY 10119	228,500 shares (F)	7.17%
12% Cumulative Exchangeable Redeemable Preferred Stock	Magten Asset Management Corp. 35 East 21st Street New York, NY 10010	221,200 shares	6.94%

- (A) Mr. Porter's holdings include 6,388,916 shares of Class A Common Stock purchasable upon exercise of a warrant.
- (B) Messrs. Aldrich, Marino, Hester, and Tellez hold options to acquire 162,000, 371,300, 170,000, and 260,000 shares of the Company's Class A Common Stock, respectively, in addition to their current common stock holdings. These shares are purchasable upon exercise of warrant and are exercisable within 60 days of March 1, 1999.
- (C) Mr. Wood owns 8,392 shares of Common Stock and he holds an option to acquire 1,483,471 shares of the Company's Class A Common Stock purchasable upon exercise of options 60 days from March 1, 1999.
- (D) Under the Company's stock option plan and certain stock option agreements, all officers and directors as a group hold options to acquire 2,737,971 shares of Class A Common Stock exercisable within 60 days after March 1, 1999.
- (E) Value Partners Ltd. and Fisher Ewing Partners have filed jointly a Schedule 13D under which they disclosed that they may act as a "group" within the meaning of Section 13(d) of the Securities Exchange Act. Each of the reporting persons disclosed that it may be deemed to beneficially own the aggregate of 714,317 shares of the Public Preferred Stock held of record by the reporting persons collectively.
- (F) Wynnefield Partners Small Cap Value L.P., Channel Partnership II, L.P. and Wynnefield Small Cap Value Offshore Fund, Ltd. Have filed jointly a Schedule 13D under which they disclosed that they may act as a "group" within the meaning of Section 13 (d) of the Securities Exchange Act.

Item 13.

Certain Relationships and Related Transactions

Mr. Joseph P. Beninati served as Chairman of the Board for the majority of 1994 before resigning January 5, 1995. The Company paid \$165,000 annually subject to a three year employment agreement that began in 1995 and terminated January 8, 1998. Mr. Beninati resigned from the Board in 1996 and received his final payment in 1998.

Mr. John R. Porter has a consulting agreement with the Company whereby he will be compensated for specific services. Expense recorded pursuant to this agreement was \$200,000 for both 1998 and 1997.

Mr. Byers, a Director of the Company, has a consulting agreement with the Company to help the Company expand its business operations into the international marketplace. Under this agreement Mr. Byers receives \$10,500 a month for his services. Mr. Byers was compensated \$125,000, \$130,000, and \$128,000 for 1998, 1997 and 1996, respectively. The consulting agreement was terminated in the fourth quarter of 1998.

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a) 1. Financial Statements

All financial statements of the registrant as set forth under Item 8 of this report on Form 10-K.

(a) 2. Financial Statement Schedules

All schedules are omitted because they are not applicable or the required information is included in the consolidated financial statements or notes thereto.

(a) 3. Exhibits:

Exhibits marked with (1*) are incorporated by reference to the Company's Registration Statement No. 2-84171 filed June 2, 1983. Exhibits marked with (3*) are incorporated by reference to the Company's Form 10-K report for the fiscal year ended March 31, 1987. Exhibits marked with (4*) are incorporated by reference to the Company's Form 10-K report for the fiscal year ended March 31, 1989. The registrant will furnish to stockholders a copy of other exhibits upon payment of \$.20 per page to cover the expense of furnishing such copies. Requests should be directed to the attention of Investor Relations at Telos Corporation, 19886 Ashburn Road, Ashburn, Virginia 20147-2358.

- 2.6 Stock Purchase Agreement dated as of January 14, 1992, by and among C3, Inc., Telos Corporation and Contel Federal Systems, Inc. (Incorporated by reference to C3, Inc. Form 8-K filed January 29, 1992)
- 3.1 (1*) Articles of Amendment and Restatement of C3, Inc.
- 3.2 (1*) Articles of Amendment of C3, Inc. dated August 31, 1981.
- 3.3 (3*) Articles supplementary of C3, Inc. dated May 31, 1984.
- 3.4 (4*) Articles of Amendment of C3, Inc. dated August 18, 1988.
- 3.5 Articles of Amendment and Restatement Supplementary to the Articles of Incorporation dated August 3, 1990. (Incorporated by reference to C3, Inc. 10-Q for the quarter ended June 30, 1990)
- 3.6 Restated Bylaws of C3, Inc. (Incorporated by reference to C3, Inc. 10-Q for the quarter ended December 31, 1990)
- 3.7 Articles of Amendment of C3, Inc. dated April 13, 1995
- 4.1 Form of Indenture between the Registrant and Bankers Trust Company, as Trustee, relating to the 12% Junior Subordinated Debentures Due 2009. (Incorporated herein by reference to C3's Registration Statement on Form S-4 filed October 20, 1989)
- 4.3 Form of the terms of the 12% Cumulative Exchangeable Redeemable Preferred Stock of the Registrant. (Incorporated herein by reference to C3's Registration Statement on Form S-4 filed October 20, 1989)
- 4.4 Shareholders Agreement dated as of August 3, 1990 by and among C3, Inc.; Union de Banques Suisses Luxembourg), S.A.; C3 Investors, L.P.; Anthony Craig, together with the investors; the Class A holders; MIM Limited; Knoll and Associates, Inc.; Murray Enterprises PLC; Electra Development Holdings; and Hartley Limited. (Incorporated by reference to C3, Inc. 10-Q for the quarter ended June 30, 1990)

- 4.5 Articles of Amendment and Restatement of the Company, filed with the Secretary of State of the State of Maryland on January 14, 1992. (Incorporated by reference to C3, Inc. Form 8-K filed January 29, 1992)
- 10.20 Revolving and Reducing Senior Facility Credit Agreement dated as of January 14, 1992, among C3, Inc., Telos Corporation and NationsBank, N.A. (Incorporated by reference to C3, Inc. Form 8-K filed January 29, 1992)
- 10.31 September 27, 1993 Settlement Agreement among John R.C. Porter, Toxford Corporation, Cantrade Nominees Ltd., Cantrade Trust Company (Cayman) Ltd., Cantrade Trustee, AG, Fred Knoll, Cottonwood Holdings, C3 Investors L.P., C3, Inc., Telos Corporation, Joseph P. Beninati, John B. Wood and Beninati & Wood, Inc. (Incorporated by reference to C3, Inc. Form 8-K filed October 18, 1993)
- 10.32 September 27, 1993 Stock Purchase and Sale Agreement between Mr. John R.C. Porter and C3 Investors, L.P. (Incorporated by reference to C3, Inc. Form 8-K filed October 18, 1993)
- 10.33 September 27, 1993 Stock Purchase and Sale Agreement between Mr. John R.C. Porter and Cottonwood Holdings, Inc. (Incorporated by reference to C3, Inc. Form 8-K filed October 18, 1993)
- 10.34 September 27, 1993 Note Interest Purchase and Sale Agreement among Mr. John R.C. Porter, Cottonwood and C3, Inc. (Incorporated by reference to C3, Inc. Form 8-K filed October 18, 1993)
- 10.35 October 8, 1993 Promissory Note in the amount of \$8,438,000 issued by Mr. John R.C. Porter in favor of C3 Investors, L.P. (Incorporated by reference to C3, Inc. Form 8-K filed October 18, 1993)
- 10.36 October 8, 1993 Promissory Note in the amount of \$1,562,000 issued by Mr. John R.C. Porter in favor of Cottonwood Holdings, Inc. (Incorporated by reference to C3, Inc. Form 8-K filed October 18, 1993)
- 10.37 September 27, 1993 Collateral Agency, Security and Pledge Agreement among Mr. John R.C. Porter, Mr. Fred Knoll, Cottonwood Holdings, C3 Investors, L.P., C3, Inc., Telos Corporation, Toxford Corporation, Cantrade Nominees Limited, Mr. Robert M. Ercole and Mr. Frank S. Jones, Jr. (Incorporated by reference to C3, Inc. Form 8-K filed October 18, 1993)
- 10.38 September 27, 1993 Standstill Agreement among Mr. John R.C. Porter, Mr. Fred Knoll, Mr. Alfredo Frohlich and C3, Inc. (Incorporated by reference to C3, Inc. Form 8-K filed October 18, 1993)
- 10.39 September 27, 1993 Mutual Release among Mr. John R.C. Porter, Mr. Fred Knoll, Cottonwood Holdings, C3 Investors, L.P., C3, Inc., Telos Corporation, Mr. Joseph P. Beninati, Mr. John B. Wood, and Beninati & Wood, Inc. (Incorporated by reference to C3, Inc. Form 8-K filed October 18, 1993)
- 10.40 September 27, 1993 Consulting Agreement among Mr. Fred Knoll, C3, Inc. and Telos Corporation. (Incorporated by reference to C3, Inc. Form 8-K filed October 18, 1993)
- 10.43 Amendment to Revolving and Reducing Senior Credit Facility dated as of December 31, 1993 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.44 Amendment to Revolving and Reducing Senior Credit Facility dated as of April 11, 1994 among C3, Inc., Telos Corporation and NationsBank, N.A.

- 10.45 Amendment to Revolving and Reducing Senior Credit Facility dated as of June 8, 1994 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.46 Amendment to Revolving and Reducing Senior Credit Facility dated as of October 7, 1994 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.47 October 7, 1994 Letter Agreement among C3, Inc., Toxford Corporation, and NationsBank, N.A. regarding cash collateral held on behalf of the Company.
- 10.48 October 25, 1994 General Release and Settlement memorandum among Sapiens International Corporation N.V., Sapiens International Corporation B.V., Sapiens U.S.A., Inc., C3, Inc. and Telos Corporation.
- 10.49 Amendment to Revolving and Reducing Senior Credit Facility dated as of January 5, 1995 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.50 Amendment to Revolving and Reducing Senior Credit Facility dated as of January 12, 1995 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.51 Waiver and Amendment to Revolving and Reducing Senior Credit Facility dated as of April 17, 1995 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.58 Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Drayton English and International Investment Trust.
- 10.59 Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and J.O. Hambro Investment Management, Ltd.
- 10.60 Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and North Atlantic Smaller Companies Investment Trust, PLC.
- 10.61 Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Mr. John R.C. Porter.
- 10.62 Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Sir Leslie Porter.
- 10.63 Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Second Consolidated Trust, PLC
- 10.64 Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Toxford Corp.
- 10.65 Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Drayton English and International Investment Trust
- 10.66 Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and J.O. Hambro Investment Management, Ltd.
- 10.67 Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and North Atlantic Smaller Companies Investment Trust, PLC.

- 10.68 Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Mr. John R.C. Porter.
- 10.69 Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Sir Leslie Porter.
- 10.70 Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Second Consolidated Trust, PLC.
- 10.71 Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Toxford Corp.
- 10.72 Amendment to Revolving and Reducing Senior Credit Facility dated as of August 4, 1995 Telos Corporation (Maryland), Telos Corporation (California) and NationsBank N.A.
- 10.73 Amendment to Revolving and Reducing Senior Credit Facility dated as of October 13, 1995 Telos Corporation (Maryland), Telos Corporation (California) and NationsBank N.A.
- 10.74 1996 Stock Option Plan
- 10.76 Sixteenth Amendment to Credit Facility and Tenth Amended and Restated Promissory Note
- 10.77 Enterworks, Inc. 1996 Stock Option Plan
- 10.78 Form of Series A Senior Subordinated Unsecured Note
- 10.79 Form of Enterworks, Inc., Capital Stock Purchase Series A Warrant
- 10.80 Asset Purchase Agreement
- 10.81 Amendment No. 1 to Asset Purchase Agreement
- 10.82 Amended and Restated Credit Agreement between Telos Corporation, a Maryland corporation; Telos Corporation, a California corporation; and NationsBank, N.A. dated as of July 1, 1997
- 10.83 Asset Purchase Agreement
- 10.84 Interim Agreement
- 10.85 Share Purchase Agreement between Telos Corporation, a Maryland corporation, formerly named and known as C3, Inc. and Union Bank of Switzerland, dated May 7, 1998
- 10.86 Series D Senior Subordinated Unsecured Note due October 1, 2000 as of November 20, 1998 between Telos Corporation (Maryland) and Foreign and Colonial Enterprise Trust PLC
- 10.87 Series D Senior Subordinated Unsecured Note due October 1, 2000 as of November 20, 1998 between Telos Corporation (Maryland) and Foreign and Colonial Enterprise Trust LP
- 10.88 Common Stock Purchase Series D Warrant between Telos Corporation (Maryland) and Foreign and Colonial Enterprise Trust PLC
- 10.89 Common Stock Purchase Series D Warrant between Telos Corporation (Maryland) and Foreign and Colonial Enterprise Trust LP
- 10.90 Form of Stock Purchase Agreement
- 21 Schedule of Subsidiaries.
- 27 Financial Data Schedule
- (b) Reports on Form 8-K

None

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Telos Corporation has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TELOS CORPORATION

By: John B. Wood

President and
Chief Executive Officer

Date: April 1, 1999

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of Telos Corporation and in the capacities and on the date indicated.

Signature -----	Title -----	Date -----
/s/ Fred Charles Ikle ----- Fred Charles Ikle	Chairman of the Board of Directors	April 1, 1999
/s/ John B. Wood ----- John B. Wood	President, Chief Executive Officer & Director (Principal Executive Officer)	April 1, 1999
/s/ Stephen D. Bryen ----- Stephen D. Bryen	Director	April 1, 1999
/s/ Norman P. Byers ----- Norman P. Byers	Director	April 1, 1999
/s/ Lorenzo Tellez ----- Lorenzo Tellez	Chief Financial Officer (Principal Financial Officer) & Principal Accounting Officer)	April 1, 1999
----- Julio E. Heurtematte, Jr.	Director	April 1, 1999
----- Malcolm M.B. Sterrett	Director	April 1, 1999

Telos Corporation
Exhibit Index

Exhibit Number -----	Exhibit Name -----	Page ----
10.86	Series D Senior Subordinated Unsecured Note due October 1, 2000 as of November 20, 1998 between Telos Corporation (Maryland) and Foreign and Colonial Enterprise Trust PLC	
10.87	Series D Senior Subordinated Unsecured Note due October 1, 2000 as of November 20, 1998 between Telos Corporation (Maryland) and Foreign and Colonial Enterprise Trust LP	
10.88	Common Stock Purchase Series D Warrant between Telos Corporation (Maryland) and Foreign and Colonial Enterprise Trust PLC	
10.89	Common Stock Purchase Series D Warrant between Telos Corporation (Maryland) and Foreign and Colonial Enterprise Trust LP	
10.90	Form of Stock Purchase Agreement	

THIS NOTE HAS NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933 OR APPLICABLE STATE SECURITIES LAWS AND MAY NOT BE SOLD, TRANSFERRED OR ASSIGNED UNLESS IT IS SO REGISTERED OR AN EXEMPTION FROM REGISTRATION IS AVAILABLE UNDER SAID ACT AND LAWS. THIS NOTE IS SUBORDINATE AND JUNIOR IN RIGHT OF PAYMENT TO SENIOR INDEBTEDNESS DUE TO NATIONSBANK, N.A. AND/OR CERTAIN OTHER BANKS OR FINANCIAL INSTITUTIONS.

Ashburn, Virginia
November 20, 1998

SERIES D SENIOR SUBORDINATED UNSECURED NOTE DUE OCTOBER 1, 2000

FOR VALUE RECEIVED, Telos Corporation, a Maryland corporation, with offices at 19886 Ashburn Road, Ashburn, Virginia 20147 (hereinafter referred to as "the Borrower" or the "Company"), promises to pay to the order of Foreign & Colonial Enterprise Trust PLC, (hereinafter referred to as "F&C Enterprise Trust PLC" or "Lender"), at c/o Berkeley Square House, Berkeley Square, London W1X 5PA, England, or at such other offices or at such other place or places as the holder hereof may from time to time designate in writing, the principal sum of One Million Four Hundred Forty Thousand Dollars (\$1,440,000) on October 1, 2000 together with interest on the principal amount hereof from time to time outstanding at the rate hereinafter provided until paid in full.

This is one of a series of the Company's Notes known as its Series D Senior Subordinated Unsecured Notes Due October 1, 2000 (collectively referred to herein as the "Series D Notes", all of like tenor, except as to the identifying number and principal amount thereof. The Series D Notes have been issued in the aggregate principal amount of \$1,800,000.

I. GENERAL TERMS

1.1 Interest only shall be payable at the rate of fourteen percent (14%) per annum, on the principal balance of this Note from time to time outstanding from and after the date hereof, and shall be due and payable quarterly, until the principal has been paid in full, on the first day of April, July, October, and January in each year. Interest shall accrue from the date hereof, but the first interest payment shall not be due until April 1, 1999. Such payment shall include all interest accrued from the date hereof until the date of such interest payment.

1.2 If not sooner paid, the outstanding and unpaid principal balance shall be paid on October 1, 2000, together with accrued and unpaid interest on this Note. In addition, interest shall be payable at the rate provided in Section 1.1 hereof on any Payment Premium from the date such premium is due until paid in full.

1.3 Principal, premium, if any, and interest on this Note are payable in lawful money of the United States. The principal of this Note may be prepaid at any time after ten (10) days' written notice to the Lender, in whole or in part, and shall be accompanied by payment in cash of all accrued and unpaid interest on the amount so prepaid, together with, to the extent not prohibited by applicable law, a Payment Premium.

1.4 In the event of a Public Offering of the common stock of the Company, or in the event of a Refinancing, the principal then outstanding shall become immediately due and payable, together with, accrued and unpaid interest thereon, and, to the extent not prohibited by applicable law, a Payment Premium in an amount equal to the lesser of (i) the Net Proceeds of such Public Offering or Refinancing, or (ii) the amount determined in accordance with 1.6(iv). The Net Proceeds shall be applied toward the payment of the outstanding and unpaid principal balance of the Notes, accrued and unpaid interest thereon and, to the extent not prohibited by applicable law, such Payment Premium.

1.5 In the event of a Merger or Dissolution, the principal then outstanding shall become immediately due and payable, together with accrued and unpaid interest thereon and, to the extent not prohibited by applicable law, a Payment Premium in the amount determined in accordance with 1.6(iv).

1.6 Definitions.

(i) "Public Offering" shall mean the distribution and sale of the Company's common stock (some of the proceeds of which sale are available to the Company) pursuant to a registration statement (other than a registration statement on Form S-4 or Form S-8) which has been filed with the U.S. Securities and Exchange Commission and become effective.

(ii) "Refinancing" shall mean a sale of securities of the Company which results in Net Proceeds to the Company in excess of \$10,000,000, other than (a) obligations for borrowed money due and payable within one year which are not extended, renewed or refinanced beyond such due date; or (b) other obligations for money borrowed money from NationsBank and/or its successors, substitutes and participants and their respective assigns and any refinancing thereof.

(iii) "Net Proceeds" shall mean the proceeds to the Company after expenses of sale and distribution, including discounts, commissions and brokerage and legal fees.

(iv) "Payment Premium" shall, except as otherwise provided in 1.4, mean an amount equal to 13.5% per annum, compounded semiannually from and after the date hereof until paid, on the principal amount of this Note outstanding from time to time until the time of payment.

(v) "Merger" shall mean a merger, consolidation or other combination to which the Company or any subsidiary is a party, in which the Company is not the surviving corporation or which results in the acquisition of "beneficial ownership" of securities of the Company representing 50% or more of the total number of votes that may be cast for the election of directors by any "person" or "group" (as such terms are defined in Rule 13(d) promulgated under the Securities Exchange Act of 1934, as amended), or a sale by the Company of all or substantially all of its assets.

(vi) "Dissolution" shall mean the adoption by the Board of Directors and/or the shareholders of the Company of a resolution to dissolve the Company and liquidate its assets, the filing by the Company of articles of dissolution or a similar application for dissolution with the appropriate officer of the state of incorporation of the Company, the entry of an order or other action by such state dissolving the Company, or the adoption by the Board of Directors or the shareholders of the Company of a plan of liquidation or a resolution approving a liquidating distribution of the Company's assets, whichever shall first occur.

1.7 At any time after the issuance of this Note, the holders of a majority in outstanding principal amount of the Series D Notes, the Series C Notes and the Series B Senior Secured Notes issued by the Company may request, in writing, that the Company effect a Public Offering, at the Company's cost and expense. Upon receipt of any such request, the Company shall, as expeditiously as possible, use its best efforts to effect a Public Offering, with the objective of realizing Net Proceeds sufficient to pay the then-outstanding principal balance of the Series D Notes, the Series C Notes and the Series B Senior Secured Notes together with accrued, unpaid interest thereon, and, to the extent not prohibited by applicable law, a Payment Premium in an amount determined in accordance with 1.4.

1.8 If any payment of principal or interest on this Note shall become due on a Saturday, Sunday, or legal holiday under the laws of the Commonwealth of Virginia, or any other day on which banking institutions in the Commonwealth of Virginia are obligated or authorized by law or executive order to close, such payment shall be made on the next succeeding business day in Virginia and any such extended time of the payment of principal shall not be included in computing compound interest in connection with such payment.

1.9 Upon receipt by the Borrower of evidence reasonably satisfactory to it of the mutilation, destruction, loss or theft of this Note, the Borrower will make and deliver to the owner a new note of like tenor in lieu of this Note so mutilated, destroyed, lost or stolen.

1.10 Payments made on account hereof shall be applied first to accrued and unpaid interest, then to principal, and then to the Payment Premium, if any.

1.11 All payments made by the Company on account of the Series D Notes or any of them shall be made pro rata, in proportion to the outstanding principal balance of each of the Series D Notes outstanding at the time of any such payment.

II. DEFAULT

2.1 It is expressly agreed by Borrower that the following shall be deemed to be Events of Default under this Note: (a) the failure to pay, when due, any amount of principal, or not more than five days after due date of any amount of premium, if any, or interest on this Note or the Series B or Series C Notes, or (b) in the event the Borrower files any petition, or any petition is filed against it and not dismissed within sixty (60) days, under any bankruptcy or insolvency law or for the appointment of a receiver for substantially all its assets or in the event the Borrower makes a general assignment for the benefit of creditors, (c) or any failure by the Borrower to perform or observe any of the other covenants, agreements or provisions to be performed or observed by it under this Note or the Series B or Series C Notes, and such default shall not be rectified or cured within 10 days after written notice thereof by the Lender to the Company, and (d) an event of default as specified in the Amended and Restated Credit Agreement, as amended from time to time, among the Company, Telos Corporation (a California corporation) and NationsBank, N.A. (the "Credit Agreement") shall have occurred and be continuing, if (and only if) such event results in acceleration of the maturity of the indebtedness under such Credit Agreement and such acceleration continues in effect.

2.2 If an Event of Default occurs, the Lender, at his option, may accelerate this Note and may by written notice to Borrower declare the entire unpaid principal amount of this Note and all interest accrued and unpaid thereon to be immediately due and payable whereupon the unpaid principal amount and all such accrued interest shall become and be forthwith due and payable, without presentment, demand, protest or further notice of any kind. The failure of the Lender to give such notice shall, in no event, be deemed a waiver of any of the Lender rights hereunder as long as the Event of Default continues.

2.3 Upon default in the payment of the principal of this Note or any other sum payable hereunder when due upon demand, at maturity or by reason of acceleration of maturity, or upon the occurrence of any other Event of Default hereunder Borrower agrees to pay all reasonable costs of collection incurred by the holder of the Note, including reasonable attorneys' fees, whether suit is brought or not, and all other costs and expenses reasonably connected with collection of the indebtedness evidenced hereby.

III. SUBORDINATION

3.1 Payment of the principal, or interest and Payment Premium on this Note

are subordinate and subject in right of payment to the prior indefeasible payment in full in cash or cash equivalents of all Senior Indebtedness, and each holder of this Note by such holder's acceptance hereof, acknowledges and confirms such subordination. "Senior Indebtedness" means all present and future obligations, liabilities and indebtedness of the Company of every type and nature, currently or hereafter due, incurred or created, arising under or in connection with the Credit Agreement or any refinancing loan documents, including, without limitation (i) all Obligations (as defined in the Credit Agreement) and any refinancing thereof, (ii) all interest provided for in the Credit Agreement, or any refinancing loan documents (including, without limitation, interest arising prior to and after the commencement of any bankruptcy or similar proceeding in which the Company is the debtor, whether or not such interest is an allowed claim in such proceeding) at the rates specified in the Credit Agreement or any refinancing loan documents; and (iii) all fees, charges, expenses, indemnities and other amounts payable under or incidental to the Credit Agreement (excluding any such amounts payable in respect of warrants or other equity-related obligations or earning participations that may be issued by the Company). Notwithstanding the foregoing, Senior Indebtedness held (whether as a result of subrogation or otherwise) by the Company, any of the subsidiaries or any other affiliate of the Company (whether as a result of subrogation or otherwise) (Telos, the subsidiaries and any other affiliates of the Company being collectively referred to herein as "Affiliated Parties") or by any person who has acquired Senior Indebtedness, directly or indirectly, which has been held by any of the Affiliated Parties, shall not constitute "Senior Indebtedness" under this Agreement (other than under this sentence) until such time as all Senior Indebtedness held by Persons other than Affiliated Parties has been indefeasibly paid in full in cash or cash equivalents, and no Affiliated Party or Person acquiring Senior Indebtedness from an Affiliated Party shall acquire any rights hereunder by virtue of holding such Senior Indebtedness.

This Note shall be construed and enforced in accordance with, and governed by the laws of, the Commonwealth of Virginia without giving effect to conflict of laws principles.

The parties hereto, including the undersigned Borrower and all guarantors and endorsers, hereby waive presentment, demand, notice, protest and all other demands and notices in connection with the delivery, acceptance, performance and enforcement of this Note, and assent to extensions of time of payment, or forbearance or other indulgence without notice.

TELOS CORPORATION

By:/s/ William L.P. Brownley
Name: William L.P. Brownley
Title: Vice President & General Counsel

Series D Senior Subordinated Unsecured Note

Due October 1, 2000

Series D Senior Subordinated Unsecured Note

Due October 1, 2000

THIS NOTE HAS NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933 OR APPLICABLE STATE SECURITIES LAWS AND MAY NOT BE SOLD, TRANSFERRED OR ASSIGNED UNLESS IT IS SO REGISTERED OR AN EXEMPTION FROM REGISTRATION IS AVAILABLE UNDER SAID ACT AND LAWS. THIS NOTE IS SUBORDINATE AND JUNIOR IN RIGHT OF PAYMENT TO SENIOR INDEBTEDNESS DUE TO NATIONSBANK, N.A. AND/OR CERTAIN OTHER BANKS OR FINANCIAL INSTITUTIONS.

Ashburn, Virginia November 20, 1998

SERIES D SENIOR SUBORDINATED UNSECURED NOTE DUE OCTOBER 1, 2000

FOR VALUE RECEIVED, Telos Corporation, a Maryland corporation, with offices at 19886 Ashburn Road, Ashburn, Virginia 20147 (hereinafter referred to as "the Borrower" or the "Company"), promises to pay to the order of Foreign & Colonial Enterprise Trust Limited Partnership, (hereinafter referred to as "F&C Enterprise Trust LP" or "Lender"), at c/o Berkeley Square House, Berkeley Square, London W1X 5PA, England, or at such other offices or at such other place or places as the holder hereof may from time to time designate in writing, the principal sum of Three Hundred Sixty Thousand Dollars (\$360,000) on October 1, 2000 together with interest on the principal amount hereof from time to time outstanding at the rate hereinafter provided until paid in full.

This is one of a series of the Company's Notes known as its Series D Senior Subordinated Unsecured Notes Due October 1, 2000 (collectively referred to herein as the "Series D Notes", all of like tenor, except as to the identifying number and principal amount thereof. The Series D Notes have been issued in the aggregate principal amount of \$1,800,000.

I. GENERAL TERMS

1.1 Interest only shall be payable at the rate of fourteen percent (14%) per annum, on the principal balance of this Note from time to time outstanding from and after the date hereof, and shall be due and payable quarterly, until the principal has been paid in full, on the first day of April, July, October, and January in each year. Interest shall accrue from the date hereof, but the first interest payment shall not be due until April 1, 1999. Such payment shall include all interest accrued from the date hereof until the date of such interest payment.

1.2 If not sooner paid, the outstanding and unpaid principal balance shall be paid on October 1, 2000, together with accrued and unpaid interest on this Note. In addition, interest shall be payable at the rate provided in Section 1.1 hereof on any Payment Premium from the date such premium is due until paid in full.

1.3 Principal, premium, if any, and interest on this Note are payable in lawful money of the United States. The principal of this Note may be prepaid at any time after ten (10) days' written notice to the Lender, in whole or in part, and shall be accompanied by payment in cash of all accrued and unpaid interest on the amount so prepaid, together with, to the extent not prohibited by applicable law, a Payment Premium.

1.4 In the event of a Public Offering of the common stock of the Company, or in the event of a Refinancing, the principal then outstanding shall become immediately due and payable, together with, accrued and unpaid interest thereon, and, to the extent not prohibited by applicable law, a Payment Premium in an amount equal to the lesser of (i) the Net Proceeds of such Public Offering or Refinancing, or (ii) the amount determined in accordance with 1.6(iv). The Net Proceeds shall be applied toward the payment of the outstanding and unpaid principal balance of the Notes, accrued and unpaid interest thereon and, to the extent not prohibited by applicable law, such Payment Premium.

1.5 In the event of a Merger or Dissolution, the principal then outstanding shall become immediately due and payable, together with accrued and unpaid interest thereon and, to the extent not prohibited by applicable law, a Payment Premium in the amount determined in accordance with 1.6(iv).

1.6 Definitions.

(i) "Public Offering" shall mean the distribution and sale of the Company's common stock (some of the proceeds of which sale are available to the Company) pursuant to a registration statement (other than a registration statement on Form S-4 or Form S-8) which has been filed with the U.S. Securities and Exchange Commission and become effective.

(ii) "Refinancing" shall mean a sale of securities of the Company which results in Net Proceeds to the Company in excess of \$10,000,000, other than (a) obligations for borrowed money due and payable within one year which are not extended, renewed or refinanced beyond such due date; or (b) other obligations for money borrowed money from NationsBank and/or its successors, substitutes and participants and their respective assigns and any refinancing thereof.

(iii) "Net Proceeds" shall mean the proceeds to the Company after expenses of sale and distribution, including discounts, commissions and brokerage and legal fees.

(iv) "Payment Premium" shall, except as otherwise provided in 1.4, mean an amount equal to 13.5% per annum, compounded semiannually from and after the date

hereof until paid, on the principal amount of this Note outstanding from time to time until the time of payment.

(v) "Merger" shall mean a merger, consolidation or other combination to which the Company or any subsidiary is a party, in which the Company is not the surviving corporation or which results in the acquisition of "beneficial ownership" of securities of the Company representing 50% or more of the total number of votes that may be cast for the election of directors by any "person" or "group" (as such terms are defined in Rule 13(d) promulgated under the Securities Exchange Act of 1934, as amended), or a sale by the Company of all or substantially all of its assets.

(vi) "Dissolution" shall mean the adoption by the Board of Directors and/or the shareholders of the Company of a resolution to dissolve the Company and liquidate its assets, the filing by the Company of articles of dissolution or a similar application for dissolution with the appropriate officer of the state of incorporation of the Company, the entry of an order or other action by such state dissolving the Company, or the adoption by the Board of Directors or the shareholders of the Company of a plan of liquidation or a resolution approving a liquidating distribution of the Company's assets, whichever shall first occur.

1.7 At any time after the issuance of this Note, the holders of a majority in outstanding principal amount of the Series D Notes, the Series C Notes and the Series B Senior Secured Notes issued by the Company may request, in writing, that the Company effect a Public Offering, at the Company's cost and expense. Upon receipt of any such request, the Company shall, as expeditiously as possible, use its best efforts to effect a Public Offering, with the objective of realizing Net Proceeds sufficient to pay the then-outstanding principal balance of the Series D Notes, the Series C Notes and the Series B Senior Secured Notes together with accrued, unpaid interest thereon, and, to the extent not prohibited by applicable law, a Payment Premium in an amount determined in accordance with 1.4.

1.8 If any payment of principal or interest on this Note shall become due on a Saturday, Sunday, or legal holiday under the laws of the Commonwealth of Virginia, or any other day on which banking institutions in the Commonwealth of Virginia are obligated or authorized by law or executive order to close, such payment shall be made on the next succeeding business day in Virginia and any such extended time of the payment of principal shall not be included in computing compound interest in connection with such payment.

1.9 Upon receipt by the Borrower of evidence reasonably satisfactory to it of the mutilation, destruction, loss or theft of this Note, the Borrower will make and deliver to the owner a new note of like tenor in lieu of this Note so mutilated, destroyed, lost or stolen.

1.10 Payments made on account hereof shall be applied first to accrued and unpaid interest, then to principal, and then to the Payment Premium, if any.

1.11 All payments made by the Company on account of the Series D Notes or any of them shall be made pro rata, in proportion to the outstanding principal balance of each of the Series D Notes outstanding at the time of any such payment.

II. DEFAULT

2.1 It is expressly agreed by Borrower that the following shall be deemed to be Events of Default under this Note: (a) the failure to pay, when due, any amount of principal, or not more than five days after due date of any amount of premium, if any, or interest on this Note or the Series B or Series C Notes, or (b) in the event the Borrower files any petition, or any petition is filed against it and not dismissed within sixty (60) days, under any bankruptcy or insolvency law or for the appointment of a receiver for substantially all its assets or in the event the Borrower makes a general assignment for the benefit of creditors, (c) or any failure by the Borrower to perform or observe any of the other covenants, agreements or provisions to be performed or observed by it under this Note or the Series B or Series C Notes, and such default shall not be rectified or cured within 10 days after written notice thereof by the Lender to the Company, and (d) an event of default as specified in the Amended and Restated Credit Agreement, as amended from time to time, among the Company, Telos Corporation (a California corporation) and NationsBank, N.A. (the "Credit Agreement") shall have occurred and be continuing, if (and only if) such event results in acceleration of the maturity of the indebtedness under such Credit Agreement and such acceleration continues in effect.

2.2 If an Event of Default occurs, the Lender, at his option, may accelerate this Note and may by written notice to Borrower declare the entire unpaid principal amount of this Note and all interest accrued and unpaid thereon to be immediately due and payable whereupon the unpaid principal amount and all such accrued interest shall become and be forthwith due and payable, without presentment, demand, protest or further notice of any kind. The failure of the Lender to give such notice shall, in no event, be deemed a waiver of any of the Lender rights hereunder as long as the Event of Default continues.

2.3 Upon default in the payment of the principal of this Note or any other sum payable hereunder when due upon demand, at maturity or by reason of acceleration of maturity, or upon the occurrence of any other Event of Default hereunder Borrower agrees to pay all reasonable costs of collection incurred by the holder of the Note, including reasonable attorneys' fees, whether suit is brought or not, and all other costs and expenses reasonably connected with collection of the indebtedness evidenced hereby.

III. SUBORDINATION

3.1 Payment of the principal, or interest and Payment Premium on this Note are subordinate and subject in right of payment to the prior indefeasible payment in full in cash or cash equivalents of all Senior Indebtedness, and each holder of this Note by such holder's acceptance hereof, acknowledges and confirms such subordination. "Senior Indebtedness" means all present and future obligations, liabilities and indebtedness of the Company of every type and nature, currently or hereafter due, incurred or created, arising under or in connection with the Credit Agreement or any refinancing loan documents, including, without limitation (i) all Obligations (as defined in the Credit Agreement) and any refinancing thereof, (ii) all interest provided for in the Credit Agreement, or any refinancing loan documents (including, without limitation, interest arising prior to and after the commencement of any bankruptcy or similar proceeding in which the Company is the debtor, whether or not such interest is an allowed claim in such proceeding) at the rates specified in the Credit Agreement or any refinancing loan documents; and (iii) all fees, charges, expenses, indemnities and other amounts payable under or incidental to the Credit Agreement (excluding any such amounts payable in respect of warrants or other equity-related obligations or earning participations that may be issued by the Company). Notwithstanding the foregoing, Senior Indebtedness held (whether as a result of subrogation or otherwise) by the Company, any of the subsidiaries or any other affiliate of the Company (whether as a result of subrogation or otherwise) (Telos, the subsidiaries and any other affiliates of the Company being collectively referred to herein as "Affiliated Parties") or by any person who has acquired Senior Indebtedness, directly or indirectly, which has been held by any of the Affiliated Parties, shall not constitute "Senior Indebtedness" under this Agreement (other than under this sentence) until such time as all Senior Indebtedness held by Persons other than Affiliated Parties has been indefeasibly paid in full in cash or cash equivalents, and no Affiliated Party or Person acquiring Senior Indebtedness from an Affiliated Party shall acquire any rights hereunder by virtue of holding such Senior Indebtedness.

This Note shall be construed and enforced in accordance with, and governed by the laws of, the Commonwealth of Virginia without giving effect to conflict of laws principles.

The parties hereto, including the undersigned Borrower and all guarantors and endorsers, hereby waive presentment, demand, notice, protest and all other demands and notices in connection with the delivery, acceptance, performance and enforcement of this Note, and assent to extensions of time of payment, or forbearance or other indulgence without notice.

TELOS CORPORATION

By: /s/ William L. P. Brownley
Name: William L. P. Brownley
Title: Vice President & General Counsel

THIS WARRANT AND THE SHARES ISSUABLE HEREUNDER HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933 OR APPLICABLE STATE SECURITIES LAWS AND MAY NOT BE SOLD, TRANSFERRED OR ASSIGNED UNLESS IT IS SO REGISTERED OR AN EXEMPTION FROM REGISTRATION IS AVAILABLE UNDER SAID ACT AND LAWS.

TELOS CORPORATION
COMMON STOCK PURCHASE
SERIES D WARRANT

This certifies that, for value received, Foreign & Colonial Enterprise Trust PLC, c/o Berkeley Square House, Berkeley Square, London W1X 5PA, England, is entitled to purchase and receive from Telos Corporation, a Maryland corporation (the "Company"), during the period hereinafter provided, 1,200,000 fully paid and non-assessable shares of the \$.01 par value common voting stock of the Company (the "Common Stock") upon surrender hereof, at the principal office of the Company in Ashburn, Virginia, and simultaneous payment of the purchase price of \$.01 for each share of the Common Stock so to be purchased; such number of shares and such purchase price per share being subject, however, to adjustment as hereinafter provided. The purchase price per share, as adjusted from time to time, is hereinafter referred to as the "Purchase Price."

This Warrant shall be exercisable commencing November 20, 1998, that being the issuance date of that certain Series D Senior Subordinated Unsecured Note Due October 1, 2000, issued by the Company to the Holder of this Series D Warrant, and shall expire on October 1, 2000.

1. Purchase Price Adjustments.

a. General. The Purchase Price shall be subject to adjustment from time to time pursuant to the terms of this Section 1.

b. Recapitalizations. If outstanding shares of the Company's Common Stock shall be subdivided into a greater number of shares or a dividend in Common Stock shall be paid in respect of Common Stock, the Purchase Price in effect immediately prior to such subdivision or at the record date of such dividend shall simultaneously with the effectiveness of such subdivision or immediately after the record date of such dividend be proportionately reduced. If outstanding shares of Common Stock shall be combined into a smaller number of shares, the Purchase Price in effect immediately prior to such combination shall, simultaneously with the effectiveness of such combination, be proportionately increased.

c. Mergers, etc. If there shall occur any capital reorganization or reclassification of the Company's Common Stock (other than a change in par value or a subdivision or combination as provided for in Subsection 1b, above), or any consolidation or merger of the Company with or into another corporation, or a transfer of all or substantially all of the assets of the Company, then, as part of any such reorganization, reclassification, consolidation, merger or sale, as the case may be, lawful provision shall be made so that the registered Holder of this Warrant shall have the right thereafter to receive upon the exercise hereof the kind and amount of shares of stock or other securities or property which such registered Holder would have been entitled to receive if, immediately prior to any such reorganization, reclassification, consolidation, merger or sale, as the case may be, such registered Holder had held the number of shares of Common Stock which were then purchasable upon the exercise of this Warrant. In any such case, appropriate adjustment (as reasonably determined in good faith by the Board of Directors of the Company) shall be made in the application of the provisions set forth herein with respect to the rights and interests thereafter of the registered Holder of this Warrant, such that the provisions set forth in this Section 1 (including provisions with respect to adjustment of the Purchase Price) shall thereafter be applicable, as nearly as is reasonably practicable, in relation to any shares of stock or other securities or property thereafter deliverable upon the exercise of this Warrant.

d. Certificate of Adjustment. When any adjustment is required to be made pursuant to this Section 1, the Company shall promptly mail to the registered Holder a certificate setting forth the Purchase Price after such adjustment and setting forth a brief statement of the facts requiring such adjustment. Such certificate shall also set forth the kind and amount of stock or other securities or property into which this Warrant shall be exercisable following such adjustment.

2. Registration Rights.

a. Certain Definitions. As used in this Warrant, the following terms shall have the following respective meanings:

"Commission" means the Securities and Exchange Commission, or any other Federal agency at the time administering the Securities Act.

"Common Stock" means the common stock, \$.01 par value per share, of the Company.

"Exchange Act" means the Securities Exchange Act of 1934, as amended, or any similar Federal statute, and the rules and regulations of the Commission issued under such Act, as they each may, from time to time, be in effect.

"Registration Statement" means a registration statement filed by the Company with the Commission for a public offering and sale of Common Stock (other than a registration statement on Form S-8 or Form S-4, or their successors, or any other form for a similar limited purpose, or any registration statement covering only securities proposed to be issued in exchange for securities or assets of another corporation).

"Registration Expenses" means the expenses described in Subsection e.

"Registrable Shares" means the shares of Common Stock issued or issuable upon exercise of this Warrant or other Series D Warrants issued contemporaneously; provided, however, that shares of Common Stock which are Registrable Shares shall cease to be Registrable Shares upon any sale of such Registrable Shares pursuant to a Registration Statement or Rule 144 under the Securities Act. Wherever reference is made in this Warrant to a request or consent of holders of a certain percentage of Registrable Shares, the determination of such percentage shall include shares of Common Stock issuable upon exercise of the Warrant even if such exercise conversion has not yet been effected.

"Securities Act" means the Securities Act of 1933, as amended, or any similar Federal statute, and the rules and regulations of the Commission issued under such Act, as they each may, from time to time, be in effect.

"Stockholders" means the Holders and any persons or entities to whom the rights granted under this Warrant are transferred by any Holders, their successors or assigns pursuant to Section 4 hereof.

b. Required Registrations.

(1) At any time after the Company becomes eligible to file a Registration Statement on Form S-3 (or any successor form relating to secondary offerings), a Stockholder or Stockholders holding in the aggregate at least 20% of the Registrable Shares issued pursuant to the Series D Warrants may request the Company, in writing, to effect the registration on Form S-3 (or such successor form), of Registrable Shares having an aggregate offering price of at least Five Hundred Thousand Dollars (\$500,000) (based on the then current public market price). Upon receipt of any such request, the Company shall promptly give written notice of such proposed registration to all Stockholders. Such Stockholders shall have the right, by giving written notice to the Company within 30 days after the Company provides its notice, to elect to have included in such registration such of their Registrable Shares as such Stockholders may request in such notice of election; provided that if the underwriter (if any) managing the offering determines that, because of marketing factors, all of the Registrable Shares requested to be registered by all Stockholders may not be included in the offering, then all Stockholders who have requested registration shall participate in the registration pro rata based upon the number of Registrable Shares which they have requested to be so registered. Thereupon, the Company shall, as expeditiously as possible, use its best efforts to effect the registration on Form S-3 (or such successor form) of all Registrable Shares which the Company has been requested to so register.

(2) The Company shall not be required to effect more than 3 registrations pursuant to Subparagraph (1) above, nor shall the Company be required to effect a registration pursuant to Subparagraph (1) above within six months after the effective date of any other Registration Statement of the Company (other than on Form S-3, or S-8, or any successor form).

(3) If at the time of any request to register Registrable Shares pursuant to this Subsection b, the Company is engaged or has fixed plans to engage within 30 days of the time of the request in a registered public offering as to which the Stockholders may include Registrable Shares pursuant to Subsection c or is engaged in any other activity which, in the good faith determination of the Company's Board of Directors, would be adversely affected by the requested registration to the material detriment of the Company, then the Company may at its option direct that such request be delayed for a period not in excess of six months from the effective date of such offering or the date of commencement of such other material activity, as the case may be.

c. Incidental Registration.

(1) Whenever the Company proposes to file a Registration Statement (other than pursuant to Subsection b(1)) at any time and from time to time, it will, prior to such filing, give written notice to all Stockholders of its intention to do so and, upon the written request of a Stockholder or Stockholders given within 20 days after the Company provides such notice (which request shall state the intended method of disposition of such Registrable Shares), the Company shall use its best efforts to cause all Registrable Shares which the Company has been requested by such Stockholder or Stockholders to register to be registered under the Securities Act to the extent necessary to permit their sale or other disposition in accordance with the intended methods of distribution specified in the request of such Stockholder or Stockholders; provided that the Company shall have the right to postpone or withdraw any registration effected pursuant to this Subsection c without obligation to any Stockholder.

(2) In connection with any registration under this Subsection c involving an underwriting, the Company shall not be required to include any Registrable Shares in such registration unless the holders thereof accept the terms of the underwriting as agreed upon between the Company and the underwriters selected by it (provided that such terms must be consistent with this Warrant). If in the opinion of the managing underwriter it is appropriate because of marketing factors to limit the number of Registrable Shares to be included in the offering, then the Company shall be required to include in the registration only that number of Registrable Shares, if any, which the managing underwriter believes should be included therein. If the number of Registrable Shares to be included in the offering in accordance with the foregoing is less than the total number of shares which the holders of Registrable Shares have requested to be included, then the holders of Registrable Shares who have requested registration and other holders of securities entitled to include them in such registration shall participate in the registration pro rata based upon their total ownership of shares of Common Stock (giving effect to the conversion into Common Stock of

all securities convertible thereinto). If any holder would thus be entitled to include more securities than such holder requested to be registered, the excess shall be allocated among other requesting holders pro rata in the manner described in the preceding sentence.

d. Registration Procedures. If and whenever the Company is required by the provisions of this Warrant to use its best efforts to effect the registration of any of the Registrable Shares under the Securities Act, the Company shall:

(1) file with the Commission a Registration Statement with respect to such Registrable Shares and use its best efforts to cause that Registration Statement to become and remain effective;

(2) as expeditiously as possible prepare and file with the Commission any amendments and supplements to the Registration Statement and the prospectus included in the Registration Statement as may be necessary to keep the Registration Statement effective, in the case of a firm commitment underwritten public offering, until each underwriter has completed the distribution of all securities purchased by it and, in the case of any other offering, until the earlier of the sale of all Registrable Shares covered thereby or 120 days after the effective date thereof;

(3) as expeditiously as possible furnish to each selling Stockholder such reasonable numbers of copies of the prospectus, including a preliminary prospectus, in conformity with the requirements of the Securities Act, and such other documents as the selling Stockholder may reasonably request in order to facilitate the public sale or other disposition of the Registrable Shares owned by the selling Stockholder; and

(4) as expeditiously as possible use its best efforts to register or qualify the Registrable Shares covered by the Registration Statement under the securities or Blue Sky laws of such states as the selling Stockholders shall reasonably request, and do any and all other acts and things that may be necessary or desirable to enable the selling Stockholders to consummate the public sale or other disposition in such states of the Registrable Shares owned by the selling Stockholder; provided, however, that the Company shall not be required in connection with this Subparagraph (4) to qualify as a foreign corporation or execute a general consent to service of process in any jurisdiction.

If the Company has delivered preliminary or final prospectuses to the selling Stockholders and after having done so the prospectus is amended to comply with the requirements of the Securities Act, the Company shall promptly notify the selling Stockholders and, if requested, the selling Stockholders shall immediately cease making offers of Registrable Shares and return all prospectuses to the Company. The Company shall promptly provide the selling Stockholders with revised prospectuses and, following receipt of the revised prospectuses, the selling Stockholders shall be free to resume making offers of the Registrable Shares.

e. Allocation of Expenses. The Company will pay all Registration Expenses of all registrations under this Warrant; provided, however, that if a registration under Subsection b is withdrawn at the request of the Stockholders requesting such registration (other than as a result of information concerning the business or financial condition of the Company which is made known to the Stockholders after the date on which such registration was requested) and if the requesting Stockholders elect not to have such registration counted as a registration requested under Subsection b, the requesting Stockholders shall pay the Registration Expenses of such registration pro rata in accordance with the number of their Registrable Shares included in such registration. For purposes of this Subsection e, the term "Registration Expenses" shall mean all expenses incurred by the Company in complying with this Warrant, including, without limitation, all registration and filing fees, exchange listing fees, printing expenses, fees and expenses of counsel for the Company and the fees and expenses of one counsel selected by the selling Stockholders to represent the selling Stockholders, state Blue Sky fees and expenses, and the expense of any special audits incident to or required by any such registration, but excluding underwriting discounts, selling commissions and the fees and expenses of selling Stockholders' own counsel (other than the counsel selected to represent all selling Stockholders).

f. Indemnification and Contribution.

(1) In the event of any registration of any of the Registrable Shares under the Securities Act pursuant to this Warrant, the Company will indemnify and hold harmless the seller of such Registrable Shares, each underwriter of such Registrable Shares, and each other person, if any, who controls such seller or underwriter within the meaning of the Securities Act or the Exchange Act against any losses, claims, damages or liabilities, joint or several, to which such seller, underwriter or controlling person may become subject under the Securities Act, the Exchange Act, state securities or Blue Sky laws or otherwise, insofar as such losses, claims, damages or liabilities (or actions in respect thereof) arise out of or are based upon any untrue statement or alleged untrue statement of any material fact contained in any Registration Statement under which such Registrable Shares were registered under the Securities Act, any preliminary prospectus or final prospectus contained in the Registration Statement, or any amendment or supplement to such Registration Statement, or arise out of or are based upon the omission or alleged omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and the Company will reimburse such seller, underwriter and each such controlling person for any legal or any other expenses reasonably incurred by such seller, underwriter or controlling person in connection with

investigating or defending any such loss, claim, damage, liability or action; provided, however, that the Company will not be liable in any such case to the extent that any such loss, claim, damage or liability arises out of or is based upon any untrue statement or omission made in such Registration Statement, preliminary prospectus or final prospectus, or any such amendment or supplement, in reliance upon and in conformity with information furnished to the Company, in writing, by or on behalf of such seller, underwriter or controlling person specifically for use in the preparation thereof.

(2) In the event of any registration of any of the Registrable Shares under the Securities Act pursuant to this Warrant, each seller of Registrable Shares, severally and not jointly, will indemnify and hold harmless the Company, each of its directors and officers and each underwriter (if any) and each person, if any, who controls the Company or any such underwriter within the meaning of the Securities Act or the Exchange Act, against any losses, claims, damages or liabilities, joint or several, to which the Company, such directors and officers, underwriter or controlling person may become subject under the Securities Act, Exchange Act, state securities or Blue Sky laws or otherwise, insofar as such losses, claims, damages or liabilities (or actions in respect thereof) arise out of or are based upon any untrue statement of a material fact contained in any Registration Statement under which such Registrable Shares were registered under the Securities Act, any preliminary prospectus or final prospectus contained in the Registration Statement, or any amendment or supplement to the Registration Statement, or arise out of or are based upon any omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, if the statement or omission was made in reliance upon and in conformity with information relating to such seller furnished in writing to the Company by or on behalf of such seller specifically for use in connection with the preparation of such Registration Statement, prospectus, amendment or supplement; provided, however, that the obligations of such Stockholders hereunder shall be limited to an amount equal to the proceeds to each Stockholder of Registrable Shares sold in connection with such registration.

(3) Each party entitled to indemnification under this Subsection f (the "Indemnified Party") shall give notice to the party required to provide indemnification (the "Indemnifying Party") promptly after such Indemnified Party has actual knowledge of any claim as to which indemnity may be sought, and shall permit the Indemnifying Party to assume the defense of any such claim or any litigation resulting therefrom; provided, that counsel for the Indemnifying Party, who shall conduct the defense of such claim or litigation, shall be approved by the Indemnified Party (whose approval shall not be unreasonably withheld); and, provided, further, that the failure of any Indemnified Party to give notice as provided herein shall not relieve the Indemnifying Party of its obligations under this Subsection f. The Indemnified Party may participate in such defense at such party's expense; provided, however, that the Indemnifying Party shall pay such expense if representation of such Indemnified Party by the counsel retained by the Indemnifying Party would be inappropriate due to actual or potential differing interests between the Indemnified Party and any other party represented by such counsel in such proceeding. No Indemnifying Party, in the defense of any such claim or litigation shall, except with the consent of each Indemnified Party, consent to entry of any judgment or enter into any settlement which does not include as an unconditional term thereof the giving by the claimant or plaintiff to such Indemnified Party of a release from all liability in respect of such claim or litigation, and no Indemnified Party shall consent to entry of any judgment or settle such claim or litigation without the prior written consent of the Indemnifying Party.

(4) In order to provide for just and equitable contribution to joint liability under the Securities Act in any case in which either (i) any holder of Registrable Shares exercising rights under this Warrant, or any controlling person of any such holder, makes a claim for indemnification pursuant to this Subsection f but it is judicially determined (by the entry of a final judgment or decree by a court of competent jurisdiction and the expiration of time to appeal or the denial of the last right of appeal) that such indemnification may not be enforced in such case notwithstanding the fact that this Subsection f provides for indemnification in such case, or (ii) contribution under the Securities Act may be required on the part of any such selling Stockholder or any such controlling person in circumstances for which indemnification is provided under this Subsection f; then, in each such case, the Company and such Stockholder will contribute to the aggregate losses, claims, damages or liabilities to which they may be subject (after contribution from others) in such proportions so that such holder is responsible for the portion represented by the percentage that the public offering price of its Registrable shares offered by the Registration Statement bears to the public offering price of all securities offered by such Registration Statement, and the Company is responsible for the remaining portion; provided, however, that, in any such case, (A) no such holder will be required to contribute any amount in excess of the proceeds to it of all Registrable Shares sold by it pursuant to such Registration Statement, and (B) no person or entity guilty of fraudulent misrepresentation, within the meaning of Section 11(f) of the Securities Act, shall be entitled to contribution from any person or entity who is not guilty of such fraudulent misrepresentation.

g. Indemnification with Respect to Underwritten Offering. In the event that Registrable Shares are sold pursuant to a Registration Statement in an underwritten offering pursuant to Subsection b, the Company agrees to enter into an underwriting agreement containing customary representations and warranties with respect to the business and operations of an issuer of the securities being registered and customary covenants and agreements to be performed by such issuer, including without limitation customary provisions with respect to indemnification by the Company of the underwriters of such offering.

h. Information by Holder. Each Stockholder including Registrable Shares in any registration shall furnish to the Company such information regarding such Stockholder and the distribution proposed by such Stockholder as the Company may reasonably request in writing and as shall be required in connection with any registration, qualification or compliance referred to in this Warrant.

i. "Stand-Off" Agreement". Each Stockholder, if requested by the Company and the managing underwriter of an offering by the Company of Common Stock or other securities of the Company pursuant to a Registration Statement, shall agree not to sell publicly or otherwise transfer or dispose of any Registrable Shares or other securities of the Company held by such Stockholder for a specified period of time (not to exceed 180 days) following the effective date of such Registration Statement; provided, that:

(1) such agreement shall only apply to the first Registration Statement covering Common Stock to be sold on its behalf to the public in an underwritten offering; and

(2) all Stockholders holding not less than the number of shares of Common Stock held by such Stockholder (including shares of Common Stock issuable upon the conversion of Shares, or other convertible securities, or upon the exercise of options, warrants or rights) and all officers and directors of the Company enter into similar agreements.

j. Termination. All of the Company's obligations to register Registrable Shares under this Warrant shall terminate on the tenth anniversary of this Warrant.

3. Exercise of Warrant.

a. The Company covenants that it will at all times maintain an available and adequate reserve of duly authorized but unissued share of its Common Stock, free from preemptive rights, sufficient to effect the full exercise of this Warrant as herein provided, and that it will at all times maintain in full force and effect an appropriate permit of the Delaware Commissioner of Corporations authorizing the issuance and sale by the Company of all shares of Common Stock issuable upon exercise of this Warrant by the holder.

The Company covenants that all shares of Common Stock issuable upon the exercise of this Warrant will, upon issuance, be validly issued, fully paid and non-assessable, and free from all taxes, liens and charges with respect to the issue thereof.

The holder hereof may surrender this Warrant for exchange at the principal office of the Company. Within a reasonable time thereafter and without expense (other than transfer taxes, if any) to each holder, the Company shall issue in exchange therefor, in such denominations (of not less than 100 shares) and issued in such name or names as the holder shall designate (if permitted by the Federal Securities laws and the relevant Blue Sky law(s), as amended from time to time), a new certificate or certificates dated the date hereof evidencing the right to purchase the same aggregate number of shares of Common Stock as are evidenced hereby, and otherwise containing the same provisions and subject to the same terms and conditions of this certificate.

Upon surrender of this Warrant at the office of the Company accompanied by payment of the appropriate Purchase Price of the Common Stock in cash or as otherwise allowed herein, the Company shall forthwith cause to be executed, issued and delivered to the holder of the Warrant a certificate or certificates for the proper number of shares of common stock or other securities of the Company; and the Company covenants that the issuance of this Warrant shall constitute full authority to those of its officers who are charged with the duty of issuing stock certificates to promptly execute, issue and deliver to the holder of the Warrant the necessary certificate for shares of Common Stock or other securities of the Company required by such exercise.

This Warrant may be exercised in accordance with its terms prior to expiration as a whole, or from time to time in part. In the event of partial exercise of the Warrant, the Company shall, in addition to delivery of the securities thereby purchased, deliver to the holder of the Warrant, a new Warrant for the remaining shares then subject to the unexercised portion of the Warrant; such new Warrant being dated the date hereof and otherwise containing the same provisions and subject to the same conditions and subject to the same terms and conditions as this Warrant. Certificates for shares of Common Stock or other securities of the Company issuable by reason of the exercise of Warrants shall be dated and shall be effective as of the date of the surrender of the Warrants for exercise or acceptance of the offering of shares or other securities, as the case may be, and the payment of the appropriate Purchase Price, notwithstanding any delay in the actual execution, issuance or delivery of the certificates or securities so purchased.

This Warrant shall be registered on the books of the Company, which shall be kept at its principal office for that purpose, and shall be transferable only on said books by the holder hereof in person or by duly authorized attorney upon surrender of this Warrant properly endorsed.

b. This Warrant may be exercised by the holder hereof, in whole or in part, by surrendering this Warrant at the principal office of the Company, or at such other office or agency as the Company may designate, accompanied by payment in full, in lawful money of the United States, of the Purchase Price payable in respect of the number of Warrant Shares purchased upon such exercise.

c. The holder hereof may, at its option, elect to pay some or all of the Purchase Price payable upon an exercise of this Warrant by canceling a portion of this Warrant exercisable for such number of Warrant Shares as is determined by dividing (i) the total Purchase Price payable in respect of the number of Warrant Shares being purchased upon such exercise by (ii) the excess of the Fair Market Value per share of Common Stock as of the effective date of exercise (the "Exercise Date") over the Purchase Price per share. The Fair Market Value per share of Common Stock shall be determined as follows:

(1) If the Common Stock is listed on a national securities exchange, the NASDAQ National Market System, the NASDAQ system, or another nationally recognized exchange or trading system as of the Exercise Date, the Fair Market Value per share of Common Stock shall be deemed to be the last reported sale price per share of Common Stock thereon on the Exercise Date; or, if no such price is reported on such date, such price on the next preceding business day (provided that if no such price is reported on the next preceding business day, the Fair Market Value per share of Common Stock shall be determined pursuant to Clause (2)).

(2) If the Common Stock is not listed on a national securities exchange, the NASDAQ National Market System, the NASDAQ system or another nationally recognized exchange or trading system as of the Exercise Date, the Fair Market Value per share of Common Stock shall be deemed to be the amount most recently determined by the Board of Directors to represent the fair market value per share of the Common Stock (including without limitation a determination for purposes of granting Common Stock options or issuing Common Stock under an employee benefit plan of the Company); and, upon request of the holder hereof, the Board of Directors (or a representative thereof) shall promptly notify the holder hereof of the Fair Market Value per share of Common Stock. Notwithstanding the foregoing, if the Board of Directors has not made such a determination within the three-month period prior to the Exercise Date, then (A) the Fair Market Value per share of Common Stock shall be the amount next determined by the Board of Directors to represent the fair market value per share of the Common Stock (including without limitation a determination for purposes of granting Common Stock options or issuing Common Stock under an employee benefit plan of the Company), (B) the Board of Directors shall make such a determination within 30 days of a request by the holder hereof that it do so, and (C) the exercise of this Warrant pursuant to this Subsection 2c shall be delayed until such determination is made.

4. Transfers of Rights. This Warrant, and the rights and obligations of each holder hereof, may be assigned by such holder hereof to any person or entity to which not fewer than 100 Shares (issued or issuable under this Warrant) are transferred by such holder hereof, and such transferee shall be deemed a "holder hereof" for purposes of this Warrant; provided that the transferee provides written notice of such assignment to the Company.

5. General.

a. Notices. All notices, requests, consents, and other communications under this Warrant shall be in writing and shall be delivered by hand or mailed by first class certified or registered mail, return receipt requested, postage prepaid:

If to the Company, at 19886 Ashburn Road, Ashburn, VA 20147, Attention:

President, or at such other address or addresses as may have been furnished in writing by the Company to the Holders, with a copy to the Chief Financial Officer and General Counsel; or

If to a holder hereof, at his or its address set forth above, or at such other address or addresses as may have been furnished to the Company in writing by such holder hereof.

Notices provided in accordance with this Section 5 shall be deemed delivered upon personal delivery or two business days after deposit in the mail.

b. Entire Agreement. This Warrant embodies the entire agreement and understanding between the parties hereto with respect to the subject matter hereof and supersedes all prior agreements and understandings relating to such subject matter.

c. Amendments and Waivers. Any term of this Warrant may be amended and the observance of any term of this Warrant may be waived (either generally or in a particular instance and either retroactively or prospectively), with the written consent of the Company and the holders of at least 90% of the Registrable Shares; provided, that this Warrant may be amended with the consent of the holders of less than all Registrable Shares only in a manner which affects all Registrable Shares in the same fashion. No waivers of or exceptions to any term, condition or provision of this Warrant, in any one or more instances, shall be deemed to be, or construed as, a further or continuing waiver of any such term, condition or provision.

d. Fractional Shares. The Company shall not be required upon the exercise of this Warrant to issue any fractional shares, but shall make an adjustment therefor in cash on the basis of the Fair Market Value per share of Common Stock, as determined in good faith by the Board of Directors or as quoted if the Common Stock is publicly traded on the day the Warrant was exercised.

Executed in Ashburn, Virginia as of the 20th day of November, 1998.

TELOS CORPORATION

By: /s/ William L.P. Brownley
William L.P. Brownley
Vice President and General Counsel

[SEAL]

Attest: /s/ Gerald D. Calhoun, Secretary
Gerald D. Calhoun, Secretary

THIS WARRANT AND THE SHARES ISSUABLE HEREUNDER HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933 OR APPLICABLE STATE SECURITIES LAWS AND MAY NOT BE SOLD, TRANSFERRED OR ASSIGNED UNLESS IT IS SO REGISTERED OR AN EXEMPTION FROM REGISTRATION IS AVAILABLE UNDER SAID ACT AND LAWS.

TELOS CORPORATION
COMMON STOCK PURCHASE
SERIES D WARRANT

This certifies that, for value received, Foreign & Colonial Enterprise Trust Limited Partnership, c/o Berkeley Square House, Berkeley Square, London W1X 5PA, England, is entitled to purchase and receive from Telos Corporation, a Maryland corporation (the "Company"), during the period hereinafter provided, 300,000 fully paid and non-assessable shares of the \$.01 par value common voting stock of the Company (the "Common Stock") upon surrender hereof, at the principal office of the Company in Ashburn, Virginia, and simultaneous payment of the purchase price of \$.01 for each share of the Common Stock so to be purchased; such number of shares and such purchase price per share being subject, however, to adjustment as hereinafter provided. The purchase price per share, as adjusted from time to time, is hereinafter referred to as the "Purchase Price."

This Warrant shall be exercisable commencing November 20, 1998, that being the issuance date of that certain Series D Senior Subordinated Unsecured Note Due October 1, 2000, issued by the Company to the Holder of this Series D Warrant, and shall expire on October 1, 2000.

1. Purchase Price Adjustments.

a. General. The Purchase Price shall be subject to adjustment from time to time pursuant to the terms of this Section 1.

b. Recapitalizations. If outstanding shares of the Company's Common Stock shall be subdivided into a greater number of shares or a dividend in Common Stock shall be paid in respect of Common Stock, the Purchase Price in effect immediately prior to such subdivision or at the record date of such dividend shall simultaneously with the effectiveness of such subdivision or immediately after the record date of such dividend be proportionately reduced. If outstanding shares of Common Stock shall be combined into a smaller number of shares, the Purchase Price in effect immediately prior to such combination shall, simultaneously with the effectiveness of such combination, be proportionately increased.

c. Mergers, etc. If there shall occur any capital reorganization or reclassification of the Company's Common Stock (other than a change in par value or a subdivision or combination as provided for in Subsection 1b, above), or any consolidation or merger of the Company with or into another corporation, or a transfer of all or substantially all of the assets of the Company, then, as part of any such reorganization, reclassification, consolidation, merger or sale, as the case may be, lawful provision shall be made so that the registered Holder of this Warrant shall have the right thereafter to receive upon the exercise hereof the kind and amount of shares of stock or other securities or property which such registered Holder would have been entitled to receive if, immediately prior to any such reorganization, reclassification, consolidation, merger or sale, as the case may be, such registered Holder had held the number of shares of Common Stock which were then purchasable upon the exercise of this Warrant. In any such case, appropriate adjustment (as reasonably determined in good faith by the Board of Directors of the Company) shall be made in the application of the provisions set forth herein with respect to the rights and interests thereafter of the registered Holder of this Warrant, such that the provisions set forth in this Section 1 (including provisions with respect to adjustment of the Purchase Price) shall thereafter be applicable, as nearly as is reasonably practicable, in relation to any shares of stock or other securities or property thereafter deliverable upon the exercise of this Warrant.

d. Certificate of Adjustment. When any adjustment is required to be made pursuant to this Section 1, the Company shall promptly mail to the registered Holder a certificate setting forth the Purchase Price after such adjustment and setting forth a brief statement of the facts requiring such adjustment. Such certificate shall also set forth the kind and amount of stock or other securities or property into which this Warrant shall be exercisable following such adjustment.

2. Registration Rights.

a. Certain Definitions. As used in this Warrant, the following terms shall have the following respective meanings:

"Commission" means the Securities and Exchange Commission, or any other Federal agency at the time administering the Securities Act.

"Common Stock" means the common stock, \$.01 par value per share, of the Company.

"Exchange Act" means the Securities Exchange Act of 1934, as amended, or any similar Federal statute, and the rules and regulations of the Commission issued under such Act, as they each may, from time to time, be in effect.

"Registration Statement" means a registration statement filed by the Company with the Commission for a public offering and sale of Common Stock (other than a registration statement on Form S-8 or Form S-4, or their

successors, or any other form for a similar limited purpose, or any registration statement covering only securities proposed to be issued in exchange for securities or assets of another corporation).

"Registration Expenses" means the expenses described in Subsection e.

"Registrable Shares" means the shares of Common Stock issued or issuable upon exercise of this Warrant or other Series D Warrants issued contemporaneously; provided, however, that shares of Common Stock which are Registrable Shares shall cease to be Registrable Shares upon any sale of such Registrable Shares pursuant to a Registration Statement or Rule 144 under the Securities Act. Wherever reference is made in this Warrant to a request or consent of holders of a certain percentage of Registrable Shares, the determination of such percentage shall include shares of Common Stock issuable upon exercise of the Warrant even if such exercise conversion has not yet been effected.

"Securities Act" means the Securities Act of 1933, as amended, or any similar Federal statute, and the rules and regulations of the Commission issued under such Act, as they each may, from time to time, be in effect.

"Stockholders" means the Holders and any persons or entities to whom the rights granted under this Warrant are transferred by any Holders, their successors or assigns pursuant to Section 4 hereof.

b. Required Registrations.

(1) At any time after the Company becomes eligible to file a Registration Statement on Form S-3 (or any successor form relating to secondary offerings), a Stockholder or Stockholders holding in the aggregate at least 20% of the Registrable Shares issued pursuant to the Series D Warrants may request the Company, in writing, to effect the registration on Form S-3 (or such successor form), of Registrable Shares having an aggregate offering price of at least Five Hundred Thousand Dollars (\$500,000) (based on the then current public market price). Upon receipt of any such request, the Company shall promptly give written notice of such proposed registration to all Stockholders. Such Stockholders shall have the right, by giving written notice to the Company within 30 days after the Company provides its notice, to elect to have included in such registration such of their Registrable Shares as such Stockholders may request in such notice of election; provided that if the underwriter (if any) managing the offering determines that, because of marketing factors, all of the Registrable Shares requested to be registered by all Stockholders may not be included in the offering, then all Stockholders who have requested registration shall participate in the registration pro rata based upon the number of Registrable Shares which they have requested to be so registered. Thereupon, the Company shall, as expeditiously as possible, use its best efforts to effect the registration on Form S-3 (or such successor form) of all Registrable Shares which the Company has been requested to so register.

(2) The Company shall not be required to effect more than 3 registrations pursuant to Subparagraph (1) above, nor shall the Company be required to effect a registration pursuant to Subparagraph (1) above within six months after the effective date of any other Registration Statement of the Company (other than on Form S-3, or S-8, or any successor form).

(3) If at the time of any request to register Registrable Shares pursuant to this Subsection b, the Company is engaged or has fixed plans to engage within 30 days of the time of the request in a registered public offering as to which the Stockholders may include Registrable Shares pursuant to Subsection c or is engaged in any other activity which, in the good faith determination of the Company's Board of Directors, would be adversely affected by the requested registration to the material detriment of the Company, then the Company may at its option direct that such request be delayed for a period not in excess of six months from the effective date of such offering or the date of commencement of such other material activity, as the case may be.

c. Incidental Registration.

(1) Whenever the Company proposes to file a Registration Statement (other than pursuant to Subsection b(1)) at any time and from time to time, it will, prior to such filing, give written notice to all Stockholders of its intention to do so and, upon the written request of a Stockholder or Stockholders given within 20 days after the Company provides such notice (which request shall state the intended method of disposition of such Registrable Shares), the Company shall use its best efforts to cause all Registrable Shares which the Company has been requested by such Stockholder or Stockholders to register to be registered under the Securities Act to the extent necessary to permit their sale or other disposition in accordance with the intended methods of distribution specified in the request of such Stockholder or Stockholders; provided that the Company shall have the right to postpone or withdraw any registration effected pursuant to this Subsection c without obligation to any Stockholder.

(2) In connection with any registration under this Subsection c involving an underwriting, the Company shall not be required to include any Registrable Shares in such registration unless the holders thereof accept the terms of the underwriting as agreed upon between the Company and the underwriters selected by it (provided that such terms must be consistent with this Warrant). If in the opinion of the managing underwriter it is appropriate because of marketing factors to limit the number of Registrable Shares to be included in the offering, then the Company shall be required to include in the registration only that number of Registrable Shares, if any, which the managing underwriter believes should be included therein. If the number of Registrable Shares to be included in the offering in accordance with the foregoing is less than the total number of shares which the holders of Registrable Shares have requested to be included, then the holders of Registrable Shares who have requested registration and other holders of securities entitled to include them in such registration shall participate in the registration pro rata based upon their total ownership of shares of Common Stock (giving effect to the conversion into Common Stock of all securities convertible therein). If any holder would thus be entitled to include more securities than such holder requested to be registered, the excess shall be allocated among other requesting holders pro rata in the manner described in the preceding sentence.

d. Registration Procedures. If and whenever the Company is required by the provisions of this Warrant to use its best efforts to effect the registration of any of the Registrable Shares under the Securities Act, the Company shall:

(1) file with the Commission a Registration Statement with respect to such Registrable Shares and use its best efforts to cause that Registration Statement to become and remain effective;

(2) as expeditiously as possible prepare and file with the Commission any amendments and supplements to the Registration Statement and the prospectus included in the Registration Statement as may be necessary to keep the Registration Statement effective, in the case of a firm commitment underwritten public offering, until each underwriter has completed the distribution of all securities purchased by it and, in the case of any other offering, until the earlier of the sale of all Registrable Shares covered thereby or 120 days after the effective date thereof;

(3) as expeditiously as possible furnish to each selling Stockholder such reasonable numbers of copies of the prospectus, including a preliminary prospectus, in conformity with the requirements of the Securities Act, and such other documents as the selling Stockholder may reasonably request in order to facilitate the public sale or other disposition of the Registrable Shares owned by the selling Stockholder; and

(4) as expeditiously as possible use its best efforts to register or qualify the Registrable Shares covered by the Registration Statement under the securities or Blue Sky laws of such states as the selling Stockholders shall reasonably request, and do any and all other acts and things that may be necessary or desirable to enable the selling Stockholders to consummate the public sale or other disposition in such states of the Registrable Shares owned by the selling Stockholder; provided, however, that the Company shall not be required in connection with this Subparagraph (4) to qualify as a foreign corporation or execute a general consent to service of process in any jurisdiction.

If the Company has delivered preliminary or final prospectuses to the selling Stockholders and after having done so the prospectus is amended to comply with the requirements of the Securities Act, the Company shall promptly notify the selling Stockholders and, if requested, the selling Stockholders shall immediately cease making offers of Registrable Shares and return all prospectuses to the Company. The Company shall promptly provide the selling Stockholders with revised prospectuses and, following receipt of the revised prospectuses, the selling Stockholders shall be free to resume making offers of the Registrable Shares.

e. Allocation of Expenses. The Company will pay all Registration Expenses of all registrations under this Warrant; provided, however, that if a registration under Subsection b is withdrawn at the request of the Stockholders requesting such registration (other than as a result of information concerning the business or financial condition of the Company which is made known to the Stockholders after the date on which such registration was requested) and if the requesting Stockholders elect not to have such registration counted as a registration requested under Subsection b, the requesting Stockholders shall pay the Registration Expenses of such registration pro rata in accordance with the

number of their Registrable Shares included in such registration. For purposes of this Subsection e, the term "Registration Expenses" shall mean all expenses incurred by the Company in complying with this Warrant, including, without limitation, all registration and filing fees, exchange listing fees, printing expenses, fees and expenses of counsel for the Company and the fees and expenses of one counsel selected by the selling Stockholders to represent the selling Stockholders, state Blue Sky fees and expenses, and the expense of any special audits incident to or required by any such registration, but excluding underwriting discounts, selling commissions and the fees and expenses of selling Stockholders' own counsel (other than the counsel selected to represent all selling Stockholders).

f. Indemnification and Contribution.

(1) In the event of any registration of any of the Registrable Shares under the Securities Act pursuant to this Warrant, the Company will indemnify and hold harmless the seller of such Registrable Shares, each underwriter of such Registrable Shares, and each other person, if any, who controls such seller or underwriter within the meaning of the Securities Act or the Exchange Act against any losses, claims, damages or liabilities, joint or several, to which such seller, underwriter or controlling person may become subject under the Securities Act, the Exchange Act, state securities or Blue Sky laws or otherwise, insofar as such losses, claims, damages or liabilities (or actions in respect thereof) arise out of or are based upon any untrue statement or alleged untrue statement of any material fact contained in any Registration Statement under which such Registrable Shares were registered under the Securities Act, any preliminary prospectus or final prospectus contained in the Registration Statement, or any amendment or supplement to such Registration Statement, or arise out of or are based upon the omission or alleged omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and the Company will reimburse such seller, underwriter and each such controlling person for any legal or any other expenses reasonably incurred by such seller, underwriter or controlling person in connection with investigating or defending any such loss, claim, damage, liability or action; provided, however, that the Company will not be liable in any such case to the extent that any such loss, claim, damage or liability arises out of or is based upon any untrue statement or omission made in such Registration Statement, preliminary prospectus or final prospectus, or any such amendment or supplement, in reliance upon and in conformity with information furnished to the Company, in writing, by or on behalf of such seller, underwriter or controlling person specifically for use in the preparation thereof.

(2) In the event of any registration of any of the Registrable Shares under the Securities Act pursuant to this Warrant, each seller of Registrable Shares, severally and not jointly, will indemnify and hold harmless the Company, each of its directors and officers and each underwriter (if any) and each person, if any, who controls the Company or any such underwriter within the meaning of the Securities Act or the Exchange Act, against any losses, claims, damages or liabilities, joint or several, to which the Company, such directors and officers, underwriter or controlling person may become subject under the Securities Act, Exchange Act, state securities or Blue Sky laws or otherwise, insofar as such losses, claims, damages or liabilities (or actions in respect thereof) arise out of or are based upon any untrue statement of a material fact contained in any Registration Statement under which such Registrable Shares were registered under the Securities Act, any preliminary prospectus or final prospectus contained in the Registration Statement, or any amendment or supplement to the Registration Statement, or arise out of or are based upon any omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, if the statement or omission was made in reliance upon and in conformity with information relating to such seller furnished in writing to the Company by or on behalf of such seller specifically for use in connection with the preparation of such Registration Statement, prospectus, amendment or supplement; provided, however, that the obligations of such Stockholders hereunder shall be limited to an amount equal to the proceeds to each Stockholder of Registrable Shares sold in connection with such registration.

(3) Each party entitled to indemnification under this Subsection f (the "Indemnified Party") shall give notice to the party required to provide indemnification (the "Indemnifying Party") promptly after such Indemnified Party has actual knowledge of any claim as to which indemnity may be sought, and shall permit the Indemnifying Party to assume the defense of any such claim or any litigation resulting therefrom; provided, that counsel for the Indemnifying Party, who shall conduct the defense of such claim or litigation, shall be approved by the Indemnified Party (whose approval shall not be unreasonably withheld); and, provided, further, that the failure of any Indemnified Party to give notice as provided herein shall not relieve the Indemnifying Party of its obligations under this Subsection f. The Indemnified Party may participate in such defense at such party's expense; provided, however, that the Indemnifying Party shall pay such expense if representation of such Indemnified Party by the counsel retained by the Indemnifying Party would be inappropriate due to actual or potential differing interests between the Indemnified Party and any other party represented by such counsel in such proceeding. No Indemnifying Party, in the defense of any such claim or litigation shall, except with the consent of each Indemnified Party, consent to entry of any judgment or enter into any settlement which does not include as an unconditional term thereof the giving by the claimant or plaintiff to such Indemnified Party of a release from all liability in respect of such claim or litigation, and no Indemnified Party shall consent to entry of any judgment or settle such claim or litigation without the prior written consent of the Indemnifying Party.

(4) In order to provide for just and equitable contribution to joint liability under the Securities Act in any case in which either (i) any holder of Registrable Shares exercising rights under this Warrant, or any controlling person of any such holder, makes a claim for indemnification pursuant to this Subsection f but it is judicially determined (by the entry of a final judgment or decree by a court of competent jurisdiction and the expiration of time to appeal or the denial of the last right of appeal) that such indemnification may not be enforced in such case notwithstanding the fact that this Subsection f provides for indemnification in such case, or (ii) contribution under the Securities Act may be required on the part of any such selling Stockholder or any such controlling person in circumstances for which indemnification is provided under this Subsection f; then, in each such case, the Company and such Stockholder will contribute to the aggregate losses, claims, damages or liabilities to which they may be subject (after contribution from others) in such proportions so that such holder is responsible for the portion represented by the percentage that the public offering price of its Registrable shares offered by the Registration Statement bears to the public offering price of all securities offered by such Registration Statement, and the Company is responsible for the remaining portion; provided, however, that, in any such case, (A) no such holder will be required to contribute any amount in excess of the proceeds to it of all Registrable Shares sold by it pursuant to such Registration Statement, and (B) no person or entity guilty of fraudulent misrepresentation, within the meaning of Section 11(f) of the Securities Act, shall be entitled to contribution from any person or entity who is not guilty of such fraudulent misrepresentation.

g. Indemnification with Respect to Underwritten Offering. In the event that Registrable Shares are sold pursuant to a Registration Statement in an underwritten offering pursuant to Subsection b, the Company agrees to enter into an underwriting agreement containing customary representations and warranties with respect to the business and operations of an issuer of the securities being registered and customary covenants and agreements to be performed by such issuer, including without limitation customary provisions with respect to indemnification by the Company of the underwriters of such offering.

h. Information by Holder. Each Stockholder including Registrable Shares in any registration shall furnish to the Company such information regarding such Stockholder and the distribution proposed by such Stockholder as the Company may reasonably request in writing and as shall be required in connection with any registration, qualification or compliance referred to in this Warrant.

i. "Stand-Off" Agreement". Each Stockholder, if requested by the Company and the managing underwriter of an offering by the Company of Common Stock or other securities of the Company pursuant to a Registration Statement, shall agree not to sell publicly or otherwise transfer or dispose of any Registrable Shares or other securities of the Company held by such Stockholder for a specified period of time (not to exceed 180 days) following the effective date of such Registration Statement; provided, that:

(1) such agreement shall only apply to the first Registration Statement covering Common Stock to be sold on its behalf to the public in an underwritten offering; and

(2) all Stockholders holding not less than the number of shares of Common Stock held by such Stockholder (including shares of Common Stock issuable upon the conversion of Shares, or other convertible securities, or upon the exercise of options, warrants or rights) and all officers and directors of the Company enter into similar agreements.

j. Termination. All of the Company's obligations to register Registrable Shares under this Warrant shall terminate on the tenth anniversary of this Warrant.

3. Exercise of Warrant.

a. The Company covenants that it will at all times maintain an available and adequate reserve of duly authorized but unissued share of its Common Stock, free from preemptive rights, sufficient to effect the full exercise of this Warrant as herein provided, and that it will at all times maintain in full force and effect an appropriate permit of the Delaware Commissioner of Corporations authorizing the issuance and sale by the Company of all shares of Common Stock issuable upon exercise of this Warrant by the holder.

The Company covenants that all shares of Common Stock issuable upon the exercise of this Warrant will, upon issuance, be validly issued, fully paid and non-assessable, and free from all taxes, liens and charges with respect to the issue thereof.

The holder hereof may surrender this Warrant for exchange at the principal office of the Company. Within a reasonable time thereafter and without expense (other than transfer taxes, if any) to each holder, the Company shall issue in exchange therefor, in such denominations (of not less than 100 shares) and issued in such name or names as the holder shall designate (if permitted by the Federal Securities laws and the relevant Blue Sky law(s), as amended from time to time), a new certificate or certificates dated the date hereof evidencing the right to purchase the same aggregate number of shares of Common Stock as are evidenced hereby, and otherwise containing the same provisions and subject to the same terms and conditions of this certificate.

Upon surrender of this Warrant at the office of the Company accompanied by payment of the appropriate Purchase Price of the Common Stock in cash or as otherwise allowed herein, the Company shall forthwith cause to be executed,

issued and delivered to the holder of the Warrant a certificate or certificates for the proper number of shares of common stock or other securities of the Company; and the Company covenants that the issuance of this Warrant shall constitute full authority to those of its officers who are charged with the duty of issuing stock certificates to promptly execute, issue and deliver to the holder of the Warrant the necessary certificate for shares of Common Stock or other securities of the Company required by such exercise.

This Warrant may be exercised in accordance with its terms prior to expiration as a whole, or from time to time in part. In the event of partial exercise of the Warrant, the Company shall, in addition to delivery of the securities thereby purchased, deliver to the holder of the Warrant, a new Warrant for the remaining shares then subject to the unexercised portion of the Warrant; such new Warrant being dated the date hereof and otherwise containing the same provisions and subject to the same conditions and subject to the same terms and conditions as this Warrant. Certificates for shares of Common Stock or other securities of the Company issuable by reason of the exercise of Warrants shall be dated and shall be effective as of the date of the surrender of the Warrants for exercise or acceptance of the offering of shares or other securities, as the case may be, and the payment of the appropriate Purchase Price, notwithstanding any delay in the actual execution, issuance or delivery of the certificates or securities so purchased.

This Warrant shall be registered on the books of the Company, which shall be kept at its principal office for that purpose, and shall be transferable only on said books by the holder hereof in person or by duly authorized attorney upon surrender of this Warrant properly endorsed.

b. This Warrant may be exercised by the holder hereof, in whole or in part, by surrendering this Warrant at the principal office of the Company, or at such other office or agency as the Company may designate, accompanied by payment in full, in lawful money of the United States, of the Purchase Price payable in respect of the number of Warrant Shares purchased upon such exercise.

c. The holder hereof may, at its option, elect to pay some or all of the Purchase Price payable upon an exercise of this Warrant by canceling a portion of this Warrant exercisable for such number of Warrant Shares as is determined by dividing (i) the total Purchase Price payable in respect of the number of Warrant Shares being purchased upon such exercise by (ii) the excess of the Fair Market Value per share of Common Stock as of the effective date of exercise (the "Exercise Date") over the Purchase Price per share. The Fair Market Value per share of Common Stock shall be determined as follows:

(1) If the Common Stock is listed on a national securities exchange, the NASDAQ National Market System, the NASDAQ system, or another nationally recognized exchange or trading system as of the Exercise Date, the Fair Market Value per share of Common Stock shall be deemed to be the last reported sale price per share of Common Stock thereon on the Exercise Date; or, if no such price is reported on such date, such price on the next preceding business day (provided that if no such price is reported on the next preceding business day, the Fair Market Value per share of Common Stock shall be determined pursuant to Clause (2)).

(2) If the Common Stock is not listed on a national securities exchange, the NASDAQ National Market System, the NASDAQ system or another nationally recognized exchange or trading system as of the Exercise Date, the Fair Market Value per share of Common Stock shall be deemed to be the amount most recently determined by the Board of Directors to represent the fair market value per share of the Common Stock (including without limitation a determination for purposes of granting Common Stock options or issuing Common Stock under an employee benefit plan of the Company); and, upon request of the holder hereof, the Board of Directors (or a representative thereof) shall promptly notify the holder hereof of the Fair Market Value per share of Common Stock. Notwithstanding the foregoing, if the Board of Directors has not made such a determination within the three-month period prior to the Exercise Date, then (A) the Fair Market Value per share of Common Stock shall be the amount next determined by the Board of Directors to represent the fair market value per share of the Common Stock (including without limitation a determination for purposes of granting Common Stock options or issuing Common Stock under an employee benefit plan of the Company), (B) the Board of Directors shall make such a determination within 30 days of a request by the holder hereof that it do so, and (C) the exercise of this Warrant pursuant to this Subsection 2c shall be delayed until such determination is made.

4. Transfers of Rights. This Warrant, and the rights and obligations of each holder hereof, may be assigned by such holder hereof to any person or entity to which not fewer than 100 Shares (issued or issuable under this Warrant) are transferred by such holder hereof, and such transferee shall be deemed a "holder hereof" for purposes of this Warrant; provided that the transferee provides written notice of such assignment to the Company.

5. General.

a. Notices. All notices, requests, consents, and other communications under this Warrant shall be in writing and shall be delivered by hand or mailed by first class certified or registered mail, return receipt requested, postage prepaid:

If to the Company, at 19886 Ashburn Road, Ashburn, VA 20147, Attention: President, or at such other address or addresses as may have been furnished in writing by the Company to the Holders, with a copy to the Chief Financial Officer and General Counsel; or

If to a holder hereof, at his or its address set forth above, or at such other address or addresses as may have been furnished to the Company in writing by such holder hereof.

Notices provided in accordance with this Section 5 shall be deemed delivered upon personal delivery or two business days after deposit in the mail.

b. Entire Agreement. This Warrant embodies the entire agreement and understanding between the parties hereto with respect to the subject matter hereof and supersedes all prior agreements and understandings relating to such subject matter.

c. Amendments and Waivers. Any term of this Warrant may be amended and the observance of any term of this Warrant may be waived (either generally or in a particular instance and either retroactively or prospectively), with the written consent of the Company and the holders of at least 90% of the Registrable Shares; provided, that this Warrant may be amended with the consent of the holders of less than all Registrable Shares only in a manner which affects all Registrable Shares in the same fashion. No waivers of or exceptions to any term, condition or provision of this Warrant, in any one or more instances, shall be deemed to be, or construed as, a further or continuing waiver of any such term, condition or provision.

d. Fractional Shares. The Company shall not be required upon the exercise of this Warrant to issue any fractional shares, but shall make an adjustment therefor in cash on the basis of the Fair Market Value per share of Common Stock, as determined in good faith by the Board of Directors or as quoted if the Common Stock is publicly traded on the day the Warrant was exercised.

Executed in Ashburn, Virginia as of the 20th day of November, 1998.

TELOS CORPORATION

By:/s/ William L.P. Brownley
William L.P. Brownley
Vice President and General Counsel

[SEAL]

Attest:/s/ Gerald D. Calhoun, Secretary

Stock Purchase Agreement

THIS STOCK PURCHASE AGREEMENT ("Agreement") made this 20th day of November, 1998, among _____ (the "Seller"), Telos Corporation, a Maryland corporation (the "Purchaser"), and John B. Connor, Escrow Agent (the "Escrow Agent").

RECITALS

The Seller is the owner of _____ shares of Telos Corporation's twelve percent (12%) cumulative exchangeable, redeemable, preferred stock, par value one penny (\$.01) per share (the "Public Preferred Stock"), with such shares owned by Seller hereinafter referred to as "Seller's Shares".

The parties have agreed upon the purchase and sale of such Public Preferred Stock under the terms and conditions contained in this Agreement.

It is therefore agreed:

1. Sale. The Seller shall sell and the Purchaser shall purchase all of the Seller's shares in the Public Preferred Stock at the price of Four Dollars (\$4.00) per share.

2. Escrow Deposit. Within five (5) days after the execution of this Agreement, the Seller will deposit with the Escrow Agent a certificate for Seller's shares in the Public Preferred Stock, endorsed in blank. Upon receipt by the Escrow Agent of all certificates representing the Seller's Shares to be purchased in this offer, the Purchaser will deposit within two (2) days with the Escrow Agent the funds to purchase all of said Seller's Shares. If the condition set forth in paragraph 3 is satisfied on or before December 1st and if the Escrow Agent shall receive written notice thereof from the Purchaser on or before that date, the Escrow Agent shall promptly thereafter deliver the certificate for such shares to the Purchaser, and shall pay the sum for the shares specified in paragraph 1 above to the Seller. If the condition set forth in paragraph 3 is not satisfied or waived on or before December 1st, or if the Escrow Agent shall not receive written notice of that fact from the Purchaser on or before that date, the Escrow Agent shall promptly thereafter deliver the certificate for such shares to the Seller, and shall pay the sum for the shares specified in paragraph 1 above (provided the funds have been received by the Escrow Agent) to the Purchaser. Upon the performance by the Escrow Agent of its obligations hereunder, all obligations of the Escrow Agent and of the Purchaser and Seller shall cease.

3. Conditions precedent. The obligations of the Purchaser to buy the Public Preferred Stock are conditioned upon the Purchaser having the funds to do so and the Purchaser being satisfied with Shareholder's title to the Public Preferred Stock tendered pursuant to the Stock Purchase Agreement.

4. Notice. All notices pursuant to this Agreement shall be in writing and shall be sufficient if delivered, sent or mailed registered or certified mail, postage prepaid, or by personal delivery as follows:

If to Escrow Agent: John B. Connor, Escrow Agent
John B. Connor, P.L.C.
1033 North Fairfax St. #310
Alexandria, VA 22314

If to Seller: _____

If to Purchaser: Telos Corporation
19886 Ashburn Road
Ashburn, VA 20147

5. Waiver. Any condition in paragraph 3 of this agreement is deemed to be exclusively for the benefit of Purchaser, and the Purchaser shall have the right, but not the obligation, to waive said contingency upon giving written notice to Escrow Agent in accordance with the procedure set forth in paragraph 2.

6. Benefit. This agreement shall be binding upon and shall inure to the benefit of the parties, their legal representative, successors, and assigns.

IN WITNESS WHEREOF, the parties have signed this agreement.

ATTEST: SELLER

Name:
Address:

Telos Corporation

ATTEST:/s/ Gerald D. Calhoun

By:/s/William L.P. Brownley
Name:William L.P. Brownley
Title:Vice President & General Counsel

ESCROW AGREEMENT

THIS ESCROW AGREEMENT ("Agreement") made this 20th day of November, 1998, by and between TELOS CORPORATION (the "Purchaser") and JOHN B. CONNOR (the "Escrow Agent") for the benefit of the Purchaser and various shareholders (the "Shareholders") of the Twelve Percent (12%) Cumulative Exchangeable, Redeemable, Preferred Stock, Par Value One Penny (\$.01) Per Share (the "Public Preferred Stock").

W I T N E S S E T H:

WHEREAS, some or all of the Shareholders and the Purchaser have or will enter into various Stock Purchase Agreements dated various dates (the "Purchase Agreements"), for the sale of certain shares of the Public Preferred Stock, a copy of which form Purchase Agreement has been delivered to the Escrow Agent, is attached hereto as Exhibit A, and the terms of which are incorporated herein by reference (all terms not otherwise defined herein shall have the meaning attributed thereto in the Purchase Agreement); and

WHEREAS, Paragraph 2 of the Purchase Agreement provides, among other things, that the Shareholders will deposit share certificates of the Public Preferred Stock, endorsed in blank, with the Escrow Agent; and

WHEREAS, Paragraph 2 of the Purchase Agreement provides, among other things, that the Purchaser will deposit funds with the Escrow Agent to purchase all of the shares;

NOW, THEREFORE, in consideration of the promises made herein and other valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties agree as follows:

1. Deposit of Share Certificates and Purchase Funds. Within ten (10) days after the execution of the various Purchase Agreements, each of the Shareholders will deposit with the Escrow Agent their certificate for the number of shares of the Public Preferred Stock listed below, endorsed in blank. Upon receipt by the Escrow Agent of all certificates representing the shares to be purchased in this offer, the Escrow Agent will notify Purchaser and the Purchaser will thereafter deposit with the Escrow Agent the funds to purchase all of said shares.

2. Disposition of Share Certificates and Purchase Funds. (a) If the condition set forth in Paragraph 3 is satisfied on or before December 1st, or the date of any extension thereof, (the "Deadline"), and if the Escrow Agent receives the funds required to finalize the purchase from the Purchaser within fifteen (15) days after the Deadline, the Escrow Agent shall promptly thereafter deliver the certificates for such shares to the Purchaser, and shall pay the sums for the purchase to each of the Shareholders as required by the Purchase Agreements. (b) If the condition set forth in Paragraph 3 is not satisfied on or before the Deadline, or if the Escrow Agent has not received written notice of waiver of such condition from the Purchaser on or before that date, the Escrow Agent shall promptly thereafter deliver the certificates for such shares to the Shareholders, and shall pay all funds received from Purchaser to the Purchaser. (c) If the Purchaser waives the condition precedent in Paragraph 3 and instructs the Escrow Agent to proceed with the purchase even though all Shareholders have not agreed thereto, Purchaser shall forthwith deliver the funds required by the Purchase Agreement to the Escrow Agent, whereupon the Escrow Agent shall deliver the shares he has received to Purchaser and distribute the funds to the Shareholders as required by the Purchase Agreements. (d) Upon the performance by the Escrow Agent of its obligations hereunder, all obligations of the Escrow Agent and of the Purchaser and Shareholders hereunder shall cease.

3. Conditions precedent. The obligations of the Purchaser to buy the Public Preferred Stock are conditioned upon the Purchaser having the funds to do so and the Purchaser being satisfied with Shareholder's title to the Public Preferred Stock tendered pursuant to the Stock Purchase Agreement. Purchaser agrees that it will diligently seek and use its best efforts to acquire the Public Preferred Stock from the Shareholders.

4. Notwithstanding any provision herein to the contrary, Purchaser reserves the right to terminate the Purchase Agreements and not proceed with the stock purchases at any time up to the delivery of funds to the Escrow Agent.

5. Extension of Deadline. The Purchaser reserves the right to extend the Deadline, in its sole and absolute discretion.

6. Limitations of Liability. The foregoing instructions are subject to the following provisions:

6.1 Depository Duty. The Escrow Agent will be liable as a depository only, and will not be responsible for the sufficiency or accuracy of the form, execution, or validity of any document delivered to it hereunder or any description of the property or other thing contained therein or the identity, authority, or rights of the persons executing or delivering, or purporting to execute or deliver, any such document. The Escrow Agent's duties hereunder are limited to the safekeeping and the delivery of the shares and purchase funds in accordance with this Agreement. The Escrow Agent shall not be liable in the event of bank failure.

6.2 Standard of Care. The Escrow Agent will not be liable for any act or omission done in good faith, or for any claim, demand, loss, or damage made or suffered by any party to this Agreement, unless it arose through or was caused by the Escrow Agent's willful misconduct or gross negligence.

6.3 Reliance. The Escrow Agent shall in all cases be entitled to rely upon and be fully protected in acting or in refraining from acting under this Agreement in accordance with any and all written notices, demands, directions, orders, or other documents received by it in accordance with this Agreement and believed by it to be genuine and correct and to have been signed or sent by the proper person.

6.4 Substitution of Escrow Agent. If for any reason the Escrow Agent is unable to serve hereunder, a successor shall be appointed by mutual agreement of the Shareholders and the Purchaser.

6.5 Modification. This Agreement is the only agreement binding on the Escrow Agent relating to the deposit of shares and the deposit of the purchase funds, and the Escrow Agent may rely absolutely on this Agreement to the exclusion of any and all other agreements between the Purchaser and the Shareholders.

7. Compensation of Escrow Agent. The Escrow Agent shall be paid by Purchaser the amount of Two Hundred and Twenty-Five Dollars (\$225.00) per hour for his service within thirty (30) days of rendering an invoice to Purchaser.

8. Miscellaneous. It is further agreed as follows:

8.1 Time. Time is of the essence of this Agreement.

8.2 Notice. All notices or communications required or permitted under this Agreement shall be in writing and shall be deemed duly given if in writing and delivered personally, or sent by reliable overnight delivery service, each method with written receipt or other evidence of delivery requested, to the following addresses (or such other addresses as may be designated in writing):

(a) if to the Shareholders: To each at the address in the records of Telos Corporation.

(b) if to the Purchaser: Telos Corporation
19886 Ashburn Road
Ashburn, VA 20147

(c) if to Escrow Agent: John B. Connor, Escrow Agent
John B. Connor, P.L.C.
1033 North Fairfax St. #310
Alexandria, VA 22314

The date of such notice shall be the date it is received by Purchaser, Shareholders or Escrow Agent, as the case may be.

8.3 Binding Effect. This Agreement shall be binding on, and inure to the benefit of, the parties and their respective heirs, personal representatives, successors and permitted assigns.

8.4 Governing Law. This Agreement is made pursuant to and shall be governed, construed and enforced in all respects and for all purposes by and in accordance with the laws of the Commonwealth of Virginia.

8.5 Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same document.

IN WITNESS WHEREOF, this Agreement has been executed and delivered on the date written above.

ATTEST:
/s/ Gerald D. Calhoun

PURCHASER:
Telos Corporation

By:/s/ William L.P. Brownley
Name:William L.P. Brownley
Title:Vice President & General Counsel

Receipt of these instructions is acknowledged and accepted this 20th day of November, 1998.

ATTEST:
/s/ Irene Coulter

ESCROW AGENT:

By: /s/ John B. Connor
Name: _____
Title: _____

TELOS CORPORATION AND SUBSIDIARIES

Form 10-K

SCHEDULE OF SUBSIDIARIES

Telos Corporation, Santa Monica, California
Incorporated: California, April 11, 1969

Telos Field Engineering, Inc., Delaware
Incorporated: Delaware, February 25, 1994

Telos International Corporation, Delaware
Incorporated: Delaware, May 16, 1995

Enterworks, Inc., Delaware
Incorporated: February 22, 1994

This schedule contains summary financial information extracted from the consolidated balance sheets and statements of operations for Telos Corporation and is qualified in its entirety by reference to such financial statements.

0000320121
Telos Corporation
U.S. Dollars

12-MOS

	DEC-31-1998	
	JAN-01-1998	
	DEC-31-1998	
1		
		408,000
		0
	57,522,000	
	739,000	
	8,662,000	
	70,724,000	
		38,480,000
	24,159,000	
	95,251,000	
37,451,000		
	54,651,000	
37,360,000		
		0
		78,000
	(45,999,000)	
95,251,000		
		101,736,000
	207,086,000	
		93,153,000
	182,915,000	
		0
	39,000	
	6,555,000	
	(8,068,000)	
	1,103,000	
(9,171,000)		
		0
		0
		0
	(9,171,000)	
		0
		0