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: September 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 November 12, 2020, the registrant had outstanding 35,857,945 shares of Class A Common Stock, no par value and 3,204,293 shares of Class B Common Stock, no par value.

TELOS CORPORATION AND SUBSIDIARIES

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Revenue				
Services	$ 44,166	$ 39,221	$ 124,210	$ 101,635
Products	3,274	6,310	10,819	11,110
	47,440	45,531	135,029	112,745
Costs and expenses				
Cost of sales - Services	28,619	26,594	82,862	71,988
Cost of sales - Products	2,259	2,624	5,790	5,453
	30,878	29,218	88,652	77,441
Selling, general and administrative expenses	12,049	10,637	36,395	31,432
Operating income	4,513	5,676	9,982	3,872
Other income (expense)				
Other income	2	2	14	195
Interest expense	(2,013)	(1,970)	(6,026)	(5,470)
Income (loss) before income taxes	2,502	3,708	3,970	(1,403)
(Provision for) benefit from income taxes (Note 7)	(8)	10	136	187
Net income (loss)	2,494	3,718	4,106	(1,216)
Less: Net income attributable to non-controlling interest (Note 2)	(2,694)	(1,485)	(6,284)	(1,705)
Net (loss) income attributable to Telos Corporation	$ (200)	$ 2,233	$ (2,178)	$ (2,921)
Net (loss) earnings per share attributable to Telos Corporation, Common A, basic	$ (0.01)	$ 0.06	$ (0.06)	$ (0.08)
Net (loss) earnings per share attributable to Telos Corporation, Common B, basic	$ (0.01)	$ 0.06	$ (0.06)	$ (0.08)
Net (loss) earnings per share attributable to Telos Corporation, Common A, diluted	$ (0.01)	$ 0.06	$ (0.06)	$ (0.08)
Net (loss) earnings per share attributable to Telos Corporation, Common B, diluted	$ (0.01)	$ 0.06	$ (0.06)	$ (0.08)
Weighted-average shares of stock outstanding, Common A, basic	35,798	34,869	35,350	34,410
Weighted-avearage shares of stock outstanding, Common B, basic	3,204	3,204	3,204	3,204
Weighted-average shares of stock outstanding, Common A, diluted	35,798	36,727	35,350	34,410
Weighted-average shares of stock outstanding, Common B, diluted	3,204	3,204	3,204	3,204

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 September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Net income (loss)	$ 2,494	$ 3,718	$ 4,106	$ (1,216)
Other comprehensive loss, net of tax:				
Foreign currency translation adjustments	(2)	(2)	(1)	–
Less: Comprehensive income attributable to non-controlling interest	(2,694)	(1,485)	(6,284)	(1,705)
Comprehensive (loss) income attributable to Telos Corporation	$ (202)	$ 2,231	$ (2,179)	$ (2,921)

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

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

	September 30, 2020 (Unaudited)	December 31, 2019
ASSETS		
Current assets		
Cash and cash equivalents	$ 10,326	$ 6,751
Accounts receivable, net of reserve of $745 and $720, respectively (Note 1)	29,116	27,942
Inventories, net of obsolescence reserve of $859 and $860, respectively (Note 1)	3,898	1,965
Deferred program expenses	12	673
Other current assets	2,717	2,914
Total current assets	46,069	40,245
Property and equipment, net of accumulated depreciation of $35,771 and $32,470, respectively	22,173	19,567
Operating lease right-of-use assets (Note 10)	1,622	1,979
Goodwill (Note 3)	14,916	14,916
Other assets	1,054	985
Total assets	$ 85,834	$ 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)

	September 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)	$ 16,919	$ --
Accounts payable and other accrued liabilities (Note 5)	16,863	15,050
Accrued compensation and benefits	11,231	12,187
Contract liabilities (Notes 1 and 5)	6,353	6,337
Finance lease obligations – short-term (Note 10)	1,310	1,224
Other current liabilities (Note 10)	4,725	2,505
Total current liabilities	57,401	37,303
Senior term loan, net of unamortized discount and issuance costs (Note 5)	--	16,335
Subordinated debt (Note 5)	3,192	2,927
Finance lease obligations – long-term (Note 10)	14,648	15,641
Operating lease liabilities – long-term (Note 10)	1,101	1,553
Deferred income taxes (Note 7)	649	621
Public preferred stock (Note 6)	142,077	139,210
Other liabilities (Note 7)	571	724
Total liabilities	219,639	214,314
Commitments and contingencies (Note 8)		
Stockholders' deficit		
Telos stockholders' deficit		
Common stock	78	78
Additional paid-in capital	4,314	4,310
Accumulated other comprehensive income	5	6
Accumulated deficit	(147,708)	(145,530)
Total Telos stockholders' deficit	(143,311)	(141,136)
Non-controlling interest in subsidiary (Note 2)	9,506	4,514
Total stockholders' deficit	(133,805)	(136,622)
Total liabilities, redeemable preferred stock, and stockholders' deficit	$ 85,834	$ 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)

	Nine Months Ended September 30,	
	2020	**2019**
Operating activities:		
Net income (loss)	$ 4,106	$ (1,216)
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Dividends from preferred stock recorded as interest expense	2,867	2,867
Depreciation and amortization	4,018	3,609
Amortization of debt issuance costs	684	275
Deferred income tax provision (benefit)	28	(206)
Other noncash items	(26)	83
Changes in other operating assets and liabilities	280	(1,028)
Cash provided by operating activities	11,957	4,384
Investing activities:		
Capitalized software development costs	(5,459)	(2,171)
Purchases of property and equipment	(624)	(3,141)
Cash used in investing activities	(6,083)	(5,312)
Financing activities:		
Proceeds from senior term loan	–	4,881
Payments under finance lease obligations	(907)	(826)
Amendment fee paid to lender	(100)	–
Distributions to Telos ID Class B member - non-controlling interest	(1,292)	(1,403)
Cash (used in) provided by financing activities	(2,299)	2,652
Increase in cash and cash equivalents	3,575	1,724
Cash and cash equivalents, beginning of period	6,751	72
Cash and cash equivalents, end of period	$ 10,326	$ 1,796
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 2,211	$ 2,294
Income taxes	$ 50	$ 39
Noncash:		
Dividends from preferred stock recorded as interest expense	$ 2,867	$ 2,867
Debt issuance costs on senior term loan	$ –	$ 110

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 September 30, 2020						
Beginning balance	$ 78	$ 4,310	$ 7	$ (147,508)	$ 7,104	$ (136,009)
Net (loss) income	–	–	–	(200)	2,694	2,494
Foreign currency translation loss	–	–	(2)	–	–	(2)
Stock-based compensation	–	4	–	–	–	4
Distributions	–	–	–	–	(292)	(292)
Ending balance	$ 78	$ 4,314	$ 5	$ (147,708)	$ 9,506	$ (133,805)
For the Three Months Ended September 30, 2019						
Beginning balance	$ 78	$ 4,310	$ 19	$ (144,283)	$ 1,857	$ (138,019)
Net income	–	–	–	2,233	1,485	3,718
Foreign currency translation loss	–	–	(2)	–	–	(2)
Distributions	–	–	–	–	(419)	(419)
Ending balance	$ 78	$ 4,310	$ 17	$ (142,050)	$ 2,923	$ (134,722)
For the Nine Months Ended September 30, 2020						
Beginning balance	$ 78	$ 4,310	$ 6	$ (145,530)	$ 4,514	$ (136,622)
Net (loss) income	–	–	–	(2,178)	6,284	4,106
Foreign currency translation loss	–	–	(1)	–	–	(1)
Stock-based compensation	–	4	–	–	–	4
Distributions	–	–	–	–	(1,292)	(1,292)
Ending balance	$ 78	$ 4,314	$ 5	$ (147,708)	$ 9,506	$ (133,805)
For the Nine Months Ended September 30, 2019						
Beginning balance	$ 78	$ 4,310	$ 17	$ (139,129)	$ 2,621	$ (132,103)
Net (loss) income	--	--	--	(2,921)	1,705	(1,216)
Distributions	--	--	--	--	(1,403)	(1,403)
Ending balance	$ 78	$ 4,310	$ 17	$ (142,050)	$ 2,923	$ (134,722)

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”), offers technologically advanced, software-based security solutions that empower and protect the world’s most security-conscious organizations against rapidly evolving, sophisticated and pervasive threats. Our portfolio of security products, services and expertise empower our customers with capabilities to reach new markets, serve their stakeholders more effectively, and successfully defend the nation or their enterprise. We protect our customers’ people, information, and digital assets so they can pursue their corporate goals and conduct their global missions with confidence in their security and privacy. Our 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 December 2019, an outbreak of COVID-19 was reported in Wuhan, China. On March 11, 2020, the World Health Organization declared COVID-19 a global pandemic and on March 13, 2020, President Donald J. Trump declared the virus a national emergency. This highly contagious disease has spread to most of the countries in the world and throughout the United States, creating a serious impact on customers, workforces, and suppliers, disrupting economies and financial markets, and potentially leading to a world-wide economic downturn. It has caused a disruption of the normal operations of many businesses, including the temporary closure or scale-back of business operations and/or the imposition of either quarantine or remote work or meeting requirements for employees, either by government order or on a voluntary basis. The pandemic may adversely affect our customers’ ability to perform their missions and is in many cases disrupting their operations. It may also impact the ability of our subcontractors, partners, and suppliers to operate and fulfill their contractual obligations, and result in an increase in their costs and cause delays in performance. These supply chain effects, and the direct effect of the virus and the disruption on our operations, may negatively impact both our ability to meet customer demand and our revenue and profit margins. Our employees, in some cases, are working remotely due either to safety concerns or to customer imposed limitations and using various technologies to perform their functions. We could see delays or changes in customer demand, particularly if government funding priorities change. Additionally, the disruption and volatility in the global and domestic capital markets may increase the cost of capital and limit our ability to access capital. Both the health and economic aspects of COVID-19 are highly fluid and the future course of each is uncertain.

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, "Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes," which simplifies the accounting for income taxes by removing certain exceptions to the general principles in Topic 740. The ASU also clarifies and amends existing guidance to improve consistent application. This standard 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 Information Assurance / Xacta® (previously referred to as Cyber & Cloud Solutions) and Secure Communications (previously referred to as Secure Communications Cyber and Enterprise Solutions) business groups and for the sale of resold products in Telos ID (previously referred to as Telos ID Enterprise Solutions) and Secure Networks (previously referred to as Secure Mobility and Network Management/Defense Enterprise Solutions), and is classified as product revenue. Revenue on these contracts is recognized when the customer obtains control of the transferred product or service, which is generally upon delivery of the product to the customer for their use, due to us maintaining control of the product until that point. Orders for the sale of software licenses may contain multiple performance obligations, such as maintenance, training, or consulting services, which are typically delivered over time, consistent with the transfer of control disclosed above for the provision of services. When an order contains multiple performance obligations, we allocate the transaction price to the performance obligations using our best estimate of standalone selling price.

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

Our contracts may include various types of variable consideration, such as claims (for instance, indirect rate or other equitable adjustments) or incentive fees. We include estimated amounts in the transaction price based on all of the information available to us, including historical information and future estimations, and to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when any uncertainty associated with the variable consideration is resolved. 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 September 30, 2020	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019
Federal	$ 45,788	$ 42,702	$ 128,756	$ 105,459
State & Local, and Commercial	1,652	2,829	6,273	7,286
Total	$ 47,440	$ 45,531	$ 135,029	$ 112,745

	Three Months Ended September 30, 2020	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019
Firm fixed-price	$ 39,483	$ 38,660	$ 113,080	$ 92,447
Time-and-materials	3,605	3,325	11,066	10,945
Cost plus fixed fee	4,352	3,546	10,883	9,353
Total	$ 47,440	$ 45,531	$ 135,029	$ 112,745

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

	September 30, 2020	December 31, 2019
Billed accounts receivable	$ 12,315	$ 11,917
Unbilled receivables	17,546	16,745
Allowance for doubtful accounts	(745)	(720)
Receivables – net	$ 29,116	$ 27,942

The following table discloses contract liabilities (in thousands):

	September 30, 2020	December 31, 2019
Contract liabilities	$ 6,353	$ 6,337

As of September 30, 2020 and December 31, 2019, we had $147.0 million and $112.4 million of remaining performance obligations, respectively, which we also refer to as funded backlog. We expect to recognize approximately 47.1% of our remaining performance obligations as revenue in 2020, an additional 46.6% in 2021, and the balance thereafter. We recognized revenue of $1.7 million and $5.2 million during the three and nine months ended September 30, 2020, respectively, and $1.0 million and $4.1 million during the three and nine months ended September 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 nine months ended September 30, 2020. During the three and nine months ended September 30, 2019, the Company sold approximately $3.2 million and $12.6 million of accounts receivable, respectively, and recognized a related loss of approximately $12,000 and $45,000 in selling, general and administrative expenses, respectively, for the same period. As of September 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 $4.8 million and $2.8 million as of September 30, 2020 and December 31, 2019, respectively. As of September 30, 2020, it is management’s judgment that we have fully provided for any potential inventory obsolescence, which was $0.9 million as of September 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 September 30, 2020 and December 31, 2019, we capitalized $11.0 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 $1.3 million for each of the three and nine months ended September 30, 2020 and 2019, respectively. Accumulated amortization was $4.4 million and $3.1 million as of September 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 September 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 September 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 September 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 during the quarter. 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 (comprised of Information Assurance / Xacta and Secure Networks), Telos ID, and Secure Communications, 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, 79,361 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 September 30, 2020, there were 59,521 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.

Net Income (Loss) per Share

Basic net loss per share is computed by dividing the net loss by the weighted-average number of common shares outstanding for the period, without consideration for potentially dilutive securities. Diluted net loss per share is computed by dividing the net loss by the weighted-average number of shares of common stock and dilutive common stock equivalents outstanding for the period determined using the treasury-stock and if-converted methods. Dilutive common stock equivalents are comprised of unvested restricted common stock. For all periods presented, there is no difference in the number of shares used to calculate basic and diluted shares outstanding as inclusion of the potentially dilutive securities would be antidilutive.

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

	Nine Months Ended September 30,	
	2020	**2019**
Unvested restricted stock	60	957
Common stock warrants, exercisable at $1.665/sh.	901	901
Total	961	1,858

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

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):

	September 30, 2020	December 31, 2019
Cumulative foreign currency translation loss	$ (102)	$ (101)
Cumulative actuarial gain on pension liability adjustment	107	107
Accumulated other comprehensive income	$ 5	$ 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, which was $2.7 million and $6.3 million for the three and nine months ended September 30, 2020, respectively, and $1.5 million and $1.7 million for the three and nine months ended September 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 $0.3 million and $1.3 million during the three and nine months ended September 30, 2020, respectively, and $0.4 million and $1.4 million during the three and nine months ended September 30, 2019, respectively.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Non-controlling interest, beginning of period	$ 7,104	$ 1,857	$ 4,514	$ 2,621
Net income	2,694	1,485	6,284	1,705
Distributions	(292)	(419)	(1,292)	(1,403)
Non-controlling interest, end of period	$ 9,506	$ 2,923	$ 9,506	$ 2,923

On October 5, 2020, we entered into a Membership Interest Purchase Agreement between the Company and the Investors to purchase all of the Class B Units of Telos ID ("Telos ID Units") owned by the Investors (the "Telos ID Purchase"). Upon the closing of the Telos ID Purchase, Telos ID will become our wholly owned subsidiary. The successful consummation of an initial public offering of our common stock is a condition to the closing of the Telos ID Purchase. If the initial public offering of our common stock is not consummated, the Telos ID Purchase will not occur.

Note 3. Goodwill

The goodwill balance was $14.9 million as of September 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 September 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 September 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 September 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 $142.1 million and $139.2 million, respectively, and the estimated fair market value was $63.7 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 September 30, 2020 and December 31, 2019, the accounts payable and other accrued liabilities consisted of $11.4 million and $13.5 million, respectively, in trade accounts payable and $5.5 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 September 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 September 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):

	September 30, 2020	December 31, 2019
Senior term loan principal, including exit fee	$ 17,200	$ 17,200
Less: Unamortized discount, debt issuance costs, and lender fees	(281)	(865)
Senior term loan, net	$ 16,919	$ 16,335

We incurred interest expense in the amount of $0.8 million and $2.3 million for the three and nine months ended September 30, 2020, respectively, and $0.7 million and $1.5 million for the three and nine months ended September 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 $90,000 and $265,000 for the three and nine months ended September 30, 2020, respectively, and $83,000 and $245,000 for the three and nine months ended September 30, 2019, respectively, on the Porter Notes. As of September 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 September 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 September 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 September 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 $110.2 million and $107.4 million as of September 30, 2020 and December 31, 2019, respectively. We accrued dividends on the Public Preferred Stock of $1.0 million and $2.9 million for each of the three and nine months ended September 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 $8,000 income tax provision and $136,000 income tax benefit for the three and nine months ended September 30, 2020, respectively, and a $10,000 and $187,000 income tax benefit for the three and nine months ended September 30, 2019, respectively. For the three and nine months ended September 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 income 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 September 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 $649,000 and $621,000 remains on our condensed consolidated balance sheets at September 30, 2020 and December 31, 2019, respectively. The income tax benefit recorded for the nine months ended September 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 nine months ended September 30, 2020 and 2019.

Under the provisions of ASC 740, we determined that there were approximately $514,000 and $673,000 of unrecognized tax benefits, including $235,000 and $304,000 of related interest and penalties, required to be recorded in other liabilities in the condensed consolidated balance sheets as of September 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 $(11.3) million and $2.9 million as of September 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. Among other rulings, the Court found Hamot and Siegel liable for the intentional tort of tortious interference with the Company's contractual relationship with one of its auditors and entered a monetary judgment in favor of the Company and against Hamot and Siegel for approximately $278,000. The Company's subsequent appeal of the amount of damages awarded to it for Hamot and Siegel's intentional interference was ultimately dismissed by way of the Mandate issued by the Court of Appeals of Maryland on October 11, 2019.

Hamot (and later, his Estate) and Siegel on multiple occasions during this litigation have sought to be indemnified or to be awarded advancement of various attorney's fees and expenses incurred by them in this litigation. On October 20, 2020, Hamot's Estate and Siegel (together the "Plaintiffs") filed their latest Motion for Indemnification of Legal Fees and Expenses against the Company in the Circuit Court for Baltimore City and a Request for a Hearing. The Motion demands that the Company indemnify the Plaintiffs for legal fees and expenses incurred in the sum of $2,540,000. The Company filed an Opposition to the Motion on November 4, 2020. The Company denies that it has any liability for indemnification to the Plaintiffs and intends to vigorously defend the matter through an opposition to the Motion and further proceedings.

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 this 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.

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 $193,000 and $517,000 for the three and nine months ended September 30, 2020, respectively, and $110,000 and $344,000 for the three and nine months ended September 30, 2019, respectively. Additionally, as of September 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 $90,000 and $265,000 for the three and nine months ended September 30, 2020, respectively, and $83,000 and $245,000 for the three and nine months ended September 30, 2019, respectively, on the Porter Notes. As of September 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 2.8 years and 5.75% and for our finance leases were approximately 8.6 years and 5.04% at September 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 September 30, 2020, operating lease ROU assets were $1.6 million and operating lease liabilities were $1.8 million, of which $1.1 million were classified as noncurrent.

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

Year ending December 31,	Operating Leases	Finance Leases
2020 (excluding the nine months ended September 30, 2020)	$ 194	$ 517
2021	752	2,097
2022	592	2,149
2023	373	2,203
2024	27	2,258
After 2024	--	10,658
Total lease payments	1,938	19,882
Less imputed interest	(151)	(3,924)
Total	$ 1,787	$ 15,958

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Operating lease cost	$ 182	$ 160	$ 542	$ 454
Short-term lease cost (1)	26	42	83	126
Finance lease cost				
Amortization of right-of-use assets	305	305	915	915
Interest on lease liabilities	205	219	622	666
Total finance lease cost	510	524	1,537	1,581
Total lease costs	$ 718	$ 726	$ 2,162	$ 2,161

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

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

	Nine Months Ended September 30,	
	2020	2019
Cash paid for amounts included in the measurement of lease liabilities:		
Cash flows from operating activities - operating leases	$ 552	$ 435
Cash flows from operating activities - finance leases	622	665
Cash flows from financing activities - finance leases	907	826
Operating lease right-of-use assets obtained in exchange for lease obligations	455	378

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

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

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

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

Our security solutions span across the following domains:

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

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

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

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

Security Solutions

- **Information Assurance / Xacta:** a premier platform for enterprise cyber risk management and security compliance automation, delivering security awareness for systems in the cloud, on-premises, and in hybrid and multi-cloud environments. Xacta delivers automated cyber risk and compliance management solutions to large commercial and government enterprises. Across the U.S. federal government, Xacta is the de facto commercial cyber risk and compliance management solution.
- **Secure Communications:**
  - **Telos Ghost:** a virtual obfuscation network-as-a-service with encryption and managed attribution capabilities to ensure the safety and privacy of people, information, and resources on the network. Telos Ghost seeks to eliminate cyber-attack surfaces by obfuscating and encrypting data, masking user identity and location, and hiding network resources. It provides the additional layers of security and privacy needed for intelligence gathering, cyber threat protection, securing critical infrastructure, and protecting communications and applications when operations, property, and even lives can be jeopardized by a single error in security.
  - **Telos Automated Message Handling System ("AMHS"):** web-based organizational message distribution and management for mission-critical communications; the recognized gold standard for organizational messaging in the U.S. government. Telos AMHS is used by military field operatives for critical communications on the battlefield and is the only web-based solution for assured messaging and directory services using the Defense Information System Agency's ("DISA") Organizational Messaging Service and its specialized communications protocols.
- **Telos ID:** offering Identity Trust and Digital Services through IDTrust360® – an enterprise-class digital identity risk platform for extending software-as-a-service ("SaaS") and custom digital identity services that mitigate threats through the integration of advanced technologies that fuse biometrics, credentials, and other identity-centric data used to continuously monitor trust. We maintain government certifications and designations that distinguish Telos ID, including TSA PreCheck™ enrollment provider, Designated Aviation Channeling provider, FBI-approved Channeler, and the Financial Industry Regulatory Authority ("FINRA") Electronic Fingerprint Submission provider. We are the only commercial entity in our industry designated as a Secure Flight Services provider for terrorist watchlist checks.

Secure Networks

- **Secure Mobility:** solutions for business and government that enable remote work and minimize concern across and beyond the enterprise. Our secure mobility team brings credentials to every engagement, supplying deep expertise and experience as well as highly desirable clearances and industry recognized certifications for network engineering, mobility, and security.
- **Network Management and Defense:** services for operating, administrating, and defending complex enterprise networks and defensive cyber operations. Our diverse portfolio of capabilities addresses common and uncommon requirements in many industries and disciplines, ranging from the military and government agencies to Fortune 500 companies.

Backlog

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.

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

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 September 30, 2020 and 2019, we had total backlog from existing contracts of approximately $374.6 million and $307.5 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 September 30, 2020 and 2019 was $147.0 million and $104.0 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 December 11, 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 nine months ended September 30, 2020 and 2019 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
	(unaudited)			
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of sales	65.1	64.2	65.7	68.7
Selling, general, and administrative expenses	25.4	23.4	26.9	27.9
Operating income	9.5	12.4	7.4	3.4
Other income	----	----	----	0.2
Interest expense	(4.2)	(4.3)	(4.5)	(4.9)
Income (loss) before income taxes	5.3	8.1	2.9	(1.3)
Benefit from income taxes	----	----	0.1	0.2
Net income (loss)	5.3	8.1	3.0	(1.1)
Less: Net income attributable to non-controlling interest	(5.7)	(3.2)	(4.6)	(1.5)
Net (loss) income attributable to Telos Corporation	(0.4)%	4.9%	(1.6)%	(2.6)%

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

Revenue increased by 4.2% to $47.4 million for the third quarter of 2020, from $45.5 million for the same period in 2019. Services revenue increased to $44.2 million for the third quarter of 2020 from $39.2 million for the same period in 2019, primarily attributable to increases in sales of $2.5 million by Telos ID, $2.1 million by Assurance / Xacta, and $1.7 million by Secure Communications, offset by a decrease in sales of $1.3 million by Secure Networks. 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 decreased to $3.3 million for the third quarter of 2020 from $6.3 million for the same period in 2019, primarily attributable to decreases in sales of $2.5 million by Assurance / Xacta and $0.6 million by Telos ID, offset by an increase in sales of $0.1 million by Secure Communications.

Cost of sales increased to $30.9 million for the third quarter of 2020, from $29.2 million for the same period in 2019, primarily due to an increase in revenue of $1.9 million, coupled with an increased cost of sales as a percentage of revenue of 0.9%. Cost of sales for services increased by $2.0 million, and as a percentage of services revenue decreased by 3.0%, due to a change in the mix of the programs and timing of certain deliverables. Cost of sales for products decreased by $0.4 million, and as a percentage of product revenue increased by 27.4% due primarily to a decrease 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 1.5% to $16.6 million for the third quarter of 2020 from $16.3 million for the same period in 2019. Gross margin decreased to 34.9% in the third quarter of 2020, from 35.8% for the same period in 2019. Services gross margin increased to 35.2% in 2020 from 32.2% in 2019 due to the change in program mix during the period as noted above, and product gross margin decreased to 31.0% in 2020 from 58.4% in 2019, due primarily to a decrease in proprietary software sales.

Selling, general, and administrative expense (SG&A) increased by 13.3% to $12.0 million for the third quarter of 2020, from $10.6 million for the same period in 2019, primarily attributable to increases in labor costs of $1.6 million, outside services of $1.6 million, legal costs of $0.4 million, and trade shows of $0.1 million, offset by a increase in capitalized software development costs of $1.4 million, and decreases in accrued bonuses of $0.7 million and travel costs of $0.2 million.

Operating income decreased by 20.5% to $4.5 million for the third quarter of 2020, from $5.7 million for the same period in 2019, due primarily to an increase in SG&A as noted above.

Interest expense increased by 2.2% to $2.0 million for the third quarter of 2020, from $2.0 million for the same period in 2019, primarily due to an increase in interest on the EnCap senior term loan.

Income tax provision was $8,000 for the third quarter of 2020, compared to income tax benefit of $10,000 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 loss attributable to Telos Corporation was $0.2 million for the third quarter of 2020, compared to a net income of $2.2 million for the same period in 2019, primarily attributable to the decrease in operating income for the quarter as discussed above.

Nine Months Ended September 30, 2020 Compared with Nine Months Ended September 30, 2019

Revenue increased by 19.8% to $135.0 million for the nine months ended September 30, 2020, from $112.7 million in the same period in 2019. Services revenue increased to $124.2 million for the nine months ended September 30, 2020, from $101.6 million for the same period in 2019, primarily attributable to increases in sales of $15.7 million by Telos ID, $6.8 million by Secure Communications, and $1.5 million by Assurance / Xacta, offset by a decrease in sales of $1.4 million by Secure Networks. 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 decreased to $10.8 million for the nine months ended September 30, 2020, from $11.1 million for the same period in 2019, primarily attributable to decreases in sales of $0.7 million by Assurance / Xacta and $0.3 million by Secure Communications, offset by an increase in sales of $0.7 million by Telos ID.

Cost of sales increased by 14.5% to $88.7 million for the nine months ended September 30, 2020, from $77.4 million for the same period in 2019, primarily due to an increase in revenue of $22.3 million, however cost of sales as a percentage of revenue decreased by 3.0%. Cost of sales for services increased by $10.9 million, and as a percentage of services revenue decreased by 4.1%, due primarily to a change in the mix of the programs and timing of certain Telos ID deliverables. Cost of sales for products increased by $0.3 million, and as a percentage of product revenue increased by 4.4% due primarily to a decrease in proprietary software sales which carry lower cost of sales. The decrease 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 31.4% to $46.4 million for the nine months ended September 30, 2020, from $35.3 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. Gross margin increased to 34.3% for the nine months ended September 30, 2020, from 31.3% in the same period in 2019.

SG&A expense increased by 15.8% to $36.4 million for the nine months ended September 30, 2020, from $31.4 million for the same period in 2019, primarily attributable to increases in outside services of $4.2 million, labor costs of $3.6 million, software maintenance costs of $0.2 million, accrued bonuses of $0.2 million, recruiting fees of $0.2 million, and legal costs of $0.1 million, offset by an increase in capitalized software development costs of $3.3 million, and a decrease in travel costs of $0.4 million.

Operating income increased by 157.8% to $10.0 million for the nine months ended September 30, 2020, from $3.9 million for the same period in 2019, due primarily to an increase in gross profit as noted above.

Interest expense increased by 10.2% to $6.0 million for the nine months ended September 30, 2020, from $5.5 million for the same period in 2019, primarily due to an increase in interest on the EnCap senior term loan.

Income tax benefit was $136,000 for the nine months ended September 30, 2019, compared to $187,000 for the same period in 2019, which is based on the estimated annual effective tax rate applied to the pretax loss incurred for the nine 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 $2.2 million for the nine months ended September 30, 2020, compared to $2.9 million for the same period in 2019, primarily attributable to the increase in operating income as discussed above, offset by an increase to income attributable to noncontrolling interest.

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 $(11.3) million and $2.9 million as of September 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 $12.0 million for the nine months ended September 30, 2020, compared to $4.4 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 $4.1 million for the nine months ended September 30, 2020, compared to a net loss of $1.2 million for the nine months ended September 30, 2019.

Cash used in investing activities was approximately $6.1 million and $5.3 million for the nine months ended September 30, 2020 and 2019, respectively, due primarily to the capitalization of software development costs of $5.5 million and $2.2 million for the nine months ended September 30, 2020 and 2019, respectively, and the purchase of property and equipment $0.6 million and $3.1 million for the nine months ended September 30, 2020 and 2019, respectively.

Cash used in financing activities for the nine months ended September 30, 2020 was $2.3 million, compared to cash provided by financing activities of $2.7 million for the same period in 2019, primarily attributable to proceeds from the EnCap senior term loan for the nine months ended September 30, 2019, and 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 September 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 $0.8 million and $2.3 million for the three and nine months ended September 30, 2020, respectively, and $0.7 million and $1.5 million for the three and nine months ended September 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 $90,000 and $265,000 for the three and nine months ended September 30, 2020, respectively, and $83,000 and $245,000 for the three and nine months ended September 30, 2019, respectively, on the Porter Notes. As of September 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 September 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 September 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 September 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 $110.2 million and $107.4 million as of September 30, 2020 and December 31, 2019, respectively. We accrued dividends on the Public Preferred Stock of $1.0 million and $2.9 million for each of the three and nine months ended September 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 September 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 September 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 September 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

The following risk factors are in addition to those risk factors disclosed in our Annual Report on Form 10-K, filed with the SEC on April 13, 2020, which are incorporated by reference herein.

We are subject to the seasonality of the U.S. government spending.

We derive a substantial portion of our revenues from U.S. government contracting, and as a result, we are subject to the annual seasonality of the U.S. government purchasing. Because the U.S. government fiscal year ends on September 30, it is not uncommon for U.S. government agencies to award extra tasks in the weeks immediately prior to the end of its fiscal year in order to avoid the loss of unexpended fiscal year funds. As a result of this seasonality, we have historically experienced higher revenues in the third and fourth fiscal quarters, ending September 30 and December 31, respectively, with the pace of orders typically substantially reduced during the first and second fiscal quarters ending March 31 and June 30, respectively.

Our pricing structures for our solutions and services may change from time to time.

We expect that we may change our pricing model from time to time, including as a result of competition, global economic conditions, and general reductions in our customers' spending levels, pricing studies, or changes in how our solutions are broadly consumed. Similarly, as we introduce new products and services, or as a result of the evolution of our existing solutions and services, we may have difficulty determining the appropriate price structure for our products and services. In addition, as new and existing competitors introduce new products or services that compete with ours, or revise their pricing structures, we may be unable to attract new customers at the same price or based on the same pricing model as we have used historically. Moreover, as we continue to target selling our solutions and services to larger organizations, these larger organizations may demand substantial price concessions. In addition, we may need to change pricing policies to accommodate government pricing guidelines for our contracts with federal, state, local, and foreign governments and government agencies. If we are unable to modify or develop pricing models and strategies that are attractive to existing and prospective customers, while enabling us to significantly grow our sales and revenue relative to our associated costs and expenses in a reasonable period of time, our business, financial condition, and results of operations may be adversely impacted.

We depend on computing infrastructure operated by Amazon Web Services ("AWS"), Microsoft, and other third parties to support some of our solutions and customers, and any errors, disruption, performance problems, or failure in their or our operational infrastructure could adversely affect our business, financial condition, and results of operations.

We rely on the technology, infrastructure, and software applications, of certain third parties, such as AWS and Microsoft Azure, in order to host or operate some of certain key platform features or functions of our business. Additionally, we rely on computer hardware and cloud capabilities purchased in order to deliver our solutions and services. We do not have control over the operations of the facilities of the third parties that we use. If any of these third-party services experience errors, disruptions, security issues, or other performance deficiencies, if they are updated such that our solutions become incompatible, if these services, software, or hardware fail or become unavailable due to extended outages, interruptions, defects, or otherwise, or if they are no longer available on commercially reasonable terms or prices (or at all), these issues could result in errors or defects in our solutions, cause our solutions to fail, our revenue and margins could decline, or our reputation and brand to be damaged, we could be exposed to legal or contractual liability, our expenses could increase, our ability to manage our operations could be interrupted, and our processes for managing our sales and servicing our customers could be impaired until equivalent services or technology, if available, are identified, procured, and implemented, all of which may take significant time and resources, increase our costs, and could adversely affect our business. Many of these third-party providers attempt to impose limitations on their liability for such errors, disruptions, defects, performance deficiencies, or failures, and if enforceable, we may have additional liability to our customers or third-party providers.

We have experienced, and may in the future experience, disruptions, failures, data loss, outages, and other performance problems with our infrastructure and cloud-based offerings due to a variety of factors, including infrastructure changes, introductions of new functionality, human or software errors, employee misconduct, capacity constraints, denial of service attacks, phishing attacks, computer viruses, malicious or destructive code, or other security-related incidents, and our disaster recovery planning may not be sufficient for all situations. If we experience disruptions, failures, data loss, outages, or other performance problems, our business, financial condition, and results of operations could be adversely affected.
Our systems and the third-party systems upon which we and our customers rely are also vulnerable to damage or interruption from catastrophic occurrences such as earthquakes, floods, fires, power loss, telecommunication failures, cybersecurity threats, terrorist attacks, natural disasters, public health crises such as the COVID-19 pandemic, geopolitical and similar events, or acts of misconduct. Despite any precautions we may take, the occurrence of a catastrophic disaster or other unanticipated problems at our or our third-party vendors' hosting facilities, or within our systems or the systems of third parties upon which we rely, could result in interruptions, performance problems, or failure of our infrastructure, technology, or solutions, which may adversely impact our business. In addition, our ability to conduct normal business operations could be severely affected. In the event of significant physical damage to one of these facilities, it may take a significant period of time to achieve full resumption of our services, and our disaster recovery planning may not account for all eventualities. In addition, any negative publicity arising from these disruptions could harm our reputation and brand and adversely affect our business.

Furthermore, our solutions are in many cases important or essential to our customers' operations, including in some cases, their cybersecurity or oversight and compliance programs, and subject to service level agreements ("SLAs"). Any interruption in our service, whether as a result of an internal or third-party issue, could damage our brand and reputation, cause our customers to terminate or not renew their contracts with us or decrease use of our solutions and services, require us to indemnify our customers against certain losses, result in our issuing credit or paying penalties or fines, subject us to other losses or liabilities, cause our solutions to be perceived as unreliable or unsecure, and prevent us from gaining new or additional business from current or future customers, any of which could harm our business, financial condition, and results of operations.

Moreover, to the extent that we do not effectively address capacity constraints, upgrade our systems as needed, and continually develop our technology and network architecture to accommodate actual and anticipated changes in technology, our business, financial condition, and results of operations could be adversely affected. The provisioning of additional cloud hosting capacity requires lead time. AWS, Microsoft Azure, and other third parties have no obligation to renew their agreements with us on commercially reasonable terms, or at all. If AWS, Microsoft Azure, or other third parties increase pricing terms, terminate or seek to terminate our contractual relationship, establish more favorable relationships with our competitors, or change or interpret their terms of service or policies in a manner that is unfavorable with respect to us, we may be required to transfer to other cloud providers or invest in a private cloud. If we are required to transfer to other cloud providers or invest in a private cloud, we could incur significant costs and experience possible service interruption in connection with doing so, or risk loss of customer contracts if they are unwilling to accept such a change.
A failure to maintain our relationships with our third-party providers (or obtain adequate replacements), and to receive services from such providers that do not contain any material errors or defects, could adversely affect our ability to deliver effective products and solutions to our customers and adversely affect our business and results of operations.

We will face risks associated with the growth of our business in new commercial markets and with new customer verticals, and we may neither be able to continue our organic growth nor have the necessary resources to dedicate to the overall growth of our business.

We plan to expand our operations in new commercial markets, including those where we may have limited operating experience, and may be subject to increased business, technology and economic risks that could affect our financial results. In recent periods, we have increased our focus on commercial customers. In the future, we may increasingly focus on such customers, including in the banking, financial services, healthcare, pharmaceutical, manufacturing, telecommunication, airlines and aerospace, insurance, retail, transportation, shipping and logistics, and energy industries, as well as other critical infrastructure industries. Entering new verticals and expanding in the verticals in which we are already operating will continue to require significant resources and there is no guarantee that such efforts will be successful or beneficial to us. Historically, sales to a new customer have often led to additional sales to the same customer or similarly situated customers. As we expand into and within new and emerging markets and heavily regulated industry verticals, we will likely face additional regulatory scrutiny, risks, and burdens from the governments and agencies which regulate those markets and industries. While this approach to expansion within new commercial markets and verticals has proven successful in the past, it is uncertain we will achieve the same penetration and organic growth in the future and our reputation, business, financial condition, and results of operations could be negatively impacted.

In the future, we may seek to enter into other credit facilities to help fund our working capital needs. These credit facilities may expose us to additional risks associated with leverage and may inhibit our operating flexibility.

We may seek to enter into other credit facilities with third-party lenders to help fund our business. Such credit facilities will likely require us to pay a commitment fee on the undrawn amount and will likely contain a number of affirmative and restrictive covenants.

If we violate any such covenants, our lenders could accelerate the maturity of any debt outstanding and we may be prohibited from making any distributions to our stockholders. Such debt may be secured by our assets, including the stock we may own in subsidiaries and the rights we have under intercompany loan agreements that we may enter into in the future with our businesses. Our ability to meet our debt service obligations may be affected by events beyond our control and will depend primarily upon cash produced by our business. Any failure to comply with the terms of our indebtedness may have a material adverse effect on our financial condition.

In addition, we expect that such credit facilities will bear interest at floating rates which will generally change as interest rates change. We will bear the risk that the rates that we are charged by our lenders will increase faster than we can grow the cash flow from our businesses, which could reduce profitability, materially adversely affect our ability to service our debt and cause us to breach covenants contained in our third-party credit facilities.

Our business is subject to complex and evolving U.S. and non-U.S. laws and regulations regarding privacy, data protection and security, technology protection, and other matters. Many of these laws and regulations are subject to change and uncertain interpretation, and could result in claims, changes to our business practices, monetary penalties, increased cost of operations, or otherwise harm our business.

We are subject to a variety of local, state, national, and international laws and directives and regulations in the United States and abroad that involve matters central to our business, including privacy and data protection, data security, data storage, retention, transfer and deletion, technology protection, and personal information. Foreign data protection, data security, privacy, and other laws and regulations can impose different obligations or be more restrictive than those in the United States. These U.S. federal and state and foreign laws and regulations, which, depending on the regime, may be enforced by private parties or government entities, are constantly evolving and can be subject to significant change, and they are likely to remain uncertain for the foreseeable future. In addition, the application, interpretation, and enforcement of these laws and regulations are often uncertain, and may be interpreted and applied inconsistently from country to country and inconsistently with our current policies and practices. A number of proposals are pending before U.S. federal, state, and foreign legislative and regulatory bodies that could significantly affect our business.

The overarching complexity of privacy and data protection laws and regulations around the world pose a compliance challenge that could manifest in costs, damages, or liability in other forms as a result of failure to implement proper programmatic controls, failure to adhere to those controls, or the malicious or inadvertent breach of applicable privacy and data protection requirements by us, our employees, our business partners, or our customers.

In addition to government regulation, self-regulatory standards and other industry standards may legally or contractually apply to us, be argued to apply to us, or we may elect to comply with such standards or to facilitate our customers' compliance with such standards. Because privacy, data protection, and information security are critical competitive factors in our industry, we may make statements on our website, in marketing materials, or in other settings about our data security measures and our compliance with, or our ability to facilitate our customers' compliance with, these standards. We also expect that there will continue to be new proposed laws and regulations concerning privacy, data protection, and information security, and we cannot yet determine the impact such future laws, regulations and standards, or amendments to or re-interpretations of existing laws and regulations, industry standards, or other obligations may have on our business. New laws, amendments to or re-interpretations of existing laws and regulations, industry standards, and contractual and other obligations may require us to incur additional costs and restrict our business operations. As these legal regimes relating to privacy, data protection, and information security continue to evolve, they may result in ever-increasing public scrutiny and escalating levels of enforcement and sanctions. Furthermore, because the interpretation and application of laws, standards, contractual obligations and other obligations relating to privacy, data protection, and information security are uncertain, these laws, standards, and contractual and other obligations may be interpreted and applied in a manner that is, or is alleged to be, inconsistent with our data management practices, our policies or procedures, or the features of our solutions. If so, in addition to the possibility of fines, lawsuits, and other claims, we could be required to fundamentally change our business activities and practices or modify our solutions, which could have an adverse effect on our business. We may be unable to make such changes and modifications in a commercially reasonable manner or at all, and our ability to fulfill existing obligations, make enhancements, or develop new solutions and features could be limited. Furthermore, the costs of compliance with, and other burdens imposed by, the laws, regulations, and policies that are applicable to the businesses of our customers may limit the use and adoption of, and reduce the overall demand for, our solutions.

These existing and proposed laws and regulations can be costly to comply with and can make our solutions and services less effective or valuable, delay or impede the development of new products, result in negative publicity, increase our operating costs, require us to modify our data handling practices, limit our operations, impose substantial fines and penalties, require significant management time and attention, or put our data or technology at risk. Any failure or perceived failure by us or our solutions to comply with U.S., or applicable foreign laws, regulations, directives, policies, industry standards, or legal obligations relating to privacy, data protection, or information security, or any security incident that results in loss of or the unauthorized access to, or acquisition, use, release, or transfer of, personal information, personal data, or other customer or sensitive data sensitive data or information may result in governmental investigations, inquiries, enforcement actions and prosecutions, private claims and litigation, indemnification or other contractual obligations, other remedies, including fines or demands that we modify or cease existing business practices, or adverse publicity, and related costs and liabilities, which could significantly and adversely affect our business and results of operations.

Changes in accounting principles or their application to us could result in unfavorable accounting charges or effects, which could adversely affect our results of operations and growth prospects.

We prepare consolidated financial statements in accordance with U.S. generally accepted accounting principles ("GAAP"). In particular, we make certain estimates and assumptions related to the adoption and interpretation of these principles including the recognition of our revenue and the accounting of our stock-based compensation expense with respect to our consolidated financial statements. If these assumptions turn out to be incorrect, our revenue or our stock-based compensation expense could materially differ from our expectations, which could have a material adverse effect on our financial results. A change in any of these principles or guidance, or in their interpretations or application to us, may have a significant effect on our reported results, as well as our processes and related controls, and may retroactively affect previously reported results or our forecasts, which may negatively impact our financial statements. For example, recent new standards issued by the Financial Accounting Standards Board could materially impact our consolidated financial statements. The adoption of these new standards may potentially require enhancements or changes in our processes or systems and may require significant time and cost on behalf of our financial management. This may in turn adversely affect our results of operations and growth prospects.

If our judgments or estimates relating to our critical accounting policies are based on assumptions that change or prove to be incorrect, our results of operations could fall below expectations of securities analysts and investors, resulting in a decline in our stock price.

The preparation of our consolidated financial statements in conformity with GAAP requires management to make judgments, estimates, and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets, liabilities, and equity, and the amount of revenue and expenses that are not readily apparent from other sources. Our results of operations may be adversely affected if our assumptions change or if actual circumstances differ from those in our assumptions, which could cause our results of operations to fall below the expectations of securities analysts and investors, resulting in a decline in the trading price of our common stock. Significant judgments, estimates, and assumptions used in preparing our consolidated financial statements include, or may in the future include, those related to revenue recognition, stock-based compensation, common stock valuations, and income taxes.

A novel strain of coronavirus, COVID-19, may adversely affect our future business operations, financial condition and our ability to execute on business or contract opportunities.

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

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 $110.2 million and $107.4 million in cash dividends as of September 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 September 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
10.1	Membership Interest Purchase Agreement, dated October 5, 2020 (Incorporated by reference to Exhibit 99.1 filed with the Company's Current Report on Form 8-K on October 6, 2020)
10.2*	Amended Voting and Support Agreement, dated October 19, 2020
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

* 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"

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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: November 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: November 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: November 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 September 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: November 13, 2020

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

Date: November 13, 2020

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

Exhibit 10.2

AMENDED VOTING AND SUPPORT AGREEMENT

This AMENDED VOTING AND SUPPORT AGREEMENT (this "**Agreement**") is entered into as of October 19, 2020, by and among Telos Corporation, a Maryland corporation (the "**Company**"), and the undersigned holders (individually, a "**Preferred Stockholder**" and, collectively, the "**Preferred Stockholders**") of shares of the 12% Cumulative Exchangeable Redeemable Preferred Stock of the Company.

WHEREAS, as of the date of this Agreement, the Preferred Stockholders own the number of shares of 12% Cumulative Exchangeable Redeemable Preferred Stock, par value $0.01 per share (the "**Public Preferred Stock**"), of the Company, set forth on Exhibit A;

WHEREAS, prior to the date of this Agreement, the Company and certain holders of the Public Preferred Stock, were engaged in litigation in which it was claimed, among other things, that the Company breached its obligations to pay dividends on or to redeem the Public Preferred Stock;

WHEREAS, there currently is limited liquidity in the trading of the Public Preferred Stock, which trades at a substantial discount to its redemption value;

WHEREAS, there have been disputes as to the redemption value of the Public Preferred Stock between certain holders of the Public Preferred Stock and the Company;

WHEREAS, certain holders of the Public Preferred Stock, including the Preferred Stockholders, desire that the Company acknowledge the redemption value as of a recent date and undertake some action that may ultimately allow the holders of the Public Preferred Stock to liquidate all or a portion of their investment in the Public Preferred Stock;

WHEREAS, in order to address the foregoing concerns related to the Public Preferred Stock and certain other matters, the Board of Directors of the Company (the "**Board**") has declared advisable certain amendments to the charter of the Company, in the form of the Second Articles of Amendment and Restatement attached hereto as Exhibit B (the "**Amendments**"), which include amendments to the terms of the Public Preferred Stock, and directed that the Amendments be submitted for approval to the stockholders of the Company; and

WHEREAS, as a condition to the willingness of the Company to engage in a Consent Solicitation (as defined below) and to undertake certain other actions in furtherance of the Amendments, and as a condition to the consummation of the same, the Preferred Stockholders have agreed, to enter into this Agreement.

NOW, THEREFORE, in consideration of the foregoing and the mutual premises, representations, warranties, covenants and agreements contained in this Agreement, the parties, intending to be legally bound, hereby agree as follows:

ARTICLE 1
DEFINITIONS

Section 1.1 **Defined Terms**. For purposes of this Agreement, the following terms in all of their tenses, cases, and correlative forms shall have the meanings assigned to them in this Section 1.1. In addition, terms which are capitalized and defined elsewhere in this Agreement shall have the meanings given to them where they are so defined.

"**Affiliate**" shall mean, with respect to any Person, another Person who directly or indirectly through one or more intermediaries controls or is controlled by or is under common control with such Person. The term "control" as used herein (including the terms "controlling," "controlled by," and "under common control with") means the possession, direct or indirect, of the power to: (a) vote ten percent (10%) or more of the outstanding voting interests of such Person; or (b) otherwise direct the management policies of such Person by contract or otherwise.

"**Consent Solicitation**" shall mean the Company's solicitation of consents to approve the Amendments pursuant to a definitive Consent Solicitation Statement on SEC Schedule 14A.

"**Constructive Sale**" shall mean, with respect to any Owned Shares, a short sale with respect to such Owned Shares, entering into or acquiring an offsetting derivative contract with respect to such Owned Shares, entering into or acquiring a future or forward contract to deliver such Owned Shares, or entering into any other hedging or other derivative transaction that has the effect of either directly or indirectly materially changing the economic benefits or risks of ownership of such Owned Shares.

"**Exchange Act**" shall mean Securities Exchange Act of 1934, as amended.

"**Owned**" shall mean direct or indirect ownership, beneficial ownership (within the meaning of the Exchange Act) or any right to acquire ownership or beneficial ownership.

"**Owned Shares**" shall mean all of the shares of Public Preferred Stock and other equity securities of the Company that are Owned by the Preferred Stockholders as of the date of this Agreement, together with any other equity securities of the Company where the power to dispose of or the voting power over which is acquired by any Preferred Stockholder during the period from and including the date hereof through and including the expiration of the Voting Period.

"**Permitted Transfer**" shall mean, in each case, with respect to any Preferred Stockholder, so long as (i) such Transfer is in accordance with applicable law and (ii) any Preferred Stockholder is, and at all times has been, in compliance with this Agreement, any (A) Transfer of Owned Shares by any Preferred Stockholder to an Affiliate of such Preferred Stockholder, so long as such Affiliate, in connection with, and prior to, such Transfer, executes a joinder to this Agreement, in form and substance reasonably acceptable to the Company, pursuant to which such Affiliate agrees to become a party to this Agreement for all purposes and be subject to the restrictions and obligations applicable to such Preferred Stockholder, or (B) any Transfer of Owned Shares to a bona fide financial institution (a "**Pledgee**") pursuant to a bona fide margin loan, pledge agreement or other similar agreement (a "**Pledging Agreement**") with such Pledgee to secure any obligations of such Preferred Stockholder or its Affiliates under such financing arrangements, the foreclosure by such Pledgee on pledged Owned Shares and the subsequent Transfer thereof by such financial institution ("**Pledging Activity**"); provided, that in connection with any Pledging Activity, prior to such foreclosure or Transfer such Pledgee shall execute a joinder to this Agreement, in form and substance reasonably acceptable to the Company, pursuant to which such Pledgee agrees to be subject to the voting obligations set forth in Section 2.1 of this Agreement with respect to the Owned Shares so foreclosed on or Transferred; provided, that notwithstanding the foregoing, other than in the case of a foreclosure and resulting Transfer, no such Transfer pursuant to clauses (A) or (B) shall relieve the transferring Preferred Stockholder from its obligations under this Agreement and, in the case of clause (B), the sole right to vote such Owned Shares shall remain with Preferred Stockholder absent a foreclosure by a Pledgee.

"**Person**" shall mean any individual, partnership, corporation, governmental entity, limited liability company, other liability limiting entity, unincorporated association, trust or estate.

“**Securities Act**” shall mean Securities Act of 1933, as amended.

“**Stockholder Meeting**” shall mean a duly called and noticed meeting of the holders of the Public Preferred Stock.

“**Transfer**” shall mean, with respect to any Owned Shares, the direct or indirect assignment, sale, transfer, tender, pledge, hypothecation, or the grant, creation or suffrage of a lien upon, or the gift, placement in trust, or the Constructive Sale or other disposition of such Owned Shares (including transfers by testamentary or intestate succession or otherwise by operation of law) or any right, title or interest therein (including any right or power to vote to which the holder thereof may be entitled, whether such right or power is granted by proxy or otherwise), or any change in the record or beneficial ownership of such Owned Shares, and any agreement, arrangement or understanding, whether or not in writing, to effect any of the foregoing.

“**Voting Period**” shall mean the period from and including the date of this Agreement through and including the Termination Date (defined below).

ARTICLE 2
VOTING AGREEMENT AND IRREVOCABLE PROXY

Section 2.1 **<u>Agreement to Vote</u>**.

(a) In the event the Board or a duly appointed officer of the Company shall call a Stockholder Meeting for the purpose of voting on a proposal or proposals to approve one or any of the Company Stockholder Matters (defined below), each of the Preferred Stockholders irrevocably, unconditionally and individually agrees with the Company that it shall, or shall cause the holder of record of the Owned Shares on each record date relevant to such a stockholder vote with respect to such Company Stockholder Matters to, appear at such meeting in person or represented by a duly executed and non-revoked proxy or otherwise cause the Owned Shares that are eligible to be voted at such stockholder meeting to be counted as present thereat for purposes of establishing a quorum at such meeting.

(b) Each of the Preferred Stockholders irrevocably, unconditionally and individually agrees with the Company, in connection with the consummation of any Consent Solicitation and when solicited, with respect to the Amendments, to consent to a proposal or proposals to the adoption and approval of the Amendments within two (2) business days after the commencement of the Consent Solicitation in accordance with the terms of any information or proxy statement pertaining to the Consent Solicitation, and not withdraw or revoke (or cause not to be withdrawn or revoked) consent to the Amendments unless and until this Agreement is terminated in accordance with its terms.

(c) In connection with a Stockholder Meeting or Consent Solicitation, each of the Preferred Stockholders further irrevocably, unconditionally and individually agrees with the Company to vote (whether by ballot at a meeting, by proxy or by executing and returning a stockholder consent), or cause its nominee holder of record on any applicable record date to vote, all of the Owned Shares as follows:

(i) If the Company presents to its stockholders for approval a proposal or proposals that they approve the following (the “**Company Stockholder Matters**”), in favor of the approval of such matters: the approval of the Amendments;

(ii) In favor of the approval of any other matter contemplated by the Amendments necessary or advisable to consummate the Amendments and the other transactions contemplated thereby that is presented by the Company for a vote of its stockholders (including any motion by the chairman of the stockholder meeting to adjourn, reconvene, recess or otherwise postpone such meeting) ; and

(iii) Against any proposals or actions that would: (A) constitute, or could reasonably be expected to result in, a breach of any covenant, representation or warranty or any other obligation or agreement of the Company or of the Preferred Stockholders under this Agreement and (B) reasonably be expected to prevent, impede, frustrate, interfere with, delay, postpone or adversely affect the Amendments or any of the other transactions contemplated thereby.

(d) Any vote required to be cast or consent required to be executed pursuant to this Section 2.1 shall be cast or executed in accordance with the applicable procedures relating thereto so as to ensure that the Owned Shares are duly counted for purposes of determining that a quorum is present (if applicable) and for purposes of recording the results of that vote or consent.

(e) Prior to the expiration of the Voting Period, each of the Preferred Stockholders individually covenants not to enter into any understanding or agreement with any Person to vote, consent or give instructions with respect to the Owned Shares in any manner inconsistent with this Section 2.1.

ARTICLE 3
COVENANTS

Section 3.1 **Voting Period Restrictions**. Each of the Preferred Stockholders agrees that it shall not, during the Voting Period, cause or permit any Transfer of any or all of the Owned Shares or any interest therein, or any economic or voting rights with respect thereto (including any rights decoupled from the underlying securities) or enter into any contract, option or other arrangement or understanding with respect thereto (including any voting trust or agreement and the granting of any proxy), other than (a) a Permitted Transfer or (b) with the prior written consent of the Company.

Section 3.2 **General Covenants**. Each of the Preferred Stockholders agrees that during the Voting Period such Preferred Stockholder and its Affiliates shall not: (a) enter into any agreement, commitment, letter of intent, agreement in principle, or understanding with any person or take any other action that violates or conflicts with or would reasonably be expected to violate or conflict with, or result in or give rise to a violation of or conflict with, each of the Preferred Stockholder’s representations, warranties, covenants and obligations under this Agreement; or (b) take any action that could restrict or otherwise affect each of the Preferred Stockholders’ legal power, authority and right to comply with and perform the covenants and obligations under this Agreement.

Section 3.3 **Stop Transfer; Changes in Owned Shares**. Each of the Preferred Stockholders agrees that during the Voting Period (a) this Agreement and the obligations hereunder shall attach to its Owned Shares and shall be binding upon any Person to which legal or beneficial ownership of such Owned Shares shall pass, whether by operation of law or otherwise, including its successors or assigns and (b) other than as permitted by this Agreement, each of the Preferred Stockholders shall not request that the Company register the Transfer (by book-entry or otherwise) of any certificate or uncertificated interest representing any or all of its Owned Shares. Notwithstanding any Transfer, each of the Preferred Stockholders shall remain liable for the performance of all of its obligations under this Agreement.

Section 3.4 **Public Statements**. Each of the Preferred Stockholders agrees that it will not issue or make any public statement with respect to this Agreement, the Amendments or any underwritten public offering of shares of stock of the Company without the prior consent of Company, except as may be required by law; provided that if any of the Preferred Stockholders proposes to issue any public statement in compliance with any legally-required disclosure obligations, it shall use commercially reasonable efforts to consult in good faith with the Company before doing so.

Section 3.5 **<u>Further Assurances</u>**. From time to time and without additional consideration, each party hereto shall take such further actions, as another party hereto may reasonably request for the purpose of carrying out and furthering the intent of this Agreement.

ARTICLE 4
REPRESENTATIONS AND WARRANTIES OF STOCKHOLDER

Each of the Preferred Stockholders hereby represents and warrants to the Company as follows:

Section 4.1 **<u>Authority Relative to Agreement; No Conflict</u>**.

(a) Each of the Preferred Stockholders has all necessary corporate power and authority to execute and deliver this Agreement and to perform its obligations hereunder. The execution, delivery and performance of this Agreement by each of the Preferred Stockholders has been duly and validly authorized by all necessary corporate action, and no other corporate action or proceeding on the part of any of the Preferred Stockholders is necessary to authorize the execution, delivery and performance of this Agreement. This Agreement has been duly executed and delivered by each of the Preferred Stockholders and, assuming due authorization, execution and delivery of this Agreement by the other parties hereto, constitutes a legal, valid and binding obligation of each of the Preferred Stockholders, enforceable against each of the Preferred Stockholders in accordance with its terms, except that (i) such enforcement may be subject to applicable bankruptcy, insolvency, reorganization, moratorium or other similar laws, now or hereafter in effect, affecting creditors' rights and remedies generally and (ii) the remedies of specific performance and injunctive and other forms of equitable relief may be subject to equitable defenses and to the discretion of the court before which any proceeding therefor may be brought (collectively, the "**Bankruptcy and Equity Exception**").

(b) Neither the execution and delivery of this Agreement by any of the Preferred Stockholders nor the performance by any of the Preferred Stockholders of its obligations hereunder will (i) conflict with or violate any law applicable to any of the Preferred Stockholders or any of their respective subsidiaries or by which any property or asset of any of the Preferred Stockholders or any of their respective subsidiaries is bound or affected (including the Owned Shares), or (ii) result in any breach of, or constitute a default (with or without notice or lapse of time, or both) under, or give rise to any right of termination, acceleration or cancellation of, require the consent, or notice to or filing with any third party pursuant to, any mortgage, bond, indenture, agreement, instrument or obligation to which any of the Preferred Stockholders or any of their respective subsidiaries is a party or by which any property or asset of any of the Preferred Stockholders or any of their respective subsidiaries is bound or affected (including the Owned Shares), or result in the creation of any lien, upon any of the property or assets of any of the Preferred Stockholders or any of their respective subsidiaries (including the Owned Shares), except for any of the foregoing as would not impair any of the Preferred Stockholders' ability to perform its obligations under this Agreement.

(c) Stockholder has not entered into any understanding or agreement with any Person to vote or give instructions with respect to the Owned Shares in any manner inconsistent with <u>Section 2.1</u> of this Agreement.

Section 4.2 **<u>Ownership of Shares</u>**. As of the date hereof, the Owned Shares of each of the Preferred Stockholders are listed on <u>Exhibit A</u>. Except as described in any Schedule 13D or 13G filed by any of the Preferred Stockholders with the U.S. Securities Exchange Commission ("**SEC**") on or prior to the date hereof, or as otherwise disclosed to the Company in writing on or prior to the date hereof, each of the Preferred Stockholders is the sole record and beneficial owner and has good, valid and marketable title to, all of the Owned Shares and has the sole power to vote (or cause to be voted) and to dispose of (or cause to be disposed of) such Owned Shares without restriction and no proxies through and including the date hereof have been given in respect of any or all of such Owned Shares other than proxies which have been validly revoked prior to the date hereof.

Section 4.3 **<u>Required Filings and Consents</u>**. No consent of, or registration, declaration or filing with, or notice to, any governmental authority is required to be obtained or made by or with respect to any of the Preferred Stockholders or any of their respective subsidiaries in connection with the execution, delivery and performance of this Agreement, other than (a) applicable requirements of and filings with the SEC under the Securities Act and/or the Exchange Act and (b) such other consents, registrations, declarations, filings or notices the failure of which to be obtained or made would not impair any of the Preferred Stockholders' ability to perform its obligations under this Agreement.

Section 4.4 **<u>Actions and Proceedings</u>**. As of the date of this Agreement, (a) there is no action, suit, arbitration, investigation, examination, litigation, lawsuit or other proceeding, whether civil, criminal or administrative (each, a "**Proceeding**"), pending or, to the knowledge of each of the Preferred Stockholders, as applicable, threatened against such Preferred Stockholder or any of its Affiliates and (b) there is no judgement or order of any governmental authority outstanding against, or, to the knowledge of each of the Preferred Stockholders, as applicable, investigation by any governmental authority involving, such Preferred Stockholder or any of its subsidiaries that, in each case of clause (a) and (b), would reasonably be expected to prevent, materially delay, hinder, impair or prevent the exercise by the Company of its rights under this Agreement or the performance by any of the Preferred Stockholders of their respective obligations under this Agreement.

Section 4.5 **<u>Acknowledgement</u>**. Each of the Preferred Stockholders understands and acknowledges that the Company is undertaking the Amendments in reliance upon the Preferred Stockholders' execution, delivery and performance of this Agreement and the covenants, representations and warranties contained herein.

ARTICLE 5
REPRESENTATIONS AND WARRANTIES OF THE COMPANY

The Company hereby represents and warrants to the Preferred Stockholders as follows:

Section 5.1 **<u>Authority Relative to Agreement; No Conflict</u>.**

(a) The Company has all necessary corporate power and authority to execute and deliver this Agreement and to perform its obligations hereunder. The execution, delivery and performance of this Agreement by the Company has been duly and validly authorized by all necessary corporate action by the Company, and no other corporate action or proceeding on the part of the Company is necessary to authorize the execution, delivery and performance of this Agreement by the Company. This Agreement has been duly executed and delivered by the Company and, assuming due authorization, execution and delivery of this Agreement by the other parties hereto, constitutes a legal, valid and binding obligation of the Company, enforceable against the Company in accordance with its terms, except that such enforcement may be subject to the Bankruptcy and Equity Exception.

(b) Neither the execution and delivery of this Agreement by the Company nor the performance by the Company of its obligations hereunder will (i) conflict with or violate any law applicable to the Company or any of its subsidiaries or by which any property or asset of the Company or any of its subsidiaries is bound or affected, or (ii) result in any breach of, or constitute a default (with or without notice or lapse of time, or both) under, or give rise to any right of termination, acceleration or cancellation of, require the consent, or notice to or filing with any third party pursuant to, any mortgage, bond, indenture, agreement, instrument or obligation to which the Company or any of its subsidiaries is a party or by which any property or asset of the Company or any of its subsidiaries is bound or affected, or result in the creation of a lien, upon any of the property or assets of the Company or any of its subsidiaries, except for any of the foregoing as would not impair the Company's ability to perform its obligations under this Agreement.

Section 5.2 **Required Filings and Consents**. No consent of, or registration, declaration or filing with, or notice to, any governmental authority is required to be obtained or made by or with respect to the Company or any of its subsidiaries in connection with the execution, delivery and performance of this Agreement, other than (a) applicable requirements of and filings with the SEC under the Securities Act and/or the Exchange Act and (b) such other consents, registrations, declarations, filings or notices the failure of which to be obtained or made would not impair the Company's ability to perform its obligations under this Agreement.

ARTICLE 6
TERMINATION

Section 6.1 **Termination**. This Agreement and all obligations of the parties hereunder shall automatically terminate upon the earliest of: (a) the public announcement by the Company that it will abandon either the Amendments or the Qualified IPO (as defined in the Amendments); (b) the failure of the Company to obtain the needed approval of the Amendments on or before November 16, 2020; or (c) the acceptance for record of the Amendments by the Department of Assessments and Taxation for the State of Maryland (as applicable, the "**Termination Date**"). Upon the termination of this Agreement, neither the Company nor any of the Preferred Stockholders shall have any rights or obligations hereunder and this Agreement shall become null and void and have no effect; provided, that Sections 7.1, and 7.3 through 7.14 shall survive such termination. Notwithstanding the foregoing, termination of this Agreement shall not prevent any party from seeking any remedies (at law or in equity) against any other party for that party's breach of any of the terms of this Agreement prior to the date of termination.

ARTICLE 7
MISCELLANEOUS

Section 7.1 **Publication**. The Preferred Stockholders hereby permit and authorize the Company to publish and disclose in press releases, proxy or information statements filed with the SEC, any current report of the Company on Form 8-K and any other disclosures or filings required by applicable law, the Preferred Stockholders' identity and ownership of the Owned Shares, the nature of the Preferred Stockholders' commitments, arrangements and understandings pursuant to this Agreement and/or the text of this Agreement. To the extent practicable and legally permissible, an advance copy of any such filing will be provided to the Preferred Stockholders.

Section 7.2 **Amendment**. Subject to applicable law, the parties hereto may modify or amend this Agreement, by written agreement executed and delivered by the duly authorized officers of each of the respective parties; provided that no amendment shall be made to this Agreement after the Termination Date.

Section 7.3 **Specific Performance**. The parties agree that irreparable damage for which monetary damages, even if available, would not be an adequate remedy, would occur in the event that any party hereto does not perform the provisions of this Agreement (including failing to take such actions as are required of it hereunder to consummate this Agreement) in accordance with its specified terms or otherwise breach such provisions. Accordingly, the parties acknowledge and agree that the parties shall be entitled to an injunction, specific performance and other equitable relief to prevent breaches of this Agreement and to enforce specifically the terms and provisions hereof (without proof of actual damages), in addition to any other remedy to which they are entitled at law or in equity. Each of the parties agrees that it will not oppose the granting of an injunction, specific performance and other equitable relief on the basis that any other party has an adequate remedy at law or that any award of specific performance is not an appropriate remedy for any reason at law or in equity. Any party seeking an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions of this Agreement shall not be required to provide any bond or other security in connection with any such order or injunction.

Section 7.4 **Notices**. All notices, consents and other communications hereunder shall be in writing and shall be given (and shall be deemed to have been duly given upon receipt) by hand delivery, by prepaid overnight courier (providing written proof of delivery) or by confirmed electronic mail, addressed as follows:

(a) If to the Company:

Telos Corporation
19886 Ashburn Road
Ashburn, Virginia 20147
Email: jvw@telos.com
Attention: Jefferson V. Wright

with a copy (which shall not constitute notice) to:

Miles & Stockbridge P.C.
100 Light Street
Baltimore, Maryland 21202
Email: cjohnson@mslaw.com
Attention: Christopher R. Johnson

(b) If to any of the Preferred Stockholders:

Wynnefield Capital Management, LLC
450 Seventh Avenue, Suite 509
New York, NY 10123
Email: nobus@wynnefieldcapital.com
Attention: Nelson Obus

with a copy (which shall not constitute notice) to:

Whiteford, Taylor & Preston LLP
7 St. Paul Street
Baltimore, Maryland 21202-1626
Email: fjones@wtplaw.com
Attention: Frank S. Jones, Jr.

or to such other address or electronic mail address for a party as shall be specified in a notice given in accordance with this Section 7.4; provided that any notice received by electronic mail or otherwise at the addressee's location on any business day after 5:00 p.m. (addressee's local time) or on any day that is not a business day shall be deemed to have been received at 9:00 a.m. (addressee's local time) on the next business day; provided, further, that notice of any change to the address or any of the other details specified in or pursuant to this Section 7.4 shall not be deemed to have been received until, and shall be deemed to have been received upon, the later of the date specified in such notice or the date that is five (5) business days after such notice would otherwise be deemed to have been received pursuant to this Section 7.4.

Section 7.5 **Headings; Titles**. Headings and titles of the Articles and Sections of this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement.

Section 7.6 **Severability**. If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction or other authority to be invalid, void, unenforceable or against its regulatory policy, the remainder of the terms, provisions, covenants and restrictions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the parties hereto shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in a mutually acceptable manner in order that the transactions contemplated hereby shall be consummated as originally contemplated to the fullest extent possible.

Section 7.7 **Entire Agreement**. This Agreement constitutes the entire agreement, and supersedes all other prior agreements and understandings, both written and oral, among the parties, or any of them, with respect to the subject matter hereof.

Section 7.8 **Assignment**. Except as expressly permitted by the terms hereof, neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned by any of the parties hereto (whether by operation of law or otherwise) without the prior written consent of the other parties. Subject to the preceding sentence, this Agreement will be binding upon, inure to the benefit of and be enforceable by the parties and their respective permitted successors and assigns. Any attempted assignment in violation of this Section 7.8 shall be null and void.

Section 7.9 **No Third Party Beneficiaries; Enforcement**. This Agreement is not intended to and shall not confer upon any person other than the parties hereto and their respective successors and permitted assigns any rights or remedies hereunder.

Section 7.10 **Interpretation**. The parties have participated collectively in the negotiation and drafting of this Agreement. In the event an ambiguity or question of intent or interpretation arises, this Agreement shall be construed as if drafted collectively by the parties, and no presumption or burden of proof shall arise favoring or disfavoring any party by virtue of the authorship of any provisions of this Agreement. References to any statute shall be deemed to refer to such statute, as amended, and to any rules or regulations promulgated thereunder, in each case, as of such date.

Section 7.11 **Governing Law; Jurisdiction; Waiver of Jury Trial**. This Agreement shall be governed and construed in accordance with the laws of the State of Maryland applicable to contracts made and performed entirely within such state, without regard to any applicable conflicts of law principles that would cause the application of the laws of another jurisdiction. The parties hereto agree that any Proceeding brought by any party to enforce any provision of, or based on any matter arising out of or in connection with, this Agreement or the transactions contemplated hereby shall be brought in the Circuit Court for Montgomery County, Maryland, or if jurisdiction over the matter is vested exclusively in federal courts, the United States District Court for the District of Maryland, and the appellate courts to which orders and judgments therefore may be appealed (collectively, the "**Acceptable Courts**"). In any such judicial proceeding, each of the parties further consents to the assignment of any proceeding in the Circuit Court for Montgomery County, Maryland to the Business and Technology Case Management Program pursuant to Maryland Rule 16-205 (or any successor thereof). Each of the parties hereto submits to the jurisdiction of any Acceptable Court in any Proceeding seeking to enforce any provision of, or based on any matter arising out of or in connection with, this Agreement or the transactions contemplated hereby, and hereby irrevocably waives the benefit of jurisdiction derived from present or future domicile or otherwise in such Proceeding. Each party hereto irrevocably waives, to the fullest extent permitted by law, any objection that it may now or hereafter have to the laying of the venue of any Proceeding in any such Acceptable Court or that any such Proceeding brought in any such Acceptable Court has been brought in an inconvenient forum. EACH PARTY HERETO ACKNOWLEDGES AND AGREES THAT ANY CONTROVERSY WHICH MAY ARISE UNDER THIS AGREEMENT IS LIKELY TO INVOLVE COMPLICATED AND DIFFICULT ISSUES, AND THEREFORE EACH SUCH PARTY HEREBY IRREVOCABLY AND UNCONDITIONALLY WAIVES ANY AND ALL RIGHT TO TRIAL BY JURY IN ANY LEGAL PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT AND THE TRANSACTIONS CONTEMPLATED HEREBY. Each party hereto (a) certifies that no representative of any other party has represented, expressly or otherwise, that such other party would not, in the event of any action, suit or proceeding, seek to enforce the foregoing waiver, (b) certifies that it makes this waiver voluntarily and (c) acknowledges that it and the other parties hereto have been induced to enter into this Agreement, by, among other things, the mutual waiver and certifications in this Section 7.11.

Section 7.12 **Counterparts**. This Agreement may be executed in multiple counterparts, all of which shall together be considered one and the same agreement. Delivery of an executed signature page to this Agreement by electronic transmission shall be as effective as delivery of a manually signed counterpart of this Agreement.

Section 7.13 **Waiver**. Except as provided in this Agreement, no action taken pursuant to this Agreement, including any investigation by or on behalf of any party, shall be deemed to constitute a waiver by the party taking such action of any other party's obligations to comply with its representations, warranties, covenants and agreements contained in this Agreement. The waiver by any party hereto of a breach of any provision hereunder (or any delay in asserting any such breach) shall not operate or be construed as a waiver of any prior or subsequent breach of the same or any other provision hereunder or in any other context.

Section 7.14 **No Ownership Interest**. Nothing contained in this Agreement shall be deemed to vest in the Company any direct or indirect ownership or incidence of ownership of, or with respect to, any Owned Shares. All rights, ownership and economic benefits of and relating to the Owned Shares shall remain vested in and belong to the Preferred Stockholders, and this Agreement shall not confer any right, power or authority upon the Company or any other Person to direct the Preferred Stockholders (a) in the voting of any of the Owned Shares, except as otherwise specifically provided herein, or (b) in the performance of any of the Preferred Stockholders' duties or responsibilities as stockholders of the Company.

[Signature page follows]

IN WITNESS WHEREOF, the Company and the Preferred Stockholders have caused this Agreement to be duly executed as of the day and year first above written.

<u>COMPANY</u>:

TELOS CORPORATION

By: /s/ Jerfferson V. Wright
Name: Jefferson V. Wright
Title: Executive V.P. & General Counsel

IN WITNESS WHEREOF, the Company and the Preferred Stockholders have caused this Agreement to be duly executed as of the day and year first above written.

PREFERRED STOCKHOLDERS:

WYNNEFIELD PARTNERS SMALL CAP VALUE, L.P.
By: Wynnefield Capital Management, LLC, its General Partner

By: /s/ Nelson Obus
Name: Nelson Obus
Title: Co-Managing Member

By: /s/ Joshua H. Landes
Name: Joshua H. Landes
Title: Co-Managing Member

WYNNEFIELD PARTNERS SMALL CAP VALUE L.P. I
By: Wynnefield Capital Management, LLC, its General Partner

By: /s/ Nelson Obus
Name: Nelson Obus
Title: Co-Managing Member

By: /s/ Joshua H. Landes
Name: Joshua H. Landes
Title: Co-Managing Member

WYNNEFIELD CAPITAL, INC. PROFIT SHARING PLAN
By: Wynnefield Capital, Inc.

By: /s/ Nelson Obus
Name: Nelson Obus

WYNNEFIELD SMALL CAP VALUE OFFSHORE FUND, LTD.
By: Wynnefield Capital, Inc.

By: /s/ Nelson Obus
Name: Nelson Obus

MINERVA ADVISORS LLC

By: /s/ David P. Cohen
David P. Cohen, President

MINERVA GROUP, LP

By: MINERVA GP, LP, its General Partner

By: MINERVA GP, INC., its General Partner

By: /s/ David P. Cohen
David P. Cohen, President

MINERVA GP, LP

By: MINERVA GP, INC., its General Partner

By: /s/ David P. Cohen
David P. Cohen, President

MINERVA GP, INC.

By: /s/ David P. Cohen
David P. Cohen, President

/s/ David P. Cohen
David P. Cohen

VICTOR A. MORGENSTERN GRANTOR RETAINED ANNUITY TRUST 2020 #2

By: /s/ Victor Morgenstern
Name: Victor Morgenstern
Title: Trustee

JUDD MORGENSTERN REVOCABLE TRUST

By: /s/ Judd Morgenstern
Name: Judd Morgenstern
Title: Trustee

JENNIFER MORGENSTERN IRREVOCABLE TRUST

By: /s/ Jennifer Morgenstern
Name: Jennifer Morgenstern
Title: Trustee

ROBYN MORGENSTERN IRREVOCABLE TRUST

By: /s/ Robyn Morgenstern
Name: Robyn Morgenstern
Title: Trustee

JUDD MORGENSTERN IRREVOCABLE TRUST

By: /s/ Judd Morgenstern
Name: Judd Morgenstern
Title: Trustee

VICTOR A. MORGENSTERN GRANDCHILDREN TRUST

By: /s/ Faye Morgenstern
Name: Faye Morgenstern
Title: Trustee

By: /s/ Antonio Gracias
Name: Antonio Gracias
Title: Trustee

/s/ Victor Morgenstern (SEAL)
Victor Morgenstern

/s/ Faye Morgentern (SEAL)
Faye Morgenstern

/s/ Judd Morgenstern (SEAL)
Judd Morgenstern

/s/ Jennifer Morgenstern (SEAL)
Jennifer Morgenstern

/s/ Robyn Morgenstern (SEAL)
Robyn Morgenstern

/s/ Antonio Gracias (SEAL)
Antonio Gracias

/s/ Gary Levenstein (SEAL)

Gary Levenstein

EXHIBIT A

OWNED SHARES

Wynnefield Preferred Stockholders	**No. of Owned Shares**
Wynnefield Partners Small Cap Value, L.P.;	165,760
Wynnefield Partners Small Cap Value L.P. I;	261,456
Wynnefield Capital, Inc. Profit Sharing Plan;	15,000
Wynnefield Small Cap Value Offshore Fund, Ltd.	112,549
TOTAL	554,765

Minerva Preferred Stockholder	**No. of Owned Shares**
Minerva Advisors, LLC	122,608
Minerva Group, LP	153,343
David P. Cohen	7,433
TOTAL	283,384

Morgenstern Preferred Stockholders	**No. of Owned Shares**
Victor A. Morgenstern Grantor Retained Annuity Trust 2020 #2	67,000
Judd Morgenstern Revocable Trust	40,000
Jennifer Morgenstern Irrevocable Trust	20,000
Robyn Morgenstern Irrevocable Trust	20,000
Judd Morgenstern Irrevocable Trust	20,000
Victor A. Morgenstern Grandchildren Trust	13,100
TOTAL:	180,100

EXHIBIT B

SECOND ARTICLES OF AMENDMENT AND RESTATEMENT

[Attached]

TELOS CORPORATION

SECOND ARTICLES OF AMENDMENT AND RESTATEMENT

FIRST: Telos Corporation, a Maryland corporation (the "Corporation"), desires to amend and restate its charter as currently in effect and as hereinafter amended.

SECOND: Upon the filing (the "Effective Time") of these Second Articles of Amendment and Restatement, each share of the Class B Common Stock, no par value per share, of the Corporation issued and outstanding immediately prior to the Effective Time (the "Class B Common Stock") shall automatically, without further action on the part of the Corporation or any holder of Class B Common Stock, be reclassified and become one fully paid and nonassessable share of Class A Common Stock, no par value per share, of the Corporation ("Class A Common Stock"). The conversion of the Class B Common Stock into Class A Common Stock will be deemed to occur at the Effective Time. From and after the Effective Time, certificates representing the Class B Common Stock shall represent the number of shares of Class A Common Stock into which such Class B Common Stock shall have been converted pursuant to these Second Articles of Amendment and Restatement.

THIRD: The Class A Common Stock shall, at the Effective Time, be renamed and redesignated as common stock, par value $0.001 per share, of the Corporation.

FOURTH: The following provisions are all the provisions of the charter of the Corporation currently in effect and as hereinafter amended:

ARTICLE I

NAME

The name of the corporation (the "Corporation") is: Telos Corporation

ARTICLE II

PURPOSE

The purposes for which the Corporation is formed are to engage in any lawful act or activity for which corporations may be organized under the general laws of the State of Maryland as now or hereafter in force.

ARTICLE III

PRINCIPAL OFFICE AND RESIDENT AGENT

The address of the principal office of the Corporation in the State of Maryland is 11 N Washington Street, Suite 700, Rockville, Maryland 20850. The name of the resident agent of the Corporation in the State of Maryland is Incorp Services, Inc., 1519 York Road, Lutherville, Maryland 21093. The resident agent is a Maryland corporation.

ARTICLE IV

PROVISIONS FOR DEFINING, LIMITING AND REGULATING CERTAIN POWERS OF THE CORPORATION AND OF THE STOCKHOLDERS AND DIRECTORS

Section 4.1 Number, Election of Directors. The business and affairs of the Corporation shall be managed under the direction of the Board of Directors. The number of directors of the Corporation is nine (9), including two (2) Class D Directors elected by holders of the Exchangeable Preferred Stock (defined below), which number may be increased or decreased only by the Board of Directors pursuant to the Bylaws of the Corporation (the "Bylaws"), but shall never be less than the minimum number required by the Maryland General Corporation Law (the "MGCL"). The names of the current directors who shall serve until their successors are duly elected and qualify are:

John B. Wood
Bernard C. Bailey
David Borland
Lt. Gen. (ret) Bruce R. Harris
Bonnie Carroll
Maj. Gen. (ret) John W. Maluda
Robert J. Marino

Class D Directors
Andrew R. Siegel
William H. Alderman

The directors (other than any director elected solely by holders of shares of one or more classes or series of Preferred Stock of the Corporation) shall be elected and serve until the next annual meeting of stockholders and, in each case, until their successors are duly elected and qualify or until their earlier death, resignation or removal. Except as may be provided by the Board of Directors in setting the terms of any class or series of Preferred Stock, and except for any vacancy among directors that may be elected by a class or series of Preferred Stock voting separately as such class or series, any and all vacancies on the Board of Directors may be filled only by the affirmative vote of a majority of the remaining directors in office, even if the remaining directors do not constitute a quorum, and any director elected to fill a vacancy shall serve for the remainder of the full term of the class in which such vacancy occurred and until a successor is duly elected and qualifies.

Section 4.2 Extraordinary Actions. Except as may be provided by the Board of Directors in setting the terms of classified or reclassified shares of stock pursuant to Section 5.3 or as specifically provided in Section 4.5 (relating to removal of directors), notwithstanding any provision of law requiring any action to be taken or approved by the affirmative vote of stockholders entitled to cast a greater number of votes, any such action shall be effective and valid if (i) declared advisable by the Board of Directors, and (ii) taken or approved by the affirmative vote of stockholders entitled to cast a majority of all the votes entitled to be cast on the matter.

Section 4.3 Authorization by Board of Stock Issuance. The Board of Directors may authorize the issuance from time to time of shares of stock of the Corporation of any class or series, whether now or hereafter authorized, or securities or rights convertible into shares of its stock of any class or series, whether now or hereafter authorized, for such consideration as the Board of Directors may deem advisable (or without consideration in the case of a stock split or stock dividend), subject to such restrictions or limitations, if any, as may be set forth in the Charter (as defined in the MGCL) of the Corporation or the Bylaws.

Section 4.4 Preemptive and Appraisal Rights. Except as may be provided by the Board of Directors in setting the terms of classified or reclassified shares of stock pursuant to Section 5.3 or as may otherwise be provided by a contract approved by the Board of Directors, no holder of shares of stock of the Corporation shall, as such holder, have any preemptive right to purchase or subscribe for any additional shares of stock of the Corporation or any other security of the Corporation which it may issue or sell. After a Qualified IPO (as defined in paragraph 7 of Section 5.4 of this Charter) and except as may be provided in Subtitle 7 of Title 3 of the MGCL, holders of shares of stock shall not be entitled to exercise any rights of an objecting stockholder provided for under Title 3, Subtitle 2 of the MGCL or any successor statute unless the Board of Directors, upon such terms and conditions as specified by the Board of Directors, shall determine that such rights apply, with respect to all or any shares of all or any classes or series of stock, to one or more transactions occurring after the date of such determination in connection with which holders of such shares would otherwise be entitled to exercise such rights.

Section 4.5 Removal of Directors. Subject to the rights of holders of one or more classes or series of stock established pursuant to Section 5.3 hereof to elect or remove one or more directors (including the rights of the holders of Exchangeable Preferred Stock to elect Class D Directors), any director, or the entire Board of Directors, may be removed from office at any time, but only by the affirmative vote of stockholders entitled to cast at least two-thirds of the votes entitled to be cast generally in the election of directors.

ARTICLE V

STOCK

Section 5.1 Authorized Shares. The Corporation has authority to issue 260,000,000 shares of stock, consisting of 250,000,000 shares of common stock, par value $0.001 per share (“Common Stock”) and 10,000,000 shares of preferred stock, par value $0.01 per share (“Preferred Stock”). The aggregate par value of all authorized shares of stock having par value is $350,000. The Board of Directors, with the approval of a majority of the entire Board and without any action by the stockholders of the Corporation, may amend the Charter from time to time to increase or decrease the aggregate number of shares of stock or the number of shares of stock of any class or series that the Corporation has authority to issue.

Section 5.2 Common Stock. Except as may otherwise be specified in the Charter, each share of Common Stock shall entitle the holder thereof to one vote. The Board of Directors may reclassify any unissued shares of Common Stock from time to time into one or more classes or series of stock.

Section 5.3 Preferred Stock. The Board of Directors may classify or reclassify any unissued shares of stock from time to time, in one or more classes or series of Preferred Stock by setting or changing the preferences, covenants or other rights, voting powers, privileges, restrictions, limitations as to dividends or other distributions, qualifications and terms and conditions of redemption for each class or series thereof.

Section 5.4 Exchangeable Preferred Stock. Under the power contained in Section 5.3, the Board of Directors classified and designated six million (6,000,000) authorized shares of Preferred Stock, par value $0.01 per share, of the Corporation as shares of 12% Cumulative Exchangeable Redeemable Preferred Stock (the “Exchangeable Preferred Stock”), par value $0.01 per share, with the following powers, preferences, rights, qualifications, limitations, restrictions and other provisions:

1. Rank. The Exchangeable Preferred Stock shall rank, with respect to dividend rights and rights on liquidation, winding up and dissolution, (a) junior to any other class or series of the Preferred Stock of the Corporation the terms of which shall specifically provide that such class or series shall rank prior to the Exchangeable Preferred Stock (any such other securities are referred to herein collectively as the “Senior Securities”), (b) on a parity with any other class or series of the Preferred Stock of the Corporation the terms of which shall specifically provide that such class or series shall rank on a parity with the Exchangeable Preferred Stock (the Exchangeable Preferred Stock and any such other securities are referred to herein collectively as the “Parity Securities”), and (c) prior to the Common Stock and any other class or series of the Preferred Stock of the Corporation the terms of which specifically provide that such class or series shall rank junior to the Exchangeable Preferred Stock (any of such other securities of the Corporation to which the Exchangeable Preferred Stock ranks prior, including the Common Stock, are referred to herein collectively as the “Junior Securities”).

2. Dividends. (a) The holders of the shares of Exchangeable Preferred Stock will be entitled to receive, when, as and if declared by the Board of Directors, out of funds legally available for the payment of dividends, cumulative dividends at the annual rate of 12% ($1.20) per share and no more. Such dividends shall be payable, in preference to dividends on the Junior Securities, in equal semi-annual payments out of funds legally available therefor (a) commencing with the first sixth-month anniversary of the first of the following to occur after the effective date (the “Effective Date”) of the merger of C3 Acquisition Corp., a Delaware corporation, with and into the Corporation (i) the fifteenth day of the month in which the Effective Date occurs or (ii) the first day of the following month, and (b) on each sixth-month anniversary thereof (each of such dates being a “Dividend Payment Date”). Such dividends shall be paid to the holders of record at the close of business on the date specified by the Board of Directors at the time such dividends are declared; provided, however, that such date shall not be more than 90 days prior to the respective Dividend Payment Date. Dividends payable on shares of Exchangeable Preferred Stock (whether payable in cash or in stock) shall be fully cumulative and shall accrue (whether or not earned or declared), without interest, from the date of issuance of the Exchangeable Preferred Stock at the Effective Date. Any dividends payable with respect to the Exchangeable Preferred Stock during the first six years after the Effective Date may be paid (subject to restrictions under applicable state law), in the sole discretion of the Board of Directors, in cash or by issuing additional fully paid and nonassessable shares of Exchangeable Preferred Stock at the rate of 0.06 of a share for each $.60 of such dividends not paid in cash, and the issuance of such additional shares shall constitute full payment of such dividends. The Corporation shall not issue fractions of Exchangeable Preferred Stock (“Fractional Shares”) in payment of any dividends. In lieu of any Fractional Shares, the Corporation will cause all Fractional Shares otherwise issuable to be aggregated and sold on the open market by an agent of the Corporation, and each holder of Exchangeable Preferred Stock otherwise entitled to receive a Fractional Share shall receive a cash payment in lieu thereof equal to such holder's proportionate interest in the net proceeds of the sale or sales of all such Fractional Shares in the open market within 20 days after the Dividend Payment Date. The Corporation’s dividend payment obligations under this paragraph 2(a) shall be discharged upon the delivery to such agent of the certificate or certificates representing shares of Exchangeable Preferred Stock equal to the aggregate of such Fractional Shares. All shares of Exchangeable Preferred Stock which may be issued as a dividend with respect to the Exchangeable Preferred Stock will thereupon be duly authorized, validly issued, fully paid and nonassessable and free of all liens and charges.

(b) All dividends paid with respect to shares of the Exchangeable Preferred Stock pursuant to paragraph 2(a) of this Section 5.4 shall be paid pro rata to the holders entitled thereto.

(c) Notwithstanding anything contained herein to the contrary, no cash dividends (other than the payment of cash in lieu of the issuance of Fractional Shares) on shares of Exchangeable Preferred Stock, the Parity Securities or the Junior Securities shall be declared by the Board of Directors and paid or set apart for payment by the Corporation at such time as the terms and provisions of any agreement regarding the borrowing of funds or the extension of credit which is binding upon the Corporation or any subsidiary of the Corporation (all such Agreements of the corporation and its subsidiaries are referred to collectively herein as the "Debt Agreements"), specifically prohibit such declaration, payment or setting apart for payment or provide that such declaration, payment or setting apart for payment would constitute a breach thereof or a default thereunder or, in the case of a Debt Agreement binding on a subsidiary of the Corporation, prohibit or restrict the payment of dividends or the making of loans to the Corporation by such subsidiary of the Corporation, prohibit or restrict the payment of dividends for the purpose of paying such dividends; provided, however, that nothing in this paragraph 2(c) shall in any way or under any circumstances be construed or deemed to require the Board of Directors to declare or the Corporation to pay or set apart for payment any cash dividends on shares of the Exchangeable Preferred Stock at any time, whether permitted by any of the Debt Agreements or not.

(d)(i) If at any time the Corporation shall have failed to pay full dividends which have accrued (whether or not declared) on any Senior Securities, no cash dividends (other than the payment of cash in lieu of the issuance of Fractional Shares) shall be declared by the Board of Directors or paid or set apart for payment by the Corporation on shares of the Exchangeable Preferred Stock or any other Parity Securities unless, prior to or concurrently with such declaration, payment or setting apart for payment, all accrued and unpaid dividends on all outstanding shares of such Senior Securities shall have been or be declared and paid or set apart for payment. No full dividends shall be declared or paid or set apart for payment on any Parity Securities for any period unless full cumulative dividends have been or contemporaneously are declared and paid or declared and a sum sufficient for the payment thereof set apart for such payment on the Exchangeable Preferred Stock for all dividend payment periods terminating on or prior to the date of payment of such full cumulative dividends. If any dividends are not paid in full, as aforesaid, upon the shares of the Exchangeable Preferred Stock and any other Parity Securities, all dividends declared upon shares of the Exchangeable Preferred Stock and any other Parity Securities shall be declared and paid pro rata so that the amount of dividends declared and paid per share on the Exchangeable Preferred Stock and such other Parity Securities shall in all cases bear to each other the same ratio that accrued dividends per share on the Exchangeable Preferred Stock and such other Parity Securities bear to each other. No interest, or sum of money in lieu of interest, shall be payable in respect of any dividend payment or payments on the Exchangeable Preferred Stock or any other Parity Securities which may be in arrears.

(ii) The Corporation shall not declare, pay or set apart for payment any dividend on any of the Exchangeable Preferred Stock or make any payment on account of, or set apart for payment money for a sinking or other similar fund for, the purchase, redemption or other retirement of, any of the Exchangeable Preferred Stock or any warrants, rights, calls or options exercisable for or convertible into any of the Exchangeable Preferred Stock, or make any distribution in respect thereof, either directly or indirectly, and whether in cash, obligations or shares of the Corporation, or other property (other than distributions or dividends in shares of Exchangeable Preferred Stock to the holders thereof), and shall not permit any corporation or other entity directly or indirectly controlled by the Corporation to purchase or redeem any of the Exchangeable Preferred Stock or any warrants, rights, calls or options exercisable for or convertible into any of the Exchangeable Preferred Stock, unless prior to or concurrently with such declaration, payment, setting apart for payment, purchase or distribution, as the case may be, all accrued and unpaid dividends on shares of any Senior Securities shall have been or be duly paid in full and all redemption payments which have become due with respect to such Senior Securities shall have been or be duly discharged.

Any dividend not paid pursuant to paragraph (2) of this Section 5.4 shall be fully cumulative and shall accrue (whether or not declared), without interest, as set forth in paragraph (2)(a) of this Section 5.4.

(e) Holders of shares of the Exchangeable Preferred Stock shall be entitled to receive the dividends provided for in paragraph (2)(a) of this Section 5.4 in preference to and in priority over any dividends upon any of the Junior Securities.

(f) Subject to the foregoing provisions of this paragraph (2) of this Section 5.4, the Board of Directors may declare, and the Corporation may pay or set apart for payment, dividends and other distributions on any of the Junior Securities, and may purchase or otherwise redeem any of the Junior Securities or any warrants, rights or options exercisable for or convertible into any of the Junior Securities, and the holders of the shares of the Exchangeable Preferred Stock shall not be entitled to share therein.

3. Liquidation Preference. (a) In the event of any voluntary or involuntary liquidation, dissolution or winding up of the affairs of the Corporation, the holders of shares of Exchangeable Preferred Stock then outstanding shall be entitled to be paid out of the assets of the Corporation available for distribution to its stockholders an amount in cash equal to $10 for each share outstanding, plus an amount in cash equal to all accrued but unpaid dividends (whether or not earned or declared) thereon to the date fixed for liquidation, dissolution or winding up before any payment shall be made or any assets distributed to the holders of any of the Junior Securities; provided, however, that the holders of outstanding shares of the Exchangeable Preferred Stock shall not be entitled to receive such liquidation payment until the liquidation payments on all outstanding shares of Senior Securities, if any, shall have been paid in full. Except as provided in the preceding sentence, holders of Exchangeable Preferred Stock shall not be entitled to any distribution in the event of liquidation, dissolution or winding up of the affairs of the Corporation. If the assets of the Corporation are not sufficient to pay in full the liquidation payments payable to the holders of outstanding shares of the Exchangeable Preferred Stock and any Parity Securities, then the holders of such shares shall share ratably in such distribution of assets in accordance with the amount which would be payable on such distribution if the amounts to which the holders of outstanding shares of Exchangeable Preferred Stock and the holders of outstanding shares of such other Parity Securities are entitled were paid in full.

(b) For the purpose of this paragraph 3 of this Section 5.4, neither the voluntary sale, lease, conveyance, exchange or transfer (for cash, shares of stock, securities or other consideration) of all or substantially all the property or assets of the Corporation nor the consolidation or merger of the Corporation with one or more other corporations shall be deemed to be a liquidation, dissolution or winding up, voluntary or involuntary, unless such voluntary sale, lease, conveyance, exchange or transfer shall be in connection with a plan of liquidation, dissolution or winding up of the business of the Corporation.

4. Redemption. (a) Subject to the legal availability of funds, any contractual restrictions then binding on the Corporation (including restrictions under Debt Agreements) and applicable state law, the Corporation may redeem at its option, at any time, the Exchangeable Preferred Stock, in whole or in part, at a redemption price of $10 per share together with all accrued and unpaid dividends (whether or not earned or declared) thereon to the date fixed for redemption, without interest. As of June 30, 2020 the redemption price set forth in the foregoing sentence was $141,121,484.

(b) Subject to the legal availability of funds, any contractual restrictions then binding on the Corporation (including restrictions under Debt Agreements) and applicable state law, commencing on the first Dividend Payment Date after the sixteenth anniversary of the Effective Date and on the first Dividend Payment Date after each anniversary of the Effective Date thereafter (each date separately referred to as a “Mandatory Redemption Date”), so long as any shares of the Exchangeable Preferred Stock shall be outstanding, the Corporation shall set aside, in trust, as and for a sinking fund for the Exchangeable Preferred Stock, a sum sufficient to redeem and shall redeem in each year an amount equal to at least 20% of the greatest number of shares of Exchangeable Preferred Stock issued and outstanding at any time, at a redemption price of $10 per share together with all accrued and unpaid dividends (whether or not earned or declared) thereon to the date fixed for redemption, without interest, and on the first Dividend Payment Date following the twentieth anniversary of the Effective Date, the Corporation shall set aside pursuant to paragraph 6 of this Section 5.4 a sum sufficient to redeem and shall redeem all outstanding shares of Exchangeable Preferred Stock at a redemption price of $10 per share together with all accrued and unpaid dividends (whether or not earned or declared) to such date.

(c) Shares of Exchangeable Preferred Stock which have been issued and reacquired in any manner, including shares purchased or redeemed, shall (upon compliance with any applicable provisions of law) have the status of authorized and unissued shares.

(d) Notwithstanding the foregoing provisions of paragraph 4 of this Section 5.4, if full cumulative dividends on all outstanding shares of Exchangeable Preferred Stock shall not have been paid or are not contemporaneously declared and paid for all past dividend periods, the Corporation may not redeem shares of Exchangeable Preferred Stock pursuant to paragraph 4(a) of this Section 5.4 unless the shares to be redeemed are selected pro rata (with rounding to the nearest whole share).

(e) If the Corporation shall fail to discharge its obligation to redeem shares of Exchangeable Preferred Stock pursuant to paragraph 4(b) of this Section 5.4 (the “Mandatory Redemption Obligation”), the Mandatory Redemption Obligation shall be discharged as soon as the Corporation is able to discharge such Mandatory Redemption Obligation.

5. [RESERVED]

6. Procedure for Redemption. (a) In the event that fewer than all the outstanding shares of Exchangeable Preferred Stock are to be redeemed, the number of shares to be redeemed shall be determined, subject to the provisions of paragraphs 4(b) and 4(d) of this Section 5.4, by the Board of Directors of the Corporation and the shares to be redeemed shall be selected by lot or pro rata as may be determined by the Board of Directors, except that in any redemption of fewer than all the outstanding shares of Exchangeable Preferred Stock, the Corporation may first redeem all shares held by any holders of a number of shares not to exceed 100 as may be specified by the Corporation.

(b) In the event the Corporation shall redeem shares of Exchangeable Preferred Stock, notice of such redemption shall be given by first class mail, postage prepaid, and mailed not less than 30 days nor more than 60 days prior to the redemption date, to each holder of record of the shares to be redeemed at such holder's address as the same appears on the stock register of the Corporation; provided, however, that no failure to give such notice nor any defect therein shall affect the validity of the proceeding for the redemption of any shares of Exchangeable Preferred Stock to be redeemed except as to the holder to whom the Corporation has failed to give said notice or except as to the holder whose notice was defective. Each such notice shall state: (i) the redemption date; (ii) the number of shares of Exchangeable Preferred Stock to be redeemed and, if less than all the shares held by such holder are to be redeemed, the number of shares of Exchangeable Preferred Stock held by such holder to be redeemed; (iii) the redemption price; (iv) the place or places where certificates for such shares are to be surrendered for payment of the redemption price; and (v) that dividends on the shares to be redeemed will cease to accrue on such redemption date or the date of exchange.

(c) Notice having been mailed as aforesaid and provided that on or before the redemption date all funds necessary for such redemption shall have been set aside by the Corporation, separate and apart from its other funds, in trust for the pro rata benefit of the holders of the shares so called for redemption so as to be and to continue to be available therefor, then, from and after the redemption date, dividends on the shares of Exchangeable Preferred Stock so called for redemption shall cease to accrue, and said shares shall no longer be deemed to be outstanding and shall not have the status of shares of Exchangeable Preferred Stock, and all rights of the holders thereof as stockholders of the Corporation (except the right to receive from the Corporation the redemption price and any accrued and unpaid dividends, whether or not earned or declared) shall cease. Upon surrender, in accordance with said notice of the certificates for any shares so redeemed (properly endorsed or assigned for transfer, if the Board of Directors shall so require and the notice shall so state), such shares shall be redeemed by the Corporation at the redemption price aforesaid. In case fewer than all the shares represented by any such certificate are redeemed, a new certificate or certificates shall be issued representing the unredeemed shares without cost to the holder thereof.

(d) If such notice of redemption shall have been duly given, and if, prior to the redemption date, the Corporation shall have irrevocably deposited the aggregate redemption price of the shares of Exchangeable Preferred Stock to be redeemed in trust for the pro rata benefit of the holders of the shares of Exchangeable Preferred Stock to be redeemed, so as to be and to continue to be available therefor, with a bank or trust company (having capital and surplus of not less than $50,000,000) in the borough of Manhattan, City of New York, then, upon making such deposit, holders of the shares of Exchangeable Preferred Stock called for redemption shall cease to be stockholders with respect to such shares and thereafter such shares shall no longer be transferable on the books of the Corporation and such holders shall have no interest in or claim against the Corporation with respect to such shares (including dividends thereon accrued after such redemption date) except the right to receive payment of the redemption price (including all dividends (whether or not earned or declared) accrued and unpaid to the date fixed for redemption) upon surrender of their certificates, without interest. Any funds deposited and unclaimed at the end of one year from the date fixed for redemption shall be repaid to the Corporation upon its request, after which repayment the holders of shares called for redemption shall look only to the Corporation as a general creditor for payment of the redemption price.

7. Voting Rights. (a) The holders of record of shares of Exchangeable Preferred Stock shall not be entitled to any voting rights except as provided in the Charter or as otherwise provided by law.

(b)(i) If at any time or times dividends payable on Exchangeable Preferred Stock shall be in arrears and unpaid for three consecutive full semi-annual periods, then the number of directors constituting the Board of Directors, without further action, shall be increased by up to two directors and the holders of Exchangeable Preferred Stock shall have the exclusive right, voting separately as a class, to elect the directors of the Corporation to fill such newly created directorships, which directors shall be designated “Class D” directors, the remaining directors to be elected by the other class or classes of stock entitled to vote therefor, at each meeting of stockholders held for the purpose of electing directors.

(ii) Whenever such voting right shall have vested, such right may be exercised initially either at a special meeting of the holders of Exchangeable Preferred Stock, called as hereinafter provided, or at any annual meeting of stockholders held for the purpose of electing directors, and thereafter at each annual meeting. Such voting right shall continue until such time as: (1) all dividends accumulated on Exchangeable Preferred Stock shall have been paid in full (subject to revesting in the event of each and every subsequent failure of the Corporation to pay dividends for the requisite number of periods as described above), (2) the rights of holders of the Exchangeable Preferred Stock shall have terminated pursuant to paragraph 6 of this Section 5.4, or (3) an ERPS Conversion Event; at which time, in each such case, such voting right of the holders of Exchangeable Preferred Stock shall automatically terminate.

(iii) At any time when such voting right shall have vested in the holders of the Exchangeable Preferred Stock and if such right shall not already have been initially exercised, a proper officer of the Corporation shall, upon the written request of any holder of record of Exchangeable Preferred Stock then outstanding, addressed to the Secretary of the Corporation, call a special meeting of holders of Exchangeable Preferred Stock. Such meeting shall be held at the earliest practicable date upon the notice required for annual meetings of stockholders at the place for holding annual meetings of stockholders of the Corporation or, if none, at a place designated by the Secretary of the Corporation. If such meeting shall not be called by the proper officers of the Corporation within 30 days after the personal service of such written request upon the Secretary of the Corporation, or within 30 days after mailing the same within the United States, by registered mail, addressed to the Secretary of the Corporation at its principal office (such mailing to be evidenced by the registry receipt issued by the postal authorities), then the holders of record of 10% of the shares of Exchangeable Preferred Stock then outstanding may designate in writing a holder of Exchangeable Preferred Stock to call such meeting at the expense of the Corporation, and such meeting may be called by such person so designated upon the notice required for annual meetings of stockholders and shall be held at the same place as is elsewhere provided in this paragraph 7(b)(iii) or at such other place as is selected by such person so designated. Any holder of Exchangeable Preferred Stock which would be entitled to vote at any such meeting shall have access to the stock books of the Corporation for the purpose of causing a meeting of stockholders to be called pursuant to the provisions of this paragraph. Notwithstanding the provisions of this paragraph, however, no such special meeting shall be called during a period within 90 days immediately preceding the date fixed for the next annual meeting of stockholders.

(iv) At any meeting held for the purpose of electing directors at which the holders of Exchangeable Preferred Stock shall have the right to elect directors as provided herein, the presence in person or by proxy of the holders of a majority of the then outstanding shares of Exchangeable Preferred Stock shall be required and be sufficient to constitute a quorum of such class for the election of directors by such class. At any such meeting or adjournment thereof, (x) the absence of a quorum of the holders of Exchangeable Preferred Stock and the absence of a quorum or quorums of the holders of capital stock entitled to elect such other directors shall not prevent the election of directors to be elected by the holders of Exchangeable Preferred Stock and (y) in the absence of a quorum of the holders of any such class of stock entitled to vote for the election of directors, a majority of the holders present in person or by proxy of such class shall have the power to adjourn the meeting insofar as it relates to the election of directors which the holders of such class are entitled to elect, from time to time, without notice (except as required by law) other than announcement at the meeting, until a quorum shall be present.

(v) The term of office of all directors elected by the holders of Exchangeable Preferred Stock pursuant to paragraph 7(b)(i) of this Section 5.4 in office at any time when the aforesaid voting rights are vested in the holders of Exchangeable Preferred Stock shall terminate upon the election of their successors at any meeting of stockholders for the purpose of electing directors. Upon any termination of the aforesaid voting rights in accordance with paragraph 7(b)(ii) of this Section 5.4, the term of office of all directors elected by the holders of Exchangeable Preferred Stock pursuant to paragraph 7(b)(i) of this Section 5.4 then in office shall thereupon terminate and upon such termination the number of directors constituting the Board of Directors shall, without further action, be reduced by the number of directors by which the number of directors constituting the Board of Directors shall have been increased pursuant to paragraph 7(b)(i) of this Section 5.4, subject always to the increase of the number of directors pursuant to paragraph 7(b)(i) of this Section 5.4 in case of the future right of the holders of Exchangeable Preferred Stock to elect directors as provided herein.

(vi) Notwithstanding any other provision hereof (including but not limited to Section 4.1), in any case of any vacancy occurring among the directors so elected, the remaining director, if any, who shall have been so elected may appoint a successor to hold office for the unexpired term of the director whose place shall be vacant. If all directors so elected by the holders of Exchangeable Preferred Stock shall cease to serve as directors before their terms shall expire, then notwithstanding any other provision hereof (including but not limited to Section 4.1), the holders of Exchangeable Preferred Stock then outstanding may, at a special meeting of the holders called as provided above, elect successors to hold office for the unexpired terms of the directors whose places shall be vacant.

(vii) Notwithstanding any other provision hereof (including but not limited to Section 4.5), any Class D director or all Class D directors may be removed from office at any time by the affirmative vote of a majority of all the votes entitled to be cast in the election of Class D directors.

(c) [Reserved]

(d) So long as any shares of Exchangeable Preferred Stock are outstanding, the Corporation shall not, without the affirmative vote of the holders of at least a majority of the then outstanding Exchangeable Preferred Stock voting separately as a class change by amendment to the Corporation's Charter or otherwise, the terms or provisions of the Exchangeable Preferred Stock so as to adversely affect the powers, special rights and preferences of the holders thereof.

(e) Any alteration or change which would not affect adversely the powers, preferences, and special rights of shares of Exchangeable Preferred Stock may be effected without the consent of holders thereof, including, without limitation, the (i) creation, authorization or issuance of any other class of stock of the Corporation senior, pari passu or subordinated as to dividends and upon liquidation to the Exchangeable Preferred Stock, (ii) creation of any indebtedness of any kind of the Corporation, (iii) increase or decrease in the amount of authorized capital stock of any class or series, including the Exchangeable Preferred Stock, or any increase, decrease or change in the par value of any such class other than the Exchangeable Preferred Stock, or (iv) merger or consolidation or similar plan or acquisition in which securities of the Corporation held by the holders of Exchangeable Preferred Stock will become or be exchanged for securities of any other person, if the sole purpose of the transaction is to change the Corporation's domicile solely within the United States.

8. Automatic Conversion. (a) Immediately upon the consummation of a Qualified IPO, each share of Exchangeable Preferred Stock shall automatically be converted into the right to receive (such conversion, a "ERPS Conversion Event"): (i) an amount of cash equal to (I) the ERPS Liquidation Value; multiplied by (II) the Discount Ratio; multiplied by (III) 0.85 and (ii) that number of shares of Common Stock (valued at the initial Qualified IPO offering price to the public) equal to (I) the ERPS Liquidation Value; multiplied by (II) the Discount Ratio; multiplied by (III) 0.15; provided, however no fractional shares of Common Stock shall be issued upon an ERPS Conversion Event but, in lieu thereof, the holder shall be entitled to receive an amount of cash equal to the fair market value of a share of Common Stock (valued at the initial Qualified IPO offering price to the public) at the time of such ERPS Conversion Event multiplied by such fractional amount (rounded to the nearest cent).

(b) The Corporation shall promptly notify the holders of Exchangeable Preferred Stock in writing of the occurrence of an ERPS Conversion Event; provided, that, the Corporation's failure to provide such notice, or its failure to be received, shall not alter or affect the automatic conversion of the Exchangeable Preferred Stock occurring in connection therewith. In addition to any information that is required by law, such notice shall state: (i) the date of the ERPS Conversion Event; (ii) the amount of cash per share to be paid to each holder of shares of Exchangeable Preferred Stock in connection with the ERPS Conversion Event; (iii) the number of shares of Common Stock per share of Exchangeable Preferred Stock to be issued to each holder of shares of Exchangeable Preferred Stock in connection with the ERPS Conversion Event; (iv) the place or places where the certificates representing shares of Exchangeable Preferred Stock are to be surrendered (or a Statement of Loss as defined in paragraph 8(c) of this Section 5.4 in lieu thereof) in connection with the ERPS Conversion Event; and (v) that payment of the foregoing cash sum (including any payment for fractional shares) and issuance of Common Stock will be made upon presentation and surrender of certificates representing shares of the Exchangeable Preferred Stock (or a Statement of Loss in lieu thereof) without any other obligation or deliverable required of any holder of shares of Exchangeable Preferred Stock in order to receive such cash and Common Stock.

(c) Upon an ERPS Conversion Event, the outstanding Exchangeable Preferred Stock shall be converted automatically without any further action by the holders thereof or by the Corporation and whether or not the certificates evidencing such Exchangeable Preferred Stock are surrendered to the Corporation or its transfer agent upon the occurrence of an ERPS Conversion Event; provided, that, the Corporation shall not be obligated to pay cash payable or issue certificates evidencing the Common Stock issuable upon such ERPS Conversion Event unless the certificates evidencing such Exchangeable Preferred Stock are delivered to the Corporation or its transfer agent, or the holder notifies the Corporation or its transfer agent that such certificates have been lost, stolen or destroyed and executes an agreement reasonably satisfactory to the Corporation solely to indemnify the Corporation from any claim that may be made against the Corporation on account of the alleged loss, theft or destruction of such certificate (a "Statement of Loss").

(d) Upon receipt of notice of the occurrence of an ERPS Conversion Event, the holders of Exchangeable Preferred Stock shall promptly surrender the certificates evidencing such shares (or a Statement of Loss in lieu thereof) at the office of the Corporation or any transfer agent for the Exchangeable Preferred Stock. Thereupon, (i) there shall be issued and delivered to such holder promptly at such office and in its name as shown on such surrendered certificate or certificates or on the Statement of Loss in lieu thereof, a certificate or certificates for the number of shares of Common Stock, as applicable, to which such holder is entitled in connection with such ERPS Conversion Event; and (ii) the cash consideration described in paragraph 8(a) of this Section 5.4.

(e) Any Common Stock issued upon an ERPS Conversion Event shall be validly issued, fully paid and non-assessable. The Corporation shall endeavor to take any action necessary to ensure that any Common Stock issued upon an ERPS Conversion Event are freely transferable and not subject to any resale restrictions under the Securities Act of 1933, as amended (the “Securities Act”) or any applicable state securities or blue sky laws (in each case other than any shares of Common Stock that may be held by an “affiliate” (as defined in Rule 144 promulgated under the Securities Act) of the Corporation). No share of Common Stock issuable or issued to the holders of Exchangeable Preferred Stock in connection with an ERPS Conversion Event under this paragraph 8 shall be encumbered by, or subject to, any agreement, term or condition imposed by the Corporation, any underwriter or other agent of the Corporation restricting: (i) the sale, tradability, distribution, pledge or other disposition of such Common Stock; (ii) the ability to offer to sell, trade, distribute, pledge or dispose such Common Stock; (iii) the ability to contract to sell, trade, distribute, pledge or dispose (including any short sale) such Common Stock; and/or (iv) the right to grant any option to purchase such Common Stock or enter into any hedging or similar transaction with the same economic effect as a sale, trade, distribution, pledge or disposition of such Common Stock. Without limiting the generality of the foregoing, no holder of the shares of Common Stock that are issuable or issued in connection with an ERPS Conversion Event shall be subject to any lock-up agreement or market standoff agreement imposed by the Corporation, any underwriter or other agent of the Corporation with respect to such shares. The Corporation shall use its best efforts to list the Common Stock required to be delivered upon an ERPS Conversion Event on the Nasdaq Stock Market at or prior to the time of such delivery.

9. Definitions. For the purpose of the Charter, the following terms shall have the following meanings:

(a) “Discount Ratio” means ninety percent (90%).

(b) “ERPS Liquidation Value” means, per each share of Exchangeable Preferred Stock, $10 together with all accrued and unpaid dividends (whether or not earned or declared) thereon calculated as of the actual date of an ERPS Conversion Event without interest, which, for the avoidance of doubt, was $141,121,484 as of June 30, 2020.

(c) “IPO” means a firm commitment underwritten initial public offering of the Common Stock registered under the Securities Act, as amended, pursuant to an effective registration statement on Form S-1 or an equivalent registration statement.

(d) “Qualified IPO” means an IPO consummated prior to March 31, 2021.

10. Notwithstanding anything to the contrary herein, until the occurrence of an ERPS Conversion Event (if any), the Corporation shall not make an election pursuant to Subtitle 8 of Title 3 of the MGCL (by charter amendment, bylaw or resolution of the Board of Directors) that would adversely affect the powers, special rights and preferences of the holders of the Exchangeable Preferred Stock, including, but not limited to, any election pursuant to Subtitle 8 of Title 3 of the MGCL that would alter or impact the voting rights of the holders of the Exchangeable Preferred Stock pursuant to paragraph 7 of this Section 5.4.

Section 5.5 Classified or Reclassified Shares. Prior to issuance of classified or reclassified shares of any class or series, the Board of Directors by resolution shall: (a) designate that class or series to distinguish it from all other classes and series of stock of the Corporation; (b) specify the number of shares to be included in the class or series; (c) set or change, subject to the express terms of any class or series of stock of the Corporation outstanding at the time, the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms and conditions of redemption for each class or series; and (d) cause the Corporation to file articles supplementary with the State Department of Assessments and Taxation of Maryland. Any of the terms of any class or series of stock set or changed pursuant to clause (c) of this Section 5.5 may be made dependent upon facts or events ascertainable outside the Charter (including determinations by the Board of Directors or other facts or events within the control of the Corporation) and may vary among holders thereof, provided that the manner in which such facts, events or variations shall operate upon the terms of such class or series of stock is clearly and expressly set forth in the articles supplementary or other Charter document.

Section 5.6 Inspection of Books and Records. After a Qualified IPO, a stockholder that is otherwise eligible under applicable law to inspect the Corporation’s books of account or stock ledger or other specified documents of the Corporation shall have no right to make such inspection if the Board of Directors determines that such stockholder has an improper purpose for requesting such inspection.

Section 5.7 Charter and Bylaws. The rights of all stockholders and the terms of all stock are subject to the provisions of the Charter and the Bylaws.

ARTICLE VI

LIMITATION OF LIABILITY; INDEMNIFICATION AND ADVANCE OF EXPENSES

Section 6.1 Limitation of Liability. To the maximum extent that Maryland law in effect from time to time permits limitation of the liability of directors and officers of a corporation, no present or former director or officer of the Corporation shall be liable to the Corporation or its stockholders for money damages.

Section 6.2 Indemnification and Advance of Expenses. To the maximum extent permitted by Maryland law in effect from time to time, the Corporation shall indemnify and, without requiring a preliminary determination of the ultimate entitlement to indemnification, shall pay or reimburse reasonable expenses in advance of final disposition of a proceeding to (a) any individual who is a present or former director or officer of the Corporation and who is made or threatened to be made a party to, or witness in, the proceeding by reason of his or her service in that capacity or (b) any individual who, while a director or officer of the Corporation and at the request of the Corporation, serves or has served as a director, officer, trustee, member, manager or partner of another corporation, limited liability company, partnership, joint venture, trust, employee benefit plan or other enterprise and who is made or threatened to be made a party to, or witness in, the proceeding by reason of his or her service in that capacity. The rights to indemnification and advance of expenses provided herein shall vest immediately upon election of a director or officer. The Corporation may, with the approval of the Board of Directors, provide such indemnification and advance of expenses to an individual who served a predecessor of the Corporation in any of the capacities described in (a) or (b) above and to any employee or agent of the Corporation or a predecessor of the Corporation. The indemnification and payment or reimbursement of expenses provided herein shall not be deemed exclusive of or limit in any way other rights to which any person seeking indemnification or payment or reimbursement of expenses may be or may become entitled under any bylaw, resolution, insurance, agreement or otherwise.

Section 6.3 Amendment or Repeal. Neither the amendment nor repeal of this Article VI, nor the adoption or amendment of any other provision of the Charter or Bylaws inconsistent with this Article VI, shall apply to or affect in any respect the applicability of the preceding sections of this Article VI with respect to any act or failure to act which occurred prior to such amendment, repeal or adoption.

ARTICLE VII

AMENDMENT

The Corporation reserves the right, from time to time, to make any amendment of it Charter, now or hereafter authorized by law, including any amendment that alters the contract rights, as expressly set forth in its Charter, or any outstanding stock.

ARTICLE VIII

EXCLUSIVE FORUM FOR CERTAIN LITIGATION

Unless the Corporation consents in writing to the selection of an alternative forum, the United States District Court for the District of Maryland, or, if that Court does not have jurisdiction, the Circuit Court for Montgomery County, Maryland, shall be the sole and exclusive forum for (a) any derivative action or proceeding brought on behalf of the Corporation, (b) any Internal Corporate Claim, as such term is defined in Section 1-101(p) of the MGCL, including, without limitation, (i) any action asserting a claim of breach of any duty owed by any director or officer or other employee of the Corporation to the Corporation or to the stockholders of the Corporation or (ii) any action asserting a claim against the Corporation or any director or officer or other employee of the Corporation arising pursuant to any provision of the MGCL, the Charter or the Bylaws, or (c) any other action asserting a claim against the Corporation or any director or officer or other employee of the Corporation that is governed by the internal affairs doctrine.

FIFTH: The amendment and restatement of the charter as hereinabove set forth have been duly advised by the Board of Directors and approved by the stockholders of the Corporation as required by law.

SIXTH: The current address of the principal office of the Corporation is as set forth in Article III of the foregoing amendment and restatement of the charter.

SEVENTH: The name and address of the Corporation's current resident agent are as set forth in Article III of the foregoing amendment and restatement of the charter.

EIGHTH: The number of directors of the Corporation and the names of those currently in office are as set forth in Article IV of the foregoing amendment and restatement of the charter.

NINTH: The total number of shares of stock which the Corporation had authority to issue immediately prior to the foregoing amendment and restatement of the charter was 61,013,500, consisting of 50,000,000 shares of Class A Common Stock, no par value; 5,000,000 shares of Class B Common Stock, no par value; 6,000,000 shares of 12% Cumulative Exchangeable Redeemable Preferred Stock, par value $0.01 per share; 3,000 shares of Senior Exchangeable Preferred Stock, par value $0.01 per share; 1,250 shares of Series A-1 Redeemable Preferred Stock, par value $0.01 per share; 1,750 shares of Series A-2 Redeemable Preferred Stock, par value $0.01 per share; and 7,500 shares of Class B Preferred Stock, par value $0.01 per share. The aggregate par value of all shares of stock having par value was $60,135.00.

TENTH: The total number of shares of stock which the Corporation has authority to issue pursuant to the foregoing amendment and restatement of the charter is 260,000, consisting of 250,000,000 shares of common stock, par value $0.01 per share, and 10,000,000 shares of preferred stock, par value $0.01 per share. The aggregate par value of all authorized shares of stock having par value is $350,000.

ELEVENTH: The undersigned acknowledges these Second Articles of Amendment and Restatement to be the corporate act of the Corporation and as to all matters or facts required to be verified under oath, the undersigned acknowledges that, to the best of his knowledge, information and belief, these matters and facts are true in all material respects and that this statement is made under the penalties for perjury.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, the Corporation has caused these Second Articles of Amendment and Restatement to be signed in its name and on its behalf by its President and Chief Executive Officer and attested to by its Secretary on this _____ day of _______________, 2020.

ATTEST:	TELOS CORPORATION
______________________________	By: ______________________________ (SEAL)
Name: Jefferson V. Wright	Name: John B. Wood
Title: Asst. Secretary	Title: President and Chief Executive Officer