

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 1999

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

Commission file number: 1-8443

TELOS CORPORATION

(Exact name of registrant as specified in its charter)

Maryland (State of Incorporation) 52-0880974 (I.R.S. Employer Identification No.)  
19886 Ashburn Road, Ashburn, Virginia 20147 (Address of principal executive offices) (Zip Code)

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

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

NONE

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES X NO \_\_\_\_\_

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

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

As of March 28, 2000, the registrant had 21,241,980 shares of Class A Common Stock, no par value; 4,037,628 shares of Class B Common Stock, no par value; and 3,185,586 shares of 12% Cumulative Exchangeable Redeemable Preferred Stock, par value \$.01 per share, outstanding.

Incorporation by Reference: None

NUMBER OF PAGES IN THIS REPORT (EXCLUDING EXHIBITS): 58

PART 1

ITEM 1. BUSINESS

HISTORY AND INTRODUCTION

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

In today's dynamic business environment, timely and accurate information flow is critical for success. Telos' specialized approach to this information challenge is based on leveraging customers' IT infrastructure, delivering user centric information, and enabling customers to achieve a fast return on investment. Many customers are turning to the virtual enterprise as a model for improving business performance through enhanced communications and business processes. The virtual enterprise is a demand driven partnership of

customers, employees, partners and suppliers to deliver solutions. Telos' solutions are aimed at overcoming the critical barriers that face the virtual enterprise: (1) the difficulty in accessing disparate data without extensive programming, (2) the inability to quickly integrate data to ensure customer responsiveness, manufacturing and distribution efficiency and overall competitive strength, (3) the problem of effectively distributing information quickly and securely and (4) the challenge of making the organizational and technological complexity invisible to end users.

Over each of the past three years, Telos has made significant investments in the development of software and service solutions to facilitate the transition of its business toward a larger mix of fixed price commerce solutions. As part of this strategy, the Company has discontinued or divested itself of those elements of its traditional business which were not consistent with this strategy. In February 1998, Telos sold Telos Information Systems ("TIS"), a contract labor division, for \$14.7 million. In September 1999, the Company sold Telos Field Engineering ("TFE"), its computer maintenance division, for \$10 million.

On December 30, 1999, Enterworks completed a private placement of convertible preferred stock, and the Company and Enterworks completed a series of concurrent transactions. As a result, Enterworks deconsolidated from Telos (See Note 2 of Notes to Consolidated Financial Statements).

#### REPORTABLE OPERATING SEGMENTS

During 1999, the Company provided its business solutions through three operating segments: Systems and Support Services, the Products Group, and its Enterworks subsidiary. On December 30, 1999, the Enterworks subsidiary was deconsolidated due to a private placement offering and concurrent transactions (See Note 2 to the Consolidated Financial Statements).

#### SYSTEMS AND SUPPORT SERVICES

The Company's Systems and Support Services Group provides software development and support services for software and hardware including technology insertion, system redesign, software re-engineering, Help Desk, and third party maintenance. Key customers of this segment include: The U.S. Army at Ft. Sill in Lawton, Oklahoma; the U.S. Army at Ft. Monmouth in Red Bank, New Jersey; and until September, 1999 the U.S. Army's Redstone Arsenal in Huntsville, Alabama. Telos is one of the largest providers of software engineering services to the U.S. Army, maintaining over 50 million lines of software code for fire support systems. In addition, the Company has supported seventy-nine tactical land and satellite communications systems for the Communications-Electronics Command's Research, Development, and Engineering Center. The Company's largest hardware services contract was for the Redstone Arsenal where the Telos Call Center responded to support the Army's Aviation and Missile Command. In addition to these traditional Telos customers and services, the Company has information security, data integration, advance messaging, and wireless network and enterprise management practices which generate higher margins than the traditional business and represent a growing component of this segment.

For 1999, the Systems and Support Services Group generated revenue of \$93.5 million, or 54.6%, of the Company's reported consolidated revenue. The TFE and TIS divisions were part of the Systems and Support Services Group prior to their respective sales in 1999 and 1998.

#### PRODUCTS GROUP

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

This operating segment also held the largest network integration contract ever awarded by the U.S. federal government, the Small Multi-user Computer ("SMC-II") contract which had a three-year term that commenced with the original award in September 1995, and was extended through April 1999. The Products Group was awarded the follow-on to the SMC II Contract, Infrastructure Solutions 1, or IS1, awarded in February 1999.

For 1999, the Products Group had revenues of \$77.8 million, or 45.4%, of the Company's reported consolidated revenues.

#### ENTERWORKS, INC.

Enterworks develops, markets and supports a software framework that integrates content and processes for companies seeking to participate in e-business. They target operators and users of e-marketplaces and portals. E-marketplaces and portals are Web-based destinations where employees, customers, partners and suppliers can interact to obtain information about products and services, and conduct business more efficiently. Enterworks' products enable customers to build or join e-marketplaces and portals rapidly, add new content and e-business participants easily, and automate the end-to-end processes required for e-business interaction.

Enterworks' products are designed to meet the business and technical challenges faced by operators and users of e-marketplaces and portals by delivering integrated, real-time content and automating business processes that bring together employees, customers, partners and suppliers. These products offer numerous competitive advantages over traditional solutions by combining both content and process integration, and by guiding people through e-business interactions.

At the end of 1999, Enterworks completed a private placement of convertible preferred stock and the Company and Enterworks completed a series of concurrent transactions. As a result, Enterworks deconsolidated from Telos (See Note 2 of Notes to Consolidated Financial Statements).

#### REVENUE BY MAJOR MARKET AND SIGNIFICANT CUSTOMERS

Revenue by major market for the Company are as follows:

	PERCENTAGE OF TOTAL CONSOLIDATED REVENUE FOR		
	1999(1)	1998	1997
	-----	----	----
Federal government	92.8%	92.9%	94.6%
Commercial	5.9	5.1	3.9
State and local governments	1.3	2.0	1.5
	---	----	----
TOTAL	100.0%	100.0%	100.0%
	=====	=====	=====

1. Major market revenue includes Enterworks revenue.

Total consolidated revenue derived from the federal government for 1999 includes 57.4% of revenue from contracts with the United States Army, 12.2% of revenue from contracts with the United States Navy, 7.4% of revenue with other Department of Defense customers, and 6.8% of revenue from the Federal Judicial branch.

#### COMPETITION

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

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

#### EMPLOYEES

The Company employed 833 persons as of December 31, 1999, down from 1,155 at December 31, 1998. The decline was principally due to the sale of TFE and the deconsolidation of Enterworks. The services the Company provides require proficiency in many fields, such as computer science, mathematics, physics, engineering, operations research, economics, and business administration.

Of the total Company personnel, 570 provide Systems and Support Services, while 122 provide System Integration (Products) Services. An additional 141 employees provide corporate and business services functions. Enterworks employed 168 persons as of December 31, 1999.

#### BACKLOG

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

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

At December 31, 1999 and 1998, the Company had total backlog from existing contracts of approximately \$242.2 million and \$923.3 million, respectively. This is the maximum value of additional future orders for systems, products, maintenance and other support services presently allowable under those contracts, including renewal options available on the contracts if exercised by the client, over periods extending up to seven years. Included in the backlog at December 31, 1998 was \$786 million from the Company's Small Multi-Computer II ("SMC-II") contract, which expired in April 1999 and therefore, did not convert to orders and revenue of this magnitude in 1999. The Company was awarded the follow-on contract to SMC II, Infrastructure Solutions-1 ("IS1"), in the first quarter of 1999. This contract has a five-year term with an award amount not to exceed \$380 million. Approximately \$45 million and \$56 million of the total was funded backlog at December 31, 1999 and 1998, respectively.

While backlog remains a measurement consideration, in recent years the Company, as well as other federal contractors, experienced a change in the manner in which the federal government procures equipment and services. These procurement changes include the growth in the use of General Services Administration ("GSA") schedules which allow agencies of the federal government to purchase significant amounts of equipment and services. The use of the GSA schedules results in a significantly shorter and much more flexible procurement

cycle, as well as increased competition as many companies hold such schedules. Along with the GSA schedules, the federal government is awarding a large number of omnibus contracts with multiple awardees. These contracts generally require extensive marketing efforts by the awardees to procure business. The use of GSA schedules and omnibus contracts, while generally not providing immediate backlog, provide areas of potential growth that the Company continues to aggressively pursue.

#### OVERVIEW OF 1999

During 1999, Telos continued to execute its strategy of transitioning its business toward a larger mix of commerce solutions.

These efforts included the continued development of Enterworks' software suite which includes Enterworks Content Integrator(TM) ("ECI"), formerly Virtual DB, and Enterworks Process Integrator(TM) ("EPI"), formerly Enterworks Process Manager. ECI 3.5 was released in December 1999 and EPI 2.0.1 was released February 2000. These efforts also included doubling the size of the sales and marketing infrastructure. As a result of these efforts, Enterworks' revenue increased in excess of 50% from 1998 revenue.

In December 1999, Enterworks completed a private placement financing whereby the Company's voting interest in Enterworks was reduced to 34.8%. As a result of this decrease in ownership, effective December 30, 1999 Enterworks has been deconsolidated from the Company's operating results. As a result, the Company will no longer be required to fund the continuing investment needed for Enterworks sales and marketing infrastructure and product development.

The Company's 1999 investments were also focused on its higher margin information security, data integration, advanced messaging and wireless networking practices. Revenue for these practices approximated \$15.8 million for 1999, which represents a more than doubling of comparable 1998 revenues. The Company expects total revenue for these practices will continue to grow in 2000 based in part on its continuing investments in sales and marketing to support these practices.

The Company's 1999 activities also focused on reducing or eliminating certain of its least profitable contracts. With these business reductions came decreases in related corporate infrastructure costs, including selling, general and administrative ("SG&A") expenses. However, on a total company basis, these cost reductions were more than offset by increases in SG&A costs to support Enterworks and the other higher margin businesses noted above.

In September 1999, the Company sold all of the net assets of its TFE division for \$10 million in cash.

#### ITEM 2. PROPERTIES

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

As of January 1, 2000, Enterworks, Inc. is subleasing 35,214 rentable square feet of space from Telos Corporation at the Ashburn, Virginia location for its corporate headquarters and operating segments. This sublease will expire in March 2001 unless a renewal of the sublease is reached by mutual agreement between the Company and Enterworks.

The Company leases additional space for regional contract work sites, training, and sales offices in 11 separate facilities located in 4 states and Europe under various leases, which expire on various dates through March 2004. At December 31, 1999, the Company sold the remaining building it owned in Amery, Wisconsin. This facility principally supported the Company's Systems and Support Services operating segment.

#### ITEM 3. LEGAL PROCEEDINGS

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

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

During the fourth quarter of 1999, no matters were submitted to a vote of security holders.

## PART II

## ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

No public market exists for the Company's Class A or Class B Common Stock. As of March 1, 2000, there were 83 holders of the Company's Class A Common Stock and 3 holders of the Company's Class B Common Stock.

## ITEM 6. SELECTED FINANCIAL DATA

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

	OPERATING RESULTS				
	YEAR ENDED DECEMBER 31,				
	1999	1998	1997	1996	1995
	----	----	----	----	----
	(amounts in thousands)				
Sales (4)(6)	\$171,364	\$207,086	\$253,787	\$188,895	\$175,759
(Loss) income from continuing operations	(9,979)	(9,171)	1,412	(9,816)	592
Discontinued operations:					
Income from discontinued Operations	--	--	--	500	423
Gain on sale of Consulting Services	--	--	--	11,524	--
(Loss) income before extraordinary items	(9,979)	(9,171)	1,412	2,208	1,015
Extraordinary items(5)	8,015	--	--	--	--
Net (loss) income	(1,964)	(9,171)	1,412	2,208	1,015

	FINANCIAL CONDITION				
	As of December 31,				
	1999(6)	1998	1997	1996	1995
	-----	----	----	----	----
	(amounts in thousands)				
Total assets (4)	\$ 56,886	\$ 95,251	\$109,718	\$110,064	\$94,492
Long-term debt (1)	25,045	54,651	56,875	32,857	47,316
Capital lease obligations, long-term (2)	11,362	11,710	12,085	12,537	--
Senior redeemable preferred stock (3)	6,054	5,631	5,207	4,828	4,494
Class B redeemable preferred stock (3)	--	--	12,035	11,087	10,252
Redeemable preferred Stock (3)	36,975	31,729	29,951	24,230	18,647

- (1) See note 5 to the consolidated financial statements in item 8 regarding long-term debt obligations of the company. Total long-term debt obligations include amounts due under the senior credit facility and subordinated notes.
- (2) See Note 9 to the Consolidated Financial Statements in Item 8 regarding the capital lease obligations of the Company.
- (3) See Note 6 to the Consolidated Financial Statements in Item 8 regarding redeemable preferred stock of the Company.
- (4) See Note 3 to the Consolidated Financial Statements in Item 8 regarding the sales of TFE and TIS.
- (5) See Note 2 to the Consolidated Financial Statements in Item 8 regarding the extraordinary item relating to the concurrent transactions of the Enterworks private placement.
- (6) See Note 2 to the Consolidated Financial Statements in Item 8 regarding the income statement presentation and exclusion of the assets, liabilities and equity of Enterworks from the consolidated accounts.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

Over the last three years, the Company has made significant investments in the development of software products, in sales and marketing, and in positioning its infrastructure to support its new business to business e-commerce products. The Company's investments in new software products provide the Company with an expanded product line that, the Company believes, offers its customers unique value added solutions for their computing and information gathering analysis problems. The investment in software products has been primarily through Enterworks Inc. and is focused on the eBusiness infrastructure market, through content and process integration products. As of December 31, 1999, the Company will no longer fund Enterworks' activities as Enterworks is no longer included in the Company's consolidated financial results. Additionally, the Company has established a comprehensive offering of products and services on its GSA schedule. These investments have enabled the Company to win most of its significant contract rebids, and continue to provide significant new business opportunities.

During 1999, the Company experienced decreases in revenue and profitability. Revenue decreased \$35.7 million, or 17.2%, as compared to 1998. Approximately \$23.9 million of this decrease was attributable to the expiration of the Products segment's SMC II contract in April 1999 and the timing of the subsequent start up period on IS-1. This decline is also due to the effects of the deconsolidation of Enterworks, which presents the results from operations of Enterworks in a single line item entitled "Equity in Net Losses of Enterworks". Operating income for 1999 was \$2.2 million, as compared to an operating loss of \$7.3 million in 1998. Operating profitability improved principally as a result of the deconsolidation of Enterworks discussed above. Exclusive of Enterworks, the Company's earnings before interest and taxes for 1999 were \$2.2 million compared to \$4.3 million for 1998. This decline was principally due to the decline in operating profit of the Products segment of \$2.0 million from 1998 to 1999.

During 1998, the Company's revenue and profitability decreased as compared to 1997. Revenue decreased \$46.7 million, or 18.4%, primarily due to the expiration of two large contracts in 1997 (further discussed below). Operating losses for 1998 were \$7.3 million, as compared to an operating profit of \$7.4 million in 1997. Operating profitability declined principally as a result of the decreases in revenue, as well as the Company's continued investment in Enterworks.

REVENUE BY CONTRACT TYPE

Approximately 94% of the Company's total revenues in 1999 were attributable to contracts with federal, state, and local governments, including 93% attributable to the federal government. The Company's revenues are generated from a number of contract vehicles. In general, the Company believes its contract portfolio is characterized as having low to moderate financial risk as the Company has limited long-term fixed price development contracts. The Company's firm fixed price contracts consist principally of contracts for the purchase of computer equipment at established contract prices or contracts for maintenance of computer hardware. A significant portion of the Company's revenue is from time and material contracts, which generally allow the pass-through of allowable costs plus a profit margin. For 1999, revenue by contract type was as follows (includes revenues generated by Enterworks): time and materials, 37.3%; firm fixed price, 51.0%; cost reimbursable, 6.4%; fixed monthly rate, 4.8%; and other, 0.5%. While the Company has not experienced any significant recent terminations or renegotiations, government contracts may be terminated or renegotiated at any time at the convenience of the government.

## STATEMENT OF OPERATIONS DATA

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

	YEAR ENDED DECEMBER 31,					
	1999		1998		1997	
	(dollar amounts in thousands)					
Sales	\$171,364	100.0%	\$207,086	100.0%	\$253,787	100.0%
Cost of sales	151,216	88.2	182,915	88.3	218,430	86.1
Selling, general and administrative expenses	17,459	10.2	30,842	14.9	27,054	10.7
Goodwill amortization	489	0.3	589	0.3	892	0.3
	---	---	---	---	---	---
Operating (loss) income	2,200	1.3	(7,260)	(3.5)	7,411	2.9
Interest expense	(6,065)	(3.5)	(6,555)	(3.1)	(7,455)	(2.9)
Gain on sale of assets	4,731	2.8	5,683	2.7	--	--
Equity in net losses of Enterworks	(18,765)	(11.0)	--	--	--	--
Other income (expense)	67	--	64	--	124	--
	-----	-----	-----	-----	-----	-----
(Loss) income before taxes	(17,832)	(10.4)	(8,068)	(3.9)	80	--
Income tax benefit (provision)	7,853	4.6	(1,103)	(0.5)	1,332	0.6
	-----	---	-----	-----	-----	---
(Loss) income before extraordinary item	(9,979)	(5.8)	(9,171)	(4.4)	1,412	0.6
Extraordinary item	8,015	4.7	--	--	--	--
	-----	---	-----	---	-----	---
Net (loss) income	\$ (1,964)	(1.1)%	\$ (9,171)	(4.4)%	\$1,412	0.6%
	=====	====	=====	====	=====	====

## FINANCIAL DATA BY OPERATING SEGMENT

The Company had three reportable operating segments: Enterworks, Inc., Systems and Support Services, and Products. Enterworks, Inc. was deconsolidated as of December 30, 1999 and therefore will not be reflected as a segment in the year 2000.

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

	YEAR ENDED DECEMBER 31,		
	1999	1998	1997
	(dollar amounts in thousands)		
Revenue:			
Enterworks, Inc.	\$ --	\$ 7,073	\$ 3,398
Systems and Support Services	93,538	98,277	121,052
Products	77,826	101,736	129,337
	-----	-----	-----
TOTAL	\$171,364	\$ 207,086	\$ 253,787
	=====	=====	=====
Gross Profit:			
Enterworks, Inc.	\$ --	\$ 1,542	\$ (132)
Systems and Support Services	16,158	14,046	20,614
Products	3,990	8,583	14,875
	-----	-----	-----
TOTAL	\$ 20,148	\$ 24,171	\$ 35,357
	=====	=====	=====
Gross Margin:			
Enterworks, Inc.	--%	21.8%	(3.9)%
Systems and Support Services	17.3%	14.3%	17.0%
Products	5.1%	8.4%	11.5%
	-----	-----	-----
TOTAL	11.8%	11.7%	13.9%

## RESULTS OF OPERATIONS

## YEARS ENDED DECEMBER 31, 1999 AND 1998

Revenue for 1999 was \$171.3 million, a \$35.7 million or 17.2% decrease from 1998. Approximately \$23.9 million of this decrease was attributable to the Products Group, which experienced a decline in revenue primarily due to the expiration of the Small Multi User Computer II ("SMCII") contract in April 1999.



The SMCII contract contributed revenue of approximately \$44.1 million in 1998 as compared to \$8.8 million in 1999. In addition, the Systems and Support Services Group experienced a \$4.7 million decrease in revenue for the year ended December 31, 1999 as compared to the same period in 1998. This decrease was primarily due to the sale of TIS in February 1998. TIS contributed \$4.0 million of revenue in 1998 prior to its sale. In addition revenue declined in part due to the deconsolidation of Enterworks to an "Equity in Enterworks nets losses" presentation.

Cost of sales was 88.2% of sales for the year ended December 31, 1999, as compared to 88.3% for the same period in 1998. The major changes in cost of sales are attributable to favorable changes in contract mix and a high margin transaction with one of the Company's partners within the Systems and Support Services Group, offset by the elimination of high margin sales within the Enterworks Group.

Gross profit decreased to \$20.1 million for the year ended December 31, 1999 compared to the same 1998 period due to the aforementioned deconsolidation of Enterworks. Gross margins were 11.8% for 1999 as compared to 11.7% for 1998.

Selling, general, and administrative expense ("SG&A") decreased by approximately \$13.4 million or 43.4%, to \$17.4 million for the year ended December 31, 1999 from \$30.8 million in the comparable period of 1998. This decrease is due primarily to the deconsolidation of Enterworks. SG&A as a percentage of revenues decreased to 10.2% for 1999 from 14.9% in the comparable 1998 period.

Goodwill amortization expense decreased \$100,000 for the comparative year periods of 1999 and 1998. This reduction is due to a decrease in the goodwill balance associated with the sales of TIS in early 1998, and TFE in September 1999.

Operating income of the Company increased by \$9.5 million to \$2.2 million for the year ended December 31, 1999 from an operating loss of \$7.3 million in the comparable 1998 period. The increase in operating profit for the comparable year periods is attributable to the decreases in S,G&A discussed above.

At the end of the third quarter of 1999, the Company sold substantially all of the assets of its computer maintenance and service business, Telos Field Engineering Inc. ("TFE"), to TFE Technology Holdings L.L.C., an affiliate of Carr & Company, for \$10 million. As a result of this sale, the Company has recorded a gain of \$4.7 million in its consolidated statement of operations for the year ended December 31, 1999.

Telos sold substantially all of the net assets of one of its divisions, TIS, in the first quarter of 1998. The transaction generated approximately \$14.7 million in cash proceeds and a gain of \$5.7 million was recorded for the year ended December 31, 1998.

In order to present the statement of operations in accordance with APB 18, the revenues, cost of sales, selling general and administrative and interest expenses for Enterworks Inc. were presented in one line item "Equity in net losses in Enterworks" due to the deconsolidation of Enterworks on December 30, 1999. (See Note 2 to the consolidated financial statements). The equity in net losses in Enterworks for 1999 was \$18.8 million.

Interest expense decreased \$490,000 from \$6.6 million in 1998 to \$6.1 million for 1999. The decrease for the year period is due to the deconsolidated presentation of Enterworks partially offset by increased debt levels in 1999.

The income tax benefit was \$7.8 million for the year ended December 31, 1999. The benefit recorded was a result of the net operating losses of the Company, partially offset by the gain from the sale of TFE. For 1998, the Company incurred a tax provision of \$1.1 million which was primarily attributable to state income taxes and an increase in allowances relating to the recoverability of deferred tax assets. The Company's net deferred tax asset includes substantial amounts of net operating loss carryforwards. Failure to achieve forecasted taxable income may affect the ultimate realization of the net deferred tax assets. Management's tax strategy contemplates the generation of taxable income in excess of operating losses sufficient in amounts to realize the net deferred tax assets.

On December 30, 1999 the Company entered into a number of concurrent transactions with its noteholders and its Enterworks subsidiary (See Note 2 of Consolidated Financial Statements). The two most noteworthy of these transactions affecting Telos were as follows:

1. The Company converted approximately \$7.6 million of its Senior Subordinated Notes, Series B, C and D held by investors, plus the accrued interest and the waiver of prepayment premium associated with these notes, into shares of Enterworks' Common Stock currently owned by the Company at an exchange ratio of one share of Enterworks' Common Stock for each \$1.00 principal amount of notes payable. These subordinated notes had a maturity date of October 1, 2000.
2. Enterworks purchased 5,000,000 shares of Enterworks' Common Stock owned by the Company at a price of \$1.00 per share. This amount was reduced by 20% of the Agent's fee, the Company's pro rata share of the proceeds from the transaction. The net amount received by Telos was \$4.7 million.

These two transactions resulted in an extraordinary gain, net of tax, of \$8.0 million, and is included in the Company's statement of

operations for the year ended December 31, 1999.

YEARS ENDED DECEMBER 31, 1998 AND 1997

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

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

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

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

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

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

Interest expense decreased \$1.0 million to \$6.5 million in 1998, from \$7.4 million in 1997. This decrease is due principally to a decrease in the average balance of the Senior Credit Facility for most of 1998 compared to 1997, as well as a reduction in the bank's base rate due to changing economic conditions.

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

#### LIQUIDITY AND CAPITAL RESOURCES

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

At December 31, 1999, the Company had an outstanding balance of \$16.5 million on its \$35 million Senior Credit Facility (the "Facility"). The Facility matures on July 1, 2001 and is collateralized by a majority of the Company's assets including inventory, accounts receivable and the Company's stock in Enterworks, Inc. The amount of borrowings fluctuates based on the underlying asset borrowing base. At December 31, 1999, the Company, under its borrowing base formula, had \$7.1 million of unused availability. The Facility has various covenants which may, among other things, restrict the ability of the Company to merge with another entity, sell or transfer certain assets, pay dividends and make other distributions beyond certain limitations. The Facility also requires the Company to meet certain leverage, net worth, interest coverage and operating goals. At December 31, 1999, the Company was not in compliance with several covenants contained in the Facility; however, the bank has waived this non-compliance. In addition, the bank has amended the covenants to conform to the Company's 2000 budget expectations.

The Company's subordinated notes are held principally by shareholders and management, and totaled \$8.5 million at December 31, 1999. These notes bear interest at rates between 14% and 17% and become payable on April 1, 2001.

The Company currently has two primary classes of redeemable preferred stock - Senior Redeemable Preferred Stock and Public Preferred Stock. Each class carries cumulative dividend rates of 12% to 14.125%. At December 31, 1999 the total carrying value of redeemable preferred stock, including accumulated and unpaid dividends, was \$43.0 million. The Company accrues dividends and provides for accretion related to the redeemable preferred stock. Mandatory redemption for the Senior Redeemable Preferred Stock including all dividends payable, is required on December 31, 2001, subject to the legal availability of funds. Mandatory redemption for the Public Preferred Stock is required from 2005 through 2009, subject to the legal availability of funds.

Cash provided by operating activities was \$11.2 million in 1999, due primarily to a decrease in accounts receivable as a result of the sale of TFE and the decline in sales from this year's fourth quarter compared to the prior year's fourth quarter. Cash provided by investing activities was \$12.7 million in 1999, reflecting capital expenditures of \$1.4 million and \$800,000 in continued investments in software development costs related to Enterworks, offset by the proceeds from the sale of TFE of \$10 million and the sale of the Company's stock in Enterworks for \$4.7 million. The Company used cash from financing activities of \$24.0 million in 1999, reflecting principally the net payments on the Facility.

In September 1999, the Company sold its TFE division for approximately \$10 million. The net proceeds from the sale were used to pay down amounts outstanding under the Facility.

In December 1999, Enterworks completed a private placement financing whereby the Company's voting interest in Enterworks was reduced to 34.8%. As a result of this decrease in ownership, effective December 30, 1999 Enterworks has been deconsolidated from the Company's operating results. As a result, the Company will no longer be required to fund the continuing investment needed for Enterworks sales and marketing infrastructure and product development.

## CAPITAL EXPENDITURES

The Company believes that its business is generally not capital intensive. Capital expenditures for property and equipment were \$1.4 million in 1999 and \$1.2 million in 1998, and \$2.6 million in 1997. The Company anticipates capital expenditures of approximately \$1.4 million in 2000; however, there can be no assurance that this level of capital expenditures will occur.

## INFLATION

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

## YEAR 2000

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

The Company, like most owners of computer software, modified significant portions of its internal use software so that it would function properly in the year 2000. Accordingly, the Company has incurred internal staff costs as well as consulting and other expenses related to software and infrastructure enhancements necessary to prepare the systems for the year 2000. Total expenditures for such costs were not material to the Company's consolidated financial statement in 1998 or 1999. The Company completed its internal use software compliance efforts prior to December 31, 1999. There were no major internal systems issues reported over the year 2000 transition.

The Company queried its key suppliers and vendors to assess their Year 2000 readiness and was informed that software licensed to the Company for resale was compliant for the Year 2000. No major vendor issues were reported over the Year 2000 transition.

As is the case with other similarly situated computer companies, if Telos' current or future customers failed to achieve Year 2000 compliance or if they diverted technology expenditures to address Year 2000 compliance problems, Telos' business, results of operations or financial condition could have been materially adversely affected. For example, agencies of the United States Government are principal customers of the Company. If such agencies experience significant Year 2000 system failures, under terms of typical government contracts, the Company's performance and/or receipt of payments due would have been delayed or contracts could be terminated for convenience, which could have a material adverse effect on the Company. If similar failures were experienced by other customers or potential customers of the Company, this could also have had a material adverse impact on the Company. To the best of the Company's knowledge, none of its major customers experienced significant Year 2000 issues.

Because the Company experienced no major year 2000-related issues internally or externally over the year 2000 transition, it does not believe that it will incur material costs or experience material disruptions in its business associated with the year 2000. However, there can be no assurance that the Company's or its suppliers' current product offerings do not contain undetected errors or defects associated with year 2000 date functions. These could give rise to increased customer satisfaction costs related to year 2000 and to litigation over year 2000 compliance issues. In addition, the Company could experience a shift in revenue to the later quarters of 2000 as customers wrap up issues in their IT environments and begin spending more proactively on new projects.

## RECENT ACCOUNTING PRONOUNCEMENTS

In March 1999, the Company adopted Statement of Position 98-1 ("SOP 98-1"), "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." This standard requires companies to capitalize qualifying computer software costs which incurred during the application development stage and amortize them over the software's estimated useful life. SOP 98-1 is effective for fiscal years beginning after December 15, 1998. The adoption of SOP 98-1 did not have a material impact on the Company's results of operations.

In June 1998, the FASB issued SFAS No. 133, "Accounting or Derivative Instruments and Hedging Activities." SFAS 133 establishes accounting and reporting standards for derivative instruments, including derivative instruments embedded in other contracts, and for hedging activities. SFAS 133, as amended by SFAS 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the effective date of FASB Statement No. 133, an amendment of FASB Statement No. 133", is effective for all quarters of the Company's year ending December 31, 2001. The Company currently does not engage or plan to engage in the use of derivative instruments, and does not expect SFAS 133 to have a material impact on the results of operations.

The Securities and Exchange Commission issued Staff Accounting Bulletin 101 "Revenue Recognition in Financial Statements" ("SAB 101") in December 1999. The Company will continue to evaluate the impact of SAB 101 as new business developments occur.

## FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects" and similar expressions are intended to identify forward-looking statements. There are a number of important factors that could cause the Company's actual results to differ materially from those indicated by such forwarding-looking statements. These factors include, without limitation, those set forth below under the caption "Certain Factors That May Affect Future Results."

## CERTAIN FACTORS THAT MAY AFFECT FUTURE RESULTS

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

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

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

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

The Company is exposed to interest rate volatility with regard to its variable rate debt obligations under its Senior Credit Facility. This facility bears interest at 1.00%, subject to certain adjustments, over the bank's base rate. The weighted average interest rate in 1999 was 9.89%. This facility expires on July 1, 2001 and has an outstanding balance of \$16.5 million at December 31, 1999.

The Company's other long-term debt at December 31, 1999 consists of Senior Subordinated Notes B and C which bear interest at fixed rates ranging from 14% to 17%. The Senior Subordinated Notes mature as to principal in the aggregate amount of \$8,537,000 on April 1, 2001. The Company has no cash flow exposure due to rate changes for its Senior Subordinated Notes.

ITEM 8.

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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INDEX TO SCHEDULES

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

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders  
of Telos Corporation

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of changes in stockholders' investment (deficit) and of cash flows present fairly, in all material respects, the financial position of Telos Corporation and its subsidiaries at December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

/s/ PRICEWATERHOUSECOOPERS LLP

McLean, VA  
March 30, 2000

TELOS CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

(AMOUNTS IN THOUSANDS)

YEAR ENDED DECEMBER 31,

	1999 -----	1998 -----	1997 -----
<b>Sales</b>			
Enterworks, Inc.	\$ --	\$ 7,073	\$ 3,398
Systems and Support Services	93,538	98,277	121,052
Products	77,826	101,736	129,337
	-----	-----	-----
	171,364	207,086	253,787
	-----	-----	-----
<b>Costs and expenses</b>			
Cost of Enterworks, Inc.	--	5,531	3,530
Cost of Systems and Support Services	77,380	84,231	100,438
Cost of Products	73,836	93,153	114,462
Selling, general and administrative expenses	17,459	30,842	27,054
Goodwill Amortization	489	589	892
	-----	-----	-----
	169,164	214,346	246,376
	-----	-----	-----
Operating income (loss)	2,200	(7,260)	7,411
<b>Other income (expenses)</b>			
Non-operating income (expense)	67	64	124
Gain on sale of assets	4,731	5,683	--
Equity in net losses of Enterworks	(18,765)	--	--
Interest Expense	(6,065)	(6,555)	(7,455)
	-----	-----	-----
(Loss) income before income taxes	(17,832)	(8,068)	80
Benefit(provision) for Income Taxes	7,853	(1,103)	1,332
	-----	-----	-----
(Loss) Income before extraordinary item	(9,979)	(9,171)	1,412
Gain from early debt retirement and sale of stock (net of income tax provision of \$5,322)	8,015	--	--
	-----	-----	-----
Net (Loss) Income	\$(1,964)	\$ (9,171)	\$ 1,412
	=====	=====	=====

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



TELOS CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(AMOUNTS IN THOUSANDS)  
ASSETS

	DECEMBER 31,	
	1999	1998
	-----	-----
Current assets		
Cash and cash equivalents		
(includes restricted cash of \$54 and \$160 at		
December 31, 1999 and 1998, respectively )	\$ 315	\$ 408
Accounts receivable, net	25,030	56,783
Receivable from Enterworks	2,000	--
Inventories, net	4,779	8,662
Deferred income taxes	4,802	4,164
Prepaid income taxes	--	220
Other Current Assets	83	487
	-----	-----
Total Current Assets	37,009	70,724
	-----	-----
Property and equipment		
Land and building	--	346
Furniture and equipment	18,924	21,677
Leasehold improvements	2,631	2,683
Property and equipment		
Under Capital Leases	13,774	13,774
	-----	-----
	35,329	38,480
Accumulated Depreciation And Amortization	(23,093)	(24,159)
	-----	-----
	12,236	14,321
	-----	-----
Goodwill, net	4,284	6,896
Investment in Enterworks	--	--
Deferred income taxes	2,930	442
Other Assets	427	2,868
	-----	-----
	\$56,886	\$ 95,251
	=====	=====

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

TELOS CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)  
LIABILITIES, MANDATORILY REDEEMABLE PREFERRED STOCK,  
AND STOCKHOLDERS' INVESTMENT (DEFICIT)

	DECEMBER 31,	
	1999	1998
	-----	-----
Current liabilities		
Accounts payable	\$13,792	\$ 25,206
Accrued compensation and benefits	7,645	7,400
Unearned warranty revenue	5,183	1,349
Current portion, capital lease obligations	370	379
Other Current Liabilities	3,051	3,117
	-----	-----
Total current liabilities	30,041	37,451
Senior credit facility	16,508	36,159
Senior subordinated notes	8,537	18,492
Capital Lease Obligations	11,362	11,710
	-----	-----
Total Liabilities	66,448	103,812
	-----	-----
Commitments and contingencies (Note 9)		
Senior mandatorily redeemable preferred stock	6,054	5,631
Mandatorily Redeemable Convertible Preferred Stock	36,975	31,729
	-----	-----
	43,029	37,360
	-----	-----
Stockholders' investment		
Class A common stock, no par value, 50,000,000 shares authorized, 21,241,980 and 21,238,980 shares issued and outstanding at 1999 and 1998, respectively	65	65
Class B common stock, no par value, 50,000,000 shares authorized, 4,037,628 shares issued and outstanding	13	13
Capital in excess of par	--	2,116
Accumulated Deficit	(52,669)	(48,115)
	-----	-----
Total Stockholders' Investment (Deficit)	(52,591)	(45,921)
	-----	-----
	\$56,886	\$ 95,251
	=====	=====

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

TELOS CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(AMOUNTS IN THOUSANDS)

	YEAR ENDED DECEMBER 31,		
	1999	1998	1997
	-----	-----	-----
Operating activities:			
Net (loss) income	\$(1,964)	\$ (9,171)	\$ 1,412
Adjustments to reconcile net income to cash used in operating activities:			
Depreciation and amortization	4,133	4,266	4,098
Loss on disposal of fixed assets	--	--	715
Goodwill amortization	489	589	892
Amortization of debt issuance costs	243	243	243
Accretion of subordinated notes	412	181	143
Provision for inventory obsolescence	600	1,254	2,150
Provision for doubtful accounts receivable	400	39	490
Gain on sale of assets	(4,731)	(5,683)	--
Gain on sale of fixed assets	(80)	--	--
Gain on sale of Enterworks stock and note conversion	(8,015)	--	--
Write off of debt issuance costs	72	--	--
Incentive bonus accrual	1,500	--	--
Provision for net realizable value of other assets	--	1,743	887
Deferred income tax (benefit) provision	(8,159)	434	(1,719)
Changes in assets and liabilities			
Decrease (increase) in accounts receivable	20,141	(2,329)	(6,913)
Decrease in inventories	2,494	2,826	2,186
Increase in other assets	(116)	(76)	795
Increase (decrease) in accounts payable and other Liabilities	3,762	3,031	(20,559)
	-----	-----	-----
Cash Provided by (Used In) Operating Activities	11,181	(2,653)	(15,180)
	-----	-----	-----
Investing activities:			
Proceeds from sale of assets	10,000	14,675	--
Proceeds from sale of fixed assets	221	--	--
Proceeds from sale of Enterworks stock	5,000	--	--
Payment of offering costs	(303)	--	--
Purchase of property and equipment	(1,389)	(1,250)	(2,589)
Investment in Other Assets	(800)	(2,040)	(3,083)
	-----	-----	-----
Cash Provided by (Used In) Investing Activities	12,729	11,385	(5,672)
	-----	-----	-----
Financing activities:			
(Payments) proceeds from Senior Credit Facility	(19,651)	(3,786)	24,526
Proceeds from debt issuance	--	1,800	--
(Decrease) increase in bank overdrafts	(3,998)	1,641	(4,838)
Repayment of long-term debt	--	--	(651)
Retirement of Class B redeemable preferred stock	--	(6,500)	--
Repurchase of 410,000 shares of redeemable preferred stock	--	(1,640)	--
Proceeds from issuance of common stock upon exercise of Company stock options	3	--	--
Payments Under Capital Lease Obligations	(357)	(426)	(379)
	-----	-----	-----
Cash (used in) provided by financing Activities	(24,003)	( 8,911)	18,658
	-----	-----	-----
Decrease in cash and cash equivalents	(93)	(179)	(2,194)
Cash and Cash Equivalents At Beginning of the Year	408	587	2,781
	-----	-----	-----
Cash and Cash Equivalents At End of Year	\$ 315	\$ 408	\$ 587
	=====	=====	=====
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	5,409	\$ 5,228	\$6,872
	=====	=====	=====
Income Taxes	\$ 272	1,088	\$ 92
	=====	=====	=====

TELOS CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(AMOUNTS IN THOUSANDS)

Year Ended December 31,  
-----  
1999                      1998                      1997  
-----                      -----                      -----

Supplemental schedule of non-cash investing activities:

Equity in Enterworks issuance of common stock warrants	100	--	--
Contribution of Enterworks common stock	211	--	--
Forgiveness of Enterworks payable	20,445	--	--
Exchange of Enterworks stock for forgiveness of Enterworks payable	4,000	--	--
Equity in Enterworks conversion of subordinated notes	1,140	--	--
Reduction of investment in Enterworks	27,386	--	--

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

TELOS CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' INVESTMENT (DEFICIT)  
(AMOUNTS IN THOUSANDS)

	Class A Common Stock -----	Class B Common Stock -----	Capital In Excess of Par -----	Accumulated Deficit -----	Total Stockholders' Investment (Deficit) -----
Balance December 31, 1996	\$ 65	\$ 13	\$ 4,048	\$(37,356)	\$(33,230)
Senior redeemable preferred stock dividend	--	--	(379)	--	(379)
Class B redeemable preferred stock dividend	--	--	(948)	--	(948)
Redeemable preferred stock dividend	--	--	(2,721)	(1,594)	(4,315)
Redeemable preferred stock accretion	--	--	--	(1,406)	(1,406)
Net Income for the Year	--	--	--	1,412	1,412
	--	--	-----	-----	-----
Balance December 31, 1997	65	13	--	(38,944)	(38,866)
Senior redeemable preferred stock dividend	--	--	(423)	--	(423)
Class B redeemable preferred stock dividend	--	--	(347)	--	(347)
Redeemable preferred stock dividend	--	--	(4,068)	--	(4,068)
Redeemable preferred stock accretion	--	--	(1,527)	--	(1,527)
Gain on retirement of Class B redeemable preferred stock	--	--	5,883	--	5,883
Repurchase of 410,000 shares of redeemable preferred stock	--	--	2,178	--	2,178
Issuance of Telos common stock warrants	--	--	420	--	420
Net Loss for the Year	--	--	--	(9,171)	(9,171)
	--	--	-----	-----	-----
Balance December 31, 1998	65	13	2,116	(48,115)	(45,921)
Senior redeemable preferred stock dividend	--	--	(423)	--	(423)
Redeemable preferred stock dividend	--	--	(1,693)	(2,132)	(3,825)
Redeemable preferred stock accretion	--	--	--	(1,424)	(1,424)
Equity in Enterworks conversion of subordinated notes	--	--	--	1,140	1,140
Issuance of common stock upon exercise of Company stock options	--	--	--	3	3
Non-cash stock-based compensation	--	--	--	12	12
Deconsolidation of Enterworks accounts	--	--	--	27,197	27,197
Reduction of investment in Enterworks	--	--	--	(27,388)	(27,388)
Net Loss for the Year	--	--	--	(1,964)	(1,964)
	--	--	-----	-----	-----
Balance December 31, 1999	\$ 65 =====	\$ 13 =====	\$ -- =====	\$(52,669) =====	\$(52,591) =====

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

TELOS CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BUSINESS AND ORGANIZATION

Telos Corporation ("Telos" or "the Company") delivers e-Solutions for Connected Enterprises(TM). Telos' complete e-business solutions help organizations become more customer intimate, realize operational advantages, and establish market leadership. Telos leverages the Internet and Web-based strategies to link complex environments, encompassing people, processes, and technologies.

Telos' clients, spanning both government agencies and commercial enterprises, are preparing to meet the demands of the new, connected economy. To address the business problems related to logistics, supply-chain management, and Web-based commerce, Telos e-Solutions include order status tracking, asset visibility, patient record access, security, motor pool and aircraft maintenance, and financial reconciliation. Telos utilizes fixed-price/fixed-time solutions to control costs and increase productivity.

The Company, founded in 1968, is incorporated under the laws of the State of Maryland.

PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of Telos Corporation and its wholly owned subsidiaries, Telos Corporation (California), and Telos International Corporation. The accounts of the Company's investment in Enterworks, Inc., ("Enterworks") have been deconsolidated as of December 30, 1999, and therefore have been removed from the consolidated balance sheet and statement of changes in stockholders equity. The statement of operations includes the results of Enterworks Inc. as "Equity in Net Losses of Enterworks" in accordance with APB 18 (Note 2). Significant intercompany transactions have been eliminated.

USE OF ESTIMATES

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

REVENUE RECOGNITION

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

TELOS CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Revenue from the licensing of software is recognized in accordance with American Institute of Certified Public Accountants (AICPA) Statement of Position ("SOP") 97-2 and 98-4, "Software Revenue Recognition". In December 1998, the AICPA issued SOP 98-9, "Modification of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions". SOP 98-9 requires revenue to be recognized using the "residual method" if certain conditions are met. This approach results in contract discounts being applied to the license with no such allocation to deferred support elements. The Company has adopted the provisions of SOP 98-9 for the year ended December 31, 1999. The adoption of SOP 98-9 did not have a significant effect on the Company's results from operations. Revenue generated from warranty service contracts is recognized ratably over the warranty service period.

CASH AND CASH EQUIVALENTS

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

INVENTORIES

Inventories are stated at the lower of cost or market, cost being determined primarily on the first-in, first-out method. Substantially all inventories consist of purchased hardware and component computer parts used in connection with system integration services performed by the Company. Inventories also include spare parts of \$478,000 and \$729,000 at December 31, 1999 and 1998, respectively, which are utilized to support maintenance contracts. Spare parts inventory is amortized on a straight line basis over five years. An allowance for obsolete, slow-moving or non-salable inventory is provided for all other inventory. This allowance is based on the Company's overall obsolescence experience and its assessment of future inventory requirements.

At December 31, 1999 and 1998, the Company's allowance for product inventory was \$1,992,000 and \$3,074,000, respectively. The components of the allowance for inventory obsolescence are set forth below (in thousands):

	Balance, Beginning Of Year -----	Additions Charged to Costs and Expense -----	Deductions(1) -----	Balance, End of Year -----
Year Ended December 31, 1999	\$ 3,074	\$ 600	\$ 1,682	\$ 1,992
Year Ended December 31, 1998	\$ 3,915	\$ 1,090	\$ 1,931	\$ 3,074
Year Ended December 31, 1997	\$ 2,357	\$ 2,150	\$ 592	\$ 3,915

(1) Inventories written off or transferred to fixed assets.

PROPERTY AND EQUIPMENT

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

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

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

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

The Company's policy on internal use software is in accordance with Statement of Position 98-1 ("SOP 98-1"), "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." This standard requires companies to capitalize qualifying computer software costs which are incurred during the application development stage and amortize them over the software's estimated useful life.

Depreciation and amortization expense related to property and equipment, including property and equipment under capital leases, was \$2,314,000, \$2,460,000 and \$2,630,000 for the years ended December 31, 1999, 1998 and 1997, respectively.

#### GOODWILL

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

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

Accumulated amortization of goodwill at December 31, 1999 and 1998 was \$9,444,000 and \$8,955,000 respectively.

#### OTHER ASSETS

Until the deconsolidation of Enterworks on December 30, 1999 (Note 2), other noncurrent assets consist principally of capitalized software development costs and debt issuance costs. The balance as of December 31, 1999 consists mostly of refundable deposits.

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

Unamortized software and product costs at December 31, 1999 and 1998 were -0- and \$1.9 million, respectively. Amortization expense associated with these capitalized software and product costs was \$1,646,000, \$2,044,000, and \$1,128,000 in 1999, 1998 and 1997, respectively. Additionally, \$1,743,000 and \$887,000 were written off as net realizable value adjustments in the fourth quarter of 1998 and in the fourth quarter of 1997, respectively.

Debt issuance costs are amortized over the term of the underlying financial instrument, which amortization method does not differ significantly from the effective interest method. Due to the retirement of \$7.6 million of Series B, C and D subordinated notes in December 1999 (Note 5), \$72,000 in debt issue costs were written off in 1999. Unamortized costs amounted to \$110,000 and \$425,000 at December 31, 1999 and 1998, respectively.

#### INCOME TAXES

The Company accounts for income taxes under Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes". Under this asset and liability method, deferred tax assets and liabilities are recognized for the estimated future tax consequences of temporary differences and income tax credits. Deferred tax assets and liabilities are measured by applying enacted statutory tax rates that are applicable to the future years in which deferred tax assets or liabilities are expected to be settled or realized to the differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. Any change in tax rates on deferred tax assets and liabilities is recognized in net income in the period in which the tax rate change is enacted. The Company provides a valuation allowance that reduces deferred tax assets when it is "more likely than not" that deferred tax assets will not be realized.



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ACCOUNTING FOR STOCK BASED COMPENSATION

The Company accounts for stock-based compensation using the intrinsic value method provided by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." Under APB 25, compensation cost is measured as the excess, if any, of the deemed fair market value of the Company's common stock at the date of grant over the exercise price of the option granted. Compensation cost for stock options, if any, is recognized over the vesting period. The Company provides additional pro forma disclosures as if the fair value measurement provisions of SFAS No. 123 had been used in determining compensation expense (See Note 7).

RESEARCH AND DEVELOPMENT

The Company charges all research and development costs to expense as incurred, until, as in the case of software, technological feasibility is reached after which time such costs are capitalized. During 1999, 1998 and 1997, the Company incurred \$7.2 million, \$6.1 million and \$1.0 million in research and development costs, respectively.

EARNINGS PER SHARE

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

COMPREHENSIVE INCOME

Comprehensive income includes changes in equity (net assets) during a period from non-owner sources. The Company has no comprehensive income components other than its net loss.

FINANCIAL INSTRUMENTS

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

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

TELOS CORPORATION AND SUBSIDIARIES  
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RECLASSIFICATIONS

Certain reclassifications have been made to the 1998 and 1997 financial statements to conform to the current period presentation.

RECENT ACCOUNTING PRONOUNCEMENTS

In March 1999, the Company adopted Statement of Position 98-1 ("SOP 98-1"), "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." This standard requires companies to capitalize qualifying computer software costs which incurred during the application development stage and amortize them over the software's estimated useful life. SOP 98-1 is effective for fiscal years beginning after December 15, 1998. The adoption of SOP 98-1 did not have a material impact on the Company's results of operations.

In June 1998, the FASB issued SFAS No. 133, "Accounting or Derivative Instruments and Hedging Activities." SFAS 133 establishes accounting and reporting standards for derivative instruments, including derivative instruments embedded in other contracts, and for hedging activities. SFAS 133, as amended by SFAS 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the effective date of FASB Statement No. 133, an amendment of FASB Statement No. 133", is effective for all quarters of the Company's year ending December 31, 2001. The Company currently does not engage or plan to engage in the use of derivative instruments, and does not expect SFAS 133 to have a material impact on the results of operations.

The Securities and Exchange Commission issued Staff Accounting Bulletin 101 "Revenue Recognition in Financial Statements" ("SAB 101") in December 1999. The Company will continue to evaluate the impact of SAB 101 as new business developments occur.

NOTE 2. DECONSOLIDATION OF ENTERWORKS, INC. SUBSIDIARY

On December 30, 1999, Enterworks, Inc. ("Enterworks"), a majority-owned subsidiary of the Company, completed a private placement of 21,739,127 shares of Series A Convertible Preferred Stock ("Preferred Stock") at a price of \$1.15 per share. The sale generated gross proceeds of \$25,000,000. In addition, the Company entered into a series of concurrent transactions pursuant to which the Company's voting interest in Enterworks was reduced to approximately 34.8%. The concurrent transactions were as follows:

1. The Company converted approximately \$7.6 million of its Senior Subordinated Notes, Series B, C and D held by investors, plus the accrued interest and the waiver of prepayment premium associated with these notes, into shares of Enterworks' Common Stock currently owned by the Company at an exchange ratio of one share of Enterworks' Common Stock for each \$1.00 principal amount of notes payable. These subordinated notes had a maturity date of October 1, 2000.
2. Enterworks purchased 5,000,000 shares of Enterworks' Common Stock owned by the Company at a price of \$1.00 per share. This amount was reduced by 20% of the Agent's fee, the Company's pro rata share of the proceeds from the transaction. The net amount received was \$4.7 million. This transaction, together with the one described above, resulted in an extraordinary gain, net of tax of \$5.3 million, of \$8.0 million, which is included in the Company's statement of operations for the year ended December 31, 1999.
3. Enterworks' payable to the Company, which was approximately \$24.4 million at December 30, 1999, was cancelled in its entirety before the issuance of Series A Preferred Stock. The forgiveness of the payable increased the Company's investment in Enterworks. Funding required to cover Enterworks' working capital needs from November 30, 1999 to the date of closing was funded by the Company and will be repaid through collections from Enterworks' trade accounts receivable. This funding approximated \$2.0 million. This forgiveness of intercompany debt is deemed by management to be a normal occurrence of a capital raising transaction.
4. Enterworks issued 4,000,000 shares of Enterworks' Common Stock to Telos concurrent with the issuance of Series A Preferred Stock. This issuance increased the Company's investment in Enterworks as it increased the number of shares the Company owned in Enterworks.
5. Enterworks issued a warrant to acquire 350,000 shares of Enterworks' Common Stock to Telos' primary lender, Bank of America, in connection with obtaining the necessary approvals for this offering. The exercise price of the warrant equaled \$1.15 per share, the same per share price of the Series A Preferred Stock. This warrant was recorded at its fair market value as a charge to interest expense and a reduction to the Company's investment in Enterworks as it increased the number of shares the Company owned in Enterworks.
6. Telos contributed 210,912 shares of Enterworks' Common Stock owned by Telos to the Enterworks Treasury for the subsequent grant of warrants to the Agent, Deutsche Bank Alex. Brown. This issuance of warrants was also part of the Agent's fee. This contribution of shares was also a charge to interest expense and a reduction to the Company's investment in Enterworks.

TELOS CORPORATION AND SUBSIDIARIES  
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As a result of the reduction of the Company's ownership percentage in Enterworks the Company has changed its method of accounting for its Enterworks subsidiary from the consolidation method to the equity method. Pursuant to this change the revenues, costs and expenses of Enterworks have been excluded from their respective captions in the Company's consolidated statement of operations, and the Company's interest in the losses of Enterworks have been reported separately as "Equity in Net Losses of Enterworks." Additionally, the assets, liabilities, and equity of Enterworks will be excluded from their respective consolidated balance sheet captions and the Company will establish an "Investment in Enterworks" account in accordance with Accounting Principles Board PB 18. As of December 30, 1999, the balance is zero in the Investment in Enterworks account.

The results of operations of Enterworks included in the "Equity in Net Losses in Enterworks" caption are comprised of the following:

Sales	\$ 11,079
Cost of sales	(6,795)
Selling, general and administrative expenses	(21,695)
Interest expense	(1,354)
	-----
Loss before income taxes	\$ (18,765)
	=====

NOTE 3. SALE OF ASSETS

On September 29, 1999, the Company sold substantially all of the assets of its computer maintenance and service business, Telos Field Engineering, Inc. ("TFE"), to TFE Technology Holdings, LLC ("TFE Holdings"), an affiliate of Carr & Company, for \$10 million. As a result of this sale, the Company has recorded a gain of \$4.7 million in its consolidated statement of operations for the year ended December 31, 1999. This gain included a write-off of \$2.1 million of goodwill allocated to TFE operations. The Company and TFE Holdings entered into a one-year corporate services agreement on the date of the sale. Under the terms of the Agreement, Telos will continue to provide certain administrative support functions to TFE Holdings, including but not limited to finance and accounting and human resources, in return for a monthly payment.

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

TELOS CORPORATION AND SUBSIDIARIES  
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NOTE 4. REVENUE AND ACCOUNTS RECEIVABLE

Revenue resulting from contracts and subcontracts with federal, state, and local governments accounted for 94.1%, 94.9% and 96.1% of consolidated revenue in 1999, 1998 and 1997, respectively. As the Company's primary customer is the federal government, the Company has a concentration of credit risk associated with its accounts receivable. However, the Company does not believe the likelihood of loss arising from such concentration is significant. The Company performs ongoing credit evaluations of its customers and generally does not require collateral from its customers. The Company maintains allowances for potential losses.

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

	DECEMBER 31,	
	1999 ----	1998 ----
Billed Accounts Receivable	\$22,592	\$ 48,222
	-----	-----
Amounts billable upon acceptance by customer	2,841	1,422
Amounts Currently Billable	2,427	7,878
	-----	-----
Total Unbilled Accounts Receivable	5,268	9,300
	-----	-----
Allowance for Doubtful Accounts	(830)	(739)
	-----	-----
	\$27,030	\$56,783
	=====	=====

The components of the allowance for doubtful accounts are set forth below (in thousands):

	Balance, Beginning of Year -----	Additions Charged to Costs and Expense -----	Deductions(1) -----	Balance, End of Year -----
Year ended December 31, 1999	\$ 739	\$ 400	\$ (309)	\$ 830
Year ended December 31, 1998	964	39	(264)	739
Year ended December 31, 1997	925	490	(451)	964

1. Accounts receivable written-off

NOTE 5. DEBT OBLIGATIONS

SENIOR REVOLVING CREDIT FACILITY

At December 31, 1999, the Company has a \$35 million Senior Revolving Credit Facility (the "Facility") with a bank which expires on July 1, 2001 and has an outstanding balance of \$16.5 million. Borrowings under the facility are collateralized by a majority of the Company's assets including accounts receivable, inventory, and the remaining Enterworks stock owned by the Company. The lien the bank held on the sold stock in Enterworks, Inc. as well as the accounts receivable balance of Enterworks was released in order to complete the Enterworks transaction and subsequent deconsolidation (Note 2). The amount of the available borrowings fluctuates based on the underlying asset borrowing base. The facility requires payment of a fee of .25% of the unused portion of the Facility. The Facility bears interest at 1.00%, subject to certain adjustments, over the bank's base rate, which was 9.5% at December 31, 1999.

The weighted average interest rate on the outstanding borrowings under the Facility was 9.89% for 1999 compared with 9.95% for 1998. At December 31, 1999, the Company had approximately \$7.1 million available under the Facility.

The Facility has various covenants which may, among other things, restrict the ability of the Company to merge with another entity, sell or transfer certain assets, pay dividends and make other distributions beyond certain limitations. The Facility also requires the Company to meet certain leverage, net worth, interest coverage and operating goals. At December 31, 1999, the Company was not in compliance with several covenants contained in the Facility; however, the bank has waived such non-compliance. In addition, the bank has amended the covenants to conform to the Company's 2000 budget expectations.

The carrying value of the Facility at December 31, 1999 and 1998 approximates fair value.

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SENIOR SUBORDINATED NOTES

In 1995 the Company issued Senior Subordinated Notes ("Notes") to certain shareholders. The Notes are classified as either Series B or Series C. Series B Notes are collateralized by fixed assets of the Company. Series C Notes are unsecured. Both the Series B and Series C Notes have a maturity date of April 1, 2001 and have interest rates ranging from 14% to 17%. Interest is paid quarterly on January 1, April 1, July 1, and October 1 of each year. The Notes can be prepaid at the Company's option. Additionally, these Notes have a cumulative payment premium of 13.5% per annum payable only upon certain circumstances. These circumstances include an initial public offering of the Company's common stock or a significant refinancing, to the extent that net proceeds from either of the above events are received and are sufficient to pay the premium. Due to the contingent nature of the premium payment, the associated premium expense will only be recorded after the occurrence of a triggering event. At December 31, 1999, the prepayment premium that would be due upon a triggering event is \$6.3 million.

In conjunction with the Enterworks private placement offering (See Note 2), the Company retired approximately \$1.0 million of Series B Notes, \$4.8 million of Series C Notes, and \$1.8 million of Series D Notes in exchange for shares of Enterworks' common stock owned by the Company at an exchange ratio of one share of Enterworks' common stock for each \$1.00 principal amount of notes payable. In addition to the retirement of these notes, accrued interest of approximately \$300,000 was forgiven and the holders of these notes waived their rights to the prepayment premium associated with these notes.

The balances of the Series B and Series C Notes were \$5.5 million and \$3.0 million, respectively, at December 31, 1999 compared to balances of \$6.5 million and \$7.9 million, respectively, at December 31, 1998.

In November 1998, the Company issued additional Senior Subordinated Notes to certain shareholders which are classified as Series D. The Series D Notes total \$1.8 million and were unsecured. The Series D Notes had a maturity date of October 1, 2000 and bear interest at 14% per annum. Interest was paid quarterly on January 1, April 1, July 1, and October 1 of each year. The notes could have been prepaid at the Company's option. These Notes contained the same payment premium provisions as the Series B and Series C Notes (see above). In connection with the debt, the Company issued 1,500,000 warrants to purchase shares of the Company's Class A Common Stock. The warrants have an exercise price of \$.01 and an exercise period of 22 months. The Company has assigned a value to the warrants of \$420,000 which has been included in capital in excess of par. These notes were retired in conjunction with the Enterworks private placement (Note 2), making the outstanding carrying balance zero at December 31, 1999 compared to \$1.4 million at December 31, 1998.

ENTERWORKS SUBORDINATED NOTES

During 1996, Enterworks completed a private financing whereby \$3,278,000 of 8% subordinated notes payable were issued. Approximately \$2,278,000 of the senior subordinated notes were payable to certain numbers of Telos' Board of Directors, management and certain Telos stockholders. The subordinated notes payable had a five-year maturity. Interest was paid quarterly on January 1, April 1, July 1, and October 1 of each year, commencing on January 1, 1998. In connection with the financing, Enterworks issued 2,048,725 detachable warrants to purchase shares of Enterworks common stock. The warrants have an exercise price of \$1.00, were immediately exercisable and expire in July 2006. The estimated fair value of the warrants of \$922,000 was recorded to capital in excess of par. Interest expense in the accompanying statements of operations includes \$142,000, \$167,000, and \$555,000 (including \$359,000 related to the acceleration of accretion at the time of repayment) in 1997, 1998, and 1999, respectively, for accretion of the difference between the carrying value and face value of these notes payable.

In connection with Enterworks' December 1999 issuance of Series A Preferred Stock (Note 2), \$572,000 of subordinated notes payable were paid and \$2,706,000 were converted into Enterworks' Common Stock.

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NOTE 6. REDEEMABLE PREFERRED STOCK

SENIOR REDEEMABLE PREFERRED STOCK

The components of the senior redeemable preferred stock are Series A-1 and Series A-2, each with \$.01 par value and 1,250 and 1,750 shares authorized, issued and outstanding, respectively. The Series A-1 and Series A-2 each carry a cumulative dividend rate of 14.125% per annum of their liquidation value of \$1,000 per share. The dividends are payable semi-annually on June 30 and December 31 of each year. The liquidation preference of the preferred stock is the face amount of the Series A-1 and A-2 Stock (\$1,000 per share), plus all accrued and unpaid dividends. The Company is required to redeem all of the outstanding shares of the stock on December 31, 2001, subject to the legal availability of funds. Mandatory redemptions are required from excess cash flows, as defined in the stock agreements. The Series A-1 and A-2 redeemable preferred stock is senior to all other present and future equity of the Company. The Series A-1 is senior to the Series A-2. The Company has not declared dividends on its senior redeemable preferred stock since its issuance. At December 31, 1999 and 1998 undeclared, unpaid dividends relating to Series A-1 and A-2 redeemable preferred stock totaled \$3,054,000 and \$2,631,000, respectively, and have been accrued and are included in the Series A-1 and A-2 redeemable preferred stock balances.

12% CUMULATIVE EXCHANGEABLE REDEEMABLE PREFERRED STOCK

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

The Company initially issued 2,858,723 shares of 12% Cumulative Exchangeable Mandatorily Redeemable Preferred Stock (the "Public Preferred Stock") pursuant to the acquisition of the Company during fiscal year 1990. The Public Preferred Stock was recorded at fair value on the date of original issue, November 21, 1989, and the Company is making periodic accretions under the interest method of the excess of the redemption value over the recorded value. Accretion for the years ended December 31, 1999 and 1998 was 1,424,000 and \$1,528,000, respectively. The Company declared stock dividends totaling 736,863 shares in 1990 and 1991.

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

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

The Public Preferred Stock accrues a semi-annual dividend at an annual rate of 12% (\$1.20) per share, based on the liquidation preference of \$10 per share, and is fully cumulative. Through November 21, 1995, the Company had the option to pay dividends in additional shares of Preferred Stock in lieu of cash. Following November 21, 1995, dividend are only payable in cash. Dividends in additional shares of the Preferred Stock are paid at the rate of 6% of a share of the Preferred Stock for each \$.60 of such dividends not paid in cash. Dividends are payable by the Company, provided the Company has legally available funds under Maryland law, when and if declared by the Board of Directors, commencing June 1, 1990, and on each six month anniversary thereof. For the years 1992 through 1994 and for the dividend payable June 1, 1995, the Company has accrued undeclared dividends in additional shares of preferred stock. These accrued dividends are valued at \$3,950,000. Had the Company accrued such dividends on a cash basis, the total amount accrued would have been \$15,101,000. For the cash dividends payable since December 1, 1995, the Company has accrued \$18,677,000.

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

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NOTE 7. STOCKHOLDERS' INVESTMENT AND EMPLOYEE BENEFIT PLANS

COMMON STOCK

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

STOCK WARRANTS

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

STOCK OPTIONS

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

The Company generally grants options under its respective plans at the estimated fair value at the date of grant. Fair value is determined by the members of the option committee based upon all information available to it.

1990 STOCK OPTION PLAN

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

	STOCK OPTION ACTIVITY	
	Numbers of Shares	Weighted Average
	(000'S)	EXERCISE PRICE
Outstanding at December 31, 1996	585	\$1.42
Granted	--	--
Exercised	--	--
Canceled	(55)	1.42
	---	----
Outstanding at December 31, 1997	530	\$1.42
Granted	1,495	1.07
Exercised	--	--
Canceled	(85)	1.42
	-----	----
Outstanding at December 31, 1998	1,940	\$ 1.27
Granted	418	1.35
Exercised	--	--
Canceled	(640)	1.12
	-----	----
Outstanding At December 31, 1999	1,718	\$1.22
	=====	=====



TELOS CORPORATION AND SUBSIDIARIES  
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1996 STOCK OPTION PLAN

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

	STOCK OPTION ACTIVITY	
	Number of Shares	Weighted Average
	(000'S)	EXERCISE PRICE
	-----	-----
Outstanding at December 31, 1996	3,738	\$0.95
Granted	772	1.01
Exercised	--	--
Canceled	(259)	0.97
	-----	-----
Outstanding at December 31, 1997	4,251	\$0.96
Granted	1,447	1.07
Exercised	--	--
Canceled	(143)	0.98
	-----	-----
Outstanding at December 31, 1998	5,555	\$0.99
Granted	353	1.35
Exercised	(3)	0.95
Canceled	(901)	1.01
	-----	-----
Outstanding At December 31, 1999	5,004	\$1.01
	=====	=====

TELOS CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

OTHER OPTION PLANS

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

	STOCK OPTION ACTIVITY	
	Number of Shares	Weighted Average
	(000'S)	EXERCISE PRICE
Outstanding at December 31, 1996	1,401	\$0.50
Granted	653	1.01
Exercised	--	--
Canceled	(700)	0.50
	-----	-----
Outstanding at December 31, 1997	1,354	\$0.75
Granted	--	--
Exercised	--	--
Canceled	--	--
	--	--
Outstanding at December 31, 1998	1,354	\$0.75
Granted	--	--
Exercised	--	--
Canceled	(103)	1.01
	-----	-----
Outstanding At December 31, 1999	1,251	\$0.72
	=====	=====

Mr. Wood has the option to cancel the 1993 stock options discussed above or receive an equal number of options under the 1996 plan at an exercise price of \$0.95 per share. Additionally, the effect on the 1996 stock option plan as of December 31, 1999 would be to increase the number of shares outstanding to 5,704,365 with a weighted average exercise price of \$1.00 per share.

TELOS CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes information about stock options outstanding and exercisable at December 31, 1999:

	Range of Exercise Prices	Number Outstanding (000'S)	OPTIONS OUTSTANDING		OPTIONS EXERCISABLE	
			Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Number Exercisable (000'S)	Weighted Average Exercise Price
1990 Stock Option Plan	\$1.07	918	8.4 years	\$1.07	368	\$1.07
	\$1.35	408	9.7 years	\$1.35	81	\$1.35
	\$1.40	18	8.6 years	\$1.07	7	\$1.07
	\$1.42	374	1.0 years	\$1.42	374	\$1.42
	-----	---	-----	-----	---	-----
	\$1.07 - \$1.42	1,718	7.1 years	\$1.22	830	\$1.26
	=====	=====	=====	=====	=====	=====
Other Stock Option Plan	\$0.50	701	4.0 years	\$0.50	701	\$0.50
	\$1.01	550	7.1 years	\$1.01	330	\$1.01
	-----	---	-----	-----	---	-----
	\$0.50 - \$1.01	1,251	5.4 years	\$0.72	1,031	\$0.66
	=====	=====	=====	=====	=====	=====
1996 Stock Option Plan	\$0.95	3,016	6.4 years	\$0.95	1,592	\$0.95
	\$0.97	88	6.6 years	\$0.97	70	\$0.97
	\$1.01	469	7.2 years	\$1.01	248	\$1.01
	\$1.07	1,046	8.4 years	\$1.07	361	\$1.07
	\$1.35	315	9.5 years	\$1.35	86	\$1.35
	\$1.40	70	8.7 years	\$1.40	61	\$1.40
	-----	---	-----	-----	---	-----
	\$0.95 - \$1.40	5,004	7.1 years	\$1.01	2,418	\$1.00
	=====	=====	=====	=====	=====	=====

The weighted-average fair value of options granted under the 1990 Stock Option Plan, the Other Stock Option Plan, and the 1996 Stock Option Plan, was \$0.28, \$0, and \$0.25, respectively, in 1999 and \$0.26, \$0, and \$0.25 per share, respectively, in 1998. Had the Company determined compensation cost consistent with SFAS No. 123 methodology, net (loss) income would have been (\$2,743,000), (\$9,666,000), and \$1,073,000 in 1999, 1998 and 1997, respectively. Significant assumptions used in determining the fair value of each option grant at the date of grant were as follows:

	1990 Stock Option Plan			Other Stock Option Plan		
	1999	1998	1997	1999	1998	1997
Expected dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Expected stock price volatility	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Risk free interest rate	5.82%	5.54%	--	--	--	6.28%
Expected life of options	4.0yrs	5.3yrs	--	--	--	4.0yrs
	-----					
	1996 Stock Option Plan					
	1999	1998	1997			
	-----	-----	-----			
Expected dividend yield	0.0%	0.0%	0.0%			
Expected stock price volatility	0.0%	0.0%	0.0%			
Risk free interest rate	5.60%	5.54%	6.28%			
Expected life of options	3.6yrs	4.8yrs	5.5yrs			

Because the pro forma disclosures under SFAS No. 123 only apply to stock options granted in or after 1995, pro forma net income for 1997, 1998 and 1999 is not necessarily indicative of future periods.

TELOS SHARED SAVINGS PLAN

The Company sponsors a defined contribution employee savings plan (the "Plan") under which substantially all full-time employees are eligible to participate. The Company matches one-half of voluntary participant contributions to the Plan up to a maximum Company contribution of 3% of a participant's salary. Total Company contributions to this Plan for 1999, 1998, and 1997 were \$1,080,000, \$835,000, and \$1,335,000, respectively.

TELOS CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8. INCOME TAXES

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

	FOR THE YEAR ENDED DECEMBER 31,		
	1999	1998	1997
	----	----	----
Current provision (benefit)			
Federal	\$ --	\$ --	\$ --
State	306	669	387
	---	---	---
Total Current	306	669	387
	---	---	---
Deferred provision (benefit)			
Federal	(6,946)	568	(1,464)
State	(1,213)	( 134)	(255)
	-----	-----	-----
Total Deferred	(8,159)	434	(1,719)
	-----	-----	-----
Total Provision (Benefit)	\$(7,853)	\$ 1,103	\$(1,332)
	=====	=====	=====

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

	FOR THE YEAR ENDED DECEMBER 31,		
	1999	1998	1997
	----	----	----
Computed expected income tax provision (benefit)	(34.0)%	(34.0)%	34.0%
Goodwill amortization	0.9	2.4	379.6
State income taxes, net of federal income tax benefit	(2.6)	(1.8)	5.9
Change in valuation allowance for deferred tax assets	(12.9)	24.9	(2,214.0)
Meals and entertainment	0.5	1.1	111.8
Sale of division/other	4.1	20.9	17.2
	---	---	---
	(44.0)%	13.5%	(1,665.5)%
	=====	=====	=====

TELOS CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1999 and 1998 are as follows (in thousands):

	DECEMBER 31,	
	1999	1998
Deferred tax assets:		
Accounts receivable, principally due to allowance for doubtful accounts	\$ 161	\$ 153
Allowance for inventory obsolescence and amortization	946	1,377
Accrued liabilities not currently deductible	1,842	794
Accrued compensation	1,786	1,562
Property and equipment, principally due to differences in depreciation methods	895	396
Net operating loss carryforwards	2,174	5,660
Alternative minimum tax credit carryforward	703	703
	-----	-----
Total gross deferred tax assets	8,507	10,645
Less valuation allowance	(572)	(4,987)
	-----	-----
Net deferred tax assets	7,935	5,658
	-----	-----
Deferred tax liabilities:		
Unbilled accounts receivable, deferred for tax purposes	(203)	(317)
Software development costs	--	(735)
	-----	-----
Total deferred tax liabilities	(203)	(1,052)
	-----	-----
Net deferred tax assets	\$7,732	\$4,606
	=====	=====

The components of the valuation allowance are as follows (in thousands):

	Balance at Beginning of Period	Additions Charged to Expenses	Deductions	Balance at End of Period
	-----	-----	-----	-----
December 31, 1999	\$ 4,987	\$ --	\$(4,415)(1)	\$ 572
December 31, 1998	2,974	2,013	--	4,987
December 31, 1997	4,702	--	(1,728)	2,974

(1) Included \$2,115 attributable to Enterworks

The net change in the valuation allowance was a decrease of \$2,300,000 for 1999 and an increase of \$2,013,000 for 1998. The decrease in the valuation allowance for 1999 is attributable to management's view that it is more likely than not that the deferred tax assets will be realized with forecasted taxable income which justifies the recognition of the net deferred tax assets recorded. The above deferred tax assets and liabilities were adjusted to reflect the deconsolidation of Enterworks from Telos on December 30, 1999.

At December 31, 1999, for federal income tax purposes the Company had net operating loss carryforwards of \$4,012,000 available to offset future regular taxable income. These net operating loss carryforwards expire in 2011 through 2015. Additionally, \$2,439,000 of alternative minimum tax net operating loss carryforwards are available to offset future alternative minimum taxable income. These alternative minimum tax net operating loss carryforwards also expire from 2011 through 2015. In addition, the Company has \$703,000 of alternative minimum tax credits available to be carried forward indefinitely to reduce future regular tax liabilities.

TELOS CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9. COMMITMENTS AND CONTINGENCIES

LEASES

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

On March 1, 1996, the Company entered into a twenty year capital lease for a building that serves as its corporate headquarters. The Company has accounted for this transaction as a capital lease and has accordingly recorded assets and a corresponding liability of approximately \$12.3 million. Under the terms of the lease, the landlord furnished the Company with \$1.3 million to fund tenant improvements and other building costs.

The following is a schedule by years of future minimum payments under capital leases together with the present value of the net minimum lease payments as of December 31, 1999 (in thousands):

	PROPERTY	EQUIPMENT	TOTAL
2000	\$ 1,543	\$ 113	\$ 1,656
2001	1,543	54	1,597
2002	1,543	--	1,543
2003	1,543	--	1,543
2004	1,543	--	1,543
Remainder	17,362	--	17,362
	-----	---	-----
Total minimum obligations	25,077	167	25,244
Less amounts representing interest	(13,470)	(42)	(13,512)
	-----	---	-----
Net present value of minimum obligations	11,607	125	11,732
Less current portion	(270)	(100)	(370)
	-----	-----	-----
Long term capital lease obligations at December 31, 1999	\$11,337	\$ 25	\$11,362
	=====	===	=====

Accumulated amortization for property and equipment under capital leases at December 31, 1999 and 1998 is \$2,787,000 and \$2,019,000, respectively.

Future minimum lease payments for all non-cancelable operating leases at December 31, 1999 are as follows (in thousands):

2000	\$ 1,653
2001	860
2002	615
2003	602
2004	128
Remainder	--
	-----
Total Minimum Lease Payments	\$ 3,858
	=====

Net rent expense charged to operations for 1999, 1998, and 1997 totaled \$2,000,000, \$2,001,000, and \$2,545,000, respectively.

LEGAL

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

TELOS CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information concerning certain relationships and related transactions between the Company and certain of its current and former officers and directors is set forth below.

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

Mr. John R. Porter, the owner of a majority of the Company's Class A Common Stock, has a consulting agreement with the Company whereby he is compensated for consulting services provided to the Company in the areas of marketing, product development, strategic planning and finance as requested by the Company. Mr. Porter was paid \$200,000 by the Company in 1999, 1998, and 1997 pursuant to this agreement, which amounts were determined by negotiation between the Company and Mr. Porter.

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

Mr. Mark Hester, former Executive Vice President and former Chief Operating Officer of the Company, has a consulting agreement with the Company to provide strategic advice concerning the Company's hardware services division. Under this agreement, Mr. Hester received \$206,000 for his services during 1999 and 2000, and was eligible for a bonus under certain circumstances, at the Company's discretion. Under this agreement Mr. Hester will receive a bonus of \$135,000 payable in installments during 2000 and 2001.

NOTE 11. REPORTABLE BUSINESS SEGMENTS

The Company adopted SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information", in 1998 which changes the way the Company reports information about its operating segments. The information for 1998 and 1997 has been restated from the prior year's presentation in order to conform to the 1999 presentation.

The Company has three reportable segments:

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

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

Enterworks - develops, markets and supports a software framework that integrates content and processes for companies seeking to participate in e-business. They target operators and users of e-marketplaces and portals. E-marketplaces and portals are Web-based destinations where employees, customers, partners and suppliers can interact to obtain information about products and services, and conduct business more efficiently. Enterworks product enables customers to build or join e-marketplaces and portals rapidly, add new content and e-business participants easily, and automate the end-to-end processes required for e-business interaction.

Enterworks' products are designed to meet the business and technical challenges faced by operators and users of e-marketplaces and portals by delivering integrated, real-time content and automating business processes that bring together employees, customers, partners and suppliers. These products offer numerous competitive advantages over traditional solutions by combining both content and process integration, and by guiding people through e-business interactions.

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

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

Enterworks, Inc. is an equity investment of the Company as of December 30, 1999 (Note 2) and has been deconsolidated as of that date. The corresponding assets and liabilities have been removed from the consolidated balance sheet as of December 31, 1999.

	Systems and Support Services -----	Products -----	Enterworks -----	Other (1) -----	Total -----
1999					
External Revenues	\$ 93,538	\$ 77,826	\$ --	\$ --	\$171,364
Intersegment Revenues	404	--	--	--	404
Gross Profit	16,158	3,990	--	--	20,148
Segment profit (loss)(3)	4,731	(2,042)	--	--	2,689
Total assets	29,623	361	--	26,902	56,886
Capital Expenditures	195	13	780	401	1,389
Depreciation & Amortization(2)	\$ 773	\$ 318	\$ 2,210	\$ 1,321	\$ 4,622
1998					
External Revenues	\$ 98,277	\$101,736	\$ 7,073	\$ --	\$207,086
Intersegment Revenues	970	2,622	1	--	3,593
Gross Profit	14,046	8,583	1,542	--	24,171
Segment profit (loss)(3)	4,849	14	(11,534)	--	(6,671)
Total assets	45,340	24,206	6,119	19,586	95,251
Capital Expenditures	179	49	587	435	1,250
Depreciation & Amortization(2)	\$ 557	\$ 479	\$ 2,332	\$ 1,487	\$ 4,855
1997					
External Revenues	\$121,052	\$129,337	\$ 3,398	\$ --	\$ 253,787
Intersegment Revenues	667	1,387	4	--	2,058
Gross Profit	20,614	14,875	(132)	--	35,357
Segment profit (loss)(3)	10,229	3,977	(5,903)	--	8,303
Total assets	55,834	24,323	6,374	23,187	109,718
Capital Expenditures	330	688	480	1,091	2,589
Depreciation & Amortization(2)	\$ 716	\$ 929	\$ 1,075	\$ 2,270	\$ 4,990

(1) Corporate assets are principally property and equipment, cash and other assets.

(2) Depreciation and amortization includes amounts relating to property and equipment, goodwill, deferred software costs and spare parts inventory.

(3) Segment profit (loss) represents operating income (loss) before goodwill amortization.

The Company does not have material international revenues, profit (loss), assets or capital expenditures. The Company's business is not concentrated in a specific geographical area within the United States, as it has 11 separate facilities located in 4 states.



ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Directors and Executive Officers

The following is certain biographical information concerning the directors and executive officers of the Company. The term of each of the directors to be elected at the Annual Meeting continues until the next annual meeting of shareholders and until his successor is elected and qualified, except that the directorships held by the Class D Directors will terminate whenever all accumulated dividends on the Exchangeable Preferred Stock have been paid.

Dr. Fred Charles Ikle, Chairman of the Board

Dr. Ikle (age 75) was elected to the Company's Board of Directors on January 31, 1994 and was elected Chairman of the Board in January 1995. He is Chairman of Conservation Management Corporation and is a member of the US Advisory Board for Zurich Financial Services Group. Dr. Ikle is also a Director of the National Endowment for Democracy and a Distinguished Scholar at the Center for Strategic & International Studies. From 1981 to 1988, Dr. Ikle served as Under Secretary of Defense for Policy.

John B. Wood, Executive Chairman of the Board

Mr. Wood (age 36) was elected to Executive Chairman of the Board on March 8, 2000. Mr. Wood also serves as Chairman of Enterworks and as Chief Executive Officer of Enterworks. Previously, Mr. Wood was the President and Chief Executive Officer of the Company. Mr. Wood was appointed Chief Operating Officer on October 8, 1993 after serving as Executive Vice President from May of 1992. He was elected to the Board of Directors on May 13, 1992. Prior to joining the Company, Mr. Wood founded a boutique investment banking firm. Mr. Wood has a BA in Finance and Computer Science from Georgetown University.

David S. Aldrich, President, Chief Executive Officer, and Director

Mr. Aldrich (age 40) was elected to the positions of President and Chief Executive Officer on March 8, 2000. He was elected to the Board of Directors on February 8, 2000. He was appointed to the position of Chief Operating Officer of the Company in January 1999. He joined the Company in September 1996 as Vice President, Corporate Development and Strategy. Prior to joining the Company, he was a partner in the Financial Advisory Services Group - Corporate Finance at Coopers & Lybrand L.L.P. Prior to joining Coopers & Lybrand L.L.P. in 1991, Mr. Aldrich was Senior Vice President at Dean Witter Capital Corp., the merchant banking arm of Dean Witter Reynolds, Inc.

Dr. Stephen D. Bryen, Director

Dr. Stephen Bryen (age 57) was elected to the Company's Board of Directors on January 31, 1994. He currently serves as a Director in Jefferson Partners, L.L.C., a strategic management consulting and merchant banking firm with offices in Washington, D.C. and New York, and as Senior Vice President of L-3 Network Security, LLC in Denver, Colorado. Dr. Bryen currently serves on the board of C-MAC Industries in Mechanicsburgh, Pennsylvania and is the senior technical advisor to Hollinger Digital Corporation in New York. From 1981 to 1988 Dr. Bryen served as the Deputy Under Secretary of Defense for Trade Security Policy and as the Director of the Defense Technology Security Administration, which he founded.

Norman P. Byers, Director

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

Julio E. Heurtematte, Jr., Class D Director

Mr. Heurtematte (age 63) was elected to the Company's Board of Directors on July 31, 1998. He has been a private consultant since 1989, specializing in international projects, trade and investments. From 1963 to 1989, he held various positions at the InterAmerican Development Bank ("IAD"), most recently as the deputy Manager for Project Analysis. From 1979 to 1989, Mr. Heurtematte was also a member of IAD Bank's Pension Fund Investment Committee. Mr. Heurtematte is also a member of the Board of Directors of Trans World Gaming Corporation. Mr. Huertematte resigned from the Board of Directors effective December 16, 1999.

Malcolm M. B. Sterrett, Class D Director

Mr. Sterrett (age 57) is a private investor and was elected to the Company's Board of Directors on July 31, 1998 as part of the preferred stockholder class. From 1989 to 1993, he was a partner at the law firm of Pepper Hamilton & Scheetz in Washington, D.C. From 1988 to 1989, he served as General Counsel to the U.S. Department of Health and Human Services and from 1982 to 1988 he was a Commissioner on the U.S. Interstate Commerce Commission. Prior thereto, he was Vice President and General Counsel to the United States Railway Association and served as Staff Director and Counsel to the U.S. Senate Committee on Commerce, Science and Transportation. Mr. Sterrett is also a member of the Board of Directors of Trans World Gaming Corporation.

John C. Boland, Class D Director

Mr. Boland (age 52) was appointed to the Board of Directors on December 17, 1999 as a result of Mr. Huertematte's resignation. He has been owner of the general partner of Remnant Partners L.P., an investment partnership, since 1992. From 1989 to 1995, he was the publisher of Bankruptcy Values, an institutional research service. Prior to entering the investment business, Mr. Boland was an editor of Barron's Financial Weekly (from 1978 to 1983) and a freelance financial writer.

William L. Prieur Brownley, Vice President and General Counsel

Mr. Brownley (age 43) joined the Company in April 1991 and is responsible for the management of the Company's legal affairs. For the five years prior to joining the Company, he served as Assistant General Counsel and then as General Counsel at Infotechnology Inc., an investment company whose holdings included various companies in the communications industry.

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

Mr. Calhoun (age 50) joined the Company as Vice President, Human Resources, in August 1989. Prior to joining the Company he served as: Director, Risk and Financial Management of BDM International, a government contractor which provides consulting services; Vice President, Human Resources of Halifax Corp., a government contractor providing technical services and third party computer maintenance; and Director for the U.S. Department of Labor, Employment Standards Administration. Mr. Calhoun left the Company during 1999.

Robert W. Lewis, President, Enterworks, Inc.

Mr. Lewis (age 38) has served as the President and Chief Operating Officer of Enterworks, Inc. since its inception in 1996 and as director since January 2000. Prior to joining Enterworks, he was an employee of the Company for 11 years. From 1991 to 1995, Mr. Lewis served in product development, operational and marketing roles. His most recent position was Director of Business Development. Mr. Lewis has a BBA in Information Technology from James Madison University and an MBA in Management and Marketing from George Mason University.

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

Mr. Marino (age 63) joined the Company in 1988 as Senior Vice President of Sales and Marketing. In 1990, his responsibilities were expanded to include Program Management in addition to Sales and Marketing. On January 1, 1994, Mr. Marino was appointed to President of Telos Systems Integration, and on January 1, 1998, he was appointed to his current position. Prior to joining the Company in February 1988, Mr. Marino held the position of Senior Vice President of Sales and Marketing with Centel Federal Systems and M/A-COM Information Systems, both of which are U.S. Government contractors.

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

Mr. Tellez (age 42) was appointed Chief Financial Officer of the Company in 1993 and Treasurer in 1994. He joined Telos Corporation (California) in 1989 where he was responsible for all financial and regulatory functions. Prior to joining Telos Corporation, Mr. Tellez served as a Senior Manager with Arthur Andersen & Company. Mr. Tellez resigned from the position of Chief Financial Officer and Treasurer in 1999.

Thomas J. Ferrara, Vice President, Finance and Accounting and Treasurer

Mr. Ferrara (age 42) was elected Vice President of Finance and Accounting and Treasurer on February 8, 2000. He joined the Company in 1994 as Director of

Pricing and was responsible for all pricing of major contracts and Company forecasts. Prior to joining Telos, Mr. Ferrara was the Accounting Manager for Cordant, a privately held government contractor.

Andrea Ayoub, Vice President of Human Resources and Corporate Secretary

Ms. Ayoub (age 35) was appointed Vice President, Human Resources and Assistant Corporate Secretary in late 1999. She was appointed as Corporate Secretary in February 2000. Ms. Ayoub joined Telos in July, 1987 working initially in the Marketing department and moved into the Human Resources function in 1988. She has held various positions within the Human Resource Department and has progressively assumed greater management responsibilities over the years.

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

ITEM. 11. EXECUTIVE COMPENSATION

The following table shows for the years ended December 31, 1999, 1998 and 1997, the cash compensation paid by the Company as well as certain other compensation paid or accrued for those years, to the chief executive officer and the four other most highly compensated executive officers of the Company in fiscal year 1999.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Annual Compensation		Long Term Compensation (2)	All Other Compensation(5)
		Salary	Bonus(1)	Awards Options/Sars(#)	
John B. Wood (Executive Chairman, Former President, Chief Executive Officer)	1999	\$348,574	\$250,000	2,000,000(3)	\$13,000(6)
	1998	\$334,198	\$ --	--	\$13,500(6)
	1997	\$299,998	\$382,000	--	\$36,750(6)
Lorenzo Tellez (Former V.P., Treasurer, Chief Financial Officer)	1999	\$260,618	\$ --	--	\$ 5,000
	1998	\$218,080	\$ --	200,000(4)	\$ 5,500
	1997	\$195,000	\$150,000	150,000(4)	\$28,750
David Aldrich (President, Chief Executive Officer)	1999	\$205,119	\$250,000	200,000(3)	\$ --
	1998	\$173,850	\$ --	210,000(4)	\$ 2,333
	1997	\$150,010	\$150,000	300,000(4)	\$ 6,000
Robert J. Marino (Chief Sales and Marketing Officer and Executive V.P.)	1999	\$206,003	\$100,000	200,000(3)	\$ 5,000
	1998	\$204,734	\$ --	362,000(4)	\$ 5,500
	1997	\$195,000	\$ 76,000	--	\$10,750
William L.P. Brownley (V.P. General Counsel)	1999	\$170,997	\$100,000	200,000(3)	\$ 4,275
	1998	\$166,961	\$ --	135,000(4)	\$ 5,380
	1997	\$150,010	\$ 85,000	--	\$ 9,167

- (1) 1997 amounts include bonuses relating to the TIS sale completed in 1998.
- (2) There are no restricted stock awards or payouts pursuant to long-term investment plans.
- (3) Options granted in 1999 are in Enterworks, Inc., common stock.
- (4) Options granted in 1998 and 1997 are in the Company's Class A common stock.
- (5) All other compensation represents Company contributions made on behalf of the executive officers to the Telos Shared Savings Plan, and in 1998 and 1997 the amounts also include automobile and living allowances.
- (6) Included in these amounts for 1999, 1998 and 1997 are \$8,000 in each of these three years for director's fees paid.

STOCK OPTION GRANTS

The Summary Table of Options/SAR Grants in the Last Fiscal Year is set forth below for the stock option grants in 1999.

Name and Principal Position	Number of Securities Underlying Options/sars Granted(1)	% of Total Options/Sars Granted	Exercise or Base Price	Expiration Date	Potential Realizable Value At Assumed Rates of Stock Price Appreciation for Option Term	
					5%	10%
John B. Wood (Executive Chairman, Former President, Chief Executive Officer)	2,000,000	22.7%	\$0.77	Aug. 2009	\$968,498	\$2,454,363
Lorenzo Tellez (Former V.P., Treasurer, Chief Financial Officer)	--	--	--	--	--	--
David Aldrich (President, Chief Executive Officer)	200,000	2.3%	\$0.77	Aug. 2009	\$ 96,850	\$ 245,436
Robert J. Marino (Chief Sales and Marketing Officer and Executive V.P.)	200,000	2.3%	\$0.77	Aug. 2009	\$ 96,950	\$ 245,436
William L.P. Brownley (V.P., General Counsel)	200,000	2.3%	\$0.77	Aug. 2009	\$ 96,950	\$ 245,436

(1) Options granted to any of the named executive officers in 1999 were in the common stock of Enterworks, Inc.

MANAGEMENT STOCK OPTIONS

The following table shows, as to the individuals named in the Summary Compensation table, the number of shares acquired during such period through the exercise of options, and the number of shares subject to and value of all unexercised options held as of December 31, 1999.

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

Name	Shares Acquired On Exercise	Value Realized	Number of Securities Underlying Unexercised Options/SARs at FY-End(1) Exercisable/ Unexercisable	Value of Unexercised In-the-Money Options/SARs at FY-End (2) Exercisable/ Unexercisable
John B. Wood (Executive Chairman, former President, Chief Executive Officer)	--	--	3,739,225/978,766	\$1,499,696/\$391,506
Lorenzo Tellez (Former V.P., Treasurer, Chief Financial Officer)(3)	--	--	352,500/330,000	\$ 147,600/\$120,000
David Aldrich (President, Chief Executive Officer)	--	--	653,500/256,500	\$ 303,780/\$79,020
Robert J. Marino (Chief Sales and Marketing Officer and Executive V.P.)	--	--	689,450/417,750	\$ 177,944/\$132,966
William L.P. Brownley (V.P., General Counsel)	--	--	387,250/142,750	\$ 138,430/\$46,570

1. These aggregate amounts include exercisable options to purchase the common stock of Enterworks, Inc. for 2,060,000 shares held by Mr. Wood, 32,500 shares held by Mr. Tellez, 400,000 shares held by Mr. Aldrich, and 245,000 shares held by Mr. Marino and 265,000 shares held by Mr. Brownley, respectively.
2. These aggregate values include values for exercisable options to purchase the common stock of Enterworks, Inc. of \$512,800 for Mr. Wood, \$28,600 for Mr. Tellez, \$222,000 for Mr. Aldrich, \$85,600 for Mr. Marino and \$103,200 for Mr. Brownley, respectively. All remaining amounts included in these values reflect the value of options to purchase the Class A Common Stock of the Company. These values are based upon an estimated fair market value at December 31, 1999 of \$1.35 per share for the Company's Class A Common Stock and \$1.00 per share for the common stock of Enterworks, Inc. These values were derived from valuations performed by an independent third party for the trustees of the Telos Shared Savings Plan, a defined contribution employee savings plan in which substantially all full-time employees are eligible to participate.
3. As of March 3, 2000, Mr. Tellez chose not to exercise his options and therefore these options reverted back to their respective plans.



## COMPENSATION OF DIRECTORS

During the fiscal year ended December 31, 1999, employee directors were paid a fee of \$2,000 for each Board meeting attended. Outside directors Mr. Byers and Dr. Bryen were paid an annual fee of \$25,000 each, and further compensated at a rate of \$750 for each meeting attended in excess of four meetings a year. Outside directors Mr. Heurtematte and Mr. Sterrett earned annual fees of \$4,000 each, and were eligible for further compensation at a rate of \$750 for each meeting attended in excess of four meetings a year. The Chairman of the Board, Dr. Ikle, is paid \$25,000 quarterly for his service on the Board. In addition, Mr. Byers receives \$5,000 per annum for his service as Proxy Chairman. The compensation paid to Mr. Byers and Dr. Bryen is paid pursuant to a proxy agreement between the Company, the Defense Security Service and certain of the Company shareholders. During the fiscal year ended December 31, 1999, Dr. Ikle received 15,000 options, Mr. Bryen and Mr. Byers received 5,000 options each, Mr. Sterrett received 2,500 options and John Wood received 2,000,000 options. All options granted to Directors were in Enterworks, Inc. common stock.

## EMPLOYMENT CONTRACTS

As of December 31, 1999, the Company was a party to agreements with certain of its executive officers. Mr. David S. Aldrich, Vice President and Chief Operating Officer, Mr. William L. P. Brownley, Vice President and General Counsel, Mr. Robert J. Marino, Chief Sales and Marketing Officer, and Mr. John B. Wood, Director, President and Chief Executive Officer, currently have employment agreements with the Company. The agreements are for one year terms and provide for a payment of two years' base salary then in effect if involuntarily terminated or if the agreements are not extended.

Accordingly, Messrs. Aldrich, Brownley, Marino, and Wood would receive annually, given their present salary levels, \$205,000, \$171,000, \$206,000, and \$350,000, respectively, for a two year period.

In addition to base salary, the executives are eligible for a bonus and for the grant of stock options under the agreements. The amount of the bonus is determined by reference to the amount, if any, of earnings before taxes and goodwill amortization of the Company for the year or at the Board of Directors and Chief Executive Officer's discretion. Each year the Company renegotiates these employment contracts as part of the yearly review process. Accordingly, in 2000, the Company expects to review the contracts described above.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Title of Class	Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership as of March 01, 2000	Percent of Class
Class A Common Stock	John R. C. Porter 79 Mount Street London W1Y 5HJ England	22,190,718 shares(A)	80.31%
Class A Common Stock	C3, Inc. 401(k) Plan and Telos Corporation Savings Plan c/o C3, Inc. 19886 Ashburn Road Ashburn, VA 20147	3,658,536 shares	17.22%
Class A Common Stock	F & C Enterprise Trust PLC Berkeley Square House, Berkeley Square London W1X 5PA England	1,533,405 shares(B)	6.73%
Class B Common Stock	F&C Nominees Limited Berkeley Square House, Berkeley Square London W1X 5PA England	3,143,358 shares (C)	77.85%
Class B Common Stock	North Atlantic Smaller Companies Investment Trust PLC 10 Park Place London SW1A 1LP England	815,700 shares	20.20%
Class A Common Stock	David S. Aldrich	321,892 shares (D)	1.49%
Class A Common Stock	William L. P. Brownley	139,342 shares (D)	0.65%
Class A Common Stock	Robert J. Marino	603,535 shares (D)	2.78%
Class A Common Stock	Lorenzo Tellez	525,268 shares (D)	2.43%
Class A Common Stock	John B. Wood	1,724,391 shares (D)	7.52%
Class A Common Stock	All Officers and Directors as a Group (10 persons)	3,602,156 shares (E)	14.76%
12% Cumulative Exchangeable Redeemable Preferred Stock	John C. Boland 28 Allegheny Avenue, Ste 505 Towson, MD 21204	76,500 shares (F)	2.40%
12% Cumulative Exchangeable Redeemable Preferred Stock	Value Partners, Ltd. 2200 Ross Avenue, Suite 4660 Dallas, TX 75201 Fisher Ewing Partners 2200 Ross Avenue, Suite 4660 Dallas, TX 75201	714,317 shares (G)	22.42%
12% Cumulative Exchangeable Redeemable Preferred Stock	Wynnefield Partners Small Cap Value, L.P. One Penn Plaza, Suite 4720 New York, NY 10119 Channel Partnership II, L.P. One Penn Plaza, Suite 4720 New York, NY 10119 Wynnefield SmallCap Value Offshore Fund, Ltd. One Penn Plaza, Suite 4720 New York, NY 10119	228,500 shares (H)	7.17%
12% Cumulative Exchangeable Redeemable Preferred Stock	Magten Asset Management Corp. 35 East 21st Street New York, NY 10010	197,105 shares	6.19%

- (A) Mr. Porter's holdings include 6,388,916 shares of Class A Common Stock purchasable upon exercise of a warrant.
- (B) The common stock holdings of F&C Enterprise Trust PLC include 1,533,405 shares of Class A Common Stock purchasable upon exercise of a warrant.
- (C) F&C Nominees Limited responded to the Company's request for the names and addresses of the beneficial owners of the Company's Class B Common Stock held by F&C Nominees Limited by providing the following information: FACET - 1,681,959 shares, FACET L.P. - 420,490 shares, Hare & Co. (Mills) - 371,021 shares, and Drayton - 669,888 shares. F&C Nominees Limited did not provide to the Company the addresses of these beneficial owners.
- (D) The common stock holdings of Messrs. Aldrich, Brownley, Marino, Tellez and Wood include -0-; 10,994; 20,283; 22,828 and 36,774 shares of the Company's Class A Common Stock, respectively, held for their beneficial interest by the C3, Inc. 401(k) Plan and Telos Corporation Savings Plan. Messrs. Aldrich, Brownley, Marino, Tellez and Wood hold options to acquire 313,500; 122,250; 461,200; 350,000; and 1,679,225 shares of the Company's Class A Common Stock, respectively, in

addition to their current common stock holdings. These shares are purchasable upon exercise of the options and are exercisable within 60 days of March 1, 2000.

- (E) The common stock holdings of the Company's officers and directors as a group include 136,257 shares of the Company's Class A Common Stock held for their beneficial interest by the C3, Inc. 401(k) Plan and Telos Corporation Savings Plan. Under the Company's stock option plan and certain stock option agreements, all officers and directors as a group hold options to acquire 3,168,525 shares of Class A Common Stock exercisable within 60 days of March 1, 2000.
- (F) John C. Boland holds 30,000 shares of the 12% cumulative exchangeable redeemable preferred stock. In addition, he is the manager and owner of the general partner of Remnant Partners LP which beneficially owns 46,500 shares of the 12% cumulative exchangeable redeemable preferred stock of the Company.
- (G) Value Partners Ltd. ("VP") and Fisher Ewing Partners ("FEP") have filed jointly a Schedule 13D under which they disclosed that they may act as a "group" within the meaning of Section 13(d) of the Securities Exchange Act. Each of the reporting persons disclosed that it may be deemed to beneficially own the aggregate of 714,317 shares of the Exchangeable Preferred Stock held of record by the reporting persons collectively. According to an Amendment to the Schedule 13D filed on May 10, 1996, each of FEP and Timothy G. Ewing and Richard W. Fisher may be deemed to have the sole power to vote and to dispose of the shares of the Exchangeable Preferred Stock held of record by the reporting persons collectively.
- (H) Wynnefield Partners SmallCap Value, L.P., ("WPSCV"), Channel Partnership II, L.P. ("CP"), and Wynnefield SmallCap Value Offshore Fund, Ltd. ("WSCVOF") have jointly filed a Schedule 13D under which they disclosed they may act as a "group" within the meaning of Section 13(d) of the Securities Exchange Act. Each of the reporting persons disclosed that it may be deemed to beneficially own the aggregate of 228,500 shares of the Exchangeable Preferred Stock held of record by the reporting persons collectively. According to the Schedule 13D, Nelson Obus and Joshua Landes, by virtue of their status as general partners of WPSCV, Mr. Obus as general partner of CP and Messrs. Obus and Landes, as officers of WSCVOF's investment manager, have the power to vote or to direct the vote and the power to dispose and to direct the disposition of the shares of Exchangeable Preferred Stock owned by WPSCV, CP and WSCVOF, respectively.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information concerning certain relationships and related transactions between the Company and certain of its current and former officers and directors is set forth below.

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

Mr. John R. Porter, the owner of a majority of the Company's Class A Common Stock, has a consulting agreement with the Company whereby he is compensated for consulting services provided to the Company in the areas of marketing, product development, strategic planning and finance as requested by the Company. Mr. Porter was paid \$200,000 by the Company in 1999, 1998 and 1997 pursuant to this agreement, which amounts were determined by negotiation between the Company and Mr. Porter.

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

Mr. Mark Hester, former Executive Vice President and former Chief Operating Officer of the Company, has a consulting agreement with the Company to provide strategic advice concerning the Company's hardware services division. Under this agreement, Mr. Hester received \$206,000 for his services during 1999 and 2000, and was eligible for a bonus under certain circumstances, at the Company's discretion. Under this agreement Mr. Hester will receive a bonus of \$135,000 payable in installments during 2000 and 2001.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) 1. Financial Statements

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

(a) 2. Financial Statement Schedules

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

(a) 3. Exhibits:

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

2.6 Stock Purchase Agreement dated as of January 14, 1992, by and among C3, Inc., Telos Corporation and Contel Federal Systems, Inc. (Incorporated by reference to C3, Inc. Form 8-K filed January 29, 1992)

3.1 (1\*) Articles of Amendment and Restatement of C3, Inc.

3.2 (1\*) Articles of Amendment of C3, Inc. dated August 31, 1981.

3.3 (3\*) Articles supplementary of C3, Inc. dated May 31, 1984.

3.4 (4\*) Articles of Amendment of C3, Inc. dated August 18, 1988.

3.5 Articles of Amendment and Restatement Supplementary to the Articles of Incorporation dated August 3, 1990. (Incorporated by reference to C3, Inc. 10-Q for the quarter ended June 30, 1990)

3.6 Restated Bylaws of C3, Inc. (Incorporated by reference to C3, Inc. 10-Q for the quarter ended December 31, 1990)

3.7 Articles of Amendment of C3, Inc. dated April 13, 1995

4.1 Form of Indenture between the Registrant and Bankers Trust Company, as Trustee, relating to the 12% Junior Subordinated Debentures Due 2009. (Incorporated herein by reference to C3's Registration Statement on Form S-4 filed October 20, 1989)

4.3 Form of the terms of the 12% Cumulative Exchangeable Redeemable Preferred Stock of the Registrant. (Incorporated herein by reference to C3's Registration Statement on Form S-4 filed October 20, 1989)

4.4 Shareholders Agreement dated as of August 3, 1990 by and among C3, Inc.; Union de Banques Suisses (Luxembourg), S.A.; C3 Investors, L.P.; Anthony Craig, together with the investors; the Class A holders; MIM Limited; Knoll and Associates, Inc.; Murray Enterprises PLC; Electra Development Holdings; and Hartley Limited. (Incorporated by reference to C3, Inc. 10-Q for the quarter ended June 30, 1990)

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

- 10.45Amendment to Revolving and Reducing Senior Credit Facility dated as of June 8, 1994 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.46Amendment to Revolving and Reducing Senior Credit Facility dated as of October 7, 1994 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.47October 7, 1994 Letter Agreement among C3, Inc., Toxford Corporation, and NationsBank, N.A. regarding cash collateral held on behalf of the Company.
- 10.48October 25, 1994 General Release and Settlement memorandum among Sapiens International Corporation N.V., Sapiens International Corporation B.V., Sapiens U.S.A., Inc., C3, Inc. and Telos Corporation.
- 10.49Amendment to Revolving and Reducing Senior Credit Facility dated as of January 5, 1995 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.50Amendment to Revolving and Reducing Senior Credit Facility dated as of January 12, 1995 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.51Waiver and Amendment to Revolving and Reducing Senior Credit Facility dated as of April 17, 1995 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.58Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Drayton English and International Investment Trust
- 10.59Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and J. O. Hambro Investment Management, Ltd.
- 10.60Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and North Atlantic Smaller Companies Investment Trust, PLC
- 10.61Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Mr. John R.C. Porter
- 10.62Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Sir Leslie Porter
- 10.63Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Second Consolidated Trust, PLC
- 10.64Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Toxford Corp.
- 10.65Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Drayton English and International Investment Trust
- 10.66Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and J.O. Hambro Investment Management, Ltd.
- 10.67Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and North Atlantic Smaller Companies Investment Trust, PLC
- 10.68Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Mr. John R.C. Porter
- 10.69Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Sir Leslie Porter
- 10.70Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Second Consolidated Trust, PLC
- 10.71Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Toxford Corp.
- 10.72Amendment to Revolving and Reducing Senior Credit Facility dated as of August 4, 1995 Telos Corporation (Maryland), Telos Corporation (California) and NationsBank N.A.
- 10.73Amendment to Revolving and Reducing Senior Credit Facility dated as of October 13, 1995 Telos Corporation (Maryland), Telos Corporation (California) and NationsBank N.A.
- 10.74 1996 Stock Option Plan
- 10.76Sixteenth Amendment to Credit Facility and Tenth Amended and Restated Promissory Note
- 10.77 Enterworks, Inc. 1996 Stock Option Plan

- 10.78 Form of Series A Senior Subordinated Unsecured Note
- 10.79 Form of Enterworks, Inc., inc. Capital Stock Purchase Series A Warrant
- 10.80 Asset Purchase Agreement
- 10.81 Amendment No. 1 to Asset Purchase Agreement
- 10.82 Amended and Restated Credit Agreement between Telos Corporation, a Maryland corporation; Telos Corporation, a California corporation; and NationsBank, N.A. dated as of July 1, 1997
- 10.83 Asset Purchase Agreement
- 10.84 Interim Agreement
- 10.85 Share Purchase Agreement between Telos Corporation, a Maryland corporation, formerly named and known as C3, Inc. and Union Bank of Switzerland, dated May 7, 1998
- 10.86 Series D Senior Subordinated Unsecured Note due October 1, 2000 as of November 20, 1998 between Telos Corporation (Maryland) and Foreign and Colonial Enterprise Trust PLC
- 10.87 Series D Senior Subordinated Unsecured Note due October 1, 2000 as of November 20, 1998 between Telos Corporation (Maryland) and Foreign and Colonial Enterprise Trust LP
- 10.88 Common Stock Purchase Series D Warrant between Telos Corporation (Maryland) and Foreign and Colonial Enterprise Trust PLC
- 10.89 Common Stock Purchase Series D Warrant between Telos Corporation (Maryland) and Foreign and Colonial Enterprise Trust LP
- 10.90 Form of Stock Purchase Agreement
- 10.91 Asset Purchase Agreement, dated as of September 29, 1999 between Telos Corporation (Maryland), Telos Corporation (California), Telos Field Engineering, Inc. and TFE Technology Holdings, Inc.
- 10.92 Letter to Bank of America concerning Enterworks private placement
- 10.93 Form of Enterworks Subdebt conversion letter
- 10.94 Form of Telos Subdebt conversion letter
- 10.95 Listing of Subdebt conversion parties
- 10.96 Transaction agreement between Telos and Enterworks
  - 21 Schedule of Subsidiaries.
  - 27 Financial Data Schedule
- (b) Reports on Form 8-K
  - None



SIGNATURES

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

TELOS CORPORATION

BY: DAVID S. ALDRICH

-----  
President and  
Chief Executive Officer

DATE: MARCH 30, 2000

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

SIGNATURE -----	TITLE -----	DATE -----
/S/ John B. Wood ----- John B. Wood	Executive Chairman of the Board of Directors	March 30, 2000
/S/ Fred Charles Ikle ----- Fred Charles Ikle	Chairman of the Board of Directors	March 30, 2000
/S/ Stephen D. Bryen ----- Stephen D. Bryen	Director	March 30, 2000
/S/ Norman P. Byers ----- Norman P. Byers	Director	March 30, 2000
/S/ Malcolm M.B. Sterrett ----- Malcolm M.B. Sterrett	Director	March 30, 2000
----- John C. Boland	Director	March 30, 2000
/S/ David S. Aldrich ----- David S. Aldrich	President, Chief Executive Officer (Principal Executive Officer)	March 30, 2000
/S/ Thomas J. Ferrara ----- Thomas J. Ferrara	Vice President, Finance & Acct. (Principal Financial Officer & Principal Accounting Officer)	March 30, 2000

Telos Corporation  
Exhibit Index

Exhibit Number -----	Exhibit Name -----	Page -----
10.91	Asset Purchase Agreement, dated September 29, 1999 between Telos Corporation (Maryland), Telos Corporation (California), Telos Field Engineering, Inc. and TFE Technology Holdings, Inc.	
10.92	Letter to Bank of America concerning Enterworks private placement	
10.93	Form of Enterworks Subdebt conversion letter	
10.94	Form of Telos Subdebt conversion letter	
10.95	Listing of Subdebt conversion parties	
10.95	Transaction agreement between Telos and Enterworks	

## ASSET PURCHASE AGREEMENT

This asset purchase agreement (this "agreement") is made and entered into as of this 29th day of September, 1999, by and among Telos Corporation, a Maryland corporation ("Telos"), Telos Corporation, a California corporation ("Shareholder"), Telos Field Engineering, Inc., a Delaware corporation ("Seller"), and TFE Technology Holdings, LLC, a Delaware limited liability company ("Purchaser").

## WITNESSETH

Whereas, Seller is the owner of all right, title and interest in and to the assets described on Schedule 2.1 hereto (the "assets"), with such assets being substantially all of the assets currently used in the Telos Field Engineering, Inc., business operated by the Seller (the "business");

WHEREAS, Telos is the owner of all the outstanding capital stock of Shareholder, and Shareholder is the owner of all of the outstanding capital stock of Seller, and each of Telos and Shareholder are reasonably expected to benefit from the transactions contemplated by this Agreement;

WHEREAS, Seller desires to sell the Assets to Purchaser and Purchaser desires to acquire the Assets from Seller, all pursuant to this Agreement as hereinafter provided; and

WHEREAS, the parties hereto desire to set forth certain representations, warranties and covenants made by each to the other as an inducement to the execution and delivery of this Agreement, and to set forth certain additional agreements related to the transactions contemplated hereby.

## AGREEMENT

NOW, THEREFORE, for and in consideration of the premises, the mutual representations, warranties and covenants herein contained and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

1. GENERAL DEFINITIONS. For purposes of this Agreement, the following terms shall have the respective meanings set forth below:

1.1 "AFFILIATE" of any Person shall mean any Person Controlling, Controlled by or under common Control with such Person.

1.2 "BEST KNOWLEDGE" of Seller means actual knowledge of any of Seller, Shareholder or Telos after reasonable inquiry and investigation.

1.3 "CONTROL" and all derivations thereof shall mean the possession, direct or indirect, of either (i) the ownership of or ability to direct the voting of, as the case may be, fifty-one percent (51%) or more of the equity interests, value or voting power in any Person, or (ii) the power to direct or cause the direction of the management and policies of a Person, whether through the ownership of voting securities, by contract or otherwise.

1.4 "GOVERNMENTAL AUTHORITY" shall mean any and all foreign, federal, state or local governments, governmental institutions, public authorities and governmental entities and courts.

1.5 "GOVERNMENTAL REQUIREMENT" shall mean any and all laws (including, but not limited to, applicable common law principles), statutes, ordinances, codes, rules, regulations, orders, judgments, writs, injunctions, decrees, decisions or pronouncements, promulgated, issued, passed or set forth by any Governmental Authority.

1.6 "PERSON" shall mean any natural person, any Governmental Authority and any entity the separate existence of which is recognized by any Governmental Authority or Governmental Requirement, including, but not limited to, corporations, partnerships, joint ventures, joint stock companies, trusts, estates, companies and associations, whether organized for profit or otherwise.

1.7 "POST CLOSING TAX PERIOD" shall mean any taxable period (or portion thereof) that begins on or after the Closing Date.

1.8 "PRE CLOSING TAX PERIOD" shall mean any taxable period (or portion thereof) ending before the Closing Date.

1.9 "TAX" OR TAXES" mean all Federal, state, county, local, municipal, foreign and other taxes, assessments, duties or similar charges of any kind whatsoever, including all corporate franchise, income, sales, use, ad valorem, receipts, value added, profits, license, withholding, payroll, employment, excise, premium, property, customs, net worth, capital gains, transfer, stamp, documentary, social security, environmental, alternative minimum, occupation, recapture and other taxes, and including all interest, penalties and additions imposed with respect to such amounts, and all amounts payable pursuant to any agreement or arrangement with respect to Taxes.

1.10 "TAXING AUTHORITY" shall mean any domestic, foreign, federal, national, state, county or municipal or other local government, any subdivision, agency, commission or authority thereof, or any quasi-governmental body

exercising tax regulatory authority.

1.11 "TAX RETURN" OR "TAX RETURNS" shall mean all returns, declarations of estimated tax payments, reports, estimates, information returns and statements, including any related or supporting information with respect to any of the foregoing, filed or to be filed with any Taxing Authority in connection with the determination, assessment, collection or administration of any Taxes.

## 2. PURCHASE AND SALE OF THE ASSETS; CLOSING DATE.

2.1 PURCHASE AND SALE. Seller shall, upon Closing (hereinafter defined in Section 2.3), sell, assign, transfer and deliver to purchaser all right, title and interest in and to the assets (as more fully described on schedule 2.1 hereto), free and clear of any liens or encumbrances of any nature whatsoever (except for any liens, encumbrances or obligations, if any, expressly assumed by Purchaser hereunder). Purchaser shall, upon Closing, purchase from Seller the Assets in consideration for the Purchase Price (as hereinafter defined) payable as set forth in Section 3 below.

2.2 DELIVERY OF ASSETS AND TRANSFER DOCUMENTS. At the Closing, Seller shall have taken all steps necessary to put Purchaser in possession of the Assets, free and clear of any liens or encumbrances of any nature whatsoever (except for liens, encumbrances or obligations, if any, expressly assumed by Purchaser hereunder), and have delivered to Purchaser (i) a duly executed general warranty bill of sale covering the Assets, in the form of and containing the same terms and provisions as the General warranty bill of sale attached hereto as exhibit a, (ii) duly executed assignments for all accounts receivable, patents, trademarks, trade names and similar intangible property included in the assets, in form and substance acceptable to purchaser and in recordable form as appropriate, and (iii) such other duly executed transfer and release documents which purchaser has reasonably requested to evidence the transfer of the assets to purchaser free and clear of any liens or encumbrances of any nature whatsoever (except for liens, encumbrances or obligations, if any, expressly assumed purchaser hereunder); provided, however, that certain assets may not be transferred to purchaser at the closing due to the need for consents to assignment, novation or subcontracting that have not been obtained as of the Closing Date.

2.3 CLOSING DATE. Subject to the terms and conditions herein contained, the consummation of the transactions referred to above shall take place (the "closing") at the offices of seller, c/o telos corporation, 19886 ashburn road, ashburn, virginia 20147, commencing at 9:00 a.m. local time on september 29, 1999, or such other date as the parties may mutually determine (the "closing date").

## 3. PURCHASE PRICE.

3.1 PRICE AND PAYMENT. The aggregate consideration for the assets and the non-competition agreements (set forth in section 13 below) shall be an amount equal to \$10,000,000.00 (the "purchase price"), based on the net assets of seller being equal to \$2,500,000 at the closing date and subject to adjustment as provided in section 3.2 below, payable by wire transfer to an account specified in writing by seller or delivery of other immediately available funds at the closing to seller or its designee; provided, however, that if it is necessary or advisable under the bank release (as defined in section 7.1(t)) that the purchase price be paid to an account for the benefit of the bank (as defined in section 7.1(t)), then the purchase price shall be paid to such account.

3.2 PURCHASE PRICE ADJUSTMENT. (a) the net assets of seller shall be initially determined at the time of closing as being equal to the pro forma total net assets of seller as of august 31, 1999, as presented on schedule 3.2 attached hereto (the "closing estimate"). the purchase price shall be increased or decreased on a dollar-for-dollar basis by the amount by which the actual net assets of seller as of the close of business on the day immediately preceding the closing date is more or less than the closing estimate (such increase or decrease, the "net asset adjustment").

(B) THE "NET ASSETS OF SELLER" shall mean the sum of the value of all of the assets less the sum of the value of all of the assumed liabilities of seller as of closing, determined in accordance with past practices of seller (which past practices are in accordance with generally accepted accounting principles, consistently applied ("gaap")), as shown on statement of net assets on schedule 3.2 attached.

(c) following the closing, the actual net assets of seller as of the closing date shall be subsequently determined within forty-five (45) days after the closing date by seller, in accordance with the terms of this agreement (at the expense of seller), which determination (the "determination") shall be submitted in writing to seller and purchaser no later than forty-five (45) days after the closing. if within ten (10) days after receipt of the determination, purchaser delivers written notice to seller that purchaser disagrees with the determination (the "disagreement notice"), then seller and purchaser shall attempt in good faith to mutually determine the correct amount of the net assets of seller within ten (10) days after the disagreement notice. if seller and purchaser cannot in good faith mutually agree upon the correct actual amount of the net assets of seller within such ten (10) day period, then seller and purchaser shall, within the immediately following five (5) day period, mutually agree upon an accounting firm, to be a "big five" accounting firm (or, if seller and purchaser are unable to agree within such period, then arthur andersen & co. shall be hereby selected as such accounting firm), to compute the actual net assets of seller as of the closing date, which computation (the "final computation") shall be final, conclusive and binding on the parties hereto.

(d) In the event of a Final Computation, Purchaser and Seller shall jointly pay the expense of the Final Computation. If Purchaser does not deliver the Disagreement Notice on a timely basis to Seller, then Purchaser shall be deemed to agree with and accept the Determination, which shall be final and conclusive against Purchaser and Seller. Any required payment by Seller or Purchaser by virtue of a Net Asset Adjustment shall be made by Seller or Purchaser, as the case may be, within ten (10) days of the receipt of the Determination or the Final Computation.

3.3 EXCLUDED ASSETS. the assets shall not include any of the assets listed on schedule 3.3 hereto (collectively, the "excluded assets").

3.4 ASSUMED LIABILITIES AND OBLIGATIONS. on the closing date, subject to the satisfaction or waiver of all of the conditions set forth in section 7.1, purchaser shall assume the liabilities and obligations of seller under all contracts and agreements transferred by seller to purchaser at the closing that are listed and described on schedule 2.1 hereto and the other liabilities and obligations set forth on schedule 3.4 hereto; provided, however, that purchaser shall only assume the liabilities and obligations under such contracts and agreements set forth on schedule 2.1 that arise after, and relate to or result from acts, events, omissions or time periods after, the closing date (collectively, such liabilities and obligations described on schedules 2.1 and 3.4, the "assumed liabilities and obligations"); and provided further, however, that purchaser specifically shall not assume any liabilities or obligations of seller under such contracts or agreements with respect to any matter (including, without limitation, damages to third parties) relating to or resulting from acts, events, omissions, or time periods occurring on or before the closing date.

3.5 EXCLUDED LIABILITIES AND OBLIGATIONS.

(a) Except as expressly set forth in Section 3.4 above, Purchaser shall not assume and shall not be liable or responsible for any debt, obligation or liability of the Business, Seller, Shareholder, Telos or any other Affiliate of Seller, or any claim against any of the foregoing parties, of any kind, whether known or unknown, contingent, absolute or otherwise.

(b) Except for the Assumed Liabilities and Obligations expressly provided for in Section 3.4 hereof, Seller, Shareholder and Telos shall jointly and severally forever defend, indemnify and hold harmless Purchaser from and against any and all liabilities, obligations, losses, claims, damages (including incidental and consequential damages), costs and expenses (including court costs and reasonable attorney's fees) related to or arising from the Business or any contract or agreement that is, or should be, listed on SCHEDULE 4.8 prior to the Closing Date.

(c) Purchaser shall forever defend, indemnify and hold harmless Seller, Shareholder and Telos from and against any and all liabilities, obligations, losses, claims, damages (including incidental and consequential damages), costs and expenses (including court costs and reasonable attorney's fees) related to or arising from the Business or any contract or agreement that is listed on SCHEDULE 4.8 AFTER THE CLOSING DATE; PROVIDED, HOWEVER, that no indemnification shall be required of Purchaser hereunder for any such liabilities, obligations, losses, claims, damages, etc., if they were caused by the action or inaction of either of Seller, Shareholder and Telos or any employee or officer thereof, or if they relate to a contract which has not been assigned, subcontracted or novated to Purchaser.

3.6 TRANSFER TAXES. Purchaser and Seller acknowledge and agree that the consideration (including, without limitation, the Purchase Price and any adjustments thereto) does not include any sales, use, transfer or other similar tax payments by Purchaser to Seller pursuant to this Agreement, and is exclusive of any and all sales, use, transfer or other similar tax imposed as a result of the consummation of the transactions contemplated by this Agreement. Telos, Shareholder and Seller each hereby agree to pay and discharge, and to indemnify Purchaser against, and protect, save and hold Purchaser harmless from, any liability, obligation, claim, assessment or deficiency (whether or not ultimately successful) for any and all sales, use, transfer or other similar taxes (and any and all interest, penalties, additions to tax and fines thereon or related thereto) resulting or arising from or incurred in connection with the consummation of the actions contemplated by this Agreement.

3.7 ALLOCATION OF PURCHASE PRICE. within 120 days after the closing date, purchaser and seller shall agree (subject to the approval of telos, which may not be unreasonably withheld or delayed) upon a schedule (the "allocation schedule") to be attached hereto as schedule 3.7, allocating the purchase price (and the value of the assumption of the assumed liabilities and obligations) to be paid by purchaser among the purchased assets transferred as of the closing date by seller. the allocation schedule shall be reasonable and shall be prepared in accordance with section 1060 of the code, the regulations thereunder and the preceding sentence. promptly after agreeing to the allocation schedule, seller and purchaser shall sign the allocation schedule and return an executed copy thereof to purchaser and seller, respectively. the purchaser and seller each agrees to file irs form 8594, and all federal, state, local and foreign tax returns, in accordance with the allocation schedule. purchaser and seller agree to promptly provide the other with any other information required to complete irs form 8594 and all federal, state, local and foreign tax returns. any allocation of the purchase price shall take into account any implicit value of any other agreements between the parties hereto, and the purchase price so allocated shall be adjusted to account for such value.

4. REPRESENTATIONS AND WARRANTIES OF TELOS, SELLER AND SHAREHOLDER. Telos, Seller and Shareholder hereby jointly and severally represent and warrant to

Purchaser as follows:

4.1 ORGANIZATION. Shareholder is a corporation duly organized, validly existing and in good standing under the laws of the State of California, and is duly authorized, qualified and licensed under all applicable Governmental Requirements to carry on its business in the places and in the manner as now conducted except where any such failure would not reasonably be expected to have a material adverse effect on the financial condition, operating results, assets, or business prospects of the Business. Seller is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware, and is duly authorized, qualified and licensed under all applicable Governmental Requirements to carry on its business in the places and in the manner as now conducted except where any such failure would not reasonably be expected to have a material adverse effect on the financial condition, operating results, assets, or business prospects of the Business. Seller is qualified to do business in every jurisdiction in which the failure to so qualify might reasonably be expected to have a material adverse effect on the financial condition, operating results, assets, or business prospects of the Business.

4.2 OWNERSHIP. Seller owns all of the Assets constituting the Business, except the government furnished equipment ("gfe") listed in schedule 4.2. There are no options, rights or other grants currently outstanding for the acquisition or purchase of any of the Assets. All of the outstanding capital stock of Seller is owned by Shareholder. All of the outstanding capital stock of Shareholder is owned by Telos.

4.3 FINANCIAL STATEMENTS. seller has delivered to purchaser copies of the following financial statements for the business, all of which are included in schedule 4.3 hereto:

(a) UNAUDITED STATEMENT OF NET ASSETS OF THE BUSINESS (the "statement of net assets") as of August 31, 1999 (the "statement date"), and the unaudited pro forma statement of operations of the business for the eight (8) month period ended on the Statement Date;

(b) UNAUDITED PRO FORMA STATEMENT OF OPERATIONS of the Business from Seller for Seller's two (2) most recent fiscal years.

(c) Management Operations Summaries of the Business for the eight (8) months ended August 31, 1999, and Seller's two (2) most recent fiscal years.

ALL FINANCIAL STATEMENTS SUPPLIED TO PURCHASER BY SELLER, INCLUDED IN SCHEDULE 4.3(A) hereto, are true and accurate in all respects and, except as set forth on schedule 4.3(B) hereto, have been prepared in accordance with past practices of Seller (which past practices are in accordance with GAAP), and present fairly the financial condition of the Business as of the dates and for the periods indicated thereon. The Statement of Net Assets reflects, as of the Statement Date, all material liabilities, debts and obligations of Seller related to the Assets, whether accrued, absolute, contingent or otherwise, and whether due, or to become due, including, but not limited to, liabilities, debts or obligations on account of taxes or other governmental charges, or penalties, interest or fines thereon or in respect thereof.

4.4 EVENTS SINCE THE STATEMENT DATE. EXCEPT AS SET FORTH ON SCHEDULE 4.4 hereto, since August 31, 1999, there has not been:

(a) any change in the condition (financial or otherwise) or in the properties, assets, liabilities, business or prospects of the Business, except normal and usual changes in the ordinary course of business, none of which has been adverse and all of which in the aggregate have not been adverse;

(b) any labor trouble, strike or any other occurrence, event or condition affecting the employees of the Business that adversely affects the condition (financial or otherwise) of the Assets or the Business;

(c) any breach or default by Seller or Shareholder or Telos, or, to the Best Knowledge of Seller, by any other party, under any agreement or obligation included in the Assets or by which any of the Assets are bound;

(d) any damage, destruction or loss (whether or not covered by insurance) adversely affecting the Assets or the Business;

(e) any change in the types, nature, composition or quality of the services of the Business, any adverse change in the contributions of any of the service lines of the Business to the revenues or net income of such Business, or any adverse change in the sales, revenue or net income of the Business;

(f) any transaction related to or affecting the Assets or the Business other than transactions in the ordinary course of business of Seller; or

(g) any other occurrence, event or condition that has adversely affected (or can reasonably be expected to adversely affect) the Assets or the Business.

4.5 COMPETING INTERESTS. None of Seller, Shareholder, or Telos, nor, to the Best Knowledge of Seller, any shareholder or officer of any of the foregoing, and no Associate (as hereinafter defined) of any of the foregoing:

(a) owns, directly or indirectly, any equity interests in, or is a director, officer or employee of, or consultant to, any entity which is a competitor, supplier or customer of the Business, or, to the Best Knowledge of Seller, a competitor, supplier or customer of Purchaser or an Associate of Purchaser (except for ownership, if any, of less than one percent (1%) by value of the outstanding capital stock of any corporation the capital stock of which

is traded on a nationally recognized securities exchange); or,

(b) owns, directly or indirectly, in whole or in part, any property, asset or right which is associated with the Assets or the Business, or which Seller is presently operating or using in connection with or the use of which is necessary for or material to the operation of the Business.

FOR PURPOSES OF THIS AGREEMENT, THE TERM "ASSOCIATE" shall mean with respect to a Person (other than an individual), any Person Controlling, Controlled by or under common Control with such Person, and any director or officer of such Person and any Associate of any such Person.

4.6 NOTES AND ACCOUNTS RECEIVABLE. All notes and accounts receivable of Seller which are part of the Assets are reflected properly on Seller's books and records, are valid receivables subject to no setoffs or counterclaims, are presently current and collectible, and will be collected in accordance with their terms at their recorded amounts, subject only to a reserve for bad debts set forth in the Statement of Net Assets through the Closing Date in accordance with the past customs and practices of the Business.

4.7 EMPLOYEE MATTERS. SCHEDULE 4.7(A) hereto, sets forth a true and complete list of the names of and current annual compensation paid to each non-temporary employee who is employed in connection with the operation of the business (each a "business employee"). except as specifically described on schedule 4.7(b) hereto, none of seller, shareholder or telos maintain or contribute to any employee benefit plans, programs or arrangements (including, but not limited to, pension plans and welfare plans within the meaning of section 3(2) and 3(1), respectively, of the employee retirement income security act of 1974, as amended ("erisa")), whether written or unwritten, formal or informal under which any current or former business employee is or may become entitled to benefits. none of seller, shareholder or telos now contributes or has ever contributed to a "multi-employer plan" as defined in section 4001(a)(3) of erisa. none of seller, shareholder or telos is a party to any collective bargaining or other union agreements, or has, within the last five (5) years, had or been threatened with any union activities, work stoppages or other labor trouble with respect to employees engaged in the business which had or might have had a material adverse effect on the business. other than wage increases in the ordinary course of business, since the statement date, none of seller, shareholder or telos has implemented or made any commitment or agreement to implement, any increase in the wages or modification of the conditions or terms of employment of any of the corporate or administrative (non-temporary) business employees, or of any business employee who is expected to receive annual compensation for 1999 of \$40,000 or more.

4.8 CONTRACTS AND AGREEMENTS. SCHEDULE 4.8 hereto sets forth a true and complete list of and briefly describes (including termination date) all of the following contracts, agreements, leases, licenses, plans, arrangements or commitments, written or oral, that relate to the Assets or the Business (including all amendments, supplements and modifications thereto):

(a) all contracts, agreements, or commitments in respect of the sale of services;

(b) all offers, tenders or the like outstanding and capable of being converted into an obligation of Seller or by an acceptance or other act of some other person or entity or both;

(c) all sales or agency agreements or franchises or legally enforceable commitments or obligations with respect thereto;

(d) all collective bargaining agreements, union agreements, employment agreements, consulting agreements or agreements providing for the services of an independent contractor;

(e) all profit-sharing, pension, stock option, severance pay, retirement, bonus, deferred compensation, group life and health insurance or other employee benefit plans, agreements, arrangements or commitments of any nature whatsoever, whether or not legally binding, and all agreements with any present or former officers or employees of Telos, Shareholder or Seller;

(f) all loan or credit agreements, indentures, guarantees (other than endorsements made for collection), mortgages, pledges, conditional sales or other title retention agreements, and all equipment financing obligations, lease and lease-purchase agreements relating to or affecting the Assets or the Business;

(g) all leases related to the Assets or the Business, and all other contracts, agreements or legally enforceable commitments relating to or affecting the Assets or the Business;

(h) all performance bonds, surety bonds, letters of credit and the like, all contracts and bids covered by such bonds, and all letters of credit and guaranties, with a list of all such performance bonds and the like specified on schedule 4.8 hereto.

(i) all consent decrees and other judgments, decrees or orders, settlement agreements and agreements relating to competitive activities, requiring or prohibiting any future action;

(j) all accounts, notes and other receivables, and all security therefore, and all documents and agreements related thereto;

(k) all contracts or agreements of any nature with any 5% or greater stockholder of Seller, or any Associate (as defined in Section 4.5 above) of any

such stockholder;

(l) all contracts, commitments and agreements entered into outside the ordinary course of the operation of the Business; and

(m) any agreements relating to the sharing or allocation of Taxes.

All of such contracts, agreements, leases, licenses, plans, arrangements, and commitments and all other such items included in the assets, but not specifically described above, (collectively, the "contracts") are valid, binding and in full force and effect in accordance with their terms and conditions and there is no existing default thereunder or breach thereof by telos, shareholder or seller, or, to the best knowledge of telos, shareholder and seller, by any other party to the contracts, or any conditions which will constitute such a default by telos, shareholder or seller, or, to the best knowledge of telos, shareholder and seller, by any other party to the contracts, and the contracts will not be breached by or give any other party a right of termination as a result of the transactions contemplated by this agreement. copies of all of the documents (or in the case of oral commitments, descriptions of the material terms thereof) relevant to the contracts listed in schedule 4.8 hereto, have been delivered by telos, shareholder and seller to purchaser, and such copies and descriptions are true, complete and accurate and include all amendments, supplements or modifications thereto. no one has advised or notified telos, shareholder or seller that any contract to be assigned to purchaser by telos, shareholder or seller pursuant to the transactions contemplated by this agreement will be terminated by any customer prior to, on or after the closing date or that any existing relationship with any customer will expire upon termination of any existing contract. except as set forth on schedule 4.8a hereto, all of the contracts may be assigned to purchaser without the approval or consent of any person.

4.9 EFFECT OF AGREEMENT. EXCEPT AS SET FORTH ON SCHEDULE 4.9, the execution and delivery of this Agreement and the consummation of the transactions contemplated hereby will not (i) result in any breach of any of the terms or conditions of, or constitute a default under, the Certificate of Incorporation or Bylaws of Seller or Shareholder or Telos, or any commitment, mortgage, note, bond, debenture, deed of trust, contract, agreement, license or other instrument or obligation to which none of Seller, Shareholder or Telos is now a party or by which Seller or Shareholder or Telos or any of their properties or assets may be bound or affected; (ii) result in any violation of any Governmental Requirement; (iii) cause Purchaser to lose the benefit of any right or privilege included in the Assets; (iv) relieve any Person of any obligation (whether contractual or otherwise) or enable any Person to terminate any such obligation or any right or benefit enjoyed by Seller or to exercise any' right under any agreement in respect of the Assets or the Business; or (v) require notice to or the consent, authorization, approval or order of any Person (except as may be contemplated by the last sentence of Section 4.8 hereof). To the Best Knowledge of Seller, the business relationships of clients, customers and suppliers of the Business will not be adversely affected by the execution and delivery of this Agreement or the consummation of the transactions contemplated hereby.

4.10 PROPERTIES, ASSETS AND LEASEHOLD ESTATES. Seller has good and marketable title to all the Assets, free and clear of all mortgages, liens, pledges, conditional sales agreements, charges, easements, covenants, assessments, options, restrictions and encumbrances of any nature whatsoever. All leases to which real property is leased in connection with the Business are in good standing, valid and enforceable with respect to their terms.

4.11 INTANGIBLE PROPERTY. except as set forth on schedule 4.11 hereto, the operation of the business as now conducted by seller does not require the use of or consist of any rights under any patents, inventions, trademarks, trade names, brand names or copyrights. seller owns and has the full and exclusive right to use in connection with the business all of the items listed on schedule 4.11 hereto (which schedule includes, without limitation, all computer software (whether from third parties or produced internally by seller, shareholder, telos or any affiliate of any of the foregoing) and licenses used by seller in the business or for administration purposes), which items are in full force and effect. seller has not transferred, encumbered or licensed to any person any rights to own or use any portion of the items listed on schedule 4.11 hereto or any other intangible property included in the assets. none of (i) the items listed on schedule 4.11, (ii) any other intangible property included in the assets, or (iii) the operation of the business as presently conducted, violates or infringes upon any patents, inventions, trademarks, trade names, brand names or copyrights owned by others. to the best knowledge of seller, none of the items listed on schedule 4.11 hereto or any other intangible property included in the assets is being infringed upon by any person.

4.12 SUITS, ACTIONS AND CLAIMS. EXCEPT AS SET FORTH IN SCHEDULE 4.12 hereto, (i) there are no suits, actions, claims, inquiries or investigations by any Person, or any legal, administrative or arbitration proceedings in which the Business is engaged or which are pending or, to the Best Knowledge of Seller, threatened against or affecting the Business or Assets or any of its properties, or which question the validity or legality of the transactions contemplated hereby, (ii) no basis or grounds for any such suit, action, claim, inquiry, investigation or proceeding exists, and (iii) there is no outstanding order, writ, injunction or decree of any Governmental Authority against or affecting Seller with respect to the Business or Assets. Without limiting the foregoing, Seller has no knowledge of any state of facts or the occurrence of any event forming the basis of any present or potential claim against Seller, Shareholder or Telos with respect to the Business or the Assets.

4.13 LICENSES AND PERMITS; COMPLIANCE WITH GOVERNMENTAL REGULATIONS. SCHEDULE 4.13 hereto, sets forth a true and complete list of all licenses and



permits necessary for the conduct of the business. seller has all such licenses and permits validly issued to it and in its name, and all such licenses and permits are in full force and effect. true and correct copies of all such licenses and permits are included in schedule 4.13 hereto. no violations are or have been recorded in respect of such licenses or permits and no proceeding is pending or, to the best knowledge of seller, threatened seeking the revocation or limitation of any of such licenses or permits. all such licenses and permits that are subject to transfer are included in the assets. to the best knowledge of seller, seller has complied with all governmental requirements applicable to the business, and all governmental requirements with respect to the distribution and sale of products and services by the business.

4.14 AUTHORIZATION. Each of Seller, Shareholder and Telos has full legal right, power and authority to enter into and deliver this Agreement and to consummate the transactions set forth herein and to perform all the terms and conditions hereto to be performed by it. The execution and delivery of this Agreement by each of Seller, Shareholder and Telos and the performance by them of the transactions contemplated herein has been duly and validly authorized by all requisite corporate action of Seller, Shareholder and Telos, and this Agreement has been duly and validly executed and delivered by Seller, Shareholder and Telos and is the legal, valid and binding obligation of each of Seller, Shareholder and Telos, enforceable against them in accordance with its terms, except as limited by applicable bankruptcy, moratorium, insolvency or other similar laws affecting generally the rights of creditors or by principles of equity.

4.15 NO UNTRUE STATEMENTS. To the Best Knowledge of Seller, the statements, representations and warranties of Seller, Shareholder and Telos set forth in this Agreement and the Schedules hereto and in all other documents furnished to Purchaser and its representatives in connection herewith do not include any untrue statement of a material fact or omit to state any material fact necessary to make the statements, representations and warranties made not misleading. There is no fact that is not disclosed to Purchaser in this Agreement or the Schedules hereto that adversely affects or, so far as Seller, Shareholder or Telos can now reasonably foresee, could adversely affect the condition or prospects (in each case, financial or otherwise) of any of the Assets or the Business or the ability of Seller, Shareholder or Telos to perform their obligations under the Agreement.

4.16 RECORDS. The books, records and minutes kept by Seller, Shareholder and Telos with respect to the Assets and the Business, including, but not limited to, all customer files, service agreements quotations, correspondence, historical revenue data and other financial data of the Business since January 1, 1997, have been kept properly and contain records of all matters required to be included therein by any Governmental Requirement, and such books, records and minutes are true, accurate and complete and (except for corporate minute books and stock records) are included in the assets, as reflected in schedule 2.1; provided, however, that for as long as seller is required to keep in its possession such books and records as a result of any Governmental Requirement, Seller may do so if it promptly after the Closing submits a true, accurate and complete copy of such books and records to Purchaser. Seller, Shareholder and Telos agree to store for a period of at least seven (7) years from the Closing Date all of Seller's tax and accounting books and records with respect to any Tax of Seller or the Business (other than those solely with respect to the Business which are included in the Assets) for the seven (7) year period prior to the Closing Date. Such records shall be made available for inspection and copying by Purchaser upon reasonable advance notice and during reasonable business hours. In the event that Shareholder, Seller or Telos intends to destroy or dispose of any such tax or accounting books and records after the seven (7) year period, then notice of such intention shall be given to Purchaser, and such books and records will be delivered to Purchaser promptly upon Purchaser's request and at Purchaser's expense.

4.17 WORK-IN-PROCESS. EXCEPT AS SET FORTH ON SCHEDULE 4.17 hereto, none of Seller, Shareholder or Telos has received any payments with respect to any work-in-process with respect to the Business.

4.18 BROKERS AND FINDERS. EXCEPT AS SET FORTH ON SCHEDULE 4.18 hereto, no broker or finder has acted for Seller, Shareholder or Telos in connection with this Agreement or the transactions contemplated by this Agreement and no broker or finder is entitled to any brokerage or finder's fee or to any commission in respect thereof based in any way on agreements, arrangements or understandings made by or on behalf of Seller, Shareholder or Telos.

4.19 ADVERSE FACTS. None of Seller, Shareholder or Telos is aware (after having made all reasonable inquiries) of any fact or matter not disclosed in this Agreement or in the Schedules hereto which might be reasonably expected to materially adversely affect the Assets or the Business after Closing.

4.20 DEPOSITS. None of Seller, Shareholder or Telos now holds, nor does either of Seller, Shareholder or Telos expect to receive between the date hereof and the Closing Date, any deposits or prepayments by third parties in respect to any of the Assets or the Business which are not reflected as liabilities on the Statement of Net Assets.

4.21 WORKERS' COMPENSATION DATA. All data set forth in the workers' compensation report of Seller attached hereto as schedule 4.21 is true, correct and complete as of the date thereof.

4.22 CUSTOMER LIST. SCHEDULE 4.22 hereto sets forth a true, correct complete list of all customers of the Business to which Seller has sold or provided services in excess of \$100,000.00 in each of the twelve (12) month periods ended December 31, 1997, and December 31, 1998. This list provides an

accurate statement of the gross revenues received from each such customer by the Business during each of the twelve (12) month periods ended December 31, 1997, and December 31, 1998, and also provides the gross revenues received from each such customer for the eight (8) month period ended August 31, 1999. Except as contractually provided, to the best knowledge of seller, no current customer of the business listed on schedule 4.22 hereto will stop or decrease its rate of buying services (on an annual basis) from Seller prior to the Closing Date, or to the extent any such customer becomes a customer of Purchaser pursuant to the transactions contemplated by this Agreement, from Purchaser after the Closing Date.

4.23 NO ROYALTIES. No royalty or similar item or amount is being paid or is owing by Seller, nor is any such item accruing, with respect to the operation, ownership or use of the Business or the Assets.

4.24 SUBSIDIARIES. EXCEPT AS SET FORTH ON SCHEDULE 4.24, Seller does not own any Subsidiaries. As used in this agreement, the word "subsidiary" means any corporation or other organization, whether incorporated or unincorporated, of which such party or any other Subsidiary of such party is a general partner, or at least a majority of the securities or other interests having by their terms ordinary voting power to elect a majority of the Board of Directors or others performing similar functions with respect to such corporation or other organization is directly or indirectly owned or controlled by such party or by any one or more of its Subsidiaries, or by such party and one or more of its Subsidiaries.

4.25 SUCCESSION. In the event that Seller is merged, obligations owing hereunder to Seller by Purchaser will be obligations of Purchaser to the person succeeding by operation of law to Seller, in the event of merger of Seller in which Seller is not the surviving entity, or Shareholder (Telos, as the case may be) in the event that Seller (or Shareholder, as the case may be, or both) is dissolved. The obligations owing hereunder to Purchaser by Seller will be the obligations of Seller to the person succeeding by operation of law to Purchaser.

4.26 TAXES. (A) EXCEPT AS SET FORTH ON SCHEDULE 4.26A, to the Best Knowledge of Seller, (i) Seller and any affiliated group, including within the meaning of section 1504 of the code, of which seller is or has been a member (any such group, a "seller group"), has filed or caused to be filed in a timely manner (within any applicable extension periods) all material Tax Returns relating to the Business or Seller required to be filed by the Code or by applicable state, local or foreign tax laws and all such Tax Returns are true, complete and correct in all material respects, (ii) all Taxes with respect to taxable periods covered by such Tax Returns, and all other Taxes for which Seller is liable, have been timely paid in full, or will be timely paid in full by the due date thereof, and (iii) there are no material liens for Taxes with respect to any of the assets or properties of the Seller except for any Taxes not yet due and payable.

(b) Any deficiency relating to the Business or Seller resulting from any audit or examination relating to Taxes by any Taxing Authority has been timely paid.

(c) Seller, Shareholder and Telos have each complied in all material respects with all applicable laws relating to the payment and withholding of Taxes and have, within the time and in the manner prescribed by applicable law, withheld from and paid over to the proper Taxing Authorities all amounts required to be so withheld and paid over under such laws.

(d) SCHEDULE 4.26B sets forth each state, county, local, municipal or foreign jurisdiction in which Seller files, or is or has been required to file, a Tax Return relating to state and local income, franchise, license, excise, net worth, property or sales and use taxes or is or has been liable for any Taxes on a "nexus" basis.

(e) Seller is not a "foreign person" within the meaning of Section 1445 of the Code.

#### 5. PURCHASER REPRESENTS AND WARRANTS TO SELLER AS FOLLOWS:

5.1 FORMATION. Purchaser is a limited liability company duly organized, validly existing and in good standing under the laws of the State of Delaware.

5.2 AUTHORIZATION. Purchaser has full legal right and corporate power to enter into and deliver this Agreement and to consummate the transactions set forth herein and to perform all the terms and conditions hereof to be performed by it. This Agreement has been duly executed and delivered by Purchaser and is a legal, valid and binding obligation of Purchaser enforceable in accordance with its terms, except as limited by applicable bankruptcy, moratorium, insolvency, or other laws affecting generally the rights of the creditors or by principals of equity. The execution and delivery of this Agreement by Purchaser and the performance by Purchaser of the transactions contemplated herein have been duly and validly authorized by all requisite corporate action of Purchaser.

5.3 BROKERS AND FINDERS. No broker or finder has acted for Purchaser in connection with this Agreement or the transactions contemplated by this Agreement and, no broker or finder is entitled to any brokerage or finder's fee or to any commission in respect thereof based in any way on agreements, arrangements or understandings made by or on behalf of Purchaser.

6. PRE-CLOSING COVENANTS. The parties agree as follows with respect to the period between the execution of this Agreement and the Closing.

6.1 GENERAL. Each of the parties will use its best efforts to take all

action and to do all things necessary, proper, or advisable to consummate and make effective the transactions contemplated by this Agreement (including satisfying the closing conditions set forth in Section 7 below).

6.2 NOTICES AND CONSENTS. Seller will give any notices to third parties, and Seller, Telos and Shareholder will each use its best efforts to obtain any third party consents that the Purchaser may request in connection with the matters pertaining to the Seller or Shareholder disclosed or required to be disclosed by this Agreement. Each of the parties will take any additional action that may be necessary, proper or advisable in connection with any other notices to, filings with, and authorizations, consents, and approvals of governments, governmental agencies, and third parties that it may be required to give, make or obtain.

6.3 OPERATION OF BUSINESS. Seller will not engage in any practice, take any action, embark on any course of inaction, or enter into any transaction outside the ordinary course of business. Without limiting the generality of the foregoing, Seller will not engage in any practice, take any action, embark on any course of inaction, or enter into any transaction of the sort described in Section 4.4 hereof.

6.4 PRESERVATION OF BUSINESS. Except for changes occurring in the ordinary course of business, Seller will keep the business and properties of the Business intact, including its present operations, physical facilities, working conditions, and relationships with lessors, licensors, suppliers, customers, and employees.

6.5 FULL ACCESS. Seller, Shareholder and Telos will permit representatives of Purchaser to have full access at all reasonable times, and in a manner so as not to interfere with the normal business operations of Seller, Shareholder, or Telos, to all premises, properties, books, records, contracts, tax records, and documents of or pertaining to the Business.

6.6 NOTICE OF DEVELOPMENTS. Seller will give prompt written notice to Purchaser of any material development affecting the assets, liabilities, business, financial condition, operations, results of operations, or future prospects of the Business. Each party will give prompt written notice to the other parties hereto of any material development affecting the ability of the parties to consummate the transactions contemplated by this Agreement. No disclosure by any party pursuant to this Section 6.6, however, shall be deemed to amend or supplement the Schedules or Exhibits hereto, or to prevent or cure any misrepresentation, breach of warranty, or breach of covenant.

6.7 EXCLUSIVITY. None of Seller, Shareholder or Telos will, with respect to the Business or the Assets, (i) solicit, initiate, or encourage the submission of any proposal or offer from any person relating to any (A) liquidation, dissolution, or recapitalization, (B) merger or consolidation, (C) acquisition or purchase of securities or assets, or (D) similar transaction or business combination involving Seller, or (ii) participate in any discussions or negotiations regarding, furnish any information with respect to, assist or participate in, or facilitate in any other manner any effort or attempt by any person to do or seek any of the foregoing. Seller will notify Purchaser immediately if any person makes any proposal, offer, inquiry, or with respect to any of the foregoing.

6.8 UPDATED SCHEDULES. Purchaser acknowledges that the preparation and delivery of the Schedules to the Agreement may not be prepared and/or final at the time of the execution and delivery of this Agreement. As such, the parties hereto agree as follows:

(a) Seller shall have the right to amend, restate or supplement the Schedules to the Agreement at any time on or prior to the Closing Date;

(b) At the Closing, Seller shall deliver to Purchaser two (2) complete copies of the proposed final Schedules to the Agreement together with an additional two (2) complete copies marked to show the changes from the Schedules last provided to Purchaser; and

(c) Purchaser shall notify Seller in writing at the Closing that either (i) Purchaser accepts such final Schedules, in which case they shall become a part of this Agreement as if such Schedules were in existence on the date this Agreement was originally executed and all such disclosures made in such Schedules shall be deemed to be disclosed as if such Schedules have been made as of the date of this Agreement, or (ii) Purchaser reasonably determines in good faith that the information disclosed in such Schedules and/or amended Schedules would result in a material adverse change or material adverse effect on the Business, Assets or future prospects of the Business and therefore elects to terminate this Agreement pursuant to the provisions of Section 8 of this Agreement without any liability to Purchaser.

6.9 SELLER TAX COVENANTS. Seller shall deliver to Purchaser at or prior to the Closing a certificate, in form and substance satisfactory to Purchaser, certifying that the Acquisition is exempt from withholding pursuant to the Foreign Investment in Real Property Tax Act.

## 7. CONDITIONS TO OBLIGATION TO CLOSE.

7.1 CONDITIONS TO OBLIGATION OF PURCHASER. The obligations of Purchaser to consummate the transactions to be performed by it in connection with the Closing is subject to satisfaction of the following conditions: (a) the representations and warranties set forth in Section 4 hereof shall be true and correct in all material respects at and as of the Closing Date; (b) Seller, Shareholder and Telos shall have performed and complied with all of their covenants hereunder in all material respects through the Closing; (c) Seller, Shareholder and Telos

shall have (i) procured all of the third party consents necessary for Closing, including, without limitation, the consents to assignment of the contracts set forth on schedule 7.1(c) hereto under the heading "major contracts to be assigned," and (ii) sub-contracted to purchaser the contracts set forth on schedule 7.1(c) hereto under the heading "major contracts to be sub-contracted;" (d) no action, suit, or proceeding shall be pending or threatened before any court or quasi-judicial or administrative agency of any federal, state, or local, or foreign jurisdiction wherein an unfavorable judgment, order, decree, stipulation, injunction, or charge would (i) prevent consummation of any of the transactions contemplated by this Agreement, (ii) cause any of the transactions contemplated by this Agreement to be rescinded following consummation, or (iii) affect adversely the right of the Purchaser to own, operate, or control the Assets (and no such judgment, order decree, stipulation, injunction, or charge shall be in effect); (e) Seller shall have delivered to Purchaser a certificate (without qualification as to knowledge or materiality or otherwise) to the effect that each of the conditions specified above in Section 7.1(a)-(d), (g), and (k)-(m) is satisfied in all respects; (f) Purchaser shall have received all other authorizations, consents, and approvals of governments and governmental agencies set forth in this Agreement; (g) all actions and approvals to be taken by Seller, Shareholder or Telos in connection with consummation of the transactions contemplated hereby (including approval of Seller's or Shareholder's or Telos' stockholders if required by law or by their respective articles of incorporation or bylaws) and all certificates, opinions, instruments, and other documents required to effect the transactions contemplated hereby will be satisfactory in form and substance to Purchaser; (h) Purchaser shall have received from Seller all necessary documents to evidence Seller's release of the persons listed on Schedule 16.2(B) from any and all obligations regarding confidentiality, non-disclosure, non-solicitation and non-competition; (i) Purchaser shall have received from counsel to Seller, Shareholder and Telos an opinion in such form as Purchaser may reasonably request; (j) Purchaser shall have received from Seller its Financial Statements specified in Section 4.3 hereof; (k) [Intentionally Deleted]; (l) Since August 31, 1999, except as permitted by this Agreement, Seller shall not have made any distribution or dividend (other than the cash of the Business), consulting or other payment from the income generated by the Business to Seller or to Seller's employees, except for employment salaries (not to exceed current compensation levels); (m) Seller shall not have experienced any material adverse change in the Business; (n) Purchaser shall have received from Telos, Shareholder and Seller an executed Corporate Administrative Services Agreement in form and substance to be mutually agreed upon by Purchaser and Telos; (o) Purchaser shall have received from Telos, Shareholder and Seller an executed GSA Subcontract Agreement in form and substance to be mutually agreed upon by Purchaser and Telos; (p) Purchaser shall have received from Telos, Shareholder and Seller an executed Repair/Maintenance Subcontract Agreement in form and substance to be mutually agreed upon by Purchaser and Telos; (q) Purchaser shall have received from Telos, Shareholder and Seller an executed Commercial Subcontract Agreement in form and substance to be mutually agreed upon by Purchaser and Telos; (r) Purchaser shall have received from Telos, Shareholder and Seller an executed Government Subcontract Agreement in form and substance to be mutually agreed upon by Purchaser and Telos; (s) Purchaser shall have received from Telos, Shareholder and Seller an executed GSA Distribution Point Agreement in form and substance to be mutually agreed upon by Purchaser and Telos; (t) Purchaser shall have received from Telos, Shareholder and Seller an executed Help Desk Subcontract Agreement in form and substance to be mutually agreed upon by Purchaser and Telos; (u) Purchaser shall have entered into employment agreements satisfactory in form and substance to Purchaser with certain senior operating management personnel of Seller, as selected by Purchaser in its sole discretion; (v) Purchaser shall be satisfied that Seller, Shareholder and Telos have made appropriate arrangements concerning their lockbox account to separate their receivables from receivables of Purchaser after the Closing. Receivables received by Telos, Shareholder or Seller for any contracts not yet assumed by, or subcontracted or novated to, Purchaser, shall be immediately transferred, within twenty-four (24) hours, from Telos', Shareholder's or Seller's bank account directly to Purchaser's designated lockbox or account. For contracts that are subcontracted to Purchaser, Telos shall, within three (3) business days after the Closing Date, send out the appropriate applications or forms to the appropriate billing customers to modify the billing instructions of such contracts to allow for direct payment to Purchaser's designated lockbox or account; (w) Shareholder and Telos shall have received and delivered to Purchaser, for the benefit of Purchaser, an executed release and waiver, in form and substance satisfactory to Purchaser, under that certain Amended and Restated Credit Agreement dated as of July 1, 1997 (the "credit agreement"), among Shareholder, Telos, and Bank of America, N.A. (as successor to NationsBank, N.A., which was Successor to American Security Bank, N.A.) (The "Bank"), whereby the bank releases all of the assets from all of the bank's liens, security interests, and other encumbrances which may cover the assets (the "bank release"). the bank release shall be, at the closing, in full force and effect, and neither Seller, Shareholder nor Telos shall take any action, or fail to take any action, which would violate or breach the Bank Release.

Purchaser may waive any condition specified in this Section 7 if it executes a writing so stating at or prior to the Closing.

7.2 CONDITIONS TO OBLIGATIONS OF SELLER, SHAREHOLDER AND TELOS. The obligations of Seller, Shareholder and Telos to consummate the transactions to be performed by it in connection with the Closing are subject to satisfaction of the following conditions:

(a) the representations and warranties set forth in Section 5 above shall be true and correct in all material respects at and as of the Closing Date;

(b) Purchaser shall have performed and complied with all of its covenants hereunder in all material respects through the Closing;

(c) no action, suit, or proceeding shall be pending before any court or quasi-judicial or administrative agency of any federal, state, local, or foreign jurisdiction wherein an unfavorable judgment, order, decree, stipulation, injunction, or charge would (i) prevent consummation of any of the transactions contemplated by this Agreement, or (ii) cause any of the transactions contemplated by this Agreement to be rescinded following consummation (and no such judgment, order, decree, stipulation, injunction, or charge shall be in effect);

(d) Purchaser shall have delivered to Seller and Shareholder a certificate (without qualification as to knowledge or materiality or otherwise) to the effect that each of the conditions specified above in Section 7.2(a)-(c) is satisfied in all respects;

(e) Seller shall have obtained the approval of its Board of Directors for the transactions contemplated by this Agreement; and

(f) Seller shall have received from counsel to Purchaser an opinion in such form as Seller may reasonably request.

Seller or Shareholder may waive any condition specified in this Section 7 if it executes a writing so stating at or prior to the Closing.

#### 7A. ALLOCATION OF TAX LIABILITIES AND INCOME

7A.1 LIABILITY FOR TAXES. (a) Seller, Shareholder and Telos shall be liable for and pay, and pursuant to Article 11 (and subject to the limitations thereof) shall indemnify and hold harmless Purchaser from and against, all Taxes (whether assessed or unassessed) applicable to the Business, the Assets or the Assumed Liabilities and Obligations, in each case attributable to Pre-Closing Tax Periods.

(b) Purchaser shall be liable for and pay, and shall indemnify and hold harmless Seller against, all Taxes (whether assessed or unassessed) applicable to the Business, the Assets or the Assumed Liabilities and Obligations, in each case attributable to Post-Closing Tax Periods. Except as otherwise provided herein, Purchaser shall be entitled to any refund of (or credit for) Taxes attributable to Post-Closing Tax Periods.

7A.2 ALLOCATION OF TAXABLE INCOME. FOR PURPOSES OF SECTION 7A(A) AND (B), whenever it is necessary to determine the liability for Taxes attributable to Pre-Closing Tax Periods, on one hand, and Post-Closing Tax Periods, on the other hand, such determination shall be made on a "closing of the books basis" by assuming that the relevant books were closed at 11:59 p.m. on the day before the day on which the closing actually occurs; provided, however, that (i) transactions occurring on the date on which the closing actually occurs that are properly allocable (based on, among other relevant factors, the factors set forth in treasury regulation ss. 1.1502-76(b)(1)(ii)(b)) to the portion of the date on which the Closing actually occurs, but before the time of the Closing, shall be allocated to Pre-Closing Tax Periods.

#### 8. TERMINATION.

8.1 TERMINATION OF AGREEMENT. Certain of the parties may terminate this Agreement as provided below:

(a) Purchaser, Seller, Shareholder and Telos may terminate this Agreement by mutual written consent at any time prior to the Closing;

(b) Purchaser may terminate this Agreement by giving written notice to Seller at any time prior to the Closing if Seller, Shareholder or Telos is in material breach of this Agreement;

(c) Seller, Shareholder or Telos may terminate this Agreement by giving written notice to Purchaser at any time prior to the Closing if the Closing shall not have occurred on or before September 30, 1999, by reason of the failure of any condition precedent under Section 7 hereof (unless the failure results primarily from Seller, Shareholder or Telos breaching any representation, warranty, or covenant contained in this Agreement);

(d) Purchaser shall have the right in its good faith discretion, to terminate this Agreement at any time prior to Closing if any material adverse change in the Business or Assets occurs or if any information is subsequently disclosed in the Schedules to be delivered by Seller hereunder after the date of execution of this Agreement which information may reasonably be expected to have a material adverse effect on the Business or the Assets following the date hereof.

8.2 EFFECT OF TERMINATION. If any party terminates this Agreement pursuant to Section 8.1 above, then all obligations of the parties hereunder shall terminate without any liability of any party to any other party (except for any liability of any party then in breach of this Agreement).

9. NATURE OF STATEMENTS OF INDEMNIFICATIONS, GUARANTEES, REPRESENTATIONS AND WARRANTIES OF TELOS, SELLER AND SHAREHOLDER. All statements of fact contained in this Agreement or in any written statement (including financial statements), certificate, schedule or other document delivered by or on behalf of Telos, Seller or Shareholder pursuant to this Agreement or in connection with the transactions contemplated hereby shall be deemed representations and warranties of Telos, Seller and Shareholder hereunder.

#### 10. SPECIAL CLOSING AND POST-CLOSING COVENANTS.

10.1 DELIVERY OF FUNDS AND OTHER ASSETS COLLECTED BY PURCHASER; POWER OF ATTORNEY. To the extent Purchaser receives any funds or other assets in payment of receivables for work-in-process incurred prior to the Closing Date or the other Excluded Assets, then Purchaser shall immediately deliver such funds and assets to Seller and take all steps necessary to vest title to such funds and assets in Seller. Purchaser hereby designates Seller as Purchaser's true and lawful attorney-in-fact, with full power of substitution, to execute or endorse for the benefit of Seller any checks, notes or other documents received by Purchaser in payment of or in substitution or exchange for any of the Excluded Assets. Purchaser hereby acknowledges and agrees that the power of attorney set forth in the preceding sentence is coupled with an interest, and further agrees to execute and deliver to Seller from time to time any documents or instruments reasonably requested by Seller to evidence such power of attorney.

10.2 DELIVERY OF FUNDS AND OTHER ASSETS COLLECTED BY SELLER, SHAREHOLDER OR TELOS; POWER OF ATTORNEY. To the extent Seller, Shareholder or Telos receives any funds or other assets in payment of receivables or work-in-process incurred on or after the Closing Date, or in connection with any other Assets being sold to Purchaser hereto, each of Seller, Shareholder and Telos shall immediately deliver such funds and assets to Purchaser and take all steps necessary to vest title to such funds and assets in Purchaser. Each of Seller, Shareholder and Telos hereby designates Purchaser and its officers as its true and lawful attorney-in-fact, with full power of substitution, to execute or endorse for the benefit of Purchaser any checks, notes or other documents received by Seller or Stockholder or Telos in payment of or in substitution or exchange for any of the Assets. Seller hereby acknowledges and agrees that the power of attorney set forth in the preceding sentence is coupled with an interest, and further agrees to execute and deliver to Purchaser from time to time any documents or instruments reasonably requested by Purchaser to evidence such power of attorney.

#### 10.3 CONSENTS OF THIRD PARTIES.

(A) LANDLORDS. Within sixty (60) days following the Closing, Seller shall have used its best efforts to obtain consents from all lessors of real property leased by Seller to the assignment of such leases to Purchaser without any amendment, modification or change in the terms of any of such leases.

(B) CUSTOMERS. Seller, Shareholder and Telos shall use their best efforts to obtain, as soon as is practicable, a consent to assignment or novation of all of the contracts comprising part of the Assets to Purchaser without any amendment, modification or change in the terms of such contracts.

10.4 USE OF TELOS NAME. For a period of two (2) years from the Closing Date, Purchaser shall have an exclusive license to use the names "Telos Field Engineering" and "TFE" in the operation of the Business post-Closing, including, without limitation, the use of such names on, in or relating to letterhead, invoices, business cards, marketing materials, advertisements, press RELEASES, PACKAGING MATERIALS, AND VERBAL COMMUNICATIONS; PROVIDED, HOWEVER, that such license does not include the use of the name "Telos" by itself or in connection with any other words other than expressly set forth above.

#### 10.5 TAXES.

(A) TAX RETURN FILINGS. Seller shall timely prepare and file with the relevant Taxing Authorities all Tax Returns of Seller the due date for filing of which, determined taking into account extensions, is after the Closing Date. Seller shall timely prepare and file with the relevant Taxing Authorities all Tax Returns for any taxable periods of Seller the due date for filing of which, determined taking into account extensions, is on or before the Closing Date. Any Tax Returns described in the preceding sentence shall be prepared on a basis consistent with the past practices of Seller. Seller shall reimburse Purchaser (in accordance with Section 11.6) for any amount owed by Seller with respect to the taxable periods covered by such Tax Returns. All Tax Returns for a taxable period including the Closing Date shall be filed on the basis that the relevant taxable period ended as of the close of business on the Closing Date, unless the relevant Taxing Authority will not accept such a Tax Return.

(B) STRADDLE PERIODS. In the case of any taxable period that includes (but does not end on) the Closing Date (a "Straddle Period"): (i) Real, Personal and Intangible Property Taxes ("Property Taxes") of Seller for the Pre-closing Tax Period shall equal the Property Taxes for such Period multiplied by a fraction, the numerator of which is the number of days during the Straddle Period that are in the Pre-Closing Tax Period and the denominator of which is the number of days in the Straddle Period; and (ii) the Taxes of Seller (other than Property Taxes) for the Pre-Closing Tax Period shall be computed as if the entire Straddle Period ended as of the close of business on the day before the Closing Date.

(C) COOPERATION. Seller and Purchaser shall reasonably cooperate, and shall cause their respective affiliates, officers, employees, agents, auditors and representatives reasonably to cooperate, in preparing and filing all Tax Returns, including maintaining and making available to each other all records necessary in connection with Taxes, and in resolving all disputes and audits with respect to all taxable periods relating to Taxes, including all Tax Claims (as defined below).

(D) REFUNDS AND CREDITS. Any refund or credit of Taxes of Seller for any taxable period ending before the Closing Date shall be for the account of Seller. Notwithstanding the foregoing, however, any such refund or credit shall be for the account of Purchaser to the extent that such refunds or credits are attributable (determined on a marginal basis) to the carryback from a Post-Closing Tax Period (or the portion of a Straddle Period that begins on the

Closing Date) of items of loss, deductions or other Tax items of Purchaser (or any of its affiliates). Any refund or credit of Taxes of Purchaser for any Post-Closing Tax Period shall be for the account of Purchaser. Any refund or credit of Taxes of Purchaser for any Straddle Period shall be equitably apportioned between Seller and Purchaser. Each party shall, or shall cause its affiliates to, forward to any other party entitled under this Section 10.5(d) to any refund or credit of Taxes any such refund within 10 days after such refund is received or reimburse such other party for any such credit within 10 days after the credit is allowed or applied against other tax liability; provided, however, that any such amounts shall be net of any tax cost or benefit to the payor party attributable to the receipt of such refund and/or the payment of such amounts to the payee party. Notwithstanding the foregoing, the control of the prosecution of a claim for refund of Taxes paid pursuant to a deficiency assessed subsequent to the Closing Date as a result of an audit shall be governed by the provisions of Section 10.5(e).

(E) PROCEDURES RELATING TO INDEMNIFICATION OF TAX CLAIMS.

(I) NOTICE. If a claim shall be made by any Taxing Authority, which, if successful, might result in an indemnity payment to any Purchaser Indemnatee pursuant to Section 11, Purchaser shall promptly notify Seller or Shareholder in writing OF SUCH CLAIM (A "TAX CLAIM"). Failure to give notice of a Tax Claim to Seller or Shareholder within a sufficient period of time and in reasonably sufficient detail to allow Seller to effectively contest such Tax Claim shall affect the liability of Seller to any Purchaser Indemnatee only to the extent that Seller's position is actually and materially prejudiced as a result thereof.

(II) CONTROL OF PROCEEDINGS. Seller shall control all proceedings taken in connection with any Tax Claim relating solely to Taxes of Seller for a Pre-Closing Tax Period, and may make all decisions in connection with such Tax Claim. Seller and Purchaser shall jointly control all proceedings taken in connection with any Tax Claim relating solely to Taxes of Seller for a Straddle Period, and neither party shall settle any such Tax Claim without the written consent of the other party. Purchaser shall control all proceedings with respect to all other Tax Claims.

10.6 PERFORMANCE BONDS. As to contracts which are subcontracted to Purchaser at the Closing, Purchaser agrees to pay Seller's premiums on the outstanding performance bonds related to such subcontracted contracts until Purchaser replaces such bonds within thirty (30) days after the Closing Date. As to contracts not assigned or subcontracted to Purchaser at the Closing, Purchaser agrees to pay Seller's premium on the outstanding performance bonds until Purchaser replaces such performance bonds at the time at which such contracts are assigned to Purchaser. If such bonds are not replaced by Purchaser within a thirty (30) day period for contracts which have been subcontracted to Purchaser at the Closing or within the period to assign the contracts not subcontracted to Purchaser at the Closing, then Purchaser agrees to establish a cash escrow for the amount of such performance bonds of Seller then outstanding and shall allow Seller to draw the respective funds from such escrow.

11. INDEMNITY BY SELLER, SHAREHOLDER AND TELOS.

11.1 INDEMNITY. SELLER, SHAREHOLDER AND TELOS (collectively, the "indemnifying parties") shall and hereby do, jointly and severally, indemnify, hold harmless and defend purchaser, its affiliates and their officers, directors, shareholders, employees, agents, representatives and consultants (collectively, the "indemnified parties") at all times from and after the date of this agreement, from and against any and all penalties, demands, damages, punitive damages, losses, loss of profits, liabilities, suits, costs, costs of any settlement or judgment, claims of any and every kind whatsoever, refund obligations (including, without limitation, interest and penalties thereon), remediation costs and expenses (including, without limitation, reasonable attorneys' fees), of or to any of the indemnified parties ("damages"), which may now or in the future be paid, incurred or suffered by or asserted against the Indemnified Parties by any Person resulting or arising from or incurred in connection with any one or more of the following (provided that this Section 11 shall not apply to any items that have been expressly assumed by Purchaser under this Agreement):

(a) any liability (whether in contract, in tort or otherwise, and whether or not successful) of or against Seller, Shareholder or Telos or related in any way to the Business or Assets of any of them (including any liability of Seller, Shareholder or Telos under all ERISA laws);

(b) any liability (whether in contract, in tort or otherwise, and whether or not successful) related in any way to the Assets or the Business to the extent such liability arises in connection with any action, omission or event occurring on or prior to the Closing Date;

(c) any liability (whether in contract, in tort or otherwise, and whether or not successful) related to any liens, obligations or encumbrances of any nature whatsoever against or in any way related to the Assets or the Business which have not been expressly assumed by the Purchaser hereunder;

(D) (I) ALL LIABILITY FOR TAXES of Seller and each Seller Group with respect to any Pre-Closing Tax Period, (ii) all liability for Taxes of such Seller or any other corporation which is or has ever been affiliated with such Seller or with whom Seller otherwise joins, has ever joined, or is or has ever been required to join in filing any consolidated, combined or unitary Tax Return prior to the Closing Date, (iii) all liability for Taxes of Seller or any Seller Group arising (directly or indirectly) as a result of the sale of the Assets or the other transactions contemplated hereby, (iv) any breach of any

representation or warranty contained in Section 4, and (v) all liability for reasonable legal fees and expenses attributable to any item in the foregoing clauses.

(e) any liability (whether or not successful) related to any lawsuit or threatened lawsuit or claim involving Seller, Shareholder or Telos, including But Not Limited To, Those Items Listed On Schedule 4.12 Hereto;

(f) any misrepresentation, breach of warranty or non-fulfillment of any covenant or agreement on the part of Seller, Shareholder or Telos under this Agreement or from any misrepresentation in or omission from any list, schedule, certificate or other instrument furnished or to be furnished to Purchaser pursuant to the terms of this Agreement;

(g) all actions, suits, proceedings, demands, assessments, adjustments, costs and expenses (including costs of court and reasonable attorneys' fees and expenses) incident to any of the foregoing.

11.2 AMOUNT OF LOSS. The amount of any Loss for which indemnification is provided under this Article 11 shall be net of any amounts recoverable by the indemnified party under insurance policies with respect to such Loss and shall be (i) increased to take account of any net Tax cost to the indemnified party arising from the receipt of indemnity payments hereunder (grossed up for such increase), and (ii) reduced to take account of any net Tax benefit realized by the indemnified party arising from the incurrence or payment of any such Loss. Any indemnity payment under this Agreement shall be treated as an adjustment to the Purchase Price for Tax purposes, unless a final determination (which shall include the execution of a Form 870AD or successor form) with respect to the indemnified party or any of its affiliates causes any such payment not to be treated as an adjustment to the Purchase Price for United States Federal income tax purposes.

11.3 LIMITATION OF CERTAIN LIABILITY. To the extent the Indemnified Parties incur or suffer Damages for any matter for which Seller and Shareholder and Telos are obligated to indemnify, hold harmless and defend Purchaser under Section 11.1(f) above, Seller and Shareholder shall not be liable for any such Damages until Purchaser has suffered aggregate losses by reason of all such misrepresentations, breaches of warranty and/or non-fulfillments of covenants or agreements on the part of Seller and/or Shareholder And/or Telos in Excess of \$150,000.00; Provided, However, That the Limitation Set Forth Above Specifically Shall Not Apply to Damages (Y) Resulting From or Attributable to Intentional fraud or any willful misconduct by Seller, Shareholder or Telos, or (z) for any matter or matters (other than those set out in Section 11.1(f) above) for which Seller, Shareholder or Telos is obligated to indemnify, hold harmless and defend Purchaser. The provisions of this Section 11.3 will terminate on the second anniversary of the Closing Date, except for Damages relating to any Taxes, which shall not terminate until the expiration of the applicable statute of limitations.

11.4 NOTICE OF CLAIM. Purchaser agrees that upon its discovery of facts giving rise to a claim for indemnity under the provisions of this Agreement, including receipt by it or any Indemnified Party of notice of any demand, assertion, claim, action or proceeding, judicial or otherwise, by any person with respect to any matter as to which any of the Indemnified Parties are entitled to Indemnity Under the Provisions of This Agreement (Such Actions Being Collectively Referred to in This Section 11 as the "Claim"), Purchaser Will Give Prompt Notice Thereof in Writing to Telos; Provided, However, That Any delay in giving or failure to give such notice shall not limit the rights of Purchaser or any Indemnified Party to indemnity hereunder, and Purchaser shall have no liability for such delay or failure, except to the extent that Telos is shown to have been materially damaged by such delay or failure.

11.5 RIGHT TO DEFEND. Any Indemnifying Party shall be entitled, at its sole cost and expense, to contest and defend by all appropriate legal proceedings any Claim with respect to which any such indemnifying party is called upon to indemnify any of the indemnified parties under the provisions of this agreement; provided, however, that notice of the intention so to contest shall be delivered by such indemnifying party to purchaser within twenty (20) days from the effective date of notice to telos by purchaser of the assertion of the claim; and provided further, however, that such right to contest and defend shall exist only if such Indemnifying Party have (i) admitted in writing to Purchaser the obligation of such Indemnifying Party to pay the indemnified obligations to the Indemnified Parties with respect to the Claim, and (ii) have provided the Indemnified Parties with satisfactory evidence of its ability to pay any indemnity obligation that reasonably may arise under the Claim. Any such contest may be conducted in the name and on behalf of Purchaser. Such contest shall be conducted by reputable attorneys employed by such Indemnifying Party and reasonably acceptable to Purchaser, but Purchaser shall have the right to participate in such proceedings and to be represented by attorneys of its own choosing at its cost and expense. If, after such opportunity, any Indemnifying Party have not satisfied all requirements for the contest of a claim by them (i.e., timely election, admission of liability and proof of ability regarding payment), then such Indemnifying Party shall (i) at their expense, except for travel expenses requested to be incurred by Purchaser, reasonably cooperate with Purchaser with respect to defense of the Claim, and (ii) be bound by the result obtained with respect to the Claim by Purchaser. At any time after the commencement of defense of any Claim, such Indemnifying Party may request Purchaser to accept a bona fide offer from the other parties to the Claim for a cash settlement payable solely from such Indemnifying Party (which places no burdens or restrictions on Purchaser and does not otherwise prejudice Purchaser), whereupon such action shall be taken unless Purchaser determines that the contest should be continued, and so notifies such Indemnifying Party in writing within fifteen (15) days of such request from such Indemnifying Party.



In the event that, after such a request by such Indemnifying Party for acceptance of a bona fide cash settlement offer, Purchaser determines that the contest should be continued, such Indemnifying Party shall be liable for indemnity hereunder only to the extent of the lesser of (i) the amount which the other party to the contested Claim had agreed to accept in settlement as of the time the such Indemnifying Party made its request therefore to Purchaser, or (ii) such amount for which such Indemnifying Party may be liable with respect to such Claim by reason of the provisions hereof.

11.6 COOPERATION BY PURCHASER. If requested by any Indemnifying Party, Purchaser and its officers and employees shall reasonably cooperate with such Indemnifying Party and its counsel in contesting any Claim with respect to which such Indemnifying Party Have Satisfied All Requirements for a Contest by Them as Set Forth in Section 12 Above; Provided, However, That Such Indemnifying Party shall reimburse Purchaser for any actual out-of-pocket expenses incurred by it in so cooperating.

11.7 PAYMENT. The Indemnifying Parties shall promptly pay to Purchaser or such other Indemnified Party as may be entitled to indemnity hereunder in cash the amount of any Damages to which Purchaser or such Indemnified Party may become entitled by reason of the provisions of this Agreement.

12. LEASE AGREEMENT. Purchaser shall assume the leases for the office space currently used by Seller in connection with the operation of the business and that are listed on schedule 12 hereto. Purchaser will, from and after Closing, hold harmless Seller from any liability thereunder accruing after Closing.

13. NON-COMPETITION AGREEMENT. As part of the inducement for Purchaser to enter into this Agreement and for the payment of the Purchase Price as provided by Section 3.1, the parties hereby agree to the provisions of this Section 13. For a period commencing on the date hereof through the third anniversary of the Closing Date, neither Seller nor Shareholder nor Telos, shall (i) within the territorial boundaries of the United States, compete directly with Purchaser insofar as the Assets, Business and transactions contemplated hereby, (ii) solicit directly any of the accounts of Seller regarding the Assets or the Business, or (iii) solicit for employment by Seller or Shareholder or Telos any of the employees of the Business. Each of Seller, Shareholder and Telos agrees that the limitations set forth herein on the rights of Seller, Shareholder and Telos to compete with Purchaser are reasonable and necessary for the protection of Purchaser. In that regard, Seller, Shareholder and Telos specifically agree that the limitations as to period of time and geographic area, as well as all other restrictions on its activities specified herein, are reasonable and necessary for the protection of the Purchaser. Seller, Shareholder and Telos each further recognize and agree that violation of any of the agreements contained in this Section 13 will cause irreparable damage or injury to Purchaser, the exact amount of which may be impossible to ascertain, and that, for such reason, among others, Purchaser shall be entitled to an injunction, without the necessity of posting a bond, regarding any violation of such agreements. Such rights to any injunction shall be in addition to, and not in limitation of, any other rights and remedies Purchaser may have against Seller, Shareholder or Telos, including, but not limited to, the recovery of damages. Further, it is agreed by Seller, Shareholder and Telos that in the event the provisions of this Agreement should ever be deemed by a court of competent jurisdiction to exceed the geographic limitations permitted by applicable law, then the provisions shall be reformed to the maximum geographic limitations permitted. Notwithstanding the foregoing, Purchaser recognizes and hereby agrees that any of Telos, Shareholder or Seller engaging in the activities described ON SCHEDULE 13 hereto shall not be deemed to be a violation of the provisions of this Section 13.

14. NONDISCLOSURE OF CONFIDENTIAL INFORMATION. Seller, Shareholder and Telos each recognizes and acknowledges that it has and will have access to certain confidential information of Seller that is included in the Assets (including, but not limited to, list of customers, and costs and financial information) that after the consummation of the transactions contemplated hereby will be valuable, special and unique property of Purchaser. Seller, Shareholder and Telos each agree that it will not disclose, and it will use its best efforts to prevent disclosure by any other Person of, any such confidential information to any Person, except to authorized representatives of Purchaser. Seller, Shareholder and Telos each recognize and agree that the violation of any of the agreements contained in this Section 14 will cause irreparable damage or injury to Purchaser, the exact amount of which may be impossible to ascertain, and that, for such reason, among others, Purchaser shall be entitled to an injunction, without the necessity of posting bond, therefore, restraining any violation of such agreements. Such rights to any injunction shall be in addition to, and not in limitation of, any other rights and remedies Purchaser may have against Seller, Shareholder or Telos.

15. ASSIGNMENT OF CONTRACTS. Notwithstanding any other provision of this Agreement, neither this Agreement nor any document entered into in connection with this Agreement or the transactions contemplated hereby shall be construed as an attempt to assign (i) any contract which, as a matter of law or by its terms, is non-assignable without the consent of the other parties thereto unless such consent has been given, or (ii) any contract or claims as to which all of the remedies for the enforcement thereof enjoyed by Seller would not, as a matter of law or by its terms, pass to Purchaser as an incident of the transfers and assignments to be made under this Agreement. In order, however, that the full value of every contract and claim of the character described in clauses (i) and (ii) above and all claims and demands on such contracts may be realized for the benefit of Purchaser, Seller, at its expense and at the request and under the direction of Purchaser, shall take all such action and do or cause to be done all such things as will, in the opinion of Purchaser, be necessary or proper in order that the obligations of Seller under such contracts may be

performed in such manner that the value of such contract will be preserved and will inure to the benefit of Purchaser, and for, and to facilitate, the collection of the monies due and payable and to become due and payable thereunder to Purchaser in and under every such contract and claim incurred after the Closing. Seller shall promptly pay over to Purchaser all monies collected by or paid to it in respect of every such contract, claim or demand to the extent such monies are earned or accrued by Purchaser on or after the Closing Date. Nothing in this Section 15 shall relieve Seller, Shareholder or Telos of their obligation to obtain, as soon as is practicable, any and all consents required for the transfer of the Assets and all rights thereunder to Purchaser, or shall relieve Seller, Shareholder or Telos from any liability to Purchaser for failure to obtain such consents.

#### 16. SPECIAL PROVISIONS REGARDING EMPLOYEES OF SELLER.

16.1 NEW EMPLOYEES OF PURCHASER. It is the intention of Purchaser, and Seller hereby acknowledges and agrees with such position, that any Business Employees that Purchaser hires will be new employees of Purchaser as of the Closing Date or the date of hire, whichever is later. Such new employees shall be entitled only to such compensation and employee benefits as are agreed to by such employees and Purchaser, or as are otherwise provided by Purchaser, in its sole discretion.

#### 16.2 HIRING OF EMPLOYEES.

(a) Purchaser will use its reasonable efforts to hire the current Business Employees (other than temporary employees) as listed on schedule 16.2(a); provided, however, that purchaser shall be entitled to review employee records, conduct employee interviews and perform such employee screening procedures as Purchaser deems appropriate, and may refuse to offer employment to any Business Employee for any reason.

(B) AS A CONDITION TO THEIR EMPLOYMENT BY PURCHASER, ALL BUSINESS EMPLOYEES LISTED IN SCHEDULE 16.2(B) may be asked to execute and deliver to Purchaser an Employment Agreement, a confidentiality agreement, and a non-competition agreement, each in form and substance acceptable to Purchaser

16.3 EXISTING EMPLOYEE BENEFIT PLANS. (a) Purchaser shall have no obligation to continue any employee benefit plans, programs or arrangements currently offered by Seller, Shareholder or Telos to any of Seller's, Shareholder's or Telos' employees. Telos agrees to indemnify and hold harmless Purchaser from and against any claim which may arise because of the failure to continue any such plans, programs or arrangements.

(b) Notwithstanding (a), above, it is Purchaser's present intention that, within a reasonable period after the Closing Date, it shall provide to the Business Employees hired by it employee benefits that are substantially similar in the aggregate to the employee benefits provided to such Business Employees immediately prior to the Closing Date.

16.4 INDEMNITY CONCERNING ACCRUED BENEFITS. Except as expressly assumed by Purchaser hereunder and as reflected in the Statement of Net Assets of Seller, each of Seller, Shareholder and Telos jointly and severally agree to indemnify and hold harmless Purchaser from and against any and all accrued and outstanding employee benefits, salary, vacation pay, bonuses, commissions and other emoluments of its past or present employees and from any other employee related matters or liabilities with respect to Seller's, Shareholder's or Telos' past or present employees.

17. EXPENSES. Whether or not the transactions contemplated hereby are consummated, Seller and Shareholder and Telos will pay all of their costs and expenses and Purchaser will pay all of its costs and expenses, in each case incurred in connection with the preparation of and execution of this Agreement and the consummation of the transactions contemplated hereby.

18. FURTHER ACTIONS. From time to time, at the request of any party hereto; the other parties hereto shall execute and deliver such instruments and take such action as may be reasonably requested to evidence the transactions contemplated hereby.

19. NOTICES. All notices, requests, demands and other communications required or permitted to be given hereunder shall be in writing and shall be deemed to have been duly given if delivered personally, given by prepaid telex or telegram, by courier, by facsimile or other similar instantaneous electronic transmission device, or by mailing first class, postage prepaid, certified United States mail, return receipt requested, as follows:

(a) If to Purchaser, at:

c/o Carr & Company, LLC  
410 Park Avenue, Suite 840  
New York, New York 10022  
Attention: Peter J. Carr  
Facsimile No.: (212) 688-1890

With a copy to:

Cadwalader, Wickersham & Taft  
100 Maiden Lane  
New York, New York 10038-4892  
Attention: A. Curtis Greer, Esq.  
Facsimile No.: (212) 504-6666

(b) If to Seller, Shareholder or Telos, at:

Telos Corporation  
19886 Ashburn Road  
Ashburn, Virginia 20147

Attention: William L. P. Brownley, Esq.  
Facsimile No.: (703) 724-3855

With a copy to:

John B. Connor, Esq.  
John B. Connor, P.L.C.  
1033 N. Fairfax Street, Suite 310  
Alexandria, Virginia 22314  
Facsimile No: (703) 836-1799

provided that any party may change its address for notice by giving to each of the other parties hereto written notice of such change. Any notice given under this Section 19 shall be effective (i) if delivered personally, when delivered, (ii) if sent by telex or telegram or by facsimile or other similar instantaneous electronic transmission device, twenty-four (24) hours after sending, and (iii) if sent by certified mail, forty-eight (48) hours after mailing.

## 20. GENERAL PROVISIONS.

20.1 Governing Law; Interpretation: Section Headings. This Agreement Shall be Governed by and Construed and Enforced in Accordance With the Laws of the State of Delaware, Without Regard to Conflict-of-laws Rules as Applied in the State of Delaware. the Section Headings Contained Herein are for Purposes of Convenience Only, and Shall Not be Deemed to Constitute a Part of This Agreement or to Affect the Meaning or Interpretation of This Agreement in Any Way. Any Action or Proceeding Arising Under This Agreement Shall Take Place in the United States District Court in Delaware.

The parties irrevocably and unconditionally agree (i) to be subject to the jurisdiction of the courts of the State of Delaware and of the federal courts sitting in the State of Delaware, and (ii) that service of process may also be made on the parties by prepaid certified mail with a proof of mailing receipt validated by the United States Postal Service constituting evidence of valid service, and that service so made shall have the same legal force and effect as if served upon such party personally within the State of Delaware.

20.2 SEVERABILITY. Should any provision of this Agreement be held unenforceable or invalid under the laws of the United States of America or the State of Delaware, or under any other applicable laws of any other jurisdiction, then the parties hereto agree that such provision shall be deemed modified for purposes of performance of this Agreement in such jurisdiction to the extent necessary to render it lawful and enforceable, or if such a modification is not possible without materially altering the intention of the parties hereto, then such provision shall be severed here from for purposes of performance of this Agreement in such jurisdiction. The validity of the remaining provisions of this Agreement shall not be affected by any such modification or severance, except that if any severance materially alters the intentions of the parties hereto as expressed herein (a modification being permitted only if there is no material alteration), then the parties hereto shall use their best reasonable effort to agree to appropriate equitable amendments to this Agreement in light of such severance, and if no such agreement can be reached within a reasonable time, any party hereto may initiate arbitration under the then current rules of the American Arbitration Association to determine and effect such appropriate equitable amendments.

20.3 ENTIRE AGREEMENT. This Agreement sets forth the entire agreement and understanding of the parties hereto with respect to the transactions contemplated hereby and supersedes all prior agreements, arrangements and understandings related to the subject matter hereof. No representation, promise, inducement or statement of intention has been made by any party hereto which is not embodied in this Agreement, and no party hereto shall be bound by or liable for any alleged representation, promise, inducement or statement of intention not so set forth.

20.4 BINDING EFFECT. All the terms, provisions, covenants and conditions of this Agreement shall be binding upon and inure to the benefit of and be enforceable by the parties hereto and their respective heirs, executors, administrators, representatives, successors and assigns.

20.5 ASSIGNMENT. This Agreement and the rights and obligations of the parties hereto shall not be assigned or, delegated by any party hereto without the prior written consent of the other parties hereto.

20.6 AMENDMENT; WAIVER. This Agreement may be amended, modified, superseded or canceled, and any of the terms, provisions, representations, warranties, covenants or conditions hereof may be waived, only by a written instrument executed by all parties hereto, or, in the case of a waiver, by the party waiving compliance. The failure of any party at time or times to require performance of any provision hereof shall in no manner affect the right to enforce the same. No waiver by any party of any condition contained in this Agreement, or of the breach of any term, provisions, representation, warranty or covenant contained in this Agreement, in any one or more instances, shall be deemed to be or construed as a further or continuing waiver of any such condition or breach, or as a waiver of any other condition or of the breach of any other term, provision, representation, warranty or covenant.

20.7 GENDER; NUMBERS. All references in this Agreement to the masculine,

feminine or neuter genders shall, where appropriate, be deemed to include all other genders. All plurals used in this Agreement shall, where appropriate, be deemed to be singular, and vice versa.

20.8 COUNTERPARTS. This Agreement may be executed simultaneously in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument. This Agreement shall be binding when one or more counterparts hereof, individually or taken together, shall bear the signatures of each of the parties reflected hereon as signatories.

20.9 TELECOPY EXECUTION AND DELIVERY. A facsimile, telecopy or other reproduction of this Agreement may be executed by one or more parties hereto, and an executed copy of this Agreement may be delivered by one or more parties hereto by facsimile or similar instantaneous electronic transmission device pursuant to which the signature of or on behalf of such party can be seen, and such execution and delivery shall be considered valid, binding and effective for all purposes. At the request of any party hereto, all parties hereto agree to execute an original of this Agreement as well as any facsimile, telecopy or other reproduction hereof.

(REMAINDER OF PAGE INTENTIONALLY LEFT BLANK - SIGNATURE PAGE FOLLOWS)

IN WITNESS WHEREOF, each of the parties hereto has executed this Agreement as of the date first above written.

TELOS:

TELOS CORPORATION,  
a Maryland corporation

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

SHAREHOLDER:

TELOS CORPORATION,  
a California corporation

SELLER:

TELOS FIELD ENGINEERING, INC.,  
a Delaware corporation

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

PURCHASER:

TFE TECHNOLOGY HOLDINGS, LLC  
a Delaware limited liability company  
BY: TFE TECHNOLOGY, LLC  
a Delaware limited liability company  
Manager

By: /s/ Peter J. Carr  
Name: Peter J. Carr  
Title: Manager

December 30, 1999

MR. DOUGLAS T. BROWN

Vice President  
Bank of America

8300 Greensboro Drive, Suite 550  
McLean, VA 22102-3604

Dear Douglas:

This letter is to formalize the agreements between Bank of America, N.A. ("Bank of America"), Telos Corporation, a Maryland corporation ("Telos (Maryland)"), Telos Corporation, a California corporation ("Telos (California)") and, together with Telos (Maryland), sometimes referred to collectively as "Telos", and Enterworks, Inc., a Delaware corporation, formerly known as "enterWorks.com, inc." ("Enterworks"), with respect to the private placement (the "Private Placement") of approximately \$25,000,000 of Series A Preferred Stock of Enterworks at \$1.15 per share and certain other related transactions which were outlined in a conversation between Bank of America and Telos (California) which resulted in a signed letter agreement between Bank of America, Telos (California) and Enterworks dated October 6, 1999. The details of these transactions have now been finalized and amended to the extent necessary to permit more specific Bank of America approval.

AS STATED IN OUR OCTOBER 6TH letter, Enterworks has agreed to exchange approximately \$2.7 million in subordinated notes issued by Enterworks for shares of Enterworks common stock, par value \$.01 per share, to be issued by Enterworks to the note holders, and Telos will likewise exchange approximately \$7.6 million in subordinated notes issued by Telos in exchange for Enterworks common stock held of record by Telos (California). The conversions of the subordinated notes will be effected at a rate of \$1.00 of principal amount per share.

As you are aware, all 27,000,000 shares of Enterworks common stock currently owned of record by Telos (California) have been pledged to Bank of America (the "Pledged Shares") pursuant to the Telos Pledge Agreement dated as of April 16, 1999 (the "Pledge Agreement") by and among Bank of America, Telos (Maryland) and Telos (California), and Telos (California) will require a release of 10,000,000 of the Pledged Shares from Bank of America as described below. Additionally, Enterworks has agreed to issue 4,000,000 additional shares to Telos (California) and Telos (California) has agreed to contribute 1,000,000 Pledged Shares to Enterworks for distribution under the Enterworks 1996 Stock Option Plan.

In order to permit the Private Placement and as part of a general restructuring of the Enterworks balance sheet, Telos and Enterworks have also agreed that Telos will cancel the existing intercompany debt of Enterworks which has accumulated through the first closing in the Private Placement in the approximate amount of \$30 million, on advice from Deutsche Banc Alex. Brown, the Private Placement investment banker.

In addition to the transactions set forth above and as previously discussed with Bank of America, Enterworks has approved the redemption of \$5 million of Enterworks common stock from Telos (California) at a price of \$1.00 per share, and Telos (California) has determined that it is in the best interests of Telos (California) to accept the redemption offer. The redemption will occur immediately after the closing of the Private Placement, and Telos (California) will receive all \$5 million of the redemption price (less fees payable to Alex.Brown) by wire transfer on the closing date of the Private Placement. On the closing date of the Private Placement, the above referenced \$5 million (less fees payable to Alex.Brown) of funds received by Telos (California) as a result of the redemption shall be used to pay down the debt owed to Bank of America under the Amended and Restated Credit Agreement by and among Telos (Maryland), Telos (California) and Bank of America dated July 1, 1997, as amended (the "Credit Agreement").

Also as previously discussed, Enterworks is seeking Bank of America's approval to create and issue up to 21,739,130 shares of Series A Preferred Stock of Enterworks at \$1.15 per share in connection with the Private Placement to various Private Placement Investors (the "Private Placement Investors"), and to execute, deliver and perform the Stock Purchase Agreement, Investor Rights Agreement, Co-Sale Agreement, Stockholders' Voting Agreement and the Enterworks charter amendments contemplated as part of the Private Placement (the "Operative Agreements"), all dated on or prior to the date hereof.

Please indicate by signing below that Bank of America approves of and consents to each of the share issues and transactions described above and the execution, delivery and performance by Telos and Enterworks in accordance with the Operative Agreements (collectively, the "Transactions"), and hereby waives the violations, defaults and events of default under or arising by or through Sections 7.3, 7.6, 7.10, 7.12 and 9.1(q) of the Credit Agreement and Section 8 of the Pledge Agreement, and any other relevant provisions of the Credit Agreement and the Pledge Agreement which may result as a consequence of the Transactions.

Within 10 days after the first closing in the Private Placement, Bank of America agrees to release 10,000,000 of the Pledged Shares (within the meaning of the Pledge Agreement) and deliver the share certificate representing the 27,000,000 Pledged Shares to Telos (California) for cancellation. Concurrently with such delivery by Bank of America, Enterworks will issue a new share certificate evidencing 17,000,000 of the remaining Pledged Shares, which shall continue to be subject to the Pledge Agreement, and Telos (California) shall concurrently deliver such certificate to Bank of America in exchange for the share certificate representing the 27,000,000 Pledged Shares. Each of the signatories to this letter agrees to promptly take whatever actions are necessary to amend the Pledge Agreement to evidence the change in Pledged Shares. In the event Telos (California) is issued more than 17,000,000 shares of Enterworks common stock, such higher number shall be pledged to Bank of America.

In the event Bank of America exercises its rights under the Credit Agreement or Pledge Agreement (or any successor arrangement) to sell or otherwise dispose of any of the remaining 17,000,000 (or greater) Pledged Shares on one or more occasions, Bank of America agrees, prior to any public or private sale or other disposition of such Pledged Shares to any person or entity other than Enterworks or the Private Placement Investors (each such sale or proposed sale being referred to as a "Third Party Sale"), to first offer such Pledged Shares to Enterworks, which offer shall remain open for a period of 10 calendar days. Any Pledged Shares not agreed to be purchased by Enterworks within such 10 calendar day period shall then be offered to the Private Placement Investors, which offer shall remain open to the Private Placement Investors for a period of 35 calendar days. In the event Enterworks and/or the Private Placement Investors have not elected to purchase all of such remaining Pledged Shares within such respective periods of time, the Pledged Shares may thereafter be sold to the original prospective purchaser in a Third Party Sale, but only on the terms and conditions on which such Pledged Shares were offered to Enterworks and the Private Placement Investors. The Pledged Shares may be offered in a subsequent Third Party Sale on terms and conditions different from the terms and conditions originally offered to Enterworks and Private Placement Investors only if such Pledged Shares have first been offered to Enterworks and the Private Placement Investors on such new terms and conditions in accordance with this paragraph.

Bank of America hereby grants the same co-sale rights to each of the Private Placement Investors in respect of the Pledged Shares as are granted to the Private Placement Investors in the Co-Sale Agreement, a copy of which is attached hereto; provided, however, that such co-sale rights shall not become an obligation of any subsequent purchaser of the Pledged Shares from Bank of America.

Notwithstanding anything to the contrary contained in the Credit Agreement, Pledge Agreement or any other agreement or document relating thereto, Bank of America agrees with Telos and Enterworks that, at any time when the voting and other consensual rights described in Section 7(d) of the Pledge Agreement would, by the terms of Pledge Agreement, become vested in Bank of America, then (a) Telos shall retain, and there shall not vest in Bank of America (i) the right to designate a member of the Enterworks board of directors or an observer thereto as provided in Section 1 of the Stockholders' Voting Agreement; and (ii) the right to approve any amendment, modification, termination of, or waiver under, any provision of any Operative Agreement to which Telos is a party; and (b) Telos shall retain, and Bank of America shall permit Telos to keep and observe, the obligation to vote its shares of Enterworks capital stock as provided in Section 1 of the Stockholders' Voting Agreement.

Bank of America agrees and acknowledges that the Private Placement Investors are third party beneficiaries with respect to the rights granted in the three previous paragraphs (but no other terms of this letter agreement). The co-sale rights, rights of first refusal and other rights granted by Bank of America in the foregoing three paragraphs shall terminate upon the date of termination of the Co-Sale Agreement referenced above as in effect on the date hereof.

Bank of America agrees and acknowledges that Enterworks is hereby forever released from any and all obligations arising out of or in connection with the Credit Agreement, Security Agreement and Pledge Agreement upon consummation of the Private Placement.

In consideration of Bank of America providing the foregoing consents, approvals and waivers, Telos (Maryland) has agreed to pay Bank of America \$450,000 in cash in two equal installments on October 6, 1999 and December 31, 1999 and Enterworks has agreed to issue 350,000 Enterworks common stock purchase warrants in the event the Private Placement closes by December 31, 1999 or 400,000 Enterworks common stock purchase warrants if the Private Placement closes after December 31, 1999 (the "Warrants"). The Warrants will have the same rights and privileges set forth in the Warrant Agreement received by Alex. Brown as Placement Agent in connection with the Private Placement, except that (i) the number of underlying shares will be in accordance with the immediately preceding sentence, and (ii) the Warrant Agreement will include the language set forth in Riders 5 and 6 attached hereto, without duplication. Bank of America acknowledges having received the first installment of \$225,000 on or prior to October 6, 1999.

If the foregoing is acceptable to Bank of America, please sign as indicated below. Thank you for your prompt attention to this matter.

\_\_\_\_\_  
TELOS CORPORATION, a Maryland corporation

\_\_\_\_\_  
By: /s/ William L.P. Brownley

\_\_\_\_\_  
\_\_\_\_\_  
Name: William L.P. Browney  
Title: Vice President/General Counsel

\_\_\_\_\_  
TELOS CORPORATION, a California corporation

\_\_\_\_\_  
\_\_\_\_\_  
By: /s/ John B. Wood  
Name: John B. Wood  
Title:

\_\_\_\_\_  
ENTERWORKS, INC., a Delaware corporation

\_\_\_\_\_  
\_\_\_\_\_  
By: /s/ Robert Lewis  
Name: Robert Lewis  
Title: President

\_\_\_\_\_  
BANK OF AMERICA, N.A.

\_\_\_\_\_  
\_\_\_\_\_  
By: /s/ Douglas T. Brown  
Name: Douglas T. Brown  
Title: Vice President

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Enterworks, Inc. (the "Company") would like to provide you and certain other investors with the opportunity to convert the subordinated Notes purchased from the Company (each a "Note" and collectively the "Notes") into shares of the Company's common stock, par value \$.01 per share (the "Common Stock") in accordance with the terms of this letter agreement. By signing and returning this letter agreement and tendering your Note(s) to the Company, you will become entitled to receive, in exchange for the outstanding principal amount and all accrued but unpaid interest under the tendered Note(s) through the conversion date (the "Conversion Date"), that number of shares of Common Stock equal to the outstanding principal amount of the Note(s) you tender. For example, if the outstanding principal amount under your Note(s) is \$100 and accrued but unpaid interest thereon is \$5 as of the Conversion Date, you will be entitled to receive 100 shares of Common Stock upon conversion and cancellation of such Note(s) on the Conversion Date.

On the date of the first closing in the currently proposed private placement (the "Private Placement"), the Company will issue you one or more Common Stock share certificates evidencing the number of shares to which you are entitled. You are the holder of a Note(s) in the amount of (dollars) dollars, therefore your Note(s) would be converted into (shares) shares of Common Stock. The Common Stock to be issued to you in exchange for your Note(s) will have and be subject to the same rights, preferences, limitations and restrictions under the Articles of Incorporation of Enterworks as the Common Stock of Enterworks into which the convertible preferred stock proposed to be issued in connection with the Private Placement will be convertible. Whether you elect to convert your Note(s) into shares of Common Stock or not, your rights under the Warrants you purchased along with the Note(s) will not be affected by this letter agreement, except that holders of equity securities of the Company (including you, as a holder of Warrants) may be diluted by additional issuances of capital stock of the Company including, but not limited to, issuances of Common Stock in the event holders of Note(s) elect to convert their Note(s) into Common Stock. The Company will provide you with a schedule of shareholders as soon as practical following the closing of the Private Placement. Further, the Company hereby informs you that there are no securities with the Company with anti-dilution rights other than the Warrants attached to the Note(s) referenced above.

Additionally, on or prior to the first closing in connection with the Private Placement, you, the Company and the other Note holders electing to exchange Notes hereunder will enter into a written shareholders' agreement which will provide for one demand registration right and standard co-sale rights as set forth below. The one (1) demand registration right may be exercised by written consent of not less than 51% of the total number of shares of Common Stock issued to all Note holders exchanging their notes hereunder, including you, and will be subject to reasonable and customary blackout periods and to cutback of shares based on market conditions. In the event of such a cutback, any Common Stock requested to be registered by you and other Note holders will be reduced before reducing any securities of the investors in the Private Placement (the "Private Placement Investors") or the Company requested to be included in such registration; provided, however that in the event the total number of shares of Common Stock you and the other Note holders properly request for inclusion is reduced pursuant to such cutback to less than 40% of the total number of shares you and such Note holders properly requested to be included in such registration, then such registration shall not count toward the one demand registration granted by the shareholders' agreement. The Private Placement Investors shall receive notice of such demand registration and shall have the right to piggyback registration rights in connection with such demand registration. You will also receive co-sale rights equivalent to the co-sale rights granted to Telos in the shareholders' agreement between Telos and certain other Company shareholders.

If you wish to have your Note(s) converted into shares of Common Stock, please countersign this letter in the signature block provided, request a Conversion Date on or after October 1, 1999, provide all other information requested below and return this letter agreement to me along with your original Note(s) at your earliest convenience, but not later than September 27, 1999. If you do not request a Conversion Date after October 1, 1999, or request a Conversion Date that occurs after the date of the first closing in connection with the Private Placement, you agree that your Note(s) will be exchanged on the date of the first closing to occur in connection with the Private Placement. If you do not wish to convert your Note(s), the courtesy of a response is nonetheless appreciated.

By signing below, you (i) agree and acknowledge that the shares of Common Stock you receive will not be registered under the Securities Act of 1933, as amended (the "Securities Act"), or applicable state securities laws, are aware that you cannot sell, assign, transfer or otherwise dispose of such shares unless they are registered under the Securities Act and applicable state securities laws or an opinion is given by counsel satisfactory to the Company that such registration is not required, and agree that the certificates evidencing the shares will contain a legend to the foregoing effect, (ii) represent that you have substantial knowledge and experience in making investment decisions of this type and are capable of evaluating the merits and risks of this exchange, and (iii) have been offered an opportunity to ask questions and receive answers from Enterworks' management to your complete satisfaction.

The Company cannot assure you that the Company will receive any funds in connection with the Private Placement, and therefore the Company must, and does, retain the right to terminate this agreement to exchange your Note(s) at any



time by written notice to you for any reason, in which case the Company will tender your Note(s) back to you as soon as practicable thereafter. Furthermore, the Company will terminate this agreement (and tender your Note(s) back to you) if an amount of funds equal to or greater than \$15 million is not raised in the above referenced Private Placement. In any event, the Company will tender your Note(s) back within 90 days of the date of this letter agreement in the event the Conversion Date does not occur prior to such time. Please let us know your decision at your earliest convenience. I appreciate your attention to this matter.

Very truly yours,

Dee Ann Revere  
Vice President & General Counsel

By signing below, I agree that my Note(s) may be converted into shares of Common Stock on the date of the first closing in connection with the Private Placement, or on \_\_\_\_\_ (insert Conversion Date) as set forth in this letter agreement and that in such event the Note(s) attached hereto will be cancelled by the Company on the Conversion Date. Please issue my share certificate(s) to \_\_\_\_\_ (insert name of person or entity in whose name the share certificates should be issued).

AGREED AND ACKNOWLEDGED,

FOR INVESTORS OTHER THAN NATURAL PERSONS:

ATTEST: \_\_\_\_\_ [INSERT NAME OF INVESTOR]

-----  
\_\_\_\_\_  
\_\_\_\_\_  
By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

FOR INVESTORS WHO ARE NATURAL PERSONS:

WITNESS: \_\_\_\_\_ [INSERT NAME OF INVESTOR]

-----  
Name: \_\_\_\_\_ Name: \_\_\_\_\_

September 29, 1999

Telos Corporation (the "Company") would like to provide you and certain other investors with the opportunity to exchange the subordinated Note(s) purchased from the Company (each a "Note" and collectively the "Notes") into shares of common stock, par value \$.01 per share (the "Common Stock"), of the Company's majority-owned subsidiary, Enterworks, Inc., a Delaware corporation ("Enterworks"), in accordance with the terms of this letter agreement. By signing and returning this letter agreement and tendering your Note(s) to the Company, you will become entitled to receive, in exchange for the outstanding principal amount and all accrued but unpaid interest under the tendered Note(s) through the conversion date (the "Conversion Date"), that number of shares of Common Stock equal to the outstanding principal amount of the Note(s) you tender. For example, if the outstanding principal amount under your Note(s) is \$100 and accrued but unpaid interest thereon is \$5 as of the Conversion Date, you will be entitled to receive 100 shares of Common Stock upon conversion and cancellation of such Note(s) on the Conversion Date.

On the date of the first closing in the currently proposed private placement (the "Private Placement"), the Company will transfer to you one or more Common Stock share certificates evidencing the number of shares to which you are entitled in connection with this exchange. You are the holder of a Note(s) in the amount of (dollars) dollars, therefore your Note(s) would be converted into (shares) shares of Common Stock. The Common Stock to be issued to you in exchange for your Note(s) will have and be subject to the same rights, preferences, limitations and restrictions under the Articles of Incorporation of Enterworks as the Common Stock of Enterworks into which the convertible preferred stock proposed to be issued in connection with the Private Placement will be convertible. In addition, you will be entitled to become a party to, and obtain the same rights and benefits with respect to your shares of Common Stock of Enterworks under, any stockholders agreement or similar agreement or arrangement (whether written or oral) as any investor in the Private Placement providing for, among other things, registration, pre-emptive, co-sale or other similar rights or benefits. The Company will provide you with a schedule of shareholders as soon as practical following the closing of the Private Placement.

If you wish to have your Note(s) converted into shares of Common Stock, please countersign this letter in the signature block below, request a Conversion Date on or after October 1, 1999, provide all other information requested below and return this letter agreement to me along with your original Note(s) at your earliest convenience, but not later than September 27, 1999. If you do not request a Conversion Date after October 1, 1999, or request a Conversion Date that occurs after the date of the first closing in connection with the Private Placement, you agree that your Note(s) will be exchanged on the date of the first closing to occur in connection with the Private Placement. If you do not wish to convert your Note(s), the courtesy of a response is nonetheless appreciated.

By signing below, you (i) agree and acknowledge that the shares of Common Stock you receive will not be registered under the Securities Act of 1933, as amended (the "Securities Act"), or applicable state securities laws, are aware that you cannot sell, assign, transfer or otherwise dispose of such shares unless they are registered under the Securities Act and applicable state securities laws or an opinion is given by counsel satisfactory to the Company that such registration is not required, and agree that the certificates evidencing the shares will contain a legend to the foregoing effect, (ii) represent that you have substantial knowledge and experience in making investment decisions of this type and are capable of evaluating the merits and risks of this exchange, and (iii) have been offered an opportunity to ask questions and receive answers from Enterworks' and the Company's management to your complete satisfaction.

Neither the Company nor Enterworks can assure you that Enterworks will receive any funds in connection with the Private Placement, and therefore the Company must, and does, retain the right to terminate this agreement to exchange your Note(s) at any time by written notice to you for any reason, in which case the Company will tender your Note(s) back to you as soon as practicable thereafter. Furthermore, the Company will terminate this agreement (and tender your Note(s) back to you) if an amount of funds equal to or greater than \$15 million is not raised in the above referenced Private Placement. In any event, the Company will tender your Note(s) back within 90 days of the date of this letter agreement in the event the Conversion Date does not occur prior to such time. Please let us know your decision at your earliest convenience. I appreciate your attention to this matter.

Very truly yours,

William L. P. Brownley  
Vice President and General Counsel

By signing below, I agree that my Note(s) may be converted into shares of Common Stock on the date of the first closing in connection with the Private Placement, or on \_\_\_\_\_ (insert Conversion Date) as set forth in this letter agreement and that in such event the Note(s) attached hereto will be cancelled by the Company on the Conversion Date. Please issue my share CERTIFICATE(S) TO (insert name of person or entity in whose name the share

certificates should be issued).

AGREED AND ACKNOWLEDGED,

FOR INVESTORS OTHER THAN NATURAL PERSONS:

ATTEST: \_\_\_\_\_ [INSERT NAME OF INVESTOR]

\_\_\_\_\_ By: \_\_\_\_\_  
\_\_\_\_\_ Name:  
\_\_\_\_\_ Title:

FOR INVESTORS WHO ARE NATURAL PERSONS:

WITNESS: \_\_\_\_\_ [INSERT NAME OF INVESTOR]

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Name: \_\_\_\_\_ Name: \_\_\_\_\_

## TELOS DEBT/NOTE CONVERSION

ISSUED TO	SHARE AMOUNT
Drayton	183,332
Drayton	151,080
Second Consolidated Trust	557,842
Second Consolidated Trust	676,930
J. O. Hambro	17,725
J. O. Hambro	21,509
Foreign & Colonial Enterprise TLP	360,000
Foreign & Colonial Trust PLC	1,440,000
North Atlantic Smaller Companies	229,065
North Atlantic Smaller Companies	277,966
John R. C. Porter	3,720,580

## ENTERWORKS DEBT/NOTE CONVERSION

ISSUED TO	SHARE AMOUNT
MLPF&S Cust FBO David Aldrich IRA	100,000
John B. Wood	50,000
Robert Marino	75,000
Gregory Barnhill	75,000
Dr. Fred Ikle	50,000
H. H. Haight	100,000
Norman P. Byers	5,000
William Melton	500,000
John R. C. Porter	1,200,000
William L. P. Brownley	5,000
Lorenzo Tellez	25,000
J. O. Hambro	129,114
Second Consolidated Trust PLC	291,846

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TRANSACTION AGREEMENT

THIS TRANSACTION AGREEMENT (THIS "AGREEMENT") IS MADE THIS 29TH DAY OF SEPTEMBER, 1999, BETWEEN TELOS CORPORATION, a MARYLAND CORPORATION ("TELOS") AND ENTERWORKS, INC., a Delaware corporation ("Enterworks").

R E C I T A L S

WHEREAS, to finance the start up and operations of Enterworks, Telos has loaned Enterworks approximately \$30,000,000 as of the date hereof, and presently intends to continue to fund the operations of Enterworks in the ordinary course until the closing of the minimum amount offered in the currently proposed private placement (the "Private Placement") of up to \$25,000,000 in common stock of the Company, par value \$.01 per share (the "Company Stock") by Deutsche Banc Alex. Brown (the "Placement Agent");

WHEREAS, Board of Directors of Enterworks, upon the advice of the Placement Agent, has determined that it is necessary to restructure Enterworks' balance sheet to provide for the forgiveness of the amounts loaned to Enterworks by Telos through the date (the "Cancellation Date") of the closing of the minimum amount in connection with the Private Placement (the "Telos Shareholder Loan Amount") as provided herein; and

WHEREAS, as part of the general restructuring of the balance sheet of Enterworks in anticipation of the Private Placement, Enterworks has agreed to issue Telos 4,000,000 shares of common stock, par value \$.01 per share ("Common Stock") pursuant to the terms of this Agreement;

WHEREAS, Telos desires to contribute 1,000,000 shares of Enterworks Common Stock owned by Telos to the capital of Enterworks for issuance to certain members of management of Telos (the "Grantees") upon exercise of options to be granted pursuant to Enterworks 1996 Stock Option Plan;

A G R E E M E N T

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

SECTION ONE. \_\_\_\_BACKGROUND OF AGREEMENT. The agreements set forth in Sections 2, 3 and 4 below are entered into as part of a general restructuring of the balance sheet of Enterworks upon the advice of the Placement Agent in order to permit the successful offering of Common Stock in the Private Placement which may alleviate the cash flow drain on Telos in connection with the funding of Enterworks by Telos and provide Enterworks with the ability to seek additional sources of funding other than Telos from and after the Private Placement.

SECTION TWO. \_\_\_\_CANCELLATION OF INDEBTEDNESS. Telos hereby agrees, with effect from Cancellation Date, to forgive and cancel the Telos Shareholder Loan Amount on the Cancellation Date in the event Enterworks receives at least the minimum offering amount in connection with the Private Placement on such date.

SECTION THREE. \_\_\_\_SHARE ISSUANCE TO TELOS. Enterworks agrees to issue Telos, with effect from the Cancellation Date, on the Cancellation Date, 4,000,000 shares of Common Stock, such shares upon issuance to be duly authorized, validly issued, fully paid and non-assessable shares of Common Stock.

SECTION FOUR. \_\_\_\_SHARE TRANSFER TO ENTERWORKS. Telos agrees to immediately transfer to Enterworks 1,000,000 shares of Common Stock, for the purpose of reserving such shares for issuance upon exercise of options granted to the Grantees pursuant to the Enterworks 1996 Stock Option Plan.

SECTION FIVE. \_\_\_\_CONTINUED FUNDING. Telos' present intention is to continue to fund Enterworks in the ordinary course from the date hereof until the first closing in connection with the Private Placement in order to facilitate a successful consummation of the Private Placement; provided, however, that circumstances may require Telos to discontinue such funding upon written notice to Telos.

SECTION SIX. \_\_\_\_GENERAL. This Agreement may not be supplemented, changed, waived, discharged, terminated, modified or amended except by written instrument executed by the parties hereto, and shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns. The Recitals set forth above shall be deemed to be a substantive part of this Agreement and may be used to construe and interpret the terms hereof.

SECTION SEVEN. \_\_\_\_GOVERNING LAW. All Questions Concerning the Construction, Validity, Interpretation or Subject Matter of This Agreement Will be Governed by and Construed in Accordance the Internal Law, and Not the Law of Conflicts, of the State of Delaware.

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

TELOS CORPORATION

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

ENTERWORKS, INC.

By: /s/ Dee Ann Revere  
Name: Dee Ann Revere  
Title: Vice President/General Counsel

TELOS CORPORATION AND SUBSIDIARIES

Form 10-K

SCHEDULE OF SUBSIDIARIES

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

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



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

0000320121  
Telos Corporation  
U.S. Dollars

12-MOS	DEC-31-1999	
	JAN-01-1999	
	DEC-31-1999	
	1	315,000
		0
	25,860,000	
	830,000	
	4,779,000	
	37,009,000	
		35,329,000
	23,093,000	
	56,886,000	
30,041,000		25,045,000
43,029,000		0
		78,000
56,886,000		(52,669,000)
	171,364,000	
	171,364,000	
		151,216,000
	151,216,000	
		0
	400,000	
	6,065,000	
	(17,832,000)	
	(7,853,000)	
(9,979,000)		0
	(8,015,000)	
		0
	(1,964,000)	
		0
		0