UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended: June 30, 2020

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

Commission file number: 001-08443

TELOS CORPORATION

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☒	Smaller reporting company	☐
		Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

As of August 7, 2020, the registrant had outstanding 45,198,460 shares of Class A Common Stock, no par value and 4,037,628 shares of Class B Common Stock, no par value.

TELOS CORPORATION AND SUBSIDIARIES

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three Months Ended June 30, 2020	Three Months Ended June 30, 2019	Six Months Ended June 30, 2020	Six Months Ended June 30, 2019
Revenue				
Services	$ 45,486	$ 34,377	$ 80,044	$ 62,414
Products	3,124	1,671	7,545	4,800
	48,610	36,048	87,589	67,214
Costs and expenses				
Cost of sales - Services	29,378	25,203	54,243	45,394
Cost of sales - Products	1,659	830	3,531	2,829
	31,037	26,033	57,774	48,223
Selling, general and administrative expenses	12,507	10,437	24,346	20,795
Operating income (loss)	5,066	(422)	5,469	(1,804)
Other income (expense)				
Other income	4	188	12	193
Interest expense	(1,996)	(1,740)	(4,013)	(3,500)
Income (loss) before income taxes	3,074	(1,974)	1,468	(5,111)
(Provision for) benefit from income taxes (Note 7)	(2)	(20)	144	177
Net income (loss)	3,072	(1,994)	1,612	(4,934)
Less: Net (income) loss attributable to non-controlling interest (Note 2)	(2,806)	253	(3,590)	(220)
Net income (loss) attributable to Telos Corporation	$ 266	$ (1,741)	$ (1,978)	$ (5,154)

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Net income (loss)	$ 3,072	$ (1,994)	$ 1,612	$ (4,934)
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	2	--	1	2
Less: Comprehensive (income) loss attributable to non-controlling interest	(2,806)	253	(3,590)	(220)
Comprehensive income (loss) attributable to Telos Corporation	$ 268	$ (1,741)	$ (1,977)	$ (5,152)

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

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

	June 30, 2020 (Unaudited)	December 31, 2019
ASSETS		
Current assets		
Cash and cash equivalents	$ 2,405	$ 6,751
Accounts receivable, net of reserve of $738 and $720, respectively (Note 1)	38,371	27,942
Inventories, net of obsolescence reserve of $861 and $860, respectively (Note 1)	3,336	1,965
Deferred program expenses	250	673
Other current assets	2,586	2,914
Total current assets	46,948	40,245
Property and equipment, net of accumulated depreciation of $34,673 and $32,470, respectively	20,683	19,567
Operating lease right-of-use assets (Note 10)	1,777	1,979
Goodwill (Note 3)	14,916	14,916
Other assets	1,066	985
Total assets	$ 85,390	$ 77,692

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

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

	June 30, 2020 (Unaudited)	December 31, 2019
LIABILITIES, REDEEMABLE PREFERRED STOCK, AND STOCKHOLDERS' DEFICIT		
Current liabilities		
Senior term loan, net of unamortized discount and issuance costs – short-term (Note 5)	$ 16,688	$ --
Accounts payable and other accrued liabilities (Note 5)	19,638	15,050
Accrued compensation and benefits	12,275	12,187
Contract liabilities (Note 1 and 5)	6,682	6,337
Finance lease obligations – short-term (Note 10)	1,281	1,224
Other current liabilities (Note 10)	3,146	2,505
Total current liabilities	59,710	37,303
Senior term loan, net of unamortized discount and issuance costs (Note 5)	--	16,335
Subordinated debt (Note 5)	3,102	2,927
Finance lease obligations – long-term (Note 10)	14,990	15,641
Operating lease liabilities – long-term (Note 10)	1,274	1,553
Deferred income taxes (Note 7)	640	621
Public preferred stock (Note 6)	141,121	139,210
Other liabilities (Note 7)	562	724
Total liabilities	221,399	214,314
Commitments and contingencies (Note 8)	--	--
Stockholders' deficit		
Telos stockholders' deficit		
Common stock	78	78
Additional paid-in capital	4,310	4,310
Accumulated other comprehensive income	7	6
Accumulated deficit	(147,508)	(145,530)
Total Telos stockholders' deficit	(143,113)	(141,136)
Non-controlling interest in subsidiary (Note 2)	7,104	4,514
Total stockholders' deficit	(136,009)	(136,622)
Total liabilities, redeemable preferred stock, and stockholders' deficit	$ 85,390	$ 77,692

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

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

	Six Months Ended June 30, 2020	Six Months Ended June 30, 2019
Operating activities:		
Net income (loss)	$ 1,612	$ (4,934)
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Dividends from preferred stock recorded as interest expense	1,911	1,912
Depreciation and amortization	2,734	2,341
Amortization of debt issuance costs	453	111
Deferred income tax provision (benefit)	19	(215)
Other noncash items	(17)	--
Changes in other operating assets and liabilities	(5,873)	6,711
Cash provided by operating activities	839	5,926
Investing activities:		
Capitalized software development costs	(3,159)	(1,287)
Purchases of property and equipment	(332)	(2,410)
Cash used in investing activities	(3,491)	(3,697)
Financing activities:		
Payments under finance lease obligations	(594)	(541)
Amendment fee paid to lender	(100)	--
Distributions to Telos ID Class B member - non-controlling interest	(1,000)	(984)
Cash used in financing activities	(1,694)	(1,525)
(Decrease) increase in cash and cash equivalents	(4,346)	704
Cash and cash equivalents, beginning of period	6,751	72
Cash and cash equivalents, end of period	$ 2,405	$ 776
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 1,474	$ 1,428
Income taxes	$ 50	$ 39
Noncash:		
Dividends from preferred stock recorded as interest expense	$ 1,911	$ 1,912

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

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

	Telos Corporation					
	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Non-Controlling Interest	Total Stockholders' Deficit
For the Three Months Ended June 30, 2020						
Beginning balance	$ 78	$ 4,310	$ 5	$ (147,774)	$ 5,298	$ (138,083)
Net income	--	--	--	266	2,806	3,072
Foreign currency translation gain	--	--	2	--	--	2
Distributions	--	--	--	--	(1,000)	(1,000)
Ending balance	$ 78	$ 4,310	$ 7	$ (147,508)	$ 7,104	$ (136,009)
For the Three Months Ended June 30, 2019						
Beginning balance	$ 78	$ 4,310	$ 19	$ (142,542)	$ 2,378	$ (135,757)
Net loss	--	--	--	(1,741)	(253)	(1,994)
Distributions	--	--	--	--	(268)	(268)
Ending balance	$ 78	$ 4,310	$ 19	$ (144,283)	$ 1,857	$ (138,019)
For the Six Months Ended June 30, 2020						
Beginning balance	$ 78	$ 4,310	$ 6	$ (145,530)	$ 4,514	$ (136,622)
Net (loss) income	--	--	--	(1,978)	3,590	1,612
Foreign currency translation gain	--	--	1	--	--	1
Distributions	--	--	--	--	(1,000)	(1,000)
Ending balance	$ 78	$ 4,310	$ 7	$ (147,508)	$ 7,104	$ (136,009)
For the Six Months Ended June 30, 2019						
Beginning balance	$ 78	$ 4,310	$ 17	$ (139,129)	$ 2,621	$ (132,103)
Net (loss) income	--	--	--	(5,154)	220	(4,934)
Foreign currency translation gain	--	--	2	--	--	2
Distributions	--	--	--	--	(984)	(984)
Ending balance	$ 78	$ 4,310	$ 19	$ (144,283)	$ 1,857	$ (138,019)

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

TELOS CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. General and Basis of Presentation

Telos Corporation, together with its subsidiaries (the “Company” or “Telos” or “We”), is an information technology solutions and services company addressing the needs of U.S. Government and commercial customers worldwide. Our principal offices are located at 19886 Ashburn Road, Ashburn, Virginia 20147. The Company was incorporated as a Maryland corporation in October 1971.

The accompanying condensed consolidated financial statements include the accounts of Telos and its subsidiaries, including Ubiquity.com, Inc., Xacta Corporation, Teloworks, Inc. and Telos APAC, Pte. Ltd., all of whose issued and outstanding share capital is owned by the Company. We have also consolidated the results of operations of Telos Identity Management Solutions, LLC (“Telos ID”) (see Note 2 – Non-controlling Interests). All intercompany transactions have been eliminated in consolidation.

The accompanying condensed consolidated financial statements reflect all adjustments (which include normal recurring adjustments) and reclassifications necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America (“GAAP”) and pursuant to rules and regulations of the Securities and Exchange Commission (“SEC”). The presented interim results are not necessarily indicative of fiscal year performance for a variety of reasons including, but not limited to, the impact of seasonal and short-term variations. We have continued to follow the accounting policies (including the critical accounting policies) set forth in the consolidated financial statements included in our 2019 Annual Report on Form 10-K filed with the SEC. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019.

In March 2020, the coronavirus disease 2019 ("COVID-19") was declared a pandemic by the World Health Organization and a national emergency by the U.S. Government. The pandemic has negatively affected the U.S. and global economy, disrupted global supply chains and financial markets, and resulted in significant travel restrictions, including mandated facility closures and shelter-in-place orders in numerous jurisdictions around the world. We are taking prudent measures to protect the health and safety of our employees, such as practicing social distancing and enabling our employees to work from home where possible. While we have experienced certain internal disruptions in adapting our operations as described above to the changed and evolving conditions, the majority of our program operations have not been adversely impacted, or we have implemented alternative means to support requirements. The financial impact of the COVID-19 pandemic cannot be reasonably estimated at this time as its impact depends on future developments, which are highly uncertain and cannot be predicted. New information may emerge concerning the scope, severity and duration of the COVID-19 pandemic, actions to contain its spread or treat its impact, and governmental, business and individuals’ actions taken in response to the pandemic (including restrictions and limitations on travel and transportation) among others.

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

Segment Reporting

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

Recent Accounting Pronouncements

Recent Accounting Pronouncements Adopted

In June 2016, the Financial Accounting Standard Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-13, “Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,” which introduces new guidance for estimating credit losses on certain types of financial instruments based on expected losses and the timing of the recognition of such losses. This standard is effective for interim and annual reporting periods beginning after December 15, 2019, which made this standard effective for us on January 1, 2020. The adoption of this ASU did not have a material impact on our condensed consolidated financial position, results of operations and cash flows.

In January 2017, the FASB issued ASU 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment," which eliminates Step 2 of the current goodwill impairment test that requires a hypothetical purchase price allocation to measure goodwill impairment. A goodwill impairment loss instead is measured at the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the recorded amount of goodwill. The provisions of this ASU are effective for years beginning after December 15, 2019, which made this standard effective for us on January 1, 2020. The adoption of this ASU did not have a material impact on our condensed consolidated financial position, results of operations and cash flows.

In August 2018, the FASB issued ASU 2018-13, “Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement”, which modifies the disclosure requirement for fair value measurement under ASC 820 to improve the effectiveness of such disclosures. Those modifications include the removal and addition of disclosure requirements as well as clarifying specific disclosure requirements. This standard is effective for interim and annual reporting periods beginning after December 15, 2019, which made this standard effective for us on January 1, 2020. The adoption of this ASU did not have a material impact on our condensed consolidated financial position, results of operations and cash flows.

In August 2018, the FASB issued ASU 2018-15, “Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract,” which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. This standard is effective for interim and annual reporting periods beginning after December 15, 2019, which made this standard effective for us on January 1, 2020. The adoption of this ASU did not have a material impact on our condensed consolidated financial position, results of operations and cash flows.

Recent Accounting Pronouncements Not Yet Adopted

In December 2019, the FASB issued ASU No. 2019-12, “Simplifying the Accounting for Income Taxes (Topic 740)”, which simplifies the accounting for income taxes. This standard will be effective for reporting periods beginning after December 15, 2020, with early adoption permitted. While we are currently assessing the impact of the adoption of this ASU, we do not believe the adoption of this ASU will have a material impact on our consolidated financial position, results of operations and cash flows.

Revenue Recognition

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

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

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

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

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

Our contracts may include various types of variable consideration, such as claims (for instance, indirect rate or other equitable adjustments) or incentive fees. We include estimated amounts in the transaction price based on all of the information available to us, including historical information and future estimations, and to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when any uncertainty associated with the variable consideration is resolved. We have revised and re-submitted several years of incurred cost submissions reflecting certain indirect rate structure changes as a result of regular Defense Contract Audit Agency ("DCAA") audits of incurred cost submissions. This resulted in signed final rate agreement letters for fiscal years 2011 to 2013 and conformed incurred cost submissions for 2014 to 2015. We evaluated the resulting changes to revenue under the applicable cost plus fixed fee contracts for the years 2011 to 2015 as variable consideration, and determined the most likely amount to which we expect to be entitled, to the extent that no constraint exists that would preclude recognizing this revenue or result in a significant reversal of cumulative revenue recognized. We included these estimated amounts of variable consideration in the transaction price and as performance on these contracts is complete, we have recognized revenue of $6.0 million during the year ended December 31, 2018.

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

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

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

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

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

We have one reportable segment. We treat sales to U.S. customers as sales within the U.S. regardless of where the services are performed. Substantially all of our revenues are from U.S. customers as revenue derived from international customers is de minimus. The following tables disclose revenue (in thousands) by customer type and contract type for the periods presented.

	Three Months Ended June 30, 2020	Three Months Ended June 30, 2019	Six Months Ended June 30, 2020	Six Months Ended June 30, 2019
Federal	$ 46,877	$ 33,774	$ 82,968	$ 62,757
State & Local, and Commercial	1,733	2,274	4,621	4,457
Total	$ 48,610	$ 36,048	$ 87,589	$ 67,214

	Three Months Ended June 30, 2020	Three Months Ended June 30, 2019	Six Months Ended June 30, 2020	Six Months Ended June 30, 2019
Firm fixed-price	$ 41,935	$ 28,857	$ 73,596	$ 53,787
Time-and-materials	3,637	3,691	7,462	7,620
Cost plus fixed fee	3,038	3,500	6,531	5,807
Total	$ 48,610	$ 36,048	$ 87,589	$ 67,214

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

	June 30, 2020	December 31, 2019
Billed accounts receivable	$ 18,420	$ 11,917
Unbilled receivables	20,689	16,745
Allowance for doubtful accounts	(738)	(720)
Receivables – net	$ 38,371	$ 27,942

The following table discloses contract liabilities (in thousands):

	June 30, 2020	December 31, 2019
Contract liabilities	$ 6,682	$ 6,337

As of June 30, 2020 and December 31, 2019, we had $84.8 million and $112.4 million of remaining performance obligations, respectively, which we also refer to as funded backlog. We expect to recognize approximately 87.6% of our remaining performance obligations as revenue in 2020, an additional 11.4% in 2021, and the balance thereafter. We recognized revenue of $1.1 million and $3.5 million during the three and six months ended June 30, 2020, respectively, and $1.2 million and $3.1 million during the three and six months ended June 30, 2019, respectively, that was included in the contract liabilities balance at the beginning of each fiscal year.

Accounts Receivable

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

On July 15, 2016, the Company entered into an accounts receivable purchase agreement under which the Company sells certain accounts receivable to a third party, or the "Factor", without recourse to the Company. The Factor initially pays the Company 90% of U.S. Federal government receivables or 85% of certain commercial prime contractors. The remaining payment is deferred and based on the amount the Factor receives from our customer, less a discount fee and a program access fee that is determined by the amount of time the receivable is outstanding before payment. The structure of the transaction provides for a true sale of the receivables transferred. Accordingly, upon transfer of the receivable to the Factor, the receivable is removed from the Company's condensed consolidated balance sheet, a loss on the sale is recorded and the residual amount remains a deferred payment as an accounts receivable until payment is received from the Factor. The balance of the sold receivables may not exceed $10 million. There were no accounts receivable sold during the three and six months ended June 30, 2020. During the three and six months ended June 30, 2019, the Company sold approximately $4.4 million and $9.4 million of accounts receivable, respectively, and recognized a related loss of approximately $15,000 and $32,000 in selling, general and administrative expenses, respectively, for the same period. As of June 30, 2020 and December 31, 2019, there were no outstanding sold accounts receivable.

Inventories

Inventories are stated at the lower of cost or net realizable value, where cost is determined using the weighted average method. Substantially all inventories consist of purchased off-the-shelf hardware and software, and component computer parts used in connection with system integration services that we perform. An allowance for obsolete, slow-moving or nonsalable inventory is provided for all other inventory. This allowance is based on our overall obsolescence experience and our assessment of future inventory requirements. This charge is taken primarily due to the age of the specific inventory and the significant additional costs that would be necessary to upgrade to current standards as well as the lack of forecasted sales for such inventory in the near future. Gross inventory was $4.2 million and $2.8 million as of June 30, 2020 and December 31, 2019, respectively. As of June 30, 2020, it is management's judgment that we have fully provided for any potential inventory obsolescence, which was $0.9 million as of June 30, 2020 and December 31, 2019.

Software Development Costs

Our policy on accounting for development costs of software to be sold is in accordance with ASC Topic 985-20, "Software – Costs of Software to be Sold, Leased, or Marketed" and ASC Topic 350-40 "Internal Use Software", in so far as our Xacta products being available in various deployment modalities including on premises licenses and cloud-based Software as a Service ("SaaS") as well as solutions developed within Telos ID. Under both standards, software development costs are expensed as incurred until technological feasibility is reached, at which time additional costs are capitalized until the product is available for general release to customers or is ready for its intended use, as appropriate. Technological feasibility is established when all planning, designing, coding and testing activities have been completed, and all risks have been identified. Beginning with the second quarter of 2017, software development costs are capitalized and amortized over the estimated product life of 2-3 years on a straight-line basis. As of June 30, 2020 and December 31, 2019, we capitalized $8.7 million and $5.6 million of software development costs, respectively, which are included as a part of property and equipment. Amortization expense was $0.4 million and $0.9 million for the three and six months ended June 30, 2020, respectively, and $0.5 million and $0.9 million for the three and six months ended June 30, 2019, respectively. Accumulated amortization was $4.0 million and $3.1 million as of June 30, 2020 and December 31, 2019, respectively. The Company analyzes the net realizable value of capitalized software development costs on at least an annual basis and has determined that there is no indication of impairment of the capitalized software development costs as forecasted future sales are adequate to support amortization costs.

Income Taxes

We account for income taxes in accordance with ASC 740, “Income Taxes.” Under ASC 740, deferred tax assets and liabilities are recognized for the estimated future tax consequences of temporary differences and income tax credits. Deferred tax assets and liabilities are measured by applying enacted statutory tax rates that are applicable to the future years in which deferred tax assets or liabilities are expected to be settled or realized for differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. Any change in tax rates on deferred tax assets and liabilities is recognized in net income in the period in which the tax rate change is enacted. We record a valuation allowance that reduces deferred tax assets when it is "more likely than not" that deferred tax assets will not be realized. We are required to establish a valuation allowance for deferred tax assets if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based on available evidence, realization of deferred tax assets is dependent upon the generation of future taxable income. We considered projected future taxable income, tax planning strategies, and reversal of taxable temporary differences in making this assessment. As such, we have determined that a full valuation allowance is required as of June 30, 2020 and December 31, 2019. As a result of a full valuation allowance against our deferred tax assets, a deferred tax liability related to goodwill remains on our condensed consolidated balance sheets at June 30, 2020 and December 31, 2019. Due to the tax reform enacted on December 22, 2017, net operating losses generated in taxable years beginning after December 31, 2017 will have an indefinite carryforward period, which will be available to offset future taxable income created by the reversal of temporary taxable differences related to goodwill. As a result, we have adjusted the valuation allowance on our deferred tax assets and liabilities at June 30, 2020 and December 31, 2019.

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

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

Goodwill

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

As the result of an acquisition, we record any excess purchase price over the net tangible and identifiable intangible assets acquired as goodwill. An allocation of the purchase price to tangible and intangible net assets acquired is based upon our valuation of the acquired assets. Goodwill is not amortized, but is subject to annual impairment tests. We complete our goodwill impairment tests as of December 31st each year. Additionally, we make evaluations between annual tests if events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The evaluation is based on the estimation of the fair values of our three reporting units, CO&D, Telos ID Enterprise Solutions, and Secure Communications Cyber and Enterprise Solutions, of which goodwill is housed in the CO&D reporting unit, in comparison to the reporting unit's net asset carrying values. Our discounted cash flows required management's judgment with respect to forecasted revenue streams and operating margins, capital expenditures and the selection and use of an appropriate discount rate. We utilized the weighted average cost of capital as derived by certain assumptions specific to our facts and circumstances as the discount rate. The net assets attributable to the reporting units are determined based upon the estimated assets and liabilities attributable to the reporting units in deriving its free cash flows. In addition, the estimate of the total fair value of our reporting units is compared to the market capitalization of the Company. The Company's assessment resulted in a fair value that was greater than the Company's carrying value, therefore the second step of the impairment test, as prescribed by the authoritative literature, was not required to be performed and no impairment of goodwill was recorded as of December 31, 2019. Subsequent reviews may result in future periodic impairments that could have a material adverse effect on the results of operations in the period recognized. Recent operating results have reduced the projection of future cash flow growth potential, which indicates that certain negative potential events, such as a material loss or losses on contracts, or failure to achieve projected growth could result in impairment in the future. We estimate fair value of our reporting unit and compare the valuation with the respective carrying value for the reporting unit to determine whether any goodwill impairment exists. If we determine through the impairment review process that goodwill is impaired, we will record an impairment charge in our consolidated statements of operations. Goodwill is amortized and deducted over a 15-year period for tax purposes.

Stock-Based Compensation

Compensation cost is recognized based on the requirements of ASC 718, "Stock Compensation," for all share-based awards granted. Since June 2008, we have issued restricted stock (Class A common) to our executive officers, directors and employees. To date, 100,000 shares have been granted in 2020. Such stock is subject to a vesting schedule as follows: 25% of the restricted stock vests immediately on the date of grant, thereafter, an additional 25% will vest annually on the anniversary of the date of grant subject to continued employment or services. As of June 30, 2020, there were 75,000 shares of restricted stock that remained subject to vesting. In the event of death of the employee or a change in control, as defined by the Telos Corporation 2008 Omnibus Long-Term Incentive Plan, the 2013 Omnibus Long-Term Incentive Plan, or the 2016 Omnibus Long-Term Incentive Plan, all unvested shares shall automatically vest in full. In accordance with ASC 718, we recorded immaterial compensation expense for any of the issuances as the value of our common stock was nominal, based on the deduction of our outstanding debt, capital lease obligations, and preferred stock from an estimated enterprise value, which was estimated based on discounted cash flow analysis, comparable public company analysis, and comparable transaction analysis. Additionally, we determined that a significant change in the valuation estimate for common stock would not have a significant effect on the condensed consolidated financial statements.

Other Comprehensive Income (Loss)

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

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

	June 30, 2020	December 31, 2019
Cumulative foreign currency translation loss	$ (100)	$ (101)
Cumulative actuarial gain on pension liability adjustment	107	107
Accumulated other comprehensive income	$ 7	$ 6

Note 2. Non-controlling Interests

On April 11, 2007, Telos ID was formed as a limited liability company under the Delaware Limited Liability Company Act. We contributed substantially all of the assets of our Identity Management business line and assigned our rights to perform under our U.S. Government contract with the Defense Manpower Data Center ("DMDC") to Telos ID at their stated book values. The net book value of assets we contributed totaled $17,000. Until April 19, 2007, we owned 99.999% of the membership interests of Telos ID and certain private equity investors ("Investors") owned 0.001% of the membership interests of Telos ID. On April 20, 2007, we sold an additional 39.999% of the membership interests to the Investor in exchange for $6 million in cash consideration. In accordance with ASC 505, "Equity," we recognized a gain of $5.8 million. As a result, we owned 60% of Telos ID, and therefore continued to account for the investment in Telos ID using the consolidation method.

On December 24, 2014 (the "Closing Date"), we entered into a Membership Interest Purchase Agreement (the "Purchase Agreement") between the Company and the Investors, pursuant to which the Investors acquired from the Company an additional ten percent (10%) membership interest in Telos ID in exchange for $5 million (the "Transaction"). In connection with the Transaction, the Company and the Investors entered into the Second Amended and Restated Operating Agreement (the "Operating Agreement") governing the business, allocation of profits and losses and management of Telos ID. Under the Operating Agreement, Telos ID is managed by a board of directors comprised of five (5) members (the "Telos ID Board"). The Operating Agreement provides for two classes of membership units, Class A (owned by the Company) and Class B (owned by the Investors). The Class A member (the Company) owns 50% of Telos ID, is entitled to receive 50% of the profits of Telos ID, and may appoint three (3) members of the Telos ID Board. The Class B member (the Investors) owns 50% of Telos ID, is entitled to receive 50% of the profits of Telos ID, and may appoint two (2) members of the Telos ID Board.

Despite the post-Transaction ownership of Telos ID being evenly split at 50% by each member, Telos maintains control of the subsidiary through its holding of three of the five Telos ID Board seats.

Under the Operating Agreement, the Class A and Class B members each have certain options with regard to the ownership interests held by the other party including the following:

- Upon the occurrence of a change in control of the Class A member (as defined in the Operating Agreement, a "Change in Control"), the Class A member has the option to purchase the entire membership interest of the Class B member.
- Upon the occurrence of the following events: (i) the involuntary termination of John B. Wood as CEO and chairman of the Class A member; (ii) the bankruptcy of the Class A member; or (iii) unless the Class A member exercises its option to acquire the entire membership interest of the Class B member upon a Change in Control of the Class A member, the transfer or issuance of more than fifty-one percent (51%) of the outstanding voting securities of the Class A member to a third party, the Class B member has the option to purchase the membership interest of the Class A member; provided, however, that in the event that the Class B member exercises the foregoing option, the Class A Member may then choose to purchase the entire interest of the Class B member.
- In the event that more than fifty percent (50%) of the ownership interests in the Class B member are transferred to persons or individuals (other than members of the immediate family of the initial owners of the Class B member) without the consent of Telos ID, the Class A member has the option to purchase the entire membership interest of the Class B member.
- The Class B member has the option to sell its interest to the Class A member at any time if there is not a letter of intent to sell Telos ID, a binding contract to sell all of the assets or membership interests in Telos ID, or a standstill for due diligence with respect to a sale of Telos ID. Notwithstanding the foregoing, the Class A member will not be obligated to purchase the interest of the Class B member if that purchase would constitute a violation of any existing line of credit available to the Company after giving effect to that purchase and the applicable lender refuses to consent to that purchase or to waive such violation.

If either the Class A member or the Class B member elects to sell its interest or buy the other member's interest upon the occurrence of any of the foregoing events, the purchase price for the interest will be based on an appraisal of Telos ID prepared by a nationally recognized investment banker. If the Class A member fails to satisfy its obligation, subject to the restrictions in the Purchase Agreement, to purchase the interest of the Class B member under the Operating Agreement, the Class B member may require Telos ID to initiate a sales process for the purpose of seeking an offer from a third party to purchase Telos ID that maximizes the value of Telos ID. The Telos ID Board must accept any offer from a bona fide third party to purchase Telos ID if that offer is approved by the Class B member, unless the purchase of Telos ID would violate the terms of any existing line of credit available to the Company and the applicable lender does not consent to that purchase or waive the violation. The sale process is the sole remedy available to the Class B member if the Class A member does not purchase its membership interest. Under such a forced sale scenario, a sales process would result in both members receiving their proportionate membership interest share of the sales proceeds and both members would always be entitled to receive the same form of consideration.

As a result of the Transaction, the Class A and Class B members each own 50% of Telos ID, as mentioned above, and as such each was allocated 50% of the profits (loss), which was $2.8 million and $3.6 million for the three and six months ended June 30, 2020, respectively, and $(0.3) million and $0.2 million for the three and six months ended June 30, 2019, respectively. The Class B member is the non-controlling interest.

Distributions are made to the members only when and to the extent determined by Telos ID's Board of Directors, in accordance with the Operating Agreement. The Class B member received a total distribution of $1.0 million during the three and six months ended June 30, 2020, and $0.3 million and $1.0 million during the three and six months ended June 30, 2019, respectively.

The following table details the changes in non-controlling interest for the three and six months ended June 30, 2020 and 2019 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	**2019**	**2020**	**2019**
Non-controlling interest, beginning of period	$ 5,298	$ 2,378	$ 4,514	$ 2,621
Net income (loss)	2,806	(253)	3,590	220
Distributions	(1,000)	(268)	(1,000)	(984)
Non-controlling interest, end of period	$ 7,104	$ 1,857	$ 7,104	$ 1,857

Note 3. Goodwill

The goodwill balance was $14.9 million as of June 30, 2020 and December 31, 2019. Goodwill is subject to annual impairment tests and if triggering events are present before the annual tests, we will assess impairment. As of June 30, 2020 and December 31, 2019, no impairment charges were taken.

Note 4. Fair Value Measurements

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

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

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

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

As of June 30, 2020 and December 31, 2019, we did not have any financial instruments with significant Level 3 inputs and we did not have any financial instruments that are measured at fair value on a recurring basis.

As of June 30, 2020 and December 31, 2019, the carrying value of the Company's 12% Cumulative Exchangeable Redeemable Preferred Stock, par value $.01 per share (the "Public Preferred Stock") was $141.1 million and $139.2 million, respectively, and the estimated fair market value was $68.5 million and $60.5 million, respectively, based on quoted market prices.

For certain of our non-derivative financial instruments, including receivables, accounts payable and other accrued liabilities, the carrying amount approximates fair value due to the short-term maturities of these instruments. The estimated fair value of the Credit Agreement (as defined below) and long-term debt is based primarily on borrowing rates currently available to the Company for similar debt issues. The fair value approximates the carrying value of long-term debt.

Note 5. Current Liabilities and Debt Obligations

Accounts Payable and Other Accrued Liabilities

As of June 30, 2020 and December 31, 2019, the accounts payable and other accrued liabilities consisted of $14.8 million and $13.5 million, respectively, in trade accounts payable and $4.8 million and $1.5 million, respectively, in accrued liabilities.

Contract Liabilities

Contract liabilities are payments received in advance and milestone payments from our customers on selected contracts that exceed revenue earned to date, resulting in contract liabilities. Contract liabilities typically are not considered a significant financing component because they are generally satisfied within one year and are used to meet working capital demands that can be higher in the early stages of a contract. Contract liabilities are reported on our condensed consolidated balance sheets on a net contract basis at the end of each reporting period. As of June 30, 2020 and December 31, 2019, the contract liabilities primarily related to product support services.

Enlightenment Capital Credit Agreement

On January 25, 2017, we entered into a Credit Agreement (the "Credit Agreement") with Enlightenment Capital Solutions Fund II, L.P., as agent (the "Agent") and the lenders party thereto (the "Lenders"), (together referenced as "EnCap"). The Credit Agreement provides for an $11 million senior term loan (the "Loan") with a maturity date of January 25, 2022, subject to acceleration in the event of customary events of default.

All borrowings under the Credit Agreement accrue interest at the rate of 13.0% per annum (the "Accrual Rate"). If, at the request of the Company, the Agent executes an intercreditor agreement with another senior lender under which the Agent and the Lenders subordinate their liens (an "Alternative Interest Rate Event"), the interest rate will increase to 14.5% per annum. After the occurrence and during the continuance of any event of default, the interest rate will increase 2.0%. The Company is obligated to pay accrued interest in cash on a monthly basis at a rate of not less than 10.0% per annum or, during the continuance of an Alternate Interest Rate Event, 11.5% per annum. The Company may elect to pay the remaining interest in cash, by payment-in-kind (by addition to the principal amount of the Loan) or by combination of cash and payment-in-kind. Upon thirty days prior written notice, the Company may prepay any portion or the entire amount of the Loan.

The Credit Agreement contains representations, warranties, covenants, terms and conditions customary for transactions of this type. In connection with the Credit Agreement, the Agent has been granted, for the benefit of the Lenders, a security interest in and general lien upon various property of the Company, subject to certain permitted liens and any intercreditor agreement. The occurrence of an event of default under the Credit Agreement could result in the Loan and other obligations becoming immediately due and payable and allow the Lenders to exercise all rights and remedies available to them under the Credit Agreement or as a secured party under the UCC, in addition to all other rights and remedies available to them.

In connection with the Credit Agreement, on January 25, 2017, the Company issued warrants (each, a "Warrant") to the Agent and certain of the Lenders representing in the aggregate the right to purchase in accordance with their terms 1,135,284.333 shares of the Class A Common Stock of the Company, no par value per share, which is equivalent to approximately 2.5% of the common equity interests of the Company on a fully diluted basis. The exercise price is $1.321 per share and each Warrant expires on January 25, 2027. The value of the warrants was determined to be de minimis and no value was allocated to them on a relative fair value basis in accounting for the debt instrument.

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

Effective February 23, 2017, the Credit Agreement was amended to change the required timing of certain post-closing items to allow for more time to complete the legal and administrative requirements around such items. On April 18, 2017, the Credit Agreement was further amended (the “Second Amendment”) to incorporate the parties’ agreement to subordinate certain debt owed by the Company to the affiliated entities of Mr. John R. C. Porter (the “Subordinated Debt”) and to redeem all outstanding shares of the Series A-1 Redeemable Preferred Stock and the Series A-2 Redeemable Preferred Stock, including those owned by Mr. John R.C. Porter and his affiliates, for an aggregate redemption price of $2.1 million.

In connection with the Second Amendment and that subordination of debt, on April 18, 2017, we also entered into Subordination and Intercreditor Agreements (the “Intercreditor Agreements”) with affiliated entities of Mr. John R. C. Porter (together referenced as “Porter”), in which Porter agreed that the Subordinated Debt is fully subordinated to the amended Credit Agreement and related documents, and that required payments, if any, under the Subordinated Debt are permitted only if certain conditions are met.

On March 30, 2018, the Credit Agreement was amended (the “Third Amendment”) to waive any actual or potential non-compliance with covenants in 2017 and to reset the covenants for 2018 measurement periods to more accurately reflect the Company’s projected performance for the year. The measurement against the covenants for consolidated leverage ratio and consolidated fixed charge coverage ratio were agreed to not be measured as of December 31, 2017 and were reset for 2018 measurement periods. Additionally, a minimum revenue covenant and a net working capital covenant were added. In consideration of these amendments, the interest rate on the loan was increased by 1%, which will revert back to the original rate upon achievement of two consecutive quarters of a specified fixed charge coverage ratio as defined in the agreement. The Company may elect to pay the increase in interest expense in cash or by payment-in-kind (by addition to the principal amount of the Loan). The increase in interest expense has been paid in cash. Contemporaneously with the Third Amendment, Mr. John B. Wood agreed to transfer 50,000 shares of the Company’s Class A Common Stock owned by him to EnCap.

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

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

The exit fee has been included in the total principal due and treated as an unamortized discount on the debt, which is being amortized over the term of the loan using the effective interest method at a rate of 17.3% over the remaining term of the loan. For the measurement period ended June 30, 2020, we were in compliance with the Credit Agreement's financial covenants, based on an agreement between the Company and EnCap on the definition of certain input factors that determine the measurement against the covenants.

On March 26, 2020, the Credit Agreement was amended (the "Fifth Amendment") to modify the financial covenants for 2020 through the maturity of the Credit Agreement to establish that the covenants will remain at the December 31, 2019 levels and to update the previously agreed-upon definition of certain financial covenants, specifically the amount of Capital Expenditures to be included in the measurement of the covenants. The Fifth Amendment also provides for the right for the Company to elect to extend the maturity date of the Credit Agreement which is currently scheduled to mature on January 15, 2021. The Fifth Amendment provides for four quarterly maturity date extensions, which would increase the Exit Fee payable under the Credit Agreement by $250,000 for each quarterly maturity date extension elected, for a total of $1 million increase to the Exit Fee were all four of the maturity date extensions to be elected. The Company paid EnCap an amendment fee of $100,000 and out-of-pocket costs and expenses in consideration for the Fifth Amendment.

As the Company has not exercised the option(s) to extend the maturity of the Credit Agreement, the current maturity date remains January 15, 2021, which is within one year from the balance sheet date. Accordingly, the balance of the EnCap loan has been classified as a current liability. However, the options to extend the maturity provide the Company with the ability by contractual right to extend the maturity of the loan, which the Company will consider exercising at the appropriate time.

The carrying amount of the Credit Agreement consisted of the following (in thousands):

	June 30, 2020	December 31, 2019
Senior term loan, including exit fee	$ 17,200	$ 17,200
Less: Unamortized discount, debt issuance costs, and lender fees	(512)	(865)
Senior term loan, net	$ 16,688	$ 16,335

We incurred interest expense in the amount of $0.7 million and $1.5 million for the three and six months ended June 30, 2020, respectively, and $0.4 million and $0.8 million for the three and six months ended June 30, 2019, respectively, under the Credit Agreement.

Accounts Receivable Purchase Agreement

On July 15, 2016, we entered into an Accounts Receivable Purchase Agreement (the "Purchase Agreement") with Republic Capital Access, LLC ("RCA" or "Buyer"), pursuant to which we may offer for sale, and RCA, in its sole discretion, may purchase, eligible accounts receivable relating to U.S. Government prime contracts or subcontracts of the Company (collectively, the "Purchased Receivables"). Upon purchase, RCA becomes the absolute owner of any such Purchased Receivables, which are payable directly to RCA, subject to certain repurchase obligations of the Company. The total amount of Purchased Receivables is subject to a maximum limit of $10 million of outstanding Purchased Receivables (the "Maximum Amount") at any given time. On November 15, 2019, the term of the Purchase Agreement was extended to June 30, 2022.

The initial purchase price of a Purchased Receivable is equal to 90% of the face value of the receivable if the account debtor is an agency of the U.S. Government, and 85% if the account debtor is not an agency of the U.S. Government; provided, however, that RCA has the right to adjust these initial purchase price rates in its sole discretion. After collection by RCA of the portion of a Purchased Receivable in excess of the initial purchase price, RCA shall pay the Company the residual 10% or 15% of such Purchased Receivable, as appropriate, less (i) a discount factor equal to 0.30%, for federal government prime contracts (or 0.56% for non-federal government investment grade account obligors or 0.62% for non-federal government non-investment grade account obligors) of the face amounts of Purchased Receivables; (ii) a program access fee equal to 0.008% of the daily ending account balance for each day that Purchased Receivables are outstanding; (iii) a commitment fee equal to 1% per annum of the Maximum Amount minus the amount of Purchased Receivables outstanding; and (iv) fees, costs and expenses relating to the preparation, administration and enforcement of the Purchase Agreement and any other related agreements.

The Purchase Agreement provides that in the event, but only to the extent, that the conveyance of Purchased Receivables by the Company is characterized by a court or other governmental authority as a loan rather than a sale, the Company shall be deemed to have granted RCA, effective as of the date of the first purchase under the Purchase Agreement, a security interest in all of the Company's right, title and interest in, to and under all of the Purchased Receivables, whether now or hereafter owned, existing or arising.

The Company provides a power of attorney to RCA to take certain actions in the Company's stead, including (a) to sell, assign or transfer in whole or in part any of the Purchased Receivables; (b) to demand, receive and give releases to any account debtor with respect to amounts due under any Purchased Receivables; (c) to notify all account debtors with respect to the Purchased Receivables; and (d) to take any actions necessary to perfect RCA's interests in the Purchased Receivables.

The Company is liable to the Buyer for any fraudulent statements and all representations, warranties, covenants, and indemnities made by the Company pursuant to the terms of the Purchase Agreement. It is considered an event of default if (a) the Company fails to pay any amounts it owes to RCA when due (subject to a cure period); (b) the Company has voluntary or involuntary bankruptcy proceedings commenced by or against it; (c) the Company is no longer solvent or is generally not paying its debts as they become due; (d) any voluntary liens, garnishments, attachments, or the like are issued against or attach to the Purchased Receivables; (e) the Company breaches any warranty, representation, or covenant (subject to a cure period); (f) the Company is not in compliance or has otherwise defaulted under any document or obligation in favor of RCA or an RCA affiliate; or (g) the Purchase Agreement or any material provision terminates (other than in accordance with the terms of the Purchase Agreement) or ceases to be effective or to be a binding obligation of the Company. If any such event of default occurs, then RCA may take certain actions, including ceasing to buy any eligible receivables, declaring any indebtedness or other obligations immediately due and payable, or terminating the Purchase Agreement.

Subordinated Debt

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

On April 18, 2017, we amended and restated the Porter Notes to reduce the interest rate from twelve percent (12%) to six percent (6%) per annum, to be accrued, and extended the maturity date from July 1, 2017 to July 25, 2022. Telos also entered into Intercreditor Agreements with Porter and EnCap, in which the Porter Notes are fully subordinated to the Credit Agreement and any subsequent senior lenders, and payments under the Porter Notes are permitted only if certain conditions are met. All other terms remain in full force and effect. We incurred interest expense in the amount of $88,000 and $175,000 for the three and six months ended June 30, 2020, respectively, and $82,000 and $162,000 for the three and six months ended June 30, 2019, respectively, on the Porter Notes. As of June 30, 2020, approximately $1.2 million of accrued interest was payable according to the stated interest rate of the Porter Notes.

Note 6. **Redeemable Preferred Stock**

A maximum of 6,000,000 shares of the Public Preferred Stock, par value $.01 per share, has been authorized for issuance. We initially issued 2,858,723 shares of the Public Preferred Stock pursuant to the acquisition of the Company during fiscal year 1990. The Public Preferred Stock was recorded at fair value on the date of original issue, November 21, 1989, and we made periodic accretions under the interest method of the excess of the redemption value over the recorded value. We adjusted our estimate of accrued accretion in the amount of $1.5 million in the second quarter of 2006. The Public Preferred Stock was fully accreted as of December 2008. We declared stock dividends totaling 736,863 shares in 1990 and 1991. Since 1991, no other dividends, in stock or cash, have been declared. In November 1998, we retired 410,000 shares of the Public Preferred Stock. The total number of shares issued and outstanding at June 30, 2020 and December 31, 2019 was 3,185,586. The Public Preferred Stock is quoted as "TLSRP" on the OTCQB marketplace and the OTC Bulletin Board.

Since 1991, no dividends were declared or paid on our Public Preferred Stock, based upon our interpretation of restrictions in our Articles of Amendment and Restatement, limitations in the terms of the Public Preferred Stock instrument, specific dividend payment restrictions in the various financing documents to which the Public Preferred Stock is subject, other senior obligations currently or previously in existence, and Maryland law limitations in existence prior to October 1, 2009. Subsequent to the 2009 Maryland law change, dividend payments have continued to be prohibited except under certain specific circumstances as set forth in Maryland Code Section 2-311. Pursuant to the terms of the Articles of Amendment and Restatement, we were scheduled, but not required, to redeem the Public Preferred Stock in five annual tranches during the years 2005 through 2009. However, due to our substantial senior obligations currently or previously in existence, limitations set forth in the covenants in the various financing documents to which the Public Preferred Stock is subject, foreseeable capital and operational requirements, and restrictions and prohibitions of our Articles of Amendment and Restatement, we were and remain unable to meet the redemption schedule set forth in the terms of the Public Preferred Stock as of the measurement dates. Moreover, the Public Preferred Stock is not payable on demand, nor callable, for failure to redeem the Public Preferred Stock in accordance with the redemption schedule set forth in the instrument. Therefore, we classify these securities as noncurrent liabilities in the condensed consolidated balance sheets as of June 30, 2020 and December 31, 2019.

On January 25, 2017, we became parties with certain of our subsidiaries to the Credit Agreement with EnCap. Under the Credit Agreement, we agreed that, until full and final payment of the obligations under the Credit Agreement, we would not make any distribution or declare or pay any dividends (other than common stock) on our stock, or purchase, acquire, or redeem any stock, or exchange any stock for indebtedness, or retire any stock. Additionally, the Porter Notes contain similar prohibitions on dividend payments or stock redemptions.

Accordingly, as stated above, we will continue to classify the entirety of our obligation to redeem the Public Preferred Stock as a long-term obligation. Various financing documents to which the Public Preferred Stock is subject prohibit, among other things, the redemption of any stock, common or preferred, other than as described above. The Public Preferred Stock by its terms also cannot be redeemed if doing so would violate the terms of an agreement regarding the borrowing of funds or the extension of credit which is binding upon us or any of our subsidiaries, and it does not include any other provisions that would otherwise require any acceleration of the redemption of or amortization of payments with respect to the Public Preferred Stock. Thus, the Public Preferred Stock is not and will not be due on demand, nor callable, within 12 months from June 30, 2020. This classification is consistent with ASC 210, "Balance Sheet" and 470, "Debt" and the FASB ASC Master Glossary definition of "Current Liabilities."

ASC 210 and the FASB ASC Master Glossary define current liabilities as follows: The term current liabilities is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities. As a balance sheet category, the classification is intended to include obligations for items which have entered into the operating cycle, such as payables incurred in the acquisition of materials and supplies to be used in the production of goods or in providing services to be offered for sale; collections received in advance of the delivery of goods or performance of services; and debts that arise from operations directly related to the operating cycle, such as accruals for wages, salaries, commissions, rentals, royalties, and income and other taxes. Other liabilities whose regular and ordinary liquidation is expected to occur within a relatively short period of time, usually twelve months, are also intended for inclusion, such as short-term debts arising from the acquisition of capital assets, serial maturities of long-term obligations, amounts required to be expended within one year under sinking fund provisions, and agency obligations arising from the collection or acceptance of cash or other assets for the account of third persons.

ASC 470 provides the following: The current liability classification is also intended to include obligations that, by their terms, are due on demand or will be due on demand within one year (or operating cycle, if longer) from the balance sheet date, even though liquidation may not be expected within that period. It is also intended to include long-term obligations that are or will be callable by the creditor either because the debtor's violation of a provision of the debt agreement at the balance sheet date makes the obligation callable or because the violation, if not cured within a specified grace period, will make the obligation callable.

If, pursuant to the terms of the Public Preferred Stock, we do not redeem the Public Preferred Stock in accordance with the scheduled redemptions described above, the terms of the Public Preferred Stock require us to discharge our obligation to redeem the Public Preferred Stock as soon as we are financially capable and legally permitted to do so. Therefore, by its very terms, the Public Preferred Stock is not due on demand or callable for failure to make a scheduled payment pursuant to its redemption provisions and is properly classified as a noncurrent liability.

We pay dividends on the Public Preferred Stock when and if declared by the Board of Directors. The Public Preferred Stock accrues a semi-annual dividend at the annual rate of 12% ($1.20) per share, based on the liquidation preference of $10 per share, and is fully cumulative. Dividends in additional shares of the Public Preferred Stock for 1990 and 1991 were paid at the rate of 6% per share for each $.60 of such dividends not paid in cash. For the cash dividends payable since December 1, 1995, we have accrued $109.3 million and $107.4 million as of June 30, 2020 and December 31, 2019, respectively. We accrued dividends on the Public Preferred Stock of $1.0 million and $1.9 million for each of the three and six months ended June 30, 2020 and 2019, respectively, which was recorded as interest expense. Prior to the effective date of ASC 480 on July 1, 2003, such dividends were charged to stockholders' accumulated deficit.

Note 7. Income Taxes

The income tax provision for interim periods is determined using an estimated annual effective tax rate adjusted for discrete items, if any, which are taken into account in the quarterly period in which they occur. We review and update our estimated annual effective tax rate each quarter. We recorded an approximately $2,000 income tax provision and $144,000 income tax benefit for the three and six months ended June 30, 2020, respectively, and a $20,000 income tax provision and $177,000 income tax benefit for the three and six months ended June 30, 2019, respectively. For the three and six months ended June 30, 2020 and 2019, our estimated annual effective tax rate was primarily impacted by the overall valuation allowance position which reduced the net tax impact from taxable loss for all periods.

In March 2020, the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") was enacted. The CARES Act, among other things, includes certain changes to U.S. tax law that impact the Company, including deferment of employer social security payments, modifications to interest deduction limitation rules, a technical correction to tax depreciation methods for certain qualified improvement property, and alternative minimum tax credit refund.

We are required to establish a valuation allowance for deferred tax assets if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based on available evidence, realization of deferred tax assets is dependent upon the generation of future taxable income. We considered projected future taxable income, tax planning strategies, and reversal of taxable temporary differences in making this assessment. As such, we have determined that a full valuation allowance is required as of June 30, 2020 and December 31, 2019. Under the Tax Cuts and Jobs Act of 2017 ("Tax Act"), we will be able to use our hanging credit deferred tax liabilities as a source of taxable income to support the indefinite-lived net operating losses created by the future reversal of our temporary differences. Accordingly, we have re-measured our existing deferred tax assets and liabilities using the enacted tax rate, and adjusted the valuation allowance on our deferred taxes. As a result, a deferred tax liability related to goodwill of $640,000 and $621,000 remains on our condensed consolidated balance sheets at June 30, 2020 and December 31, 2019, respectively. The income tax benefit recorded for the six months ended June 30, 2020 is primarily related to this change in deferred tax liability and is due to the release of FIN 48 liability on state nexus.

As a result of the Tax Act, we are subject to several provisions of the Tax Act including computations under Section 162(m) executive compensation limitation and Section 163(j) interest limitation rule. We have considered the impact of each of these provisions in our computation of income tax expense for the three and six months ended June 30, 2020 and 2019.

Under the provisions of ASC 740, we determined that there were approximately $508,000 and $673,000 of unrecognized tax benefits, including $229,000 and $304,000 of related interest and penalties, required to be recorded in other liabilities in the condensed consolidated balance sheets as of June 30, 2020 and December 31, 2019, respectively. We believe that the total amounts of unrecognized tax benefits will not significantly increase or decrease within the next 12 months.

Note 8. Commitments and Contingencies

Financial Condition and Liquidity

As described in Note 5 – Current Liabilities and Debt Obligations, we maintain a Credit Agreement with EnCap and a Purchase Agreement with RCA. The willingness of RCA to purchase our accounts receivable under the Purchase Agreement, and our ability to obtain additional financing, may be limited due to various factors, including the eligibility of our receivables, the status of our business, global credit market conditions, and perceptions of our business or industry by EnCap, RCA, or other potential sources of financing. If we are unable to maintain the Purchase Agreement, we would need to obtain additional credit to fund our future operations. If credit is available in that event, lenders may impose more restrictive terms and higher interest rates that may reduce our borrowing capacity, increase our costs, or reduce our operating flexibility. The failure to maintain, extend, renew or replace the Purchase Agreement with a comparable arrangement or arrangements that provide similar amounts of liquidity for the Company would have a material negative impact on our overall liquidity, financial and operating results.

While a variety of factors related to sources and uses of cash, such as timeliness of accounts receivable collections, vendor credit terms, or significant collateral requirements, ultimately impact our liquidity, such factors may or may not have a direct impact on our liquidity, based on how the transactions associated with such circumstances impact the availability under our credit arrangements. For example, a contractual requirement to post collateral for a duration of several months, depending on the materiality of the amount, could have an immediate negative effect on our liquidity, as such a circumstance would utilize cash resources without a near-term cash inflow back to us. Likewise, the release of such collateral could have a corresponding positive effect on our liquidity, as it would represent an addition to our cash resources without any corresponding near-term cash outflow. Similarly, a slow-down of payments from a customer, group of customers or government payment office would not have an immediate and direct effect on our availability unless the slowdown was material in amount and over an extended period of time. Any of these examples would have an impact on our cash resources, our financing arrangements, and therefore our liquidity: The Credit Agreement currently matures in January 2021, but we may extend the maturity to January 2022 at our election in accordance with the Fifth Amendment. Our ability to renew or refinance the Credit Agreement after January 2022 or to enter into a new credit facility to replace or supplement the Credit Agreement may be limited due to various factors, including the status of our business, global credit market conditions, and perceptions of our business or industry by sources of financing. In addition, if credit is available, lenders may seek more restrictive covenants and higher interest rates that may reduce our borrowing capacity, increase our costs, or reduce our operating flexibility. The failure to extend, renew or replace the Credit Agreement beyond the current or ultimate maturity date of January 2022 (assuming we exercise all options to extend as provided by the Fifth Amendment) with a comparable credit facility that provides similar amounts of liquidity for the Company would have a material negative impact on our overall liquidity, financial and operating results.

Management may determine that, in order to reduce capital and liquidity requirements, planned spending on capital projects and indirect expense growth may be curtailed, subject to growth in operating results. Additionally, management may seek to put in place a credit facility with a commercial bank, although no assurance can be given that such a facility could be put in place under terms acceptable to the Company. Should management determine that additional capital is required, management would likely look first to the sources of funding discussed above to meet any requirements or may seek to raise additional capital by selling equity, although no assurances can be given that these investors would be able to invest or that the Company and the investors would agree upon terms for such investments.

Our working capital was $(12.8) million and $2.9 million as of June 30, 2020 and December 31, 2019, respectively. Our current working capital deficit is due to the classification of the EnCap Credit Agreement as a current liability as discussed in Note 5 to the financial statements, although the Fifth Amendment to the Credit Agreement provides us the option to extend the maturity of the agreement. We intend to consider exercising the option at the appropriate time. Although no assurances can be given, we expect that our financing arrangements with EnCap and RCA, collectively, and funds generated from operations are sufficient to maintain the liquidity we require to meet our operating, investing and financing needs for the next 12 months.

Legal Proceedings

Hamot et al. v. Telos Corporation

As previously disclosed in Note 13 of the Consolidated Financial Statements contained in our Annual Report on Form 10-K for the year ended December 31, 2019, beginning on August 2, 2007, Messrs. Seth W. Hamot ("Hamot") and Andrew R. Siegel ("Siegel"), principals of Costa Brava Partnership III, L.P. ("Costa Brava"), were involved in litigation against the Company as Plaintiffs and Counter-defendants in the Circuit Court for Baltimore City, Maryland (the "Circuit Court"). Mr. Siegel is a Class D Director of the Company and Mr. Hamot was a Class D Director of the Company until his resignation on March 9, 2018. The Plaintiffs initially alleged that certain documents and records had not been provided to them promptly and were necessary to fulfill their duties as directors of the Company. Subsequently, Hamot and Siegel further alleged that the Company had failed to follow certain provisions concerning the noticing of Board committee meetings and the recording of Board meeting minutes and, additionally, that Mr. John Wood's service as both CEO and Chairman of the Board was improper and impermissible under the Company's Bylaws. On April 23, 2008, the Company filed a counterclaim against Hamot and Siegel for money damages and preliminary and injunctive relief based upon Hamot and Siegel's interference with, and improper influence of, the Company's independent auditors regarding, among other things, a specific accounting treatment. On June 27, 2008, the Circuit Court granted the Company's motion for preliminary injunction and enjoined Hamot and Siegel from contacting the Company's auditors until the completion of the Company's Form 10-K for the preceding year, which injunction later expired by its own terms. As previously disclosed, trial on Hamot and Siegel's claims and the Company's counterclaims took place in July through September 2013, and the Court subsequently issued decisions on the various claims by way of memorandum opinions and orders dated September 11, 2017. The Company's subsequent appeal of the amount of damages awarded to it for Hamot and Siegel's intentional interference with the relationships with its former auditor was ultimately dismissed by way of the Mandate issued by the Court of Appeals of Maryland on October 11, 2019.

Hamot (and later, his Estate) and Siegel at various times in this litigation have sought to be indemnified or to be awarded advancement of various attorney's fees and expenses incurred by them in this litigation. No claim for indemnification is pending as of the reporting date.

There have been no material developments in connection with this litigation during the three months ended June 30, 2020.

At this stage of the litigation, it is impossible to reasonably determine the degree of probability related to the Company's success in relation to any possible further claim by Hamot's Estate and Siegel for indemnification for certain attorney's fees and expenses incurred in this litigation. The Company intends to vigorously defend the matter and oppose any claim for indemnification were it to be pursued.

Other Litigation

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

Note 9. Related Party Transactions

Emmett J. Wood, the brother of our Chairman and CEO, has been an employee of the Company since 1996. The amounts paid to this individual as compensation were $151,000 and $324,000 for the three and six months ended June 30, 2020, respectively, and $76,000 and $234,000 for the three and six months ended June 30, 2019, respectively. Additionally, as of June 30, 2020 and December 31, 2019, Mr. Wood owned 810,000 shares of the Company's Class A Common Stock and 50,000 shares of the Company's Class B Common Stock.

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

On April 18, 2017, we amended and restated the Porter Notes to reduce the interest rate from twelve percent (12%) to six percent (6%) per annum, to be accrued, and extended the maturity date from July 1, 2017 to July 25, 2022. Telos also entered into Intercreditor Agreements with Porter and EnCap, in which the Porter Notes are fully subordinated to the Credit Agreement and any subsequent senior lenders, and payments under the Porter Notes are permitted only if certain conditions are met. All other terms remain in full force and effect. We incurred interest expense in the amount of $88,000 and $175,000 for the three and six months ended June 30, 2020, respectively, and $82,000 and $162,000 for the three and six months ended June 30, 2019, respectively, on the Porter Notes. As of June 30, 2020, approximately $1.2 million of accrued interest was payable according to the stated interest rate of the Porter Notes.

Note 10 – Leases

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

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

The operating lease ROU assets and liabilities are recognized as of the lease commencement date at the present value of the lease payments over the lease term. Most of our leases do not provide an implicit rate that can readily be determined. Therefore, we use a discount rate based on our incremental borrowing rate which was 5.75% for all operating leases. Our operating lease agreements may include options to extend the lease term or terminate it early. We have included options to extend in the operating lease ROU assets and liabilities when we are reasonably certain that we will exercise such options. The weighted average remaining lease terms and discount rates for our operating leases were approximately 3.0 years and 5.75% and for our finance leases were approximately 8.8 years and 5.04% at June 30, 2020. Operating lease expense is recognized as rent expense on a straight-line basis over the lease term. Some of our operating leases contain lease and non-lease components, which we account for as a single component. We evaluate ROU assets for impairment consistent with our property and equipment policy disclosure included in our 2019 Form 10-K.

As of June 30, 2020, operating lease ROU assets were $1.8 million and operating lease liabilities were $1.9 million, of which $1.3 million were classified as noncurrent.

Future minimum lease commitments at June 30, 2020 were as follows (in thousands):

Year ending December 31,	Operating Leases	Finance Leases
2020 (excluding the six months ended June 30, 2020)	$ 371	$ 1,033
2021	752	2,097
2022	592	2,149
2023	373	2,203
2024	27	2,258
After 2024	--	10,658
Total lease payments	2,115	20,398
Less imputed interest	(178)	(4,127)
Total	$ 1,937	$ 16,271

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Operating lease cost	$ 182	$ 147	$ 360	$ 294
Short-term lease cost (1)	30	42	57	84
Finance lease cost				
Amortization of right-of-use assets	305	305	610	610
Interest on lease liabilities	208	222	419	447
Total finance lease cost	513	527	1,029	1,057
Total lease costs	$ 725	$ 716	$ 1,446	$ 1,435

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

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

	Six Months Ended June 30,	
	2020	2019
Cash paid for amounts included in the measurement of lease liabilities:		
Cash flows from operating activities - operating leases	$ 375	$ 279
Cash flows from operating activities - finance leases	1,012	987
Operating lease right-of-use assets obtained in exchange for lease obligations	300	245

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

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words “believes,” “anticipates,” “plans,” “expects” and similar expressions are intended to identify forward-looking statements. There are a number of important factors that could cause the Company’s actual results to differ materially from those indicated by such forward-looking statements. These factors include, without limitation, those set forth in the risk factors section included in the Company’s Form 10-K for the year ended December 31, 2019, as filed with the SEC.

General

The solutions we offer secure cyberspace, the cloud environment, and the people and operations of the enterprise. These three facets of the modern organization share much in common, but also require a diverse range of skills, capabilities, and experience to meet the important requirements of security-conscious customers. Telos’ decades-long resume of providing a broad spectrum of technology and security solutions uniquely qualifies us to meet our customers’ needs in these three areas. Our experience in addressing challenges in one operation of the enterprise informs our work in meeting requirements in others. We understand that a range of complementary capabilities may be needed to solve a single challenge, and we also recognize when a single solution might address multiple challenges.

Our substantive expertise in developing, orchestrating, and delivering solutions across these areas gives us the vision and the confidence to provide solutions that empower and protect the enterprise at an integrated, holistic level.

Our capabilities include:

- *Cybersecurity* – Today’s enterprises need to understand and manage their cyber risk and reduce their cyber attack surfaces. Telos helps our customers assure the ongoing security, integrity, and compliance of their on-premises and cloud-based systems and to reduce threats and vulnerabilities to foil cyber adversaries before they can attack. Our consultants assess our customers’ security environments and design, engineer, and operate the systems they need to strengthen their cybersecurity posture.

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

- *Enterprise Security* – Securing the enterprise means protecting the essential and timeless elements common to every organization: Its people and processes, its supply chain and inventories, its finances and facilities, its information and communications. As ICT and OT systems have become part of the organizational DNA, Telos has led with offerings that ensure personnel can work securely and productively across and beyond the enterprise.

In March 2020, the coronavirus disease 2019 ("COVID-19") was declared a pandemic by the World Health Organization and a national emergency by the U.S. Government. The pandemic has negatively affected the U.S. and global economy, disrupted global supply chains and financial markets, and resulted in governments around the world implementing increasingly stringent measures to help control the spread of the virus, including quarantines, “shelter in place” and “stay at home” orders, travel restrictions, business curtailments, school closures, and other measures. In addition, governments and central banks in several parts of the world have enacted fiscal and monetary stimulus measures to counteract the impacts of COVID-19.

We are taking prudent measures to protect the health and safety of our employees, such as practicing social distancing and enabling our employees to work from home where possible. As a result of travel restrictions, social distancing guidelines and other efforts that have been adopted by public health officials to mitigate the impact of the COVID-19 pandemic, we have made changes to our operating schedules and staffing plans to accommodate these restrictions while maintaining the ability of our employees to continue to support and work with our customers to the maximum extent possible. Such changes include the implementation of telework or other means of remote work for our employees, who support both mission-critical programs and our internal support organization. For programs that cannot be supported remotely we have accommodated those customers who have implemented shiftwork or other mitigation protocols by maintaining our workforce in a “mission ready” state.

As a company that is included in the defense industrial base, we are operating in a critical infrastructure industry, as defined by the U.S. Department of Homeland Security. Consistent with federal guidelines and with state and local orders to date, we have been advised that our operations are considered essential, and we currently continue to operate. Notwithstanding our continued operations, COVID-19 may have negative impacts on our operations, supply chain, transportation networks and customers, which may compress our sales and our margins, including as a result of preventative and precautionary measures that we, other businesses and governments are taking.

While we have experienced certain internal disruptions in adapting our operations as described above to the changed and evolving conditions, the majority of our program operations have not been adversely impacted, and we have implemented alternative means to support requirements. Due to the essential nature of the majority of our business, the programs that were adversely impacted did not experience those effects until the final two weeks of the first quarter, and the overall impact of the COVID-19 pandemic on our results of operations and liquidity were immaterial in the first two quarters of 2020. The financial impact of the COVID-19 pandemic cannot be reasonably estimated at this time as its impact depends on future developments, which are highly uncertain and cannot be predicted. New information may emerge concerning the scope, severity and duration of the COVID-19 pandemic, actions to contain its spread or treat its impact, and governmental, business and individuals' actions taken in response to the pandemic (including restrictions and limitations on travel and transportation) among others. Additionally, COVID-19 and the mitigation efforts adopted to limit the spread of the disease have had a significant impact on the global economy. With economic activity curtailing in the United States and other regions, we could experience delays in our supply chain or challenges when attempting to access financial markets.

Backlog

Many of our contracts with the U.S. Government are funded year to year by the procuring U.S. Government agency as determined by the fiscal requirements of the U.S. Government and the respective procuring agency. Such a contracting process results in two distinct categories of backlog: funded and unfunded. Total backlog consists of the aggregate contract revenues remaining to be earned by us at a given time over the life of our contracts, whether funded or not. Funded backlog consists of the aggregate contract revenues remaining to be earned by us at a given time, but only to the extent, in the case of U.S. Government contracts, when funded by the procuring U.S. Government agency and allotted to the specific contracts. Unfunded backlog is the difference between total backlog and funded backlog. Included in unfunded backlog are revenues which may be earned only when and if customers exercise delivery orders and/or renewal options to continue such existing contracts.

A number of contracts that we undertake 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 our backlog.

At June 30, 2020 and 2019, we had total backlog from existing contracts of approximately $308.6 million and $255.0 million, respectively. Such backlog was $354.5 million at December 31, 2019. Such amounts are the maximum possible 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 fully exercised by the customers.

Funded backlog as of June 30, 2020 and 2019 was $84.8 million and $74.1 million, respectively. Funded backlog was $112.4 million at December 31, 2019.

While backlog remains a measurement consideration, in recent years we, as well as other U.S. Government contractors, experienced a material change in the manner in which the U.S. Government procures equipment and services. These procurement changes include the growth in the use of General Services Administration ("GSA") schedules which authorize agencies of the U.S. 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 with many companies holding such schedules. Along with the GSA schedules, the U.S. Government is awarding a large number of omnibus contracts with multiple awardees. Such contracts generally require extensive marketing efforts by the multiple awardees to procure business under the omnibus contract through separate task or delivery orders. The use of GSA schedules and omnibus contracts, while generally not providing immediate backlog, provide areas of growth that we continue to aggressively pursue.

Consolidated Results of Operations (Unaudited)

The accompanying condensed consolidated financial statements include the accounts of Telos Corporation and its subsidiaries including Ubiquity.com, Inc., Xacta Corporation, Teloworks, Inc., and Telos APAC Pte. Ltd., all of whose issued and outstanding share capital is owned by Telos Corporation (collectively, the "Company" or "Telos" or "We"). We have also consolidated the results of operations of Telos ID (see Note 2 – Non-controlling Interests). All intercompany transactions have been eliminated in consolidation.

Our operating cycle involves many types of solutions, product and service contracts with varying delivery schedules. Accordingly, results of a particular quarter, or quarter-to-quarter comparisons of recorded sales and operating profits may not be indicative of future operating results and the following comparative analysis should therefore be viewed in such context.

Our revenues are generated from a number of contract vehicles and task orders. Over the past several years we have sought to diversify and improve our operating margins through an evolution of our business from an emphasis on product reselling to that of an advanced solutions technologies provider. To that end, although we continue to offer resold products through our contract vehicles, we have focused on selling solutions and outsourcing product sales, as well as designing and delivering Telos manufactured and branded technologies. We believe our contract portfolio is characterized as having low to moderate financial risk due to the limited number of long-term fixed price development contracts. Our firm fixed-price activities consist principally of contracts for the products and services at established contract prices. Our time-and-material contracts generally allow the pass-through of allowable costs plus a profit margin.

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

U.S. Government appropriations have been and continue to be affected by larger U.S. Government budgetary issues and related legislation. In 2011, Congress enacted the Budget Control Act of 2011 (the "BCA"), which established specific limits on annual appropriations for fiscal years 2012-2021. The BCA has been amended a number of times, most recently by the Bipartisan Budget Act of 2019 (the "BBA"), which was enacted on August 2, 2019. As a result, DoD funding levels have fluctuated over this period and have been difficult to predict. Most recently, while the two-year BBA allowed for modestly increased defense spending in FY 2020, unless and until it is again modified, the BBA also essentially will maintain defense spending in FY 2021 with only a minor increase (less than one percent) permitted above the current FY 2020 appropriated funding level.

According to the Office of Management and Budget, federal outlays devoted to defense programs have fallen from 4.5 percent to 3.2 percent as a share of Gross Domestic Product (GDP) since enactment of the BCA. Moreover, as a result of the spending caps imposed by the BCA, annual DoD budget authority in FY 2020 is only 3.7 percent higher (in unadjusted dollars) than it was a decade ago in FY 2010.

Since final enactment in December 2019 of appropriations legislation for FY 2020, and the February 10, 2020 submission of the President's proposed FY 2021 budget, the Coronavirus pandemic and associated economic dislocation in the United States has resulted in the need for an overwhelming federal response. This has led to the enactment of several comprehensive appropriations and economic stimulus measures, as well as negotiations between Congress and the White House for additional massive initiatives for the current year and into the next fiscal year, the details of which are not yet finalized. These substantial alterations to FY 2020 spending baselines are also likely to further impact FY 2021 spending in ways that cannot be predicted. The impact of the health and economic crisis, and the resulting large increase in federal spending, on the government contracts that we hold and the federal procurements that we would otherwise compete for cannot be known.

In addition to the ongoing need to respond to the crisis in the current fiscal year, Congress and the President must agree on FY 2021 appropriations legislation prior to October 1, 2020; failing to do so by then would likely mean DoD and other departments will again be funded for an unknown period of time under another Continuing Resolution, which would again restrict new spending initiatives. This is consistent with the practice for a number of years where the U.S. Government has been unable to complete its appropriations process prior to the beginning of the next fiscal year, resulting in actual or threatened governmental shut-downs and repeated use for extended time periods each year of Continuing Resolutions to fund part or all of the government. The impact of the substantial additional spending on the Coronavirus pandemic on the appropriations for FY 2021, and the appropriations process itself, is not known.

The current health and economic crisis is highly fluid, and it is likely to continue to affect multiple federal departments and agencies for an unknown period of time and in ways that are difficult to predict. Nonetheless, we believe that the federal government will very likely endeavor to maintain continuity of services and, with much of the business of government now being conducted through use of information technology systems and in many cases during the crisis remotely, we believe there will still be a need on the part of the government for the types of solutions and services provided by Telos.

We anticipate there will continue to be a significant amount of debate and negotiations within the U.S. Government over federal and defense spending, and these deliberations may be impacted by the health and economic impacts of the COVID-19 pandemic in ways that are at this time difficult to foresee. In the context of these negotiations, it is possible that the U.S. Government, or portions of the U.S. Government, could be shut down or disrupted for periods of time, and that government programs could be modified, cut or replaced as part of broader reforms to reduce the federal deficit or efforts to redirect federal spending, whether related or unrelated to the COVID-19 crisis. For more information on the risks and uncertainties related to U.S. Government contracts, see Part I – Item 1A Risk Factors as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2019.

The principal elements of the Company's operating expenses as a percentage of sales for the three and six months ended June 30, 2020 and 2019 are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
	(unaudited)			
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of sales	63.8	72.2	66.0	71.8
Selling, general, and administrative expenses	25.8	29.0	27.8	30.9
Operating income (loss)	10.4	(1.2)	6.2	(2.7)
Other income	----	0.5	----	0.3
Interest expense	(4.1)	(4.8)	(4.6)	(5.2)
Income (loss) before income taxes	6.3	(5.5)	1.6	(7.6)
Benefit from income taxes	----	----	0.2	0.3
Net income (loss)	6.3	(5.5)	1.8	(7.3)
Less: Net (income) loss attributable to non-controlling interest	(5.8)	0.7	(4.1)	(0.3)
Net income (loss) attributable to Telos Corporation	0.5%	(4.8)%	(2.3)%	(7.6)%

Three Months Ended June 30, 2020 Compared with Three Months Ended June 30, 2019

Revenue increased by 34.8% to $48.6 million for the second quarter of 2020, from $36.0 million for the same period in 2019. Services revenue increased to $45.5 million for the second quarter of 2019 from $34.4 million for the same period in 2019, primarily attributable to increases in sales of $9.6 million of Telos ID Enterprise Solutions and $2.8 million of Secure Communications Cyber and Enterprise Solutions, offset by decreases in sales of $1.2 million of Secure Mobility and Network Management/Defense Enterprise Solutions and $0.1 million of Cyber & Cloud Solutions. The change in product and services revenue varies from period to period depending on the mix of solutions sold and the nature of such solutions, as well as the timing of deliverables. Product revenue increased to $3.1 million for the second quarter of 2020 from $1.7 million for the same period in 2019, primarily attributable to increases in sales of $1.5 million of Telos ID Enterprise Solutions and $0.3 million of Cyber & Cloud Solutions, offset by a decrease in sales of $0.4 million of Secure Communications Cyber and Enterprise Solutions.

Cost of sales increased to $31.0 million for the second quarter of 2020, from $26.0 million for the same period in 2019, primarily due to an increase in revenue of $12.6 million, however cost of sales as a percentage of revenue decreased by 8.4%. Cost of sales for services increased by $4.2 million, and as a percentage of services revenue decreased by 8.7%, due to a change in the mix of the programs and timing of certain Telos ID Enterprise Solutions deliverables. Cost of sales for products increased by $0.8 million, and as a percentage of product revenue increased by 3.4% due primarily to an increase in product reselling, which carries a greater cost of sales. The increase in cost of sales as a percentage of revenue is not necessarily indicative of a trend as the mix of solutions sold and the nature of such solutions can vary from period to period, and further can be affected by the timing of deliverables.

Gross profit increased by 75.5% to $17.6 million for the second quarter of 2020 from $10.0 million for the same period in 2019. Gross margin increased to 36.2% in the second quarter of 2020, from 27.8% for the same period in 2019. Services gross margin increased to 35.4% in 2020 from 26.7% in 2019 due to the change in program mix during the period as noted above, primarily in Telos ID Enterprise Solutions, and product gross margin decreased to 46.9% in 2020 from 50.3% in 2019, due primarily to an increase in product reselling.

Selling, general, and administrative expense (SG&A) increased by 19.8% to $12.5 million for the second quarter of 2020, from $10.4 million for the same period in 2019, primarily attributable to increases in outside services of $1.4 million, labor costs of $1.3 million, and accrued bonuses of $0.9 million, offset by an increase in capitalized software development costs of $1.0 million, and decreases in trade shows costs of $0.3 million and travel costs of $0.2 million.

Operating income was $5.1 million for the second quarter of 2020, compared to an operating loss of $0.4 million for the same period in 2019, due primarily to an increase in gross profit as noted above.

Interest expense increased by 14.7% to $2.0 million for the second quarter of 2020, from $1.7 million for the same period in 2019, primarily due to an increase in interest on the EnCap senior term loan.

Income tax provision was $2,000 for the second quarter of 2020, compared to $20,000 for the same period in 2019, which is based on the estimated annual effective tax rate applied to the pretax income incurred for the quarter plus discreet tax items, based on our expectation of pretax loss for the fiscal year.

Net income attributable to Telos Corporation was $0.3 million for the second quarter of 2020, compared to a net loss of $1.7 million for the same period in 2019, primarily attributable to the operating income for the quarter as discussed above.

Six Months Ended June 30, 2020 Compared with Six Months Ended June 30, 2019

Revenue increased by 30.3% to $87.6 million for the six months ended June 30, 2020, from $67.2 million in the same period in 2019. Services revenue increased to $80.0 million for the six months ended June 30, 2020, from $62.4 million for the same period in 2019, primarily attributable to increases in sales of $13.2 million of Telos ID Enterprise Solutions and $5.1 million of Secure Communications Cyber and Enterprise Solutions, offset by decreases in sales of $0.6 million of Cyber & Cloud Solutions and $0.1 million of Secure Mobility and Network Management/Defense Enterprise Solutions. The change in product and services revenue varies from period to period depending on the mix of solutions sold and the nature of such solutions, as well as the timing of deliverables. Product revenue increased to $7.5 million for the six months ended June 30, 2020, from $4.8 million for the same period in 2019, primarily attributable to increases in sales of $1.7 million of Cyber & Cloud Solutions proprietary software deliverables and $1.3 million of Telos ID Enterprise Solutions, offset by a decrease in sales of $0.3 million of Secure Communications Cyber and Enterprise Solutions.

Cost of sales increased by 19.8% to $57.8 million for the six months ended June 30, 2020, from $48.2 million for the same period in 2019, primarily due to an increase in revenue of $20.4 million, however cost of sales as a percentage of revenue decreased by 5.8%. Cost of sales for services increased by $8.8 million, and as a percentage of services revenue decreased by 5.0%, due primarily to a change in the mix of the programs and timing of certain Telos ID Enterprise Solutions deliverables. Cost of sales for products increased by $0.7 million, and as a percentage of product revenue decreased by 12.1% due primarily to an increase in proprietary software sales which carry lower cost of sales. The increase in cost of sales as a percentage of revenue is not necessarily indicative of a trend as the mix of solutions sold and the nature of such solutions can vary from period to period, and further can be affected by the timing of deliverables.

Gross profit increased by 57.0% to $29.8 million for the six months ended June 30, 2020, from $19.0 million compared to the same period in 2019, due primarily to the change in the mix of the solutions sold as discussed above, primarily in Telos ID Enterprise Solutions. Gross margin increased to 34.0% for the six months ended June 30, 2020, from 28.2% in the same period in 2019.

SG&A expense increased by 17.1% to $24.3 million for the six months ended June 30, 2020, from $20.8 million for the same period in 2019, primarily attributable to increases in outside services of $2.6 million, labor costs of $2.1 million, and accrued bonuses of $0.9 million, offset by an increase in capitalized software development costs of $1.9 million, and a decrease in legal costs of $0.3 million.

Operating income was $5.5 million for the six months ended June 30, 2020, compared to an operating loss of $1.8 million for the same period in 2019, due primarily to an increase in gross profit as noted above.

Interest expense increased by 14.7% to $4.0 million for the six months ended June 30, 2020, from $3.5 million for the same period in 2019, primarily due to an increase in interest on the EnCap senior term loan.

Income tax benefit was $144,000 for the six months ended June 30, 2019, compared to $177,000 for the same period in 2019, which is based on the estimated annual effective tax rate applied to the pretax loss incurred for the six month period plus discreet tax items, adjusted for the income tax benefit previously provided, based on our expectation of pretax loss for the fiscal year.

Net loss attributable to Telos Corporation was $2.0 million for the six months ended June 30, 2020, compared to $5.2 million for the same period in 2019, primarily attributable to the operating income as discussed above.

Liquidity and Capital Resources

As described in Note 5 – Current Liabilities and Debt Obligations, we maintain a Credit Agreement with EnCap and a Purchase Agreement with RCA. The willingness of RCA to purchase our accounts receivable under the Purchase Agreement, and our ability to obtain additional financing, may be limited due to various factors, including the eligibility of our receivables, the status of our business, global credit market conditions, and perceptions of our business or industry by EnCap, RCA, or other potential sources of financing. If we are unable to maintain the Purchase Agreement, we would need to obtain additional credit to fund our future operations. If credit is available in that event, lenders may impose more restrictive terms and higher interest rates that may reduce our borrowing capacity, increase our costs, or reduce our operating flexibility. The failure to maintain, extend, renew or replace the Purchase Agreement with a comparable arrangement or arrangements that provide similar amounts of liquidity for the Company would have a material negative impact on our overall liquidity, financial and operating results.

While a variety of factors related to sources and uses of cash, such as timeliness of accounts receivable collections, vendor credit terms, or significant collateral requirements, ultimately impact our liquidity, such factors may or may not have a direct impact on our liquidity based on how the transactions associated with such circumstances impact the availability under our credit arrangements. For example, a contractual requirement to post collateral for a duration of several months, depending on the materiality of the amount, could have an immediate negative effect on our liquidity, as such a circumstance would utilize cash resources without a near-term cash inflow back to us. Likewise, the release of such collateral could have a corresponding positive effect on our liquidity, as it would represent an addition to our cash resources without any corresponding near-term cash outflow. Similarly, a slow-down of payments from a customer, group of customers or government payment office would not have an immediate and direct effect on our availability unless the slowdown was material in amount and over an extended period of time. Any of these examples would have an impact on our cash resources, our financing arrangements, and therefore our liquidity: The Credit Agreement currently matures in January 2021, but we may extend the maturity to January 2022 at our election in accordance with the Fifth Amendment. Our ability to renew or refinance the Credit Agreement after January 2022 or to enter into a new credit facility to replace or supplement the Credit Agreement may be limited due to various factors, including the status of our business, global credit market conditions, and perceptions of our business or industry by sources of financing. In addition, if credit is available, lenders may seek more restrictive covenants and higher interest rates that may reduce our borrowing capacity, increase our costs, or reduce our operating flexibility. The failure to extend, renew or replace the Credit Agreement beyond the current or ultimate maturity date of January 2022 (assuming we exercise all options to extend as provided by the Fifth Amendment) with a comparable credit facility that provides similar amounts of liquidity for the Company would have a material negative impact on our overall liquidity, financial and operating results.

Management may determine that, in order to reduce capital and liquidity requirements, planned spending on capital projects and indirect expense growth may be curtailed, subject to growth in operating results. Additionally, management may seek to put in place a credit facility with a commercial bank, although no assurance can be given that such a facility could be put in place under terms acceptable to the Company. Should management determine that additional capital is required, management would likely look first to the sources of funding discussed above to meet any requirements or may seek to raise additional capital by selling equity, although no assurances can be given that these investors would be able to invest or that the Company and the investors would agree upon terms for such investments.

Our working capital was $(12.8) million and $2.9 million as of June 30, 2020 and December 31, 2019, respectively. Our current working capital deficit is due to the classification of the EnCap Credit Agreement as a current liability as discussed in Note 5 to the financial statements, although the Fifth Amendment to the Credit Agreement provides us the option to extend the maturity of the agreement. We intend to consider exercising the option at the appropriate time. Although no assurances can be given, we expect that our financing arrangements with EnCap and RCA, collectively, and funds generated from operations are sufficient to maintain the liquidity we require to meet our operating, investing and financing needs for the next 12 months.

Cash provided by operating activities was $0.8 million for the six months ended June 30, 2020, compared to $5.9 million for the same period in 2019. Cash provided by or used in operating activities is primarily driven by the Company's operating income, the timing of receipt of customer payments, the timing of its payments to vendors and employees, and the timing of inventory turnover, adjusted for certain non-cash items that do not impact cash flows from operating activities. Additionally, net income was $1.6 million for the six months ended June 30, 2020, compared to a net loss of $4.9 million for the six months ended June 30, 2019.

Cash used in investing activities was approximately $3.5 million and $3.7 million for the six months ended June 30, 2020 and 2019, respectively, due primarily to the capitalization of software development costs of $3.2 million and $1.3 million for the six months ended June 30, 2020 and 2019, respectively, and the purchase of property and equipment $0.3 million and $2.4 million for the six months ended June 30, 2020 and 2019, respectively.

Cash used in financing activities for the six months ended June 30, 2020 was $1.7 million, compared to $1.5 million for the same period in 2019, primarily attributable to payments under finance leases and distribution to the Telos ID Class B member for both periods.

Additionally, our capital structure consists of redeemable preferred stock and common stock. The capital structure is complex and requires an understanding of the terms of the instruments, certain restrictions on scheduled payments and redemptions of the various instruments, and the interrelationship of the instruments especially as it relates to the subordination hierarchy. Therefore, a thorough understanding of how our capital structure impacts our liquidity is necessary and, accordingly, we have disclosed the relevant information about each instrument as follows:

Enlightenment Capital Credit Agreement

On January 25, 2017, we entered into a Credit Agreement (the "Credit Agreement") with Enlightenment Capital Solutions Fund II, L.P., as agent (the "Agent") and the lenders party thereto (the "Lenders") (together referenced as “EnCap”). The Credit Agreement provided for an $11 million senior term loan (the "Loan") with a maturity date of January 25, 2022, subject to acceleration in the event of customary events of default.

All borrowings under the Credit Agreement accrue interest at the rate of 13.0% per annum (the “Accrual Rate”). If, at the request of the Company, the Agent executes an intercreditor agreement with another senior lender under which the Agent and the Lenders subordinate their liens (an "Alternative Interest Rate Event"), the interest rate will increase to 14.5% per annum. After the occurrence and during the continuance of any event of default, the interest rate will increase 2.0%. The Company is obligated to pay accrued interest in cash on a monthly basis at a rate of not less than 10.0% per annum or, during the continuance of an Alternate Interest Rate Event, 11.5% per annum. The Company may elect to pay the remaining interest in cash, by payment-in-kind (by addition to the principal amount of the Loan) or by combination of cash and payment-in-kind. Upon thirty days prior written notice, the Company may prepay any portion or the entire amount of the Loan.

The Credit Agreement contains representations, warranties, covenants, terms and conditions customary for transactions of this type. In connection with the Credit Agreement, the Agent has been granted, for the benefit of the Lenders, a security interest in and general lien upon various property of the Company, subject to certain permitted liens and any intercreditor agreement. The occurrence of an event of default under the Credit Agreement could result in the Loan and other obligations becoming immediately due and payable and allow the Lenders to exercise all rights and remedies available to them under the Credit Agreement or as a secured party under the UCC, in addition to all other rights and remedies available to them.

In connection with the Credit Agreement, on January 25, 2017, the Company issued warrants (each, a "Warrant") to the Agent and certain of the Lenders representing in the aggregate the right to purchase in accordance with their terms 1,135,284.333 shares of the Class A Common Stock of the Company, no par value per share, which is equivalent to approximately 2.5% of the common equity interests of the Company on a fully diluted basis. The exercise price is $1.321 per share and each Warrant expires on January 25, 2027. The value of the warrants was determined to be de minimis and no value was allocated to them on a relative fair value basis in accounting for the debt instrument.

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

Effective February 23, 2017, the Credit Agreement was amended to change the required timing of certain post-closing items, to allow for more time to complete the legal and administrative requirements around such items. On April 18, 2017, the Credit Agreement was further amended (the “Second Amendment”) to incorporate the parties’ agreement to subordinate certain debt owed by the Company to the affiliated entities of Mr. John R. C. Porter (the “Subordinated Debt”) and to redeem all outstanding shares of the Series A-1 Redeemable Preferred Stock and the Series A-2 Redeemable Preferred Stock, including those owned by Mr. John R.C. Porter and his affiliates, for an aggregate redemption price of $2.1 million.

In connection with the Second Amendment and that subordination of debt, on April 18, 2017, we also entered into Subordination and Intercreditor Agreements (the “Intercreditor Agreements”) with affiliated entities of Mr. John R. C. Porter (together referenced as “Porter”), in which Porter agreed that the Subordinated Debt is fully subordinated to the amended Credit Agreement and related documents, and that required payments, if any, under the Subordinated Debt are permitted only if certain conditions are met.

On March 30, 2018, the Credit Agreement was further amended (the “Third Amendment”) to waive certain covenant defaults and to reset the covenants for 2018 measurement periods to more accurately reflect the Company’s projected performance for the year. The measurement against the covenants for consolidated leverage ratio and consolidated fixed charge coverage ratio were agreed to not be measured as of December 31, 2017 and were reset for 2018 measurement periods. Additionally, a minimum revenue covenant and a net working capital covenant were added. In consideration of these amendments, the interest rate on the loan was increased by 1%, which will revert back to the original rate upon achievement of two consecutive quarters of a specified fixed charge coverage ratio as defined in the agreement. The Company may elect to pay the increase in interest expense in cash or by payment-in-kind (by addition to the principal amount of the Loan). The increase in interest expense has been paid in cash. Contemporaneously with the Third Amendment, Mr. John B. Wood agreed to transfer 50,000 shares of the Company’s Class A Common Stock owned by him to EnCap.

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

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

The exit fee has been included in the total principal due and treated as an unamortized discount on the debt, which is being amortized over the term of the loan using the effective interest method at a rate of 17.3% over the remaining term of the loan. For the measurement period ended June 30, 2020, we were in compliance with the Credit Agreement’s financial covenants, based on an agreement between the Company and EnCap on the definition of certain input factors that determine the measurement against the covenants.

On March 26, 2020, the Credit Agreement was amended (the "Fifth Amendment") to modify the financial covenants for 2020 through the maturity of the Credit Agreement to establish that the covenants will remain at the December 31, 2019 levels and to update the previously agreed-upon definition of certain financial covenants, specifically the amount of Capital Expenditures to be included in the measurement of the covenants. The Fifth Amendment also provides for the right for the Company to elect to extend the maturity date of the Credit Agreement which is currently scheduled to mature on January 15, 2021. The Fifth Amendment provides for four quarterly maturity date extensions, which would increase the Exit Fee payable under the Credit Agreement by $250,000 for each quarterly maturity date extension elected, for a total of $1 million increase to the Exit Fee were all four of the maturity date extensions to be elected. The Company paid EnCap an amendment fee of $100,000 and out-of-pocket costs and expenses in consideration for the Fifth Amendment.

As the Company has not exercised the option(s) to extend the maturity of the Credit Agreement, the current maturity date remains January 15, 2021, which is within one year from the balance sheet date. Accordingly, the balance of the EnCap loan has been classified as a current liability. However, the options to extend the maturity provide the Company with the ability by contractual right to extend the maturity of the loan, which the Company intends to consider exercising at the appropriate time.

We incurred interest expense in the amount of $0.7 million and $1.5 million for the three and six months ended June 30, 2020, respectively, and $0.4 million and $0.8 million for the three and six months ended June 30, 2019, respectively, under the Credit Agreement.

Accounts Receivable Purchase Agreement

On July 15, 2016, we entered into an Accounts Receivable Purchase Agreement (the "Purchase Agreement") with Republic Capital Access, LLC ("RCA" or "Buyer"), pursuant to which we may offer for sale, and RCA, in its sole discretion, may purchase, eligible accounts receivable relating to U.S. Government prime contracts or subcontracts of the Company (collectively, the "Purchased Receivables"). Upon purchase, RCA becomes the absolute owner of any such Purchased Receivables, which are payable directly to RCA, subject to certain repurchase obligations of the Company. The total amount of Purchased Receivables is subject to a maximum limit of $10 million of outstanding Purchased Receivables (the "Maximum Amount") at any given time. On November 15, 2019, the term of the Purchase Agreement was extended to June 30, 2022.

The initial purchase price of a Purchased Receivable is equal to 90% of the face value of the receivable if the account debtor is an agency of the U.S. Government, and 85% if the account debtor is not an agency of the U.S. Government; provided, however, that RCA has the right to adjust these initial purchase price rates in its sole discretion. After collection by RCA of the portion of a Purchased Receivable in excess of the initial purchase price, RCA shall pay the Company the residual 10% or 15% of such Purchased Receivable, as appropriate, less (i) a discount factor equal to 0.30%, for federal government prime contracts (or 0.56% for non-federal government investment grade account obligors or 0.62% for non-federal government non-investment grade account obligors) of the face amounts of Purchased Receivables; (ii) a program access fee equal to 0.008% of the daily ending account balance for each day that Purchased Receivables are outstanding; (iii) a commitment fee equal to 1% per annum of the Maximum Amount minus the amount of Purchased Receivables outstanding; and (iv) fees, costs and expenses relating to the preparation, administration and enforcement of the Purchase Agreement and any other related agreements.

The Purchase Agreement provides that in the event, but only to the extent, that the conveyance of Purchased Receivables by the Company is characterized by a court or other governmental authority as a loan rather than a sale, the Company shall be deemed to have granted RCA, effective as of the date of the first purchase under the Purchase Agreement, a security interest in all of the Company's right, title and interest in, to and under all of the Purchased Receivables, whether now or hereafter owned, existing or arising.

The Company provides a power of attorney to RCA to take certain actions in the Company's stead, including (a) to sell, assign or transfer in whole or in part any of the Purchased Receivables; (b) to demand, receive and give releases to any account debtor with respect to amounts due under any Purchased Receivables; (c) to notify all account debtors with respect to the Purchased Receivables; and (d) to take any actions necessary to perfect RCA's interests in the Purchased Receivables.

The Company is liable to the Buyer for any fraudulent statements and all representations, warranties, covenants, and indemnities made by the Company pursuant to the terms of the Purchase Agreement. It is considered an event of default if (a) the Company fails to pay any amounts it owes to RCA when due (subject to a cure period); (b) the Company has voluntary or involuntary bankruptcy proceedings commenced by or against it; (c) the Company is no longer solvent or is generally not paying its debts as they become due; (d) any voluntary liens, garnishments, attachments, or the like are issued against or attach to the Purchased Receivables; (e) the Company breaches any warranty, representation, or covenant (subject to a cure period); (f) the Company is not in compliance or has otherwise defaulted under any document or obligation in favor of RCA or an RCA affiliate; or (g) the Purchase Agreement or any material provision terminates (other than in accordance with the terms of the Purchase Agreement) or ceases to be effective or to be a binding obligation of the Company. If any such event of default occurs, then RCA may take certain actions, including ceasing to buy any eligible receivables, declaring any indebtedness or other obligations immediately due and payable, or terminating the Purchase Agreement.

Subordinated Debt

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

On April 18, 2017, we amended and restated the Porter Notes to reduce the interest rate from twelve percent (12%) to six percent (6%) per annum, to be accrued, and extended the maturity date from July 1, 2017 to July 25, 2022. Telos also entered into Intercreditor Agreements with Porter and EnCap, in which the Porter Notes are fully subordinated to the Credit Agreement and any subsequent senior lenders, and payments under the Porter Notes are permitted only if certain conditions are met. All other terms remain in full force and effect. We incurred interest expense in the amount of $88,000 and $175,000 for the three and six months ended June 30, 2020, respectively, and $82,000 and $162,000 for the three and six months ended June 30, 2020, respectively, on the Porter Notes. As of June 30, 2020, approximately $1.2 million of accrued interest was payable according to the stated interest rate of the Porter Notes.

Public Preferred Stock

A maximum of 6,000,000 shares of the Public Preferred Stock, par value $.01 per share, has been authorized for issuance. We initially issued 2,858,723 shares of the Public Preferred Stock pursuant to the acquisition of the Company during fiscal year 1990. The Public Preferred Stock was recorded at fair value on the date of original issue, November 21, 1989, and we made periodic accretions under the interest method of the excess of the redemption value over the recorded value. We adjusted our estimate of accrued accretion in the amount of $1.5 million in the second quarter of 2006. The Public Preferred Stock was fully accreted as of December 2008. We declared stock dividends totaling 736,863 shares in 1990 and 1991. Since 1991, no other dividends, in stock or cash, have been declared. In November 1998, we retired 410,000 shares of the Public Preferred Stock. The total number of shares issued and outstanding at June 30, 2020 and December 31, 2019 was 3,185,586. The Public Preferred Stock is quoted as "TLSRP" on the OTCQB marketplace and the OTC Bulletin Board.

Since 1991, no dividends were declared or paid on our Public Preferred Stock, based upon our interpretation of restrictions in our Articles of Amendment and Restatement, limitations in the terms of the Public Preferred Stock instrument, specific dividend payment restrictions in the various financing documents to which the Public Preferred Stock is subject, other senior obligations currently or previously in existence, and Maryland law limitations in existence prior to October 1, 2009. Subsequent to the 2009 Maryland law change, dividend payments have continued to be prohibited except under certain specific circumstances as set forth in Maryland Code Section 2-311. Pursuant to the terms of the Articles of Amendment and Restatement, we were scheduled, but not required, to redeem the Public Preferred Stock in five annual tranches during the years 2005 through 2009. However, due to our substantial senior obligations currently or previously in existence, limitations set forth in the covenants in the various financing documents to which the Public Preferred Stock is subject, foreseeable capital and operational requirements, and restrictions and prohibitions of our Articles of Amendment and Restatement, we were and remain unable to meet the redemption schedule set forth in the terms of the Public Preferred Stock as of the measurement dates. Moreover, the Public Preferred Stock is not payable on demand, nor callable, for failure to redeem the Public Preferred Stock in accordance with the redemption schedule set forth in the instrument. Therefore, we classify these securities as noncurrent liabilities in the condensed consolidated balance sheets as of June 30, 2020 and December 31, 2019.

On January 25, 2017, we became parties with certain of our subsidiaries to the Credit Agreement with EnCap. Under the Credit Agreement, we agreed that, until full and final payment of the obligations under the Credit Agreement, we would not make any distribution or declare or pay any dividends (other than common stock) on our stock, or purchase, acquire, or redeem any stock, or exchange any stock for indebtedness, or retire any stock. Additionally, the Porter Notes contain similar prohibitions on dividend payments or stock redemptions.

Accordingly, as stated above, we will continue to classify the entirety of our obligation to redeem the Public Preferred Stock as a long-term obligation. Various financing documents to which the Public Preferred Stock is subject prohibit, among other things, the redemption of any stock, common or preferred, other than as described above. The Public Preferred Stock by its terms also cannot be redeemed if doing so would violate the terms of an agreement regarding the borrowing of funds or the extension of credit which is binding upon us or any of our subsidiaries, and it does not include any other provisions that would otherwise require any acceleration of the redemption of or amortization of payments with respect to the Public Preferred Stock. Thus, the Public Preferred Stock is not and will not be due on demand, nor callable, within 12 months from June 30, 2020. This classification is consistent with ASC 210, “Balance Sheet” and 470, “Debt” and the FASB ASC Master Glossary definition of “Current Liabilities.”

ASC 210 and the FASB ASC Master Glossary define current liabilities as follows: The term current liabilities is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities. As a balance sheet category, the classification is intended to include obligations for items which have entered into the operating cycle, such as payables incurred in the acquisition of materials and supplies to be used in the production of goods or in providing services to be offered for sale; collections received in advance of the delivery of goods or performance of services; and debts that arise from operations directly related to the operating cycle, such as accruals for wages, salaries, commissions, rentals, royalties, and income and other taxes. Other liabilities whose regular and ordinary liquidation is expected to occur within a relatively short period of time, usually twelve months, are also intended for inclusion, such as short-term debts arising from the acquisition of capital assets, serial maturities of long-term obligations, amounts required to be expended within one year under sinking fund provisions, and agency obligations arising from the collection or acceptance of cash or other assets for the account of third persons.

ASC 470 provides the following: The current liability classification is also intended to include obligations that, by their terms, are due on demand or will be due on demand within one year (or operating cycle, if longer) from the balance sheet date, even though liquidation may not be expected within that period. It is also intended to include long-term obligations that are or will be callable by the creditor either because the debtor’s violation of a provision of the debt agreement at the balance sheet date makes the obligation callable or because the violation, if not cured within a specified grace period, will make the obligation callable.

If, pursuant to the terms of the Public Preferred Stock, we do not redeem the Public Preferred Stock in accordance with the scheduled redemptions described above, the terms of the Public Preferred Stock require us to discharge our obligation to redeem the Public Preferred Stock as soon as we are financially capable and legally permitted to do so. Therefore, by its very terms, the Public Preferred Stock is not due on demand or callable for failure to make a scheduled payment pursuant to its redemption provisions and is properly classified as a noncurrent liability.

We pay dividends on the Public Preferred Stock when and if declared by the Board of Directors. The Public Preferred Stock accrues a semi-annual dividend at the annual rate of 12% ($1.20) per share, based on the liquidation preference of $10 per share, and is fully cumulative. Dividends in additional shares of the Public Preferred Stock for 1990 and 1991 were paid at the rate of 6% per share for each $.60 of such dividends not paid in cash. For the cash dividends payable since December 1, 1995, we have accrued $109.3 million and $107.4 million as of June 30, 2020 and December 31, 2019, respectively. We accrued dividends on the Public Preferred Stock of $1.0 million and $1.9 million for each of the three and six months ended June 30, 2020 and 2019, respectively, which was recorded as interest expense. Prior to the effective date of ASC 480 on July 1, 2003, such dividends were charged to stockholders' accumulated deficit.

Recent Accounting Pronouncements

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

Critical Accounting Policies

During the three months ended June 30, 2020, there were no material changes to our critical accounting policies as reported in our Annual Report on Form 10-K for the year ended December 31, 2019 as filed with the SEC on April 13, 2020.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

None.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

An evaluation of the effectiveness of our disclosure controls and procedures as of June 30, 2020 was performed under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in its reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and that information required to be disclosed by the Company in the reports the Company files or submits under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during the quarter ended June 30, 2020 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

There were no material changes in the period ended June 30, 2020 in our risk factors as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2019.

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

None.

Item 3. Defaults upon Senior Securities

12% Cumulative Exchangeable Redeemable Preferred Stock

Through November 21, 1995, we had the option to pay dividends in additional shares of Public Preferred Stock in lieu of cash (provided there were no restrictions on payment as further discussed below). As more fully explained in the next paragraph, dividends are payable by us, when and if declared by the Board of Directors, commencing June 1, 1990, and on each six-month anniversary thereof. Dividends in additional shares of the Preferred Stock for 1990 and 1991 were paid at the rate of 6% of a share for each $.60 of such dividends not paid in cash. Dividends for the years 1992 through 1994, and for the dividend payable June 1, 1995, were accrued under the assumption that such dividends would be paid in additional shares of preferred stock and were valued at $4.0 million. Had we accrued these dividends on a cash basis, the total amount accrued would have been $15.1 million. However, as a result of the redemption of the 410,000 shares of the Public Preferred Stock in November 1998, such amounts were reduced and adjusted to $3.5 million and $13.4 million, respectively. As more fully disclosed in Note 6 – Redeemable Preferred Stock, in the second quarter of 2006, we accrued an additional $9.9 million in interest expense to reflect our intent to pay cash dividends in lieu of stock dividends, for the years 1992 through 1994, and for the dividend payable June 1, 1995. We have accrued $109.3 million and $107.4 million in cash dividends as of June 30, 2020 and December 31, 2019, respectively.

Since 1991, no dividends were declared or paid on our Public Preferred Stock, based upon our interpretation of restrictions in our Articles of Amendment and Restatement, limitations in the terms of the Public Preferred Stock instrument, specific dividend payment restrictions in the various financing documents to which the Public Preferred Stock is subject, other senior obligations currently or previously in existence, and Maryland law limitations in existence prior to October 1, 2009. Subsequent to the 2009 Maryland law change, dividend payments have continued to be prohibited except under certain specific circumstances as set forth in Maryland Code Section 2-311. Pursuant to the terms of the Articles of Amendment and Restatement, we were scheduled, but not required, to redeem the Public Preferred Stock in five annual tranches during the period 2005 through 2009. However, due to our substantial senior obligations currently or previously in existence, limitations set forth in the covenants in the various financing documents to which the Public Preferred Stock is subject, foreseeable capital and operational requirements, and restrictions and prohibitions of our Articles of Amendment and Restatement, we were and remain unable to meet the redemption schedule set forth in the terms of the Public Preferred Stock as of the measurement dates. Moreover, the Public Preferred Stock is not payable on demand, nor callable, for failure to redeem the Public Preferred Stock in accordance with the redemption schedule set forth in the instrument. Therefore, we classify these securities as noncurrent liabilities in the condensed consolidated balance sheets as of June 30, 2020 and December 31, 2019.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Description of Exhibit
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32*	Certification pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase
101.DEF**	XBRL Taxonomy Extension Definition Linkbase
101.LAB**	XBRL Taxonomy Extension Label Linkbase
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase

* filed herewith
** in accordance with Regulation S-T, the XBRL-related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall be deemed to be "furnished" and not "filed"

SIGNATURES

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

Date: August 13, 2020

TELOS CORPORATION

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

/s/ Michele Nakazawa
Michele Nakazawa
Chief Financial Officer (Principal Financial and Accounting Officer)

Exhibit 31.1

CERTIFICATION

I, John B. Wood, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: August 13, 2020

/s/ John B. Wood

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

Exhibit 31.2

CERTIFICATION

I, Michele Nakazawa, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: August 13, 2020

/s/ Michele Nakazawa
Michele Nakazawa
Chief Financial Officer (Principal Financial and Accounting Officer)

Exhibit 32

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

In connection with the Quarterly Report of Telos Corporation (the "Company") on Form 10-Q for the period ended June 30, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, John B. Wood and Michele Nakazawa, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to our knowledge:

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

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

Date: August 13, 2020

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

Date: August 14, 2020

/s/ Michele Nakazawa
Michele Nakazawa
Chief Financial Officer (Principal Financial and Accounting Officer)