

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 1995

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

Commission file number: 1-8443

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

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

460 Herndon Parkway, Herndon, Virginia 22070-5201  
(Address of principal executive offices) (Zip Code)

Registrant's Telephone Number,  
including area code: (703) 471-6000

C3, INC  
(Former Name of Registrant)

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

NONE

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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

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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. [X]

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

As of March 1, 1996, the registrant had 23,076,753 shares of Class A Common Stock, no par value; 4,037,628 shares of Class B Common Stock, no par value; and 3,595,586 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): 55

Item 1. Business

History and Introduction

Founded in 1968, Telos Corporation ("Telos" or the "Company") provides information and network technology products and services primarily to the government and industry. The Company's offerings encompass the full life cycle of computer services, including analysis, system specification, evaluation, hardware and software integration, deployment, installation, training, hardware maintenance and software sustainment.

A substantial portion of the Company's revenues are generated by long-standing customers. In 1995, over 55% of the Company's total revenue was generated from customers who have done business continuously with the Company for at least five years. For example, since 1976, the Company has provided life-cycle software engineering services for the U.S. Army's tactical fire support systems. The first contract award from this customer was for \$1.7 million of software services. Since 1976, the Company has generated \$197 million of revenue from this customer, and in May 1994 a new five-year contract for an additional \$90 million was awarded. In addition, the Company has historically received orders from this customer for follow-on work, which may significantly increase the contract amount. The most recently completed fire support contract was for an initial award of \$70.5 million; however, \$99.4 million was recognized in revenue as a result of follow-on work.

Certain other long-term customers of the Company include the California Institute of Technology's Jet Propulsion Laboratory, for which the Company has designed, developed and supported ground based telemetry and mission operations systems since 1975; subsidiaries of Hughes Aircraft Company, for which the Company has provided technical consultation, design, development, and test support for tactical military systems since 1969; the U.S. Coast Guard, for which the Company has provided integrated hardware solutions and technical support services since 1981; and the U.S. Navy and Marines, for which the Company has provided ruggedized computer systems since 1988.

The Company has further enhanced its ability to deliver solutions to its customers' information requirements by providing tools and applications focused in emerging information and network technology markets. These tools and applications include, data mining, data warehousing, middleware connectivity, public-private network security, data access and workflow, high speed information exchange and communication systems; and electronic commerce. The Company also offers proprietary software applications that support Internet-based electronic commerce, criminal justice, military tactical, and simulation training environments.

Customers include organizations in numerous agencies of federal, state, and local governments, as well as financial, industrial, and services industries. The Company provides its services primarily in the United States and in a limited number of international markets.

Operating Groups

The Company provides its services through three operating groups. Although the groups operate on a substantially decentralized basis, they work together to offer customers a broad range of information and network technology services. The Company believes that this cooperative approach enables each of the operating groups to offer its services in specific market segments using their specialized expertise and market knowledge, while drawing on the market access, technical breadth and management capability of the entire Telos organization. The market segments in which the Company operates and the operating groups performing services within these areas are as follows:

- o Systems and Services provides computer and large scale network integration services to customers through software and hardware engineering; computer hardware integration and component manufacture; and installation, training and service support.
- o Field Engineering provides computer hardware maintenance to federal, state and local government clients, as well as commercial entities.
- o Consulting Services provides computer consulting services and contract labor to support its customers' existing information technology capabilities. Specific tasks include concept formulation, system specification, system engineering design/development, and project management.

#### Systems and Services

The Company's Systems and Services Group provides turnkey system solutions and maintains and extends the life of existing systems through technology insertion, system redesign, and software reengineering. The units also perform value engineering and system integration activities, including design and manufacturing engineering, network integration, data warehousing and middleware connectivity, COTS integration, system installation, and support services. This group (i) holds the largest network integration contract ever awarded by the federal government, a three year contract representing backlog of over \$900 million (see backlog discussions), (ii) is the largest provider of life cycle software engineering services to the U.S. Army and (iii) is the largest provider of ground based technical services to the California Institute of Technology Jet Propulsion Laboratory, a federally funded Research and Development Center managed by the National Aeronautics and Space Administration ("NASA"). Additionally, the group is developing and installing the information system technology infrastructure in support of the Immigration and Naturalization Service ("INS").

Telos' Systems and Services group is a leading implementer and innovator of enabling technology. In 1981, the group implemented one of the first client-server architectures for the U.S. Coast Guard and, as a system integrator, developed the Navy's flagship desktop tactical computer system, the DTC-II. Today, one of the main focuses of the group is developing and bringing to market software applications to support the emerging Internet marketplace. Subsequent to December 31, 1995 the Company formed enterWorks.com, a wholly-owned subsidiary focused on the Internet and related software products including Pangaea, the Company's Commerceware product line, to pursue and expand such opportunities.

For fiscal year 1995, this group generated \$142.9 million in revenues, or 70.5% of the Company's total revenues. Of this amount, contracts with the U.S. Army Communications-Electronics Command for its fire support and communication life cycle software engineering contracts and its contract with the Immigration and Naturalization Service accounted for 26% and 20%, respectively, of the Company's total revenue in 1995.

#### Field Engineering

Hardware maintenance services are provided by the field engineering group, known as Telos Field Engineering ("TFE"). TFE was formed in 1977 and provides a "one stop" maintenance service approach that includes hardware maintenance and repair, quality assurance, configuration management, and property management. In response to the increasing prevalence of customers owning more than one type or brand of computer, TFE specializes in third party maintenance of computer hardware and peripheral equipment manufactured by others. The majority of TFE's revenues are generated from work performed on Sun Microsystems, DEC, IBM, Data General, Hewlett-Packard, Wang, and Telos (previously known as C3) equipment.

For fiscal year 1995, TFE generated revenues of \$32.8 million or 16.2% of the Company's total revenue.

## Consulting Services

Consulting services are provided by Telos Consulting Services ("TCS"). TCS, formed in 1969, delivers consulting expertise, primarily on a contract labor basis, in support of the client's own information technology capabilities. TCS's areas of expertise include business process reengineering, team application development, software and hardware engineering and analysis, networking, computer security, team facilitation, and team communication. Operating from eleven field offices throughout the United States, TCS supports a business base of several hundred clients, many with multiple contracts. TCS's staff of professionals work as part of client organizations' teams, helping customers meet their organizational goals.

For fiscal year 1995, TCS generated revenues of \$27.1 million or 13.3% of the Company's total revenue.

### Revenues by Major Market and Significant Customers

Revenue by major market for the Company is:

	Percentage of total revenues for fiscal year		
	1995	1994	1993
Federal Government	80.6%	84.5%	89.0%
Commercial	15.2	11.4	7.8
State and local governments	4.2	4.1	3.2
	----	----	-----
Total	100.0%	100.0%	100.0%
	=====	=====	=====

Total Company revenue at December 31, 1995 includes 43.1% of revenue from contracts with the Department of Defense, 6.1% of revenue from subcontracts with U.S. government prime contractors, 6.0% of revenue from the contracts with National Aeronautics and Space Administration ("NASA"), and 20.0% of revenue from contracts with the U.S. Department of Justice.

### Overview of 1995

The Company viewed 1995 as a year to solidify its market position in existing markets, achieve profitability, and create value through planned and focused diversification in emerging markets. The Company was successful in achieving these goals.

From a market positioning stand-point, the Company was successful in its efforts to maintain and increase its contract base. During 1995, the Company won a significant rebid with an award from the U.S. Army Communication-Electronics Command of \$118 million for systems and software engineering. Additionally, the Company won the largest network integration contract ever awarded by the federal government, a three year contract representing backlog of over \$900 million.

The Company achieved profitability and positioned itself for future stability and growth through investment in bid and proposal, marketing and sales activities. During 1995, the Company achieved 310% growth in total backlog, establishing a solid base for future years. (See Backlog). While there can be no assurance of future contract awards, the Company continued to invest in its marketing, proposal and sales activities in 1995 in order to develop and capture new business opportunities.

In the area of focused diversification, the Company is establishing itself in two emerging markets: internet commerce and international business. With regard to the emerging internet market, the Company has enhanced and expanded its Commerceware product line, Pangaea. The Company's second generation firewall, NetSeer, and its middleware connectivity/data mining product, Virtual db, were successfully released and are in use by commercial customers, including McDonnell Douglas, Northrop Grumman, and the Internet Cafe. In addition, the Company established an international joint venture to pursue third party maintenance contracts in the Middle East.

During 1995, the Company continued the streamlining and consolidation of its infrastructure with consolidation of marketing efforts as well as consolidation of various general and administrative functions. The Company continuously evaluates its organizational structure in response to customer and market demands as well as to ensure it is providing cost effective solutions. In order to gain further operational efficiencies, in 1996 the Company will consolidate and reorganize certain divisions.

#### 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 that operate exclusively or primarily outside the United States. Some of the larger 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 that compete with the Company are consulting firms, computer services firms, applications software companies and the consulting groups of accounting firms, as well as the computer service arms of computer manufacturing companies and defense and aerospace firms. Thousands of firms fall into these categories. Among the major competitors are AT&T, Computer Data Systems, Computer Sciences Corporation, Electronic Data Systems Corporation, Unisys, Scientific Applications International Corporation, GTE Corporation and General Electric Corporation. In addition, the internal staffs of client organizations, non-profit federal contract research centers and universities are competitors of the Company. Some of the Company's competitors have greater financial and other resources than the Company and may have greater capabilities to perform services similar to those provided by 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, and 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 employs approximately 1,658 persons as of December 31, 1995. 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, approximately 955 provide Systems and Services, 295 provide Maintenance Services, and 280 provide Consulting Services. An additional 128 employees provide corporate and business services functions.

## Backlog

Many of the Company's contracts with the U.S. Government are funded by the procuring government agency from year to year, primarily based upon the government's fiscal requirements. This results in two different categories of backlog: funded and unfunded. Total backlog consists of the aggregate contract revenues remaining to be earned by the Company based on total contract value 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 that 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 whether or when revenue will be realized on projects included in the Company's backlog.

At December 31, 1995 and 1994, the Company had total backlog from existing contracts of \$1.3 billion and \$328.4 million, respectively. This is the maximum value of additional future orders for systems, products, consulting services, 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 five years. Approximately \$65.6 million and \$93.4 million of the total was funded backlog at December 31, 1995 and 1994, respectively.

## Other

The Company has been incorporated under the laws of Maryland since 1971.

In 1995, the Company's shareholders and directors approved an amendment to the Company's Charter changing the Company's name to Telos Corporation. References to the "Company" or to "Telos" herein represent Telos Corporation (Maryland) (formerly C3, Inc.) and except where expressly noted, its consolidated subsidiaries. References to "Telos Corporation (California)" are to the Company's wholly-owned subsidiary.

## Item 2. Properties

The Company leases 150,256 square feet of space in Herndon, Virginia for its corporate headquarters, integration facility, and primary service depot. This lease expires in March 1997, with a five year extension available at the Company's option. The Company, given its recent contract wins, has assessed its current office and integration space requirements. In March 1996, the Company signed a long-term lease for a building in Loudoun County, Virginia that will serve as its Corporate headquarters as well as provide significant additional manufacturing and integration space.

The Company leases additional space for regional field engineering, contract work sites, training, and sales offices in 53 separate facilities located in 22 states, the District of Columbia, and Europe under various leases, each of which expires on different dates through February, 2000. The Company also owns two buildings and a warehouse in Amery, Wisconsin. One of these two owned buildings is currently being leased to another company.

Item 3. Legal Proceedings

A description of certain legal matters follows:

Rosecliff, Inc., et al v. C3, Inc., et al. (94 CIV. 9104)

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This case was filed in December, 1994 in the United States District Court for the Southern District of New York. Rosecliff, Inc. ("Rosecliff") is a merchant banking group with whom the Company had been negotiating an equity/subordinated debt private placement transaction. Upon termination of this transaction, Rosecliff filed a suit seeking payment of its expenses, the specific enforcement of the acquisition agreement (or in the alternative lost profits) and \$1 million for the violation of the "no-shop" provision in the Agreement. On motion to dismiss, the Court dismissed the claim seeking specific enforcement or lost profits (whether the plaintiffs will seek to replead that claim is unclear). A magistrate has recommended that the Company be held liable for the payment of Rosecliff's expenses in the amount of \$1.1 million. Discovery is ongoing as to the remainder of the suit. While no ultimate assurances can be made as to those claims that the Court has not dismissed, the Company believes it has substantial defenses to the claim for violation of the no-shop provision and has made adequate provision for the payment of Rosecliff expenses.

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

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

During the fourth quarter of fiscal year 1995, 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 B Common Stock. As of March 1, 1996, there were 72 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				
	1995 ----	Year Ended December 31			Nine Month Period Ended
		1994 ----	1993 ----	1992(1) -----	December 31, 1991 -----
	(amounts in thousands)				
Sales	\$202,828	\$175,121	\$211,229	\$224,751	\$82,798
Operating income (loss)	6,554	(4,189)	8,888	2,747	1,197
Income (loss) before extraordinary item	1,015	(12,421)	548	(2,615)	930
Extraordinary item	--	(196)	---	4,316	456
Net income (loss)	1,015	(12,617)	548	1,701	1,386

## FINANCIAL CONDITION

	As of December 31				
	1995 ----	1994 ----	1993 ----	1992(1) -----	1991 ----
	(amounts in thousands)				
Total assets	\$94,492	\$86,872	\$84,796	\$97,277	\$54,216
Debt (2)	47,316	40,414	30,790	40,710	23,126
Senior redeemable preferred stock	4,494	4,192	3,922	3,653	8,256
Class B redeemable preferred stock	10,252	9,497	8,822	8,149	---
Redeemable preferred stock	18,647	14,263	11,417	9,951	8,564

(1) See Note 1 to the Consolidated Financial Statements included in Item 8 regarding the acquisition of Telos Corporation during fiscal year 1992.

(2) See Note 5 to the Consolidated Financial Statements in Item 8 regarding debt obligations of the Company at December 31, 1995. Total debt obligations include amounts due under the senior credit facility and senior subordinated notes.



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

General

Over the past two years, the Company has invested significant resources into marketing, bid and proposal efforts, and into development of certain software and hardware products. The purpose of the marketing investment was to (1) retain significant contracts that were being rebid and (2) to capture new business. The Company has won all of its significant rebids including a \$118 million software services contract with the U.S. Army Communications-Electronics Command. In addition, in 1995, the Company was awarded the Army's Small Multiuser Computer II Contract, which has a potential value of \$907 million, the Realtime Automated Personnel Identification System ("RAPIDS") contract valued at nearly \$18 million and a contract with the United States House of Representatives with a minimum value of \$3.4 million.

As a result of the above contract awards, total backlog from existing contracts increased to \$1.3 billion as of December 31, 1995, as compared to \$328.4 million at December 31, 1994. As of December 31, 1995, the funded backlog of the Company totaled \$65.6 million as compared to \$93.4 million at December 31, 1994.

The Company has also invested in certain new software products primarily focused around the Internet. These investments have led to the development of a number of software products including NetSeer, an Internet firewall product, and Pangaea, the Company's Commerceware product line. The Company has also invested in certain new computer hardware products in support of new contract and business initiatives. While there can be no assurance as to the ultimate success of these investments, management believes that these investments will provide the Company with opportunity to expand its presence in the rapidly growing Internet market and to obtain additional revenues through new contract vehicles.

Revenue by Contract Type

Approximately 84.8% of the Company's total revenues in 1995 were attributable to contracts with federal, state, and local governments, including 80.6% attributable to the federal government. The Company's revenues are generated from various contract vehicles. In general, the Company believes its contract portfolio is characterized as having low to moderate financial risk as the Company has minimal long-term fixed price development contracts. The Company's firm fixed price contracts represent either contracts for the purchase of computer equipment at established contract prices or contracts for maintenance of computer hardware. A significant portion of the Company's revenue is from time and material and cost reimbursable contracts, which generally allow the pass-through of allowable costs plus a profit margin. For the year ended December 31, 1995, revenue by contract type was as follows: time and material, 36.7%; firm fixed price, 36.1%; cost reimbursable, 18.7%; fixed monthly rate, 8.1%; and other, 0.4%. 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 Income Data

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

	Year Ended December 31					
	1995		1994		1993	
	(dollar amounts in thousands)					
Sales	\$202,828	100.0%	\$175,121	100.0%	\$211,229	100.0%
Cost of sales	167,578	82.6	147,236	84.1	173,651	82.2
Selling, general and administrative expenses	26,326	13.0	28,896	16.5	25,512	12.1
Goodwill amortization	2,370	1.2	3,178	1.8	3,178	1.5
	-----	---	-----	----	-----	----
Operating income (loss)	6,554	3.2	(4,189)	(2.4)	8,888	4.2
Interest expense	(5,491)	(2.7)	(4,057)	(2.3)	(3,028)	(1.4)
Other income (expense)	27	--	(5,458)	(3.1)	(3,440)	(1.6)
	---	---	-----	----	-----	----
Income (loss) before taxes and minority interest	1,090	0.5	(13,704)	(7.8)	2,420	1.2
Income tax provision (benefit)	75	--	(1,283)	.7	1,872	.9
Extraordinary item	--	--	(196)	(.1)	--	--
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Net income (loss)	\$ 1,015	0.5%	\$(12,617)	(7.2)%	\$ 548	.3%
	=====	===	=====	====	=====	=====

Financial Data By Market Segment

The Company operates in three market segments: systems and services (the "Systems and Services Group"), which consists of systems integration and software services; computer hardware maintenance (the "Field Engineering Group"); and consulting services (the "Consulting Group"). Field engineering and consulting services are considered by the Company to be additional segments of the complete life cycle services offered by the Company. The Company is currently evaluating its organizational structure and its defined market segments and in order to gain further operational efficiencies, in 1996 the Company will consolidate and reorganize certain divisions.

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

	Year Ended December 31		
	1995	1994	1993
	(dollar amounts in thousands)		
<b>Sales:</b>			
Systems and Services	\$142,939	\$116,059	\$145,433
Field Engineering	32,820	34,617	41,852
Consulting Services	27,069	24,445	23,944
	-----	-----	-----
Total	\$202,828	\$175,121	\$211,229
	=====	=====	=====
<b>Gross Profit:</b>			
Systems and Services	\$26,844	\$ 18,132	\$ 27,851
Field Engineering	3,393	5,326	6,815
Consulting Services	5,013	4,427	2,912
	-----	-----	-----
Total	\$35,250	\$ 27,885	\$ 37,578
	=====	=====	=====
<b>Gross Margin:</b>			
Systems and Services	18.8%	15.6%	19.2%
Field Engineering	10.3%	15.4	16.3
Consulting Services	18.5%	18.1	12.2
	----	----	----
Total	17.4%	15.9%	17.8%
	=====	=====	=====

#### Results of Operations

Years ended December 31, 1995 and 1994

Sales increased \$27.7 million, or 15.8%, from \$175.1 million to \$202.8 million for the year ended December 31, 1995 as compared to the same 1994 period. This increase was primarily attributable to the Systems and Services Group, which reported an increase in sales of \$26.9 million for the year, and to the Consulting Group which reported increased sales of \$2.6 million. These increases were offset by a decline in sales in the Field Engineering Group of \$1.8 million for the year.

Within the Systems and Services Group, systems integration sales accounted for the majority of the increase, as sales improved \$30.7 million to \$70 million in 1995 from \$39.3 million in 1994 due to increased order volume during the second half of 1995. Increased orders in systems integration were due to the INS contract, as well as increased sales in other business lines of the division. Software services sales experienced a decline of \$3.8 million for the year ended December 31, 1995 as compared to the same period in 1994. These decreases in sales were due to declines in contract activity on existing contracts as well as certain contracts not being renewed during 1995.

The increase in Consulting Services sales of \$2.6 million is attributable to expansion of the breadth of services within this group in such areas as system integration services and software products, as well as an increase in billable hours in its traditional business areas. The revenue decline in the Field Engineering Group is primarily due to lower warranty revenue resulting from the low 1994 system integration sales, lack of follow-on maintenance contracts after the end of the warranty period for certain of the TSI equipment previously sold and delayed starts on certain of the Group's recent contract awards. In addition, the Field Engineering Group is experiencing a shift in its business as its customers migrate from mainframe computing to distributed processing through personal computers and networks. Generally, maintenance services for distributed processing equipment generate a lower revenue stream as billing rates for maintaining personal computers are lower.

Based on the Company's significant growth in backlog, 1996 should present significant opportunities for revenue growth. However, sales have been adversely impacted during the first quarter of 1996 by the Federal government shutdown and budget impasse that occurred in late 1995 and early 1996. As the Company begins its 1996 fiscal year, the Company has experienced reduced order flow on its large equipment contracts with certain agencies of the Federal government. Accordingly, the Company anticipates lower sales and profitability for the first half of 1996 than might otherwise have been expected given its performance in the second half of 1995. It is management's belief that sales and related profitability should recover during the second half of 1996, although there can be no assurance as to such performance.

Cost of sales increased by \$20.3 million, or 13.8%, to \$167.6 million in 1995, from \$147.2 million in 1994. This increase is the result of the increase in sales for the period.

Gross profit increased by \$7.4 million for the year to \$35.3 million, from \$27.9 million in the comparable 1994 period. The increase in the period is primarily attributable to the higher sales volume previously discussed within the Systems and Services Group and the Consulting Services Group. These increases were offset by declines in gross profit for the Field Engineering Group, attributable primarily to start-up costs associated with recent contract awards as well as lower profit margins associated with maintaining distributed processing equipment. Also negatively impacting profit margins of the Group is the investment currently being made in certain international offices to support the Company's international efforts. The Group has recently undertaken a number of cost-cutting measures such as staff reduction and branch consolidation to increase its profitability. The Company's gross margin was 17.4% for the year ended December 31, 1995 as compared to 15.9% for the comparable period of 1994.

Selling, general, and administrative expense ("SG&A") decreased for the year by approximately \$2.6 million, to \$26.3 million in 1995 from \$28.9 million in 1994 for the comparable period. These decreases were primarily due to reduced expenses associated with research and development initiatives, lower contract rebid efforts in 1995 as compared to 1994, and reduced expenses in certain administrative cost areas. Also, in 1995, based on a review of its operations and requirements, the Company had certain one-time adjustments to previously recorded reserves which reduced SG&A by \$1.7 million in such areas as employee benefits and certain closure reserves. For 1996, the Company believes that SG&A will increase over 1995 levels due to additional investment in sales, marketing and products, and taking into account the effect of the one time adjustments described above. SG&A as a percentage of sales decreased to 13.0% for the year ended December 31, 1995 from 16.5% in the comparable 1994 period.

Goodwill amortization expense was \$2.4 million for the year ended December 31, 1995 compared to \$3.2 million for the period ended December, 1994. The reduction in goodwill amortization is attributable to the completion of the amortization of the goodwill created by the 1989 leveraged buyout of the Company. The Company continues to amortize the goodwill balance which resulted from the acquisition of Telos Corporation (California).

Operating income (loss) increased by \$10.8 million to \$6.6 million in the year from (\$4.2) million in the comparable 1994 period as a result of the aforementioned increases in sales and gross profit.

Other non-operating income was approximately \$27,000 for the year ended December 31, 1995 compared to approximately \$5.5 million of other non-operating expense in the comparable 1994 period. The \$5.5 million expense in 1994 was attributable to costs incurred from attempts to recapitalize the Company's balance sheet and refinance the Company's existing debt. It was also due to the write-off of the remaining asset value of a software license purchased from Sapien's International in 1993. (See the transaction costs section in Note 5 as well as the discussion of Sapiens International in Note 8 to the consolidated financial statements.)

Interest expense increased approximately \$1.4 million to \$5.5 million for the year ended December 31, 1995 from \$4.1 million in the comparable 1994 period. The variance is a result of the increase in the average outstanding balance of the senior credit facility and related interest rate, as well as an increase in the outstanding balance of the subordinated debt and related interest rate. The Company believes its interest expense in 1996 will at least approximate the 1995 level and may be higher depending on its working capital financing requirements.

The Company had an income tax provision of \$75,000 for the year ended December 31, 1995 primarily due to state income taxes. For the comparable period of 1994, the Company had a tax benefit of \$1.3 million.

Years Ended December 31, 1994 and 1993

The Company viewed 1994 with several objectives. These objectives included completing a refinancing/recapitalization in order to provide enhanced liquidity and funding for future growth. Second, to increase bid and proposal spending to retain existing contracts up for rebid and to increase the Company's contract base through new awards. Third, to continue to consolidate and streamline its administrative functions as well as enhance its internal information systems. The Company was successful in expanding its contract base as demonstrated by its backlog growth. The Company also continued to consolidate administrative functions including finance and accounting and certain marketing efforts. The Company was not successful in completing several refinancing and recapitalization alternatives, and incurred significant costs in doing so. However, funding of the Company's financial requirements was completed by a combination of an increased senior credit facility and additional advances by certain of the Company's existing shareholders.

Sales declined \$36.1 million, or 17.1%, from \$211.2 million to \$175.1 million for the year ended December 31, 1994 as compared to 1993. The decrease for the year is primarily attributable to the Systems and Services Group, which reported decreases in sales of \$29.4 million for the year and to the Field Engineering Group, which reported decreased sales of \$7.2 million for 1994 as compared to 1993.

Within the Systems and Services Group, systems integration sales accounted for the majority of the decrease, as sales declined \$25.3 million for the year, due to reduced order volume which began in the fourth quarter of 1993 and continued throughout 1994. The reduced volume was a result of completion of a large contract with the U.S. Navy in 1993 and lack of a significant new contract. Services sales declined \$4.1 million for the year ended December 31, 1994 due to reduced contract volume. The reduced volume in services is due to the completion of certain contracts either as a result of the contract requirements ending or the follow-on contract becoming small business set aside contracts.

The decline in sales within the Field Engineering Group of \$7.2 million for 1994 is attributable to the shutdown of a board repair facility, reductions in contract activity for the segment and a reduction in warranty services related to systems integration customers.

Cost of sales decreased by \$26.4 million, or 15.2%, to \$147.2 million for the year ended December 31, 1994, from \$173.6 million in 1993. The decline is the result of the decrease in sales for the year.

For 1994, gross profit decreased by \$9.7 million to \$27.9 million from \$37.6 million in 1993. The decline is primarily attributable to the lower sales volume previously discussed within the Systems and Services Group and the Field Engineering Group. The gross overall margin for 1994 was 15.9% as compared to 17.8% for the comparable period of 1993.

Selling, general, and administrative expense ("SG&A") increased by approximately \$3.4 million, to \$28.9 million in 1994 from \$25.5 million in 1993. The increase is primarily due to an increase in marketing and bid and proposal costs, funding of new product development and

technology research, and increased internal information system spending to enhance the Company's capability. Also, SG&A for 1994 includes the costs associated with Mr. Beninati's decision to resign as Chairman of the Board. Mr. Beninati will continue to serve as a director of the Company. SG&A as a percentage of sales increased to 16.5% in 1994 from 12.1% in the comparable 1993 period.

Goodwill amortization expense was \$3.2 million in each of 1994 and 1993, as the Company continues to amortize its goodwill balance which resulted primarily from the acquisition of Telos Corporation (California) in 1992.

Operating income decreased by \$13.1 million to a loss of \$4.2 million for the year from \$8.9 million in 1993, as a result of the aforementioned declines in sales and gross profit as well as SG&A expenditures.

For 1994, non-operating expenses were \$5.5 million as compared to an expense of \$3.4 million for 1993. During 1994 the Company attempted to restructure its debt and capital structure. During the fourth quarter of 1994, the Company concluded that the pending transactions were not going to be completed and therefore expensed the associated costs that the Company had incurred. Such expenses total \$4.1 million, of which \$1.9 million has been paid at December 31, 1994. The Company recorded these financing expenses as non-operating for financial statement presentation purposes. Also, during the fourth quarter of 1994, the Company reassessed its business plans and strategy for the mainframe software license tools purchased. As a result of concluding that the initial strategy was not going to produce the business results first planned, the Company wrote-off the remaining asset value of the license investment. As the investment in licenses did not contribute to the operations, the Company recorded the \$1.4 million charge as a non-operating expense.

In 1993, the Company incurred \$3.2 million in costs in connection with the settlement of a shareholder suit. These costs represented legal fees paid on behalf of the Company and other parties to the suit, and estimated future consulting fees and expenses incurred in connection with the suit.

Interest expense for 1994 increased \$1.1 million to \$4.1 million from \$3.0 million in 1993. The increase is a result of the increase in the outstanding balance of the senior credit facility and the related interest rate due to increases in the prime lending rate. Also, during 1994, the Company recorded interest expense of \$410,000 associated with the funding by its majority shareholder, Mr. John R.C. Porter ("Porter") (see "Liquidity and Capital Resources" below).

The income tax benefit of \$1.3 million for the year ended December 31, 1994, due to the carryback of the operating loss, compares to a provision of \$1.9 million in the comparable 1993 period.

The \$196,000 of extraordinary loss in 1994 results from the early retirement of \$1.8 million of senior subordinated notes and represents unamortized debt discount that was expensed when the notes were retired.

#### Liquidity And Capital Resources

In 1995, the Company experienced improved liquidity particularly during the third and fourth quarters. This improvement in liquidity resulted from the completion of the transaction with certain of the Company's common shareholders whereby the shareholders provided \$13.5 million of cash to the Company for the retirement of senior subordinated notes, held by Union de Banques Suisses (Luxembourg) S.A. ("UBS"), and for the reduction of the outstanding balance of the senior credit facility. The Company issued Senior Subordinated Notes - Series B and C, in the total amount of \$14.4 million in October 1995 to the shareholders providing the cash infusion.

Also improving the Company's liquidity were significantly improved operating results in the third and fourth quarter of 1995. The combined third and fourth quarter net income totaled \$913,000 as compared to net income of \$102,000 for the first two quarters of 1995. The improved results were due to significantly higher revenue in the last two quarters of 1995 due primarily to the increased volume in the Company's system integration division.

For the year ended December 31, 1995, the Company used approximately \$6.4 million of cash in operating activities. This use of cash in operations was primarily a result of the increases in the accounts receivable and inventory balances after adjustment for non-cash items. The growth in accounts receivable and inventory was primarily due to increased third and fourth quarter revenue activity thereby increasing products and services purchased from the Company's vendors. Also contributing to the growth in accounts receivable at December 31, 1995 was the Federal government shut-down which resulted in the closing of one of the Company's significant customers and its paying office. The Company also used cash in purchase of property and equipment as well as in investments in internally developed software and hardware products for sale to third parties. The use of cash resulting from the operating and investing activities was funded by the issuance of the senior subordinated notes as mentioned above.

At December 31, 1995, the Company had an outstanding balance of \$32.3 million on its \$45 million senior credit facility. The facility is collateralized by certain assets of the Company (primarily inventory and accounts receivable) and the amount of borrowings fluctuates based on the underlying asset borrowing base as well as the Company's working capital requirements. At December 31, 1995, the Company, under its borrowing base formula, had \$7,200,000 of unused availability. The facility expires on July 1, 1996.

At December 31, 1995, the Company was not in compliance with two of the four financial covenants contained in the Facility. Subsequent to December 31, 1995, the Company's bank waived the non-compliance with the covenants and entered into an agreement with the Company to refinance its \$45 million Facility and extend the maturity date to July 1, 1997. Other terms and conditions of the Facility are similar to the Company's previous Facility.

With the contract awards in 1995, the Company is evaluating its financing requirements to support these contracts. The Company anticipates that its current Facility will be adequate for the first half of 1996. The Company currently believes that an expanded senior credit facility may be required in the future and is currently reviewing with its senior lender a prospective multi-bank syndication arrangement.

The Company is actively reviewing its business opportunities surrounding its Internet products. Subsequent to December 31, 1995 the Company formed enterWorks.com, a wholly-owned subsidiary focused on the Internet and related software products, including Pangaea, to pursue and expand such opportunities. While the Company is currently funding the on-going product development and business growth in this area, it is reviewing the potential for external capital to fully exploit this emerging market and to build the enterWorks.com business.

During the first quarter of 1996, the Company's liquidity was impacted by the various Federal Government shutdowns and the related impasse on the 1996 Federal Government budget. While the services side of the Company's business was generally unaffected, certain of its large equipment contracts within its system integration division were adversely impacted both through reduced order volume and collections on outstanding accounts receivable. The effect of this was an overall reduction in the Company's liquidity. The Company has counteracted this negative effect with an aggressive cash management program. One of these aggressive actions has been to establish extended payment terms to the Company's vendors as well as to reduce discretionary spending in certain areas. While the Company has recently begun to see improved order flow and cash collections, the Company believes that the impact from the Government shut-down and budget impasse will be felt through the middle of the second quarter of 1996 in its results from operations and financial condition.

The Company has a net deferred tax asset of \$3.1 million at December 31, 1995. Management believes that the asset is fully realizable given the Company's existing backlog and projected future taxable income and the expected reversal of temporary differences existing at December 31, 1995.

#### Capital Expenditures

The Company believes that its business is not capital intensive, however, the Company expects that property, plant and equipment expenditures in 1996 will experience moderate growth compared to 1995 and 1994 levels. The Company, given its recent contract wins, is actively reviewing its office and integration space requirements. In March 1996, the Company signed a long term lease for a building that will serve as its Corporate headquarters and provide significant additional manufacturing and integration space. The lease, which has a twenty year term, will result in significant cost savings to the Company as it provides for reduced monthly lease payments compared to the costs incurred under the Company's current leasing arrangement.

#### Inflation

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

#### Forward-looking Statements

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

#### Certain Factors That May Affect Future Results

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

A number of uncertainties exist that could affect the Company's future operating results, including, without limitation, general economic conditions, the timing and approval of the Federal government's fiscal year budget, business growth through obtaining new business and, once obtained, the Company's ability to successfully perform at a profit, the Company's ability to convert contract backlog to revenue, the Company's ability to secure adequate capital and financing to support continued business growth 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 its contracts at its convenience, should this occur, the Company's operating results would be adversely impacted.

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

The Company's success and future growth opportunities are highly dependent upon its ability to timely identify new market opportunities, and aggressively pursue and capture marketshare.

The Company has been successful in increasing its contract backlog in 1995. However, the Company's future success is highly dependent upon it converting the backlog into revenue.

While the Company believes it has adequate financing to support a revenue base consistent with 1995 results, the Company's growth depends upon its ability to obtain additional capital and financing sources. The Company is actively identifying and planning for the additional financing. However, no assurance can be made on whether such financing can be obtained, or if available, that it will be available on acceptable terms.



Item 8. Financial Statements and Supplementary Data

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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

We have audited the accompanying consolidated balance sheets of Telos Corporation and Subsidiaries as of December 31, 1995 and 1994, and the related consolidated statements of income, stockholders' investment (deficit), and cash flows for each of the three years in the period ended December 31, 1995. 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 in accordance with generally accepted auditing standards. Those standards 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Telos Corporation and Subsidiaries as of December 31, 1995 and 1994, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1995, in conformity with generally accepted accounting principles.

COOPERS & LYBRAND L.L.P.

Washington, DC  
March 29, 1996

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

	Year Ended December 31,		
	1995	1994	1993
Sales			
Systems and Services	\$142,939	\$116,059	\$145,433
Field Engineering	32,820	34,617	41,852
Consulting Services	27,069	24,445	23,944
	-----	-----	-----
	202,828	175,121	211,229
	-----	-----	-----
Costs and expenses			
Cost of Systems and Services	116,095	97,927	117,582
Cost of Field Engineering	29,427	29,291	35,037
Cost of Consulting Services	22,056	20,018	21,032
Selling, general and administrative expenses	26,326	28,896	25,512
Goodwill amortization	2,370	3,178	3,178
	-----	-----	-----
	196,274	179,310	202,341
	-----	-----	-----
Operating income (loss)	6,554	(4,189)	8,888
Other income (expenses)			
Non-operating income (expense)	27	(5,458)	(3,440)
Interest expense	(5,491)	(4,057)	(3,028)
	-----	-----	-----
Income (loss) before taxes and extraordinary items	1,090	(13,704)	2,420
Income tax provision (benefit)	75	(1,283)	1,872
	-----	-----	-----
Income (loss) before extraordinary item	1,015	(12,421)	548
Extraordinary items			
Loss from early debt retirement	--	(196)	--
	-----	-----	-----
Net income (loss)	\$1,015	\$(12,617)	\$ 548
	=====	=====	=====

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

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

ASSETS

	As of December 31	
	1995	1994
	----	----
Current assets		
Cash and cash equivalents	\$ 735	\$ 441
Accounts receivable, net	44,112	40,345
Inventories, net	15,877	8,696
Deferred income taxes	1,217	584
Prepaid income taxes	320	2,845
Other current assets	384	489
	----	-----
Total current assets	62,645	53,400
	-----	-----
Property and equipment		
Land and building	408	408
Furniture and equipment	18,180	17,178
Leasehold improvements	2,683	2,666
	-----	-----
Accumulated depreciation	21,271 (18,600)	20,252 (16,769)
	-----	-----
Total property and equipment	2,671	3,483
	-----	-----
Goodwill	22,814	26,822
Deferred income taxes	1,868	448
Other assets	4,494	2,719
	-----	-----
	\$94,492	\$86,872
	=====	=====

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

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

LIABILITIES AND STOCKHOLDERS' INVESTMENT

	As of December 31,	
	----- 1995 -----	----- 1994 -----
Current liabilities		
Accounts payable	\$ 26,528	\$20,302
Accrued compensation and benefits	8,804	10,272
Senior subordinated notes	--	6,414
Unearned warranty revenue	699	515
Other current liabilities	6,253	9,659
	-----	-----
Total current liabilities	42,284	47,162
	-----	-----
Senior credit facility	32,312	34,000
Senior subordinated notes	15,004	--
Other long-term liabilities	1,108	2,941
	-----	-----
Total liabilities	90,708	84,103
	-----	-----
Commitments and contingencies		
Preferred stock		
Senior redeemable preferred stock		
Series A-1, and A-2	4,494	4,192
Class B Redeemable Preferred Stock par value \$.01, 7,500 shares authorized, issued and outstanding	10,252	9,497
Redeemable preferred stock, \$.01 par value, 6,000,000 shares authorized, 3,595,586 shares issued, and outstanding \$10.00 per share liquidation and redemption value	18,647	14,263
	-----	-----
Total preferred stock	33,393	27,952
	-----	-----
Stockholders' investment		
Class A common stock, no par value, 23,076,753 shares issued and outstanding	65	65
Class B common stock, no par value, 4,037,628 shares issued and outstanding	13	13
Capital in excess of par	7,669	12,095
Retained earnings (deficit)	(37,356)	(37,356)
	-----	-----
Total stockholders' investment (deficit)	(29,609)	(25,183)
	-----	-----
	\$94,492	\$86,872
	=====	=====

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,		
	1995	1994	1993
<b>Operating activities:</b>			
Net income (loss)	\$1,015	\$(12,617)	\$ 548
Adjustments to reconcile net income (loss) to cash provided by operating activities:			
Depreciation and amortization	3,376	4,289	3,898
Goodwill amortization	2,370	3,178	3,178
Amortization of discount on debt	17	68	18
Non-cash interest expense	--	410	--
Provision for inventory obsolescence	312	(899)	1,210
Provision for doubtful accounts receivable	103	(319)	1,243
Deferred rent obligation	--	--	342
Loss from early repayment of debt	--	196	--
Provision for loss on shutdown of division	(760)	--	1,614
Provision for settlement agreement	--	--	1,197
Provision for lease terminations	--	--	780
Provision for employee benefits	974	600	--
Provision for employee insurance	(891)	--	--
Write-down of license investment	--	1,440	--
Changes in assets and liabilities			
(Increase) decrease in accounts receivable	(3,870)	(9,347)	8,443
(Increase) decrease in inventories	(8,582)	(1,124)	184
Decrease (increase) in other assets	1,845	(751)	(1,199)
(Decrease) increase in accounts payable and other current liabilities and noncurrent liabilities	(2,342)	7,796	(10,369)
Cash (used in) provided by operating activities	(6,433)	(7,080)	11,087
<b>Investing activities:</b>			
Purchase of property and equipment	(1,013)	(1,226)	(1,442)
Investment in joint venture	(111)	--	--
Investment in products	( 569)	(1,354)	--
Cash used in investing activities	(1,693)	(2,580)	(1,442)
<b>Financing activities:</b>			
(Repayment of) proceeds from senior credit facility	(1,688)	11,185	(9,938)
Proceeds from debt issuance	14,373	--	--
Increase in book overdrafts	2,722	--	377
Repayment of long-term debt	(5,800)	(1,825)	(307)
Debt issue costs	(1,187)	--	--
Issuance of Class A common stock	--	(3)	12
Cash provided by (used in) financing activities	8,420	9,357	(9,856)
Increase (decrease) in cash and cash equivalents	294	(303)	(211)
Cash and cash equivalents at beginning of the period	441	744	955
Cash and cash equivalents at end of period	\$ 735	\$ 441	\$ 744
<b>Supplemental disclosures of cash flow information:</b>			
Cash paid during the period for:			
Interest	\$5,348	\$ 3,697	\$ 3,011
Income taxes paid (refunded)	\$(2,155)	\$ (1,672)	\$ 4,111
<b>Supplemental schedule of non-cash investing activities:</b>			
Inventory transferred to property and equipment	\$ --	\$ 16	\$ 157
Sapiens Settlement	\$ --	\$ 3,735	\$ --

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

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

	Class A Common Stock -----	Class B Common Stock -----	Capital In Excess of Par -----	Retained Earnings (Deficit) -----	Total Stockholders' Investment (Deficit) -----
Balance December 31, 1992	65	13	17,326	(24,739)	(7,335)
Senior redeemable preferred stock dividend	--	--	--	(269)	(269)
Class B redeemable preferred stock dividend	--	--	(394)	(279)	(673)
Redeemable preferred stock dividend	--	--	(533)	--	(533)
Redeemable preferred stock accretion	--	--	(932)	--	(932)
Net income for the year	--	--	--	548	548
Issuance of Class A common stock	--	--	12	--	12
Balance December 31, 1993	65	13	15,479	(24,739)	(9,182)
Senior redeemable preferred stock dividend	--	--	(271)	--	(271)
Class B redeemable preferred stock dividend	--	--	(675)	--	(675)
Redeemable preferred stock dividend	--	--	(1,805)	--	(1,805)
Redeemable preferred stock accretion	--	--	(1,040)	--	(1,040)
Net loss for the year	--	--	--	(12,617)	(12,617)
Retirement of employee stock	--	--	(3)	--	(3)
Issuance of Class A common stock	--	--	410	--	410
Balance December 31, 1994	\$ 65	\$13	\$12,095	\$(37,356)	\$(25,183)
Senior redeemable preferred stock dividend	--	--	--	(302)	(302)
Class B redeemable preferred stock dividend	--	--	(42)	(713)	(755)
Redeemable preferred stock dividend	--	--	(3,236)	--	(3,236)
Redeemable preferred stock accretion	--	--	(1,148)	--	(1,148)
Net income for the year	--	--	--	1,015	1,015
Balance December 31, 1995	\$65	\$13	\$7,669	\$(37,356)	\$(29,609)

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") (formerly C3, Inc.) provides information and network technology products and services primarily to various agencies of the Federal Government. The Company also provides these services to state and local governments and the private sector. Services provided by the Company encompass the full life cycle of computer services including system specification and evaluation, hardware and software integration deployment, installation, training, hardware maintenance and software sustainment. The Company has further enhanced its ability to deliver solutions to its customers by providing tools and applications focused on emerging information and network technology markets such as data mining, data warehousing, middleware connectivity and data access and workflow.

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

Acquisitions

In 1992, the Company acquired all of the outstanding capital stock of Telos Corporation, (California) from Contel Federal Systems, Inc. ("Contel"), a wholly owned subsidiary of GTE Corporation for \$32 million in a transaction accounted for as a purchase.

Principles Of Consolidation

The accompanying consolidated financial statements include the accounts of Telos Corporation and its wholly owned subsidiaries, Telos Corporation (California), Telos Field Engineering, Inc. and Telos International Corporation (collectively the "Company"). All significant inter-company transactions have been eliminated in consolidation. The Company also has an investment in a joint venture located in Kuwait that is accounted for under the equity method of accounting.

Revenue Recognition

The majority of the Company's sales are made directly or indirectly to the Federal Government. A substantial portion of the Company's revenues are derived from time and materials and cost reimbursement contracts, under which revenue is recognized as services are performed and costs are incurred. The Company generally recognizes equipment revenue as products are shipped, although certain revenue recognition practices are dependent upon contract terms. Revenue for maintenance contracts is recognized as such services are performed. Revenue from the licensing of software is recognized, in accordance with AICPA SOP 91-1 "Software Revenue Recognition" whereby revenue is recognized when a non cancelable revenue agreement is in force, the product has been shipped and no significant obligations remain. Revenue generated from warranty service contracts is recognized ratably over the warranty service period. The Company records loss provisions for its contracts, if required, at the time such losses are identified.

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 \$1,508,000 and \$2,008,000 at December 31, 1995 and 1994, 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, 1995, 1994, and 1993, the Company's allowance for inventory obsolescence was \$1,385,000, \$1,078,000 and \$2,189,000 respectively. The components of the allowance for inventory obsolescence are set forth below (in thousands):

	Balance Beginning of Period -----	Additions Charged to Costs and Expense -----	Deductions(1) -----	Balance at End of Period -----
Year Ended December 31, 1995	\$1,078	\$ 312	\$ 5	\$ 1,385
Year Ended December 31, 1994	\$2,189	\$ (899)	\$ 212	\$1,078
Year Ended December 31, 1993	\$2,849	\$1,210	\$1,870	\$2,189

(1) Inventories written off.

## Property and Equipment

Property and equipment is recorded at cost. Depreciation and amortization are provided for using the straight-line method over the estimated useful lives of the assets as follows:

Buildings	19 Years
Machinery and equipment	3 - 7 Years
Office furniture and fixtures	5 - 7 Years
Leasehold	Life of Lease

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

Depreciation and amortization expense related to property and equipment was \$1,862,000, \$2,463,000, and \$2,978,000 for the years ended December 31, 1995, 1994 and 1993, respectively.

## Goodwill

Goodwill of approximately \$31.19 million resulted from the acquisition of Telos Corporation (California) and has been assigned a useful life of twenty years. The twenty year life considered a number of factors including the Company's maintenance of long-term customer relationships with significant customers for periods of up to twenty-seven years and its strong

positions in the marketplace. Also, Telos Corporation (California) did not perform significant software development for general resale or license to customers thereby avoiding the risks associated with rapidly changing technological environments .

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 undiscounted operating cash flow (excluding goodwill amortization, interest expense, and non-recurring charges). If an impairment of goodwill appears to have occurred, impairment is measured based on projected discounted operating cost flow (excluding goodwill amortization, interest expense, and non-recurring charges) 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 for Telos Corporation (California) at December 31, 1995 and 1994 was \$6,054,000 and \$4,628,000, respectively. The goodwill amortization related to the purchase of Telos Corporation (Maryland) (formerly C3, Inc.) was \$944,000 for 1995 and has now been fully amortized as of December 31, 1995.

#### Income Taxes

The Company has adopted Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (SFAS 109). Under this 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.

#### 401(k) Retirement Savings And Profit Sharing 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. Additionally, the Company, on a discretionary basis, has contributed 1% of all eligible employee wages to the Plan regardless of whether the employee elected to participate in the Plan. Total Company contributions to the Plan for 1995 and 1994 were \$2,397,000, \$2,517,000, respectively. In 1993, the Company had two different savings plans for which it contributed \$2,925,000.

#### Software Development Costs

The Company expenses all research and development costs incurred in connection with software development projects until such software achieves technical feasibility. All costs thereafter are capitalized. The Company is amortizing such capitalized costs over the estimated product life of three years. The Company periodically evaluates the realizability of these capitalized costs through evaluation of anticipated gross revenue as compared to current gross revenues.

Unamortized software costs at December 31, 1995 and 1994 were \$1.2 million and \$649,000, respectively. Amortization expense associated with these capitalized software costs was \$80,000 in 1995 and zero during 1994.

During 1995 and 1994, the Company incurred \$1.4 million, and \$1.9 million in research and development costs, respectively. Prior to 1994, these types of costs were not significant.

#### 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. Actual results could differ from those estimates.

#### Newly Issued Accounting Pronouncements

Statement of Financial Accounting Standards ("SFAS" or "Standard") No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" establishes standards for recognizing and measuring impairment of long-lived assets to be held and used as well as assets held for disposal. The effective date for SFAS 121 is for fiscal years beginning after December 15, 1995, with earlier application encouraged. The Company's current accounting policies incorporate the requirements of the new Standard; therefore, the Company has effectively implemented the Standard as of December 31, 1995.

SFAS No. 123 "Accounting for Stock-Based Compensation" establishes a fair-value based method of accounting for stock compensation plans with employees and others. Entities are encouraged but not required to adopt SFAS 123; the entity may continue to account for stock-based compensation under APB Opinion 25, so long as the entity adopts the disclosure requirements of SFAS 123. Recognition and measurement in accordance with SFAS 123 can only be applied to awards granted after the beginning of the fiscal year in which the SFAS is adopted. The disclosure requirements of the Standard are effective for fiscal years beginning after December 15, 1995. The Company did not award stock based compensation to employees or others during 1995, and is still reviewing which method of recognition and disclosure it will adopt under the standard.

#### Reclassifications

Certain reclassifications have been made to the prior years' financial statements to conform to the classifications used in the current period.

#### Note 2. Changes in Company Ownership

In September 1993, the Company entered into a Settlement Agreement with Mr. John R.C. Porter ("Porter"), the Company's majority shareholder, and related entities; Mr. Fred Knoll, formerly Chairman of the Board of Directors; Cottonwood Holdings, Inc. ("Cottonwood"); C3 Investors, L.P. ("C3 Investors"); Mr. Joseph P. Beninati, a Company director and formerly the Chairman of the Board of Directors; Mr. John B. Wood, a Company director and its Chief Executive Officer; and the Company's wholly-owned subsidiary, Telos Corporation (California). The Settlement Agreement of October 8, 1993 provided for the settlement of a dispute instituted by Mr. Knoll against the other three Company directors, Messrs. Porter, Beninati and Wood, and the Company, regarding the ownership, control and management of the Company.

Pursuant to the terms of the Settlement Agreement, Cottonwood and C3 Investors sold to Porter for a purchase price of \$12,000,000 all of the Company securities which they previously held, excepting only \$1,825,000 in debt evidenced by a Series A senior subordinated note issued by the Company which Cottonwood retained (retired in July 1994).

In connection with the Settlement Agreement, Mr. Knoll resigned as a Company director and officer and from all other posts held with the Company and entered into an agreement prohibiting Mr. Knoll from acquiring any interest in the Company's publicly-held 12% Cumulative Exchangeable Redeemable Preferred Stock. Additionally, under the terms of the Settlement Agreement, Mr. Knoll has been retained as a consultant to the Company for a period of four years at an annual rate of \$300,000. The parties also agreed to a schedule regarding the payment by the Company of \$450,000 in deferred fees owed to Mr. Knoll and these fees were paid in 1995.

Under the terms of the Settlement Agreement the Company incurred \$3,174,000 of other non-operating expenses which include legal fees. All legal costs incurred in connection with the suit were paid by the Company on behalf of all the parties to the Settlement Agreement, pursuant to indemnification by the Company's bylaws. Through the year ended December 31, 1995, the Company has paid \$2,652,000 related to the costs incurred under the Settlement Agreement.

Note 3. Revenue and Accounts Receivable

Revenue resulting from contracts and subcontracts with Federal, state, and local governments accounted for 84.8% 88.6%, and 92.2% of total revenue in the years ended December 31, 1995, 1994 and 1993, 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 components of accounts receivable are as follows (in thousands):

	As of December 31,	
	1995	1994
	----	----
Billed accounts receivable	\$30,286	\$32,483
	-----	-----
Amounts billable upon acceptance by customer	6,900	4,805
Amounts currently billable	7,650	4,326
Costs incurred in excess of contractual authorization, billable upon contractual amendment increasing funding	--	18
	---	---
Total unbilled accounts receivable	14,550	9,149
	-----	-----
Allowance for doubtful accounts	(724)	(1,287)
	-----	-----
	\$44,112	\$40,345
	=====	=====

The provision for doubtful accounts was \$103,000, \$(319,000), and \$1,243,000 for the years ended December 31, 1995, 1994 and 1993, respectively. Reductions to the allowance were primarily due to account receivable write-offs and other adjustments.

Note 4. Income Taxes

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

	For The Year Ended December 31,		
	1995	1994	1993
Current (benefit) provision			
Federal	\$ --	\$(3,017)	\$ 1,833
State	75	(406)	539
Total current	75	(3,423)	2,372
Deferred (benefit) provision			
Federal	--	1,865	(448)
State	--	275	(52)
Total deferred	--	2,140	(500)
Total provision (benefit)	\$ 75	\$(1,283)	\$ 1,872

The provisions for income taxes vary from the amount of income taxes 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,		
	1995	1994	1993
Computed expected tax provision (benefit)	34.0%	(34.0%)	34.0%
Goodwill amortization	74.4%	7.9%	49.9%
State income taxes, net of federal tax benefit	5.9%	(5.9%)	3.9%
Change in valuation allowance of deferred tax assets	(112.4)%	(8.6%)	(16.4%)
Limitation of net operating loss carryback	--	26.8%	--
Other	5.0%	4.4%	5.9%
	6.9%	(9.4)%	77.3%

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1995 and 1994 are as follows (in thousands):

	As of December 31,	
	----- 1995 ----	1994 -----
Deferred tax assets:		
Accounts receivable, principally due to allowance for doubtful accounts	\$ 176	\$ 320
Inventory valuation allowance and amortization	1,500	3,033
Accrued liabilities not currently deductible	1,412	2,742
Accrued compensation	2,486	2,999
Deferred office rents and accrued sublease liabilities	498	815
Property and equipment, principally due to differences in depreciation method	1,472	850
Net operations loss carryforward	3,922	3,398
Alternative minimum tax credit carryforwards	994	558
	-----	-----
Total gross deferred tax assets	12,460	14,715
Less valuation allowance	( 8,155)	(12,350)
	-----	-----
Net deferred tax assets	4,305	2,365
	=====	-----
Deferred tax liabilities:		
Unbilled revenue, deferred for tax purposes	(1,166)	(1,232)
Other	(54)	(101)
	-----	-----
Total deferred tax liabilities	(1,220)	(1,333)
	-----	-----
Net deferred tax assets	\$3,085	\$ 1,032
	=====	=====

The net change in the valuation allowance was a decrease of \$4,195,000 for 1995 and an increase of \$2,314,000 for 1994. Included in the change in the valuation allowance were decreases of approximately \$1,391,000 and \$720,000 for 1995 and 1994, respectively, related to the reversal of temporary differences acquired from Telos Corporation. The reversals of the temporary differences related to the Telos Corporation acquisition reduce goodwill. The total tax benefits of future deductible temporary differences acquired in connection with the Telos Corporation acquisition were \$6,097,000 at January 14, 1992. As of December 31, 1995, \$1,549,000 of tax benefits remain and will reverse in future years.

For the year ended December 31, 1995, for Federal income tax purposes, the Company generated a net operating loss of \$3,872,000 which increases the net operating loss available for carryforward to \$9,819,000 to offset future regular taxable income. Additionally, \$8,181,000 is available to offset future alternative minimum taxable income. The net operating loss carryforward will begin expiring in the year 2011. Additionally, the Company has \$994,000 of alternative minimum tax credits available to be carried forward indefinitely to reduce future regular tax liabilities.

During 1995 the Company settled an Internal Revenue Service audit for the years 1987 through 1991. The audit resulted in the disallowance of certain costs that the Company had previously claimed, thereby reducing the Company's net operating loss carryforward by \$1.3 million. Accordingly, the Company reduced its deferred tax asset and the related valuation allowance.

At December 31, 1995, the Company has a \$3.1 million deferred tax asset. The realization of this asset is largely dependent upon future income, which cannot be predicted with certainty. However, given the Company's return to profitability and its backlog growth, the Company believes that it is more likely than not that the Company will realize the net deferred tax asset recorded.

#### Note 5. Debt Obligations

The Company's debt obligations consist of a \$45 million Senior Revolving Credit Facility, and three levels of Senior Subordinated Notes, Series A, B and C. Each of these obligations is described below.

##### Senior Revolving Credit Facility

At December 31, 1995, the Company has a \$45 million Senior Revolving Credit Facility (the "Facility") with its bank which expires on July 1, 1996 and has an outstanding balance of \$32.3 million. Borrowings under the facility are collateralized by certain assets of the Company (primarily accounts receivable and inventory), and the amount of borrowings fluctuate based on the underlying asset borrowing base as well as on the Company's working capital requirements. The Facility bears interest at 1.5% over the bank's base rate or 10.00% at December 31, 1995. The weighted average interest rate on the outstanding borrowings under the facility was 9.32% for the year ended December 31, 1995 compared with 8.60% for the year ended December 31, 1994. At December 31, 1995, the Company had \$7,200,000 of availability under the Facility.

During 1994 and 1995, Porter and certain of the Company's shareholders deposited a total of \$7.0 million with the Company's bank to provide the Company with additional borrowing capacity under the Facility. In October, 1995, these deposits were transferred to the Company in exchange for the issuance to the shareholders of Senior Subordinated Notes, Series B and C. (Refer to Senior Subordinated Notes and Note 7 for further discussion).

At December 31, 1995, the Company is not compliant with two of the four financial covenants contained in the Facility. Subsequent to December 31, 1995, the Company's bank waived the covenant violations and agreed to refinance the Facility. Under the agreement, the Facility will remain at \$45 million with terms and conditions similar to the Company's previous Facility with an expiration date of July 1, 1997.

##### Senior Subordinated Notes

At December 31, 1995 the Company had a \$675,000 Senior Subordinated Note, Series A with a balance of \$631,000 outstanding with Porter. The Note had an interest rate per annum of 11.875% from January 1 through January 14, 1995, then increased to 14% per annum from January 15, 1995 through January 14, 1997, and increases to 17% thereafter. Interest is payable in semi-annual installments on June 30 and December 31 of each year. The note is collateralized by certain assets of the Company. The note was issued in 1992 and matures on January 14, 2002.

On June 8, 1995, the Company entered into an agreement with Union de Banques Suisses (Luxembourg) S.A. ("UBS") whereby the Company paid UBS \$5.8 million in outstanding principal, \$500,000 of accrued interest and \$200,000 of legal and other fees in exchange for the retirement of the Series B-1 and B-2 Senior Subordinated Notes.

The funds to pay UBS were provided by certain of the Company's common shareholders. The shareholders were issued \$6.5 million Subordinated Bridge Notes in exchange for these funds. On October 13, 1995, the Company issued to these shareholders \$14.4 million of Senior

Subordinated Notes ("Notes") which included shareholder fees related to the debt issuance, in exchange for the \$6.5 million Subordinated Bridge Notes, as well as the transfer to the Company of these shareholders' deposits held with the Company's bank. The Notes are classified as either Series B or Series C. Series B Notes, which total \$6.5 million and replace the Senior Subordinated Notes Series B held by UBS, are collateralized by fixed assets of the Company. Series C Notes which total \$7.9 million are unsecured.

Both the Series B and Series C Notes have a maturity date of October 1, 2000 and have interest rates ranging from 14% to 17%. Interest is paid quarterly on January 1, April 1, July 1, and October 1 of each year. The Notes can be prepaid at the Company's option. Additionally, these notes have a cumulative payment premium of 13.5% per annum payable only upon certain circumstances. These circumstances include an initial public offering of the Company's common stock or a significant refinancing, to the extent that net proceeds from either of the above events are received and are sufficient to pay the premium. Due to the contingent nature of the premium payment, the associated premium expenses will only be recorded after occurrence of a triggering event. However, the interest portion of the notes is treated as a period expense.

#### Transaction Costs

In 1994, the Company attempted to recapitalize its balance sheet and refinance its existing debt. These transactions were not completed and accordingly, the Company recorded \$4,205,000 of non-operating expenses for the cost of the failed transactions in December 1994. Included in the above amount are certain provisions for settlement with parties involved in the failed financing transaction. The Company has paid \$2.9 million of the costs as of December 31, 1995.

#### Note 6. Redeemable Preferred Stocks

##### Senior Redeemable Preferred Stock

The components of the senior redeemable preferred stock are Series A-1 and Series A-2 redeemable preferred stock each with \$.01 par value and 1,250 and 1,750 shares authorized, issued and outstanding, respectively. Through June 30, 1995, the Series A-1 and Series A-2 carried a cumulative per annum dividend rate of 9% of their liquidation value of \$1,000 per share. From July 1, 1995 through June 30, 1997, the Series A-1 and A-2 each carry a cumulative dividend rate equal to 11.125%, and increases again to 14.125% per annum thereafter. 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. The Series A-1 and A-2 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. At December 31, 1995 and 1994 undeclared, unpaid dividends relating to Series A-1 and A-2 Preferred Stock totaled \$1,494,000 and \$1,192,000, respectively, and have been accrued and are included in the Series A-1 and A-2 redeemable preferred stock balance. Mandatory redemptions are required from excess cash flows, as defined in the stock agreements. Through December 31, 1995, there has been no available cash flow permitting mandatory redemption.

##### Class B Redeemable Preferred Stock

The Class B Redeemable Preferred Stock has a \$.01 par value, with 7,500 shares authorized, issued and outstanding. Through June 30, 1995, the Class B Redeemable Preferred Stock carried a cumulative per annum dividend rate of 9% of its liquidation value of \$1,000 per share. From July 1, 1995 through June 30, 1997, the Class B Redeemable Preferred Stock has a cumulative dividend rate per annum equal to 11.125% and increases to 14.125% per annum



thereafter. The Class B Redeemable Preferred Stock may be redeemed at its liquidation value together with all accrued and unpaid dividends at any time at the option of the Company. The liquidation preference of the Class B Redeemable Preferred stock is the face amount, \$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. At December 31, 1995 and 1994 undeclared, unpaid dividends relating to the Class B Redeemable Preferred Stock totaled \$2,752,000 and \$1,997,000, respectively, and have been accrued and are included in the Class B Redeemable Preferred Stock balance.

Redemption of the stock may occur after payment in full of the principal and interest amount due on the senior subordinated notes, and the redemption of the Series A-1 and A-2 Preferred Stock. Mandatory redemptions are required from excess cash flows, as defined in the stock agreements. Through December 31, 1995, there has been no available cash flow permitting mandatory redemption.

#### 12% Cumulative Exchangeable Redeemable Preferred Stock

The Company initially issued 2,858,723 shares of 12% Cumulative Exchangeable Redeemable Preferred Stock (the "Public Preferred Stock"), par value \$.01 per share, 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, 1995 and 1994 was \$1,148,000 and \$1,040,000, respectively.

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, the date of the stock's issuance, leaving 20% to be redeemed at maturity. On any dividend payment date, after November 21, 1991, the Company may exchange the Public Preferred Stock, in whole or in part, for 12% Junior Subordinated Debentures that are redeemable upon terms substantially similar to the Public Preferred Stock and subordinated to all indebtedness for borrowed money and like obligations of the Company.

The Public Preferred Stock accrues a semi-annual dividend at an annual rate of 12% (\$1.20) per share, based on the liquidation preference of \$10 per share, and is fully cumulative. Through November 21, 1995, the Company had the option to pay dividends in additional shares of Preferred Stock in lieu of cash. Dividends in additional shares of the Preferred Stock are paid at the rate of 0.06 of a share of the Preferred Stock for each \$.60 of such dividends not paid in cash. Dividends are payable by the Company, provided the Company has legally available funds under Maryland law, when and if declared by the Board of Directors, commencing June 1, 1990, and on each six month anniversary thereof. For the years 1992 through 1994 and for the dividend payable June 1, 1995, the Company has accrued undeclared dividends in additional shares of preferred stock. These accrued dividends are valued at \$3,950,000. Had the Company accrued such dividends on a cash basis, the total amount accrued would have been \$15,101,000. For the dividend payable December 1, 1995, the Company accrued \$2,157,000 of dividends using a cash basis. All future dividend accruals will be on a cash basis.

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.

Note 7. Stockholders' Investment and Stock Options

Common Stock

At December 31, 1995 and 1994, common stock consists of 50,000,000 shares authorized and 23,076,753 shares issued and outstanding of Class A common stock; and 5,000,000 shares authorized and 4,037,628 shares issued and outstanding of Class B common stock. The common stock has no par value and an aggregate capital value for all shares of \$77,500.

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 preferred stock, holders of Class A and the Class B common stock are entitled to receive such dividends as may be declared.

Stock Warrants

The Company issued the Class B Preferred Stock shareholder common stock warrants to purchase up to 3,150,468 of Class A common stock of the Company in 1992. The stock warrant was valued at \$1,109,000 and such amount was shown as an increase in Capital in Excess of Par. The warrant was initially exercisable to purchase up to 1,181,425 shares at any time. The warrant increased by 656,348 shares on June 30, 1993, and July 1, 1994 and by 656,347 shares on July 1, 1995. Through December 31, 1995, 1,837,773 shares of Class A Common Stock has been purchased under the warrant. The price per share at which shares have been purchased and are purchasable upon the exercise of the warrant is \$.0025.

In 1994, Porter deposited \$3 million with the Company's bank to provide the Company with increased borrowing capability under its senior credit facility (see Note 5). In exchange, Porter 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 Porter a warrant 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. The warrant is fully exercisable and has a term of ten years from the date of issue.

## Stock Options

The Company's Long-Term Incentive Compensation Plan (the "Stock Option Plan") provides for the issuance of both incentive and non statutory stock options. Under the terms of the Stock Option Plan, 2,168,215 shares of the Company's Class A common stock are available for issuance under options granted by the Plan Administrator, who is appointed by the Board of Directors, to key employees, including officers and directors. The option price of \$1.42 per share, determined by the Board of Directors, is 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 options is as follows (amounts in thousands, except per share data):

	Options	
	Outstanding	Option price per share
Balance, December 31, 1992	702	\$1.42
Granted	10	1.42
Exercised	(3)	1.42
Canceled	(26)	1.42
	---	---
Balance, December 31, 1993	683	1.42
Granted	--	--
Exercised	--	--
Canceled	(57)	1.42
	-----	-----
Balance, December 31, 1994	626	1.42
Granted	--	--
Exercised	--	--
Canceled	(28)	1.42
	-----	-----
Balance, December 31, 1995	598	\$1.42

In 1993, an agreement was reached to provide Mr. Beninati and Mr. Wood with an option to individually purchase up to 700,459 shares of the Company's Class A Common Stock from the Company at \$.50 per share. Under the terms of the agreement 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 \$.82 per share at the measurement date of the stock options.

In March 1996, the Board of Directors approved, subject to ratification by the voting common stockholders, two stock option plans for certain key executives and for a larger employee group. Under the plans, a total of 6,644,974 shares of common stock may be awarded at an exercise price not lower than fair market value with vesting based upon the passage of time and/or certain significant events.

Note 8. Agreement with Sapiens International

In 1993, the Company entered into a series of agreements (the "Sapiens Agreements") with Sapiens, the developers of certain commercial user interface software. The Sapiens Agreements gave the Company exclusive rights to distribute and integrate certain Sapiens software to the Federal Government, in selected areas of the United States and parts of the Pacific Rim. During 1994, the Company and Sapiens restructured the existing agreements releasing the Company from its existing obligations under the agreements in certain U.S. locations and parts of Asia and relinquishing certain exclusive rights in those territories. The Company retained certain rights to market certain software to the Federal Government and others in exchange for remaining payments of \$800,000 in license fees, payable in eight monthly installments of \$100,000 beginning December 1994, which have been fully paid. The Company also agreed to terminate a proposed joint venture with Sapiens, and accordingly repaid Sapiens the amount of \$400,000 previously paid to the Company in contemplation of the proposed joint venture. In 1994, the Company also recorded a provision of approximately \$1.4 million to fully write-off the remaining asset value of the license based on a reevaluation of its business plans.

Note 9. Commitments and Contingencies

Leases

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

At December 31, 1995, minimum rent payments under non-cancelable operating leases are as follows (in thousands):

1996	\$5,486
1997	3,349
1998	2,005
1999	1,495
2000	254
	----
Total minimum lease payments	12,589
Less total minimum sublease rentals	(936)
	-----
Net minimum lease commitments	\$11,653
	=====

Rent expense charged to operations for 1995, 1994, and 1993 totaled \$4,349,000, \$5,178,000 and \$6,188,000, respectively.

In March 1996, the Company signed a twenty year lease with annual lease payments of \$1,447,000 for a building that will serve as its Corporate headquarters and provide significant additional manufacturing and integration space. This lease will result in a reduction of the Company's lease costs.

Legal

A description of certain legal matters follows:

Rosecliff, Inc., et al v. C3, Inc., et al. (94 CIV. 9104)

This case was filed in December, 1994 in the United States District Court for the Southern District of New York. Rosecliff, Inc. ("Rosecliff") is a merchant banking group with whom the Company had been negotiating an equity/subordinated debt private placement transaction. Upon termination of this transaction, Rosecliff filed a suit seeking payment of its expenses, the specific enforcement of the acquisition agreement (or in the alternative lost profits) and \$1 million for the violation of the "no-shop" provision in the Agreement. On motion to dismiss, the Court dismissed the claim seeking specific enforcement or lost profits (whether the plaintiffs will seek to replead that claim is unclear). A magistrate has recommended that the Company be held liable for the payment of Rosecliff's expenses in the amount of \$1.1 million. Discovery is ongoing as to the remainder of the suit. While no ultimate assurances can be made as to those claims that the Court has not dismissed, the Company believes it has substantial defenses to the claim for violation of the no-shop provision and has made adequate provision for the payment of Rosecliff expenses.

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

Note 10. Related Parties

Mr. Joseph P. Beninati and Mr. John B. Wood became employees of the Company in 1992 and currently serve as a Director, and President, Chief Executive Officer and Director, respectively. Mr. Beninati served as Chairman of the Board for the majority of 1994 before resigning January 5, 1995 and the Company will pay him \$165,000 annually subject to a three year employment agreement beginning in 1995. Prior to 1992 they provided consulting services to the Company through their firm, Beninati & Wood, Inc. for which unpaid advisory fees at December 31, 1995 totaled \$525,000. During 1993, \$132,000 in legal costs were paid by the Company on behalf of Mr. Beninati and Mr. Wood in connection with the Settlement Agreement, pursuant to indemnification provisions of the Company's bylaws.

Mr. Fred Knoll, former Chairman of the Board of Directors of the Company, and various related entities, were paid \$759,000 in 1993 for reimbursement of expenses. Amounts reimbursed in fiscal year 1993 include \$612,000 of legal fees and other costs incurred in connection with the Settlement Agreement, pursuant to indemnification provisions of the Company's bylaws.

Mr. Porter has a consulting agreement with the Company whereby he will be compensated \$200,000 a year for specified services. Mr. Porter has not requested payment under this agreement in 1995 or 1994.

Mr. Byers, a director of the Company, has a consulting agreement with the Company to help the Company expand its business operations into the international marketplace. Under this agreement Mr. Byers receives \$8,000 a month for his services, and receives an additional \$500 per day for overseas travel undertaken on behalf of the Company. In 1995, Mr. Byers was compensated \$121,500.

Note 11. Business Segments

The Company operates in three market segments: systems and services ("The Systems and Services Group"); maintenance services (the "Field Engineering Group") and consulting services (the "Consulting Group").

The Systems and Services Group consists of systems integration and software services. This group provides turnkey system solutions, supports clients through software, hardware and systems engineering services, hardware integration, facilities management, training and post-implementation technical services.

The Field Engineering Group provides third party computer hardware maintenance services.

The Consulting Group provides computer consulting (primarily on a contract labor basis) to support its customers' existing information technology capabilities.

Field Engineering and Consulting are viewed by the Company to be additional segments of the complete life cycle services offered by the Company.

In order to gain further operational efficiencies, in 1996 the Company will consolidate and reorganize certain divisions.

Selected financial information for the Company's three business segments is presented below (in thousands). For a description of the accounting policies related to this information see Note 1.

	For the Year Ended December 31,		
	1995	1994	1993
	-----		
Operating Revenues(1)			
Systems and Services	\$142,939	\$116,059	\$145,433
Field Engineering	32,820	34,617	41,852
Consulting Services	27,069	24,445	23,944
	-----	-----	-----
Total Revenues	\$202,828	\$175,121	\$211,229
	=====	=====	=====
Operating (Loss) Income			
Systems and Services	\$6,378	\$ (3,541)	\$ 8,972
Field Engineering	597	1,678	2,919
Consulting Services	1,949	852	175
	----	----	----
	8,924	(1,011)	12,066
Corporate and Unallocable Expenses	2,370	3,178	3,178
	----	----	----
Total Operating (Loss) Income	6,554	\$(4,189)	\$ 8,888
	=====	=====	=====
Identifiable Assets			
Systems and Services	\$51,410	\$38,306	\$ 42,526
Field Engineering	7,837	9,836	11,044
Consulting Services	4,766	4,810	4,020
Corporate (2)	30,479	33,920	27,206
	-----	-----	-----
Total Consolidated Assets	\$94,492	\$ 86,872	\$84,796
	=====	=====	=====
Depreciation and Amortization			
Systems and Services	\$1,256	\$ 1,704	\$ 2,046
Field Engineering	1,210	1,523	1,417
Consulting Services	57	87	85
Corporate	3,223	4,153	3,528
	----	----	----
Total Depreciation and Amortization	\$5,746	\$7,467	\$7,076
	=====	=====	=====
Capital Expenditures			
Systems and Services	\$575	\$ 585	\$ 968
Field Engineering	30	63	81
Consulting Services	60	31	72
Corporate	348	547	321
	----	----	----
Total Capital Expenditures	\$1,013	\$1,226	\$1,442
	=====	=====	=====

(1) Revenues between segments are not material.

(2) Corporate assets are principally goodwill, property and equipment, cash, and other assets. Goodwill and related amortization from the acquisitions of C3 and Telos Corporation has not been allocated to the industry segments due to the arbitrary nature of any allocation process.

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

None



PART III

Item 10. Directors and Executive Officers of the Registrant

Dr. Fred Charles Ikl'e, Chairman of the Board

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Dr. Ikl'e (age 71) was elected to the Company's Board of Directors on January 31, 1994 and was elected Chairman of the Board at the January 6, 1995 Board of Directors meeting. He is Chairman of Conservation Management Corporation and Director of the Zurich-American Insurance Companies. Dr. Ikl'e 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. Ikl'e served as Under Secretary of Defense for Policy.

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

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Mr. Wood (age 32) was elected President and Chief Executive Officer on February 16, 1994. Mr. Wood was appointed Chief Operating Officer on October 8, 1993 after serving as Executive Vice President from May of 1992. He was elected to the Board of Directors on May 13, 1992. Mr. Wood joined the Company on February 13, 1992. Prior to joining the Company, Mr. Wood was a founder of Beninati & Wood, Inc., an investment banking firm which had provided services to the Company. Prior to that time, in 1990, he was a member of the Private Placement Department at UBS Securities, Inc.

Joseph P. Beninati, Director

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Mr. Beninati (age 32), a director, is presently a founding general partner of Antares, a private equity firm devoted to information technology and healthcare investments. Mr. Beninati was the Company's Chairman of the Board from 1994 until 1995. Mr. Beninati was appointed Chief Marketing Officer in October of 1993, and prior to that served as Executive Vice President of Finance. He joined the Company in February of 1992 and was elected to the Board of Directors in May of 1992. Mr. Beninati resigned in 1995 to organize Antares while operating Beninati & Wood, Inc., an investment banking firm which he co-founded in 1990. In the 1980's Mr. Beninati was an officer of the Long-Term credit Bank of Japan and in the Corporate Finance Department of Dean Witter Reynolds, Inc.

Dr. Stephen D. Bryen, Director

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Dr. Stephen Bryen (53) was elected to the Company's Board of Directors on January 31, 1994. He is currently President of Delta Tech, a high technology consulting and government relations firm. Delta Tech specializes in U.S. and foreign high technology issues. Delta Tech's mission is to promote new technology, represent high technology companies and identify business opportunities for Delta Tech clients. Concurrently, Dr. Bryen is President of Secured Communications Technology, Inc. a developer of computer security software. Dr. Bryen serves as a Security Board Member of the Space Systems/Loral Corporation of Palo Alto, California which develops and manufactures civilian and military satellites for telecommunications, television, weather forecasting, mapping, scientific measurement and other tasks. Dr. Bryen is a board member of Greenray/CMAC Industries, based in Mechanicsburg, Pennsylvania. Greenray/CMAC makes high technology quartz crystals used in various defense and civilian electronics applications. From 1981 to 1988 Dr. Bryen served as 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  
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Mr. Byers (age 49) was elected to the Board of Directors on January 31, 1994. He has been president of International Strategies Limited, a Washington, DC international business consulting firm since November, 1993. Before that appointment, he had served as the vice president of the Beaconsfield Corporation, 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.

William L. Prieur Brownley, Vice President and General Counsel and Secretary  
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Mr. Brownley (age 39) 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. Mr. Brownley also served as a Director at Comtex Scientific Corporation and the Learning Channel, Inc. from 1990 to 1991.

Gerald D. Calhoun, Vice President, Human Resources, and Secretary, Telos Corporation  
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Mr. Calhoun (age 46) 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 as Director for the U.S. Department of Labor, Employment Standards Administration.

F. Bruce Eckhoff, President, Telos Consulting Services  
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Mr. Eckhoff (age 51) became President of Telos Consulting Services in 1992. Mr. Eckhoff served as Chairman and Chief Executive Officer of Telos's Corporation subsidiary, Telecommunications Sciences Corporation, from 1989 until its divestiture in 1992. Mr. Eckhoff joined Telos Corporation in 1980 as a Regional Manager. Prior to joining Telos Corporation, Mr. Eckhoff was an independent consultant in the programming and analysis field.

Mark W. Hester, President, Telos Field Engineering and Vice President, Telos Corporation  
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Mr. Hester (age 43) joined Telos in 1979 and was appointed as President of Field Engineering in 1987. He is responsible for all new business activities and operations activities at 85 computer Field Service locations nationally as well as 6 overseas locations. Previously he has held progressive positions within Telos as a Field and Regional Manager of Operations and Vice President of Marketing. Mr. Hester received extensive training from IBM Corporation after a successful military commitment of nearly eight years.

Robert J. Marino, President, Telos Systems Integration and Executive Vice President  
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Mr. Marino (age 59) joined the Company in 1988 as Senior Vice President of Sales and Marketing. In 1990, his responsibilities were expanded to include Program Management in addition to sales and marketing. On January 1, 1994, Mr. Marino was promoted to President of Telos Systems Integration, a position he currently holds. Prior to joining the Company in February, 1988, Mr. Marino held the position of Sr. Vice President of Sales and Marketing with Centel Federal Systems and M/A-COM Information Systems, both of which are U.S. Government contractors.

Robert A. Spearing, President, Telos Information Systems  
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Mr. Spearing (age 56) was appointed President of Telos Information Systems in 1993 and is responsible for all sales and operations activities of that division. Previously, Mr. Spearing held the position of Vice President of Eastern Operations within the Telos Systems Group. Prior to joining Telos Corporation in 1992, Mr. Spearing was with the National Aeronautics and Space Administration for 28 years. His last assignment at NASA was Director of Mission Operations and Data Systems at the Goddard Space Flight Center.

Lorenzo Tellez, Chief Financial Officer, Treasurer, and Vice President  
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Mr. Tellez (age 38) 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. Mr. Tellez is a Certified Public Accountant. Prior to joining Telos Corporation, Mr. Tellez served as a Senior Manager with Arthur Andersen & Company, a public accounting firm.

Lee R. Whitley, President, Telos Federal Systems  
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Mr. Whitley (age 58) was appointed President of Telos Federal Systems in October 1993, and has been with Telos Corporation in various diversified key management positions since 1981. Previously, Mr. Whitley was Vice President of Central Operations in Telos Systems Group. Before joining Telos Corporation, Mr. Whitley served for twenty years in the U.S. Army Field Artillery, retiring as a Lieutenant Colonel. Mr. Whitley resigned from the Company in January 1996.

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

#### Item. 11. Executive Compensation

Information is set forth in the Summary Compensation Table included on the following page with respect to all forms of compensation for service rendered in all capacities to the Company during the fiscal years ended December 31, 1995, 1994, and 1993, of the Chief Executive Officer and four other most highly paid executive officers during 1995.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Annual Compensation			Long-Term Compensation			All Other Compensation (2)
		Salary	Bonus	Other Annual Compensation(1)	Awards		Payouts	
					Restricted Stock Award(s) (\$)	Options/SARs(#)	LTIP Payouts (\$)	
Gerald D. Calhoun (V.P., Human Resources, & Secretary, Telos Corp.)	1995	\$143,943	\$40,000	\$ 6,000	--	--	--	\$4,603
	1994	119,595	65,657	6,000	--	--	--	3,520
	1993	105,000	63,000	6,000	--	--	--	2,235
Mark W. Hester (President, Telos Field Engineering, V.P. Telos Corp.)	1995	181,695	40,000	6,000	--	--	--	4,992
	1994	164,635	40,805	6,000	--	--	--	3,949
	1993	161,384	130,000	--	--	--	--	8,994
Robert J. Marino (President, Telos Systems Integration, Senior V.P, Telos Corp.)	1995	158,546	50,000	6,000	--	--	--	6,565
	1994	147,118	36,000	6,000	--	--	--	1,264
	1993	150,000	150,000	6,000	--	--	--	4,497
Lorenzo Tellez (V.P., Treasurer, Chief Financial Officer)	1995	166,624	50,000	6,000	--	--	--	6,846
	1994	157,014	56,000	6,000	--	--	--	4,620
	1993	129,816	149,375	--	--	--	--	8,994
John B. Wood (President, Chief Executive Officer)	1995	234,990	325,000	24,000	--	--	--	7,029
	1994	161,833	--	38,000	--	--	--	3,976
	1993	150,870	145,000	6,000	--	700,459	--	3,317

(1) Other annual compensation represents Director's Fees paid and automobile allowances provided to executives.

(2) All other compensation represents Company contributions made on behalf of the executive officers to the Telos Corp. 401(k) Retirement Savings and Profit Sharing Plan.

## Stock Option Grants

The Company did not grant any stock options in 1995, and therefore the Summary Table of Options/SAR Grants in the Last Fiscal Year has been omitted.

## 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, 1995.

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

Name	Shares Acquired on Exercise	Value Realized	Number of Unexercised Options/SARs at FY-End	Value of Unexercised In-the-Money Options/SARs at FY-End (1)
			Exercisable/ Unexercisable	Exercisable/ Unexercisable
Gerald Calhoun (V.P. Human Resources, and Secretary, Telos Corp.)	--	--	69,900/0	--
Mark W. Hester (President, Telos Field Engineering & V.P. Telos Corporation)	--	--	--	--
Robert J. Marino (President, Telos Systems Integration, Senior V.P., Telos Corp.)	--	--	164,900/0	--
Lorenzo Tellez (V.P., Treasurer, Chief Financial Officer)	--	--	--	--
John B. Wood (President, Chief Executive Officer)	--	--	700,459/0	\$315,207/0

(1) Based on an estimated fair market value of the Company's Class A common stock of \$ 0.95 per share at December 31, 1995.

## Compensation of Directors

During the fiscal year ended December 31, 1995, employee directors were paid a fee of \$2,000 for each Board meeting attended. Outside directors Mr. Byers and Dr. Bryen were paid an annual fee of \$25,000, and further compensated at a rate of \$750 for each meeting in excess of four meetings a year. Chairman of the Board, Dr. Ikle', is paid \$25,000 quarterly for his service on the Board. In addition, Mr. Byers receives \$5,000 per annum for his service as Proxy Chairman. The compensation paid to the outside directors is paid pursuant to a proxy agreement between the Company, the Defense Investigative Service and certain of the Company shareholders. Other directors have been awarded stock options in prior years as additional

compensation for their services as directors. Additional options may be awarded to outside directors in the future. During the fiscal year ended December 31, 1995, no directors of the Company were awarded options.

#### Employment Contracts

The Company is a party to agreements with certain of its executive officers. Mr. William Brownley, General Counsel, Mr. Gerald Calhoun, Vice President Human Resources, Mr. Mark Hester, President of Telos Field Engineering, Mr. Robert Marino, President of Telos Systems Integration, Mr. Lorenzo Tellez, Chief Financial Officer, and Mr. John Wood, Chief Executive Officer, have agreements with the Company which provide for a payment of two year's base salary then in effect if involuntarily terminated. Accordingly, Mr. Brownley, Calhoun, Hester, Marino, Tellez and Wood would receive, given their present salary levels, \$130,000, \$130,000, \$163,500, \$165,000, \$170,000 and \$225,000, respectively. In addition, these executive officer's agreements provide for bonus payments should certain operating results be attained.

The Company is also a party to a three year employment agreement with Mr. Beninati, Director, and former Chairman of the Board. Under the agreement, Mr. Beninati will receive \$165,000 in each of the next two years.

Item 12. Security Ownership of Certain Beneficial Owners and Management

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

(1)	(2)	(3)	(4)
Title of Class -----	Name and Address of Beneficial Owner -----	Amount and Nature of Beneficial Ownership as of March 1, 1996 -----	Percent of Class -----
Class A Common Stock	John Porter Chelverton Properties Limited 63 Chester Square London SW1W 9EA England	23,030,718 shares(A)	75.99%
Class A Common Stock	C3, Inc. 401(k) Plan and Telos Corporation Savings Plan c/o C3, Inc. 460 Herndon Parkway Herndon, Virginia 22070	3,658,536 shares	15.85%
Class A Common Stock	Union de Banques Suisses (Luxembourg) S.A. 299 Park Ave., 37th Fl. New York, NY 10171	3,150,468 shares(B)	12.92%
Class B Common Stock	F&C Nominees Limited 11 Devonshire Square London EC 2M 4YR England	3,143,358 shares	77.85%
Class B Common Stock	Bank of Scotland (London) Nominees Limited 11 Devonshire Square London EC 2M 4YR England	815,700 shares	20.20%
Class A Common Stock	Gerald A. Calhoun	88,293 shares (C)	0.38%
Class A Common Stock	Mark W. Hester	60,976 shares	0.26%
Class A Common Stock	Robert J. Marino	286,952 shares (C)	1.23%
Class A Common Stock	Lorenzo Tellez	152,440 shares	0.66%
Class A Common Stock	John B. Wood	700,459 shares (D)	2.95%
Class A Common Stock	All Officers And Directors As A Group (8 persons)	2,058,360 shares (E)	8.32%

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT (Cont'd)

(1)	(2)	(3)	(4)
Title of Class -----	Name and Address of Beneficial Owner -----	Amount and Nature of Beneficial Ownership as of March 1, 1996 -----	Percent of Class -----
12% Cumulative Exchange- able Redeemable Preferred Stock	Gotham Partners, L.P. 230 Park Avenue, #1245 New York, NY 10169	340,929 shares	9.45%
12% Cumulative Exchangeable Redeemable Preferred Stock	C.C. Partners Ltd. 15 Hudson Ave., PO Box 832 Shelter Island Heights, NY 11965	220,953 shares (F)	6.15%
12% Cumulative Exchangeable Redeemable Preferred Stock	R. Cromwell Coulson Carr Securities Corp. 17 Battery Place New York, NY 10004	220,953 shares (F)	6.15%
12% Cumulative Exchangeable Redeemable Preferred Stock	Value Partners, Ltd. 2200 Ross Avenue, Ste 4660 Dallas, TX 75201	673,317 shares (G)	18.73%
12% Cumulative Exchangeable Redeemable Preferred Stock	Fisher Ewing Partners 2200 Ross Avenue, Ste 4660 Dallas, TX 75201	673,317 shares (G)	18.73%

- (A) Mr. Porter's holdings include 7,228,916 shares of Class A Common Stock purchasable upon exercise of a warrant.
- (B) Union de Banques Suisses (Luxembourg) S.A. holdings include 1,312,695 shares of Class A Common Stock purchasable upon exercise of a warrant.
- (C) Messrs. Calhoun and Marino hold options to acquire 69,900 and 164,900 shares of the Company's Class A Common Stock, respectively, in addition to their current common stock holdings. These shares are purchaseable upon exercise of warrant.
- (D) Mr. Wood owns no shares of Common Stock, however, he holds an option to acquire 700,459 shares of the Company's Class A Common Stock purchasable upon exercise of options.
- (E) Under the Company's stock option plan and certain stock option agreements, all officers and directors as a group hold options to acquire 1,655,718 shares of Class A Common Stock exercisable within 60 days after March 1, 1996.
- (F) C.C. Partners Ltd. and R. Cromwell Coulson 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 220,953 shares of the Public Preferred Stock held of record by the reporting persons collectively.
- (G) Value Partners Ltd. and Fisher Ewing Partners have filed jointly a Schedule 13D under which they disclosed that they may act as a "group" within the meaning of Section 13(d) of the Securities Exchange Act. Each of the reporting persons disclosed that it may be deemed to beneficially own the aggregate of 673,317 shares of the Public Preferred Stock held of record by the reporting persons collectively.



Item 13. Certain Relationships and Related Transactions

Mr. Joseph P. Beninati and Mr. John B. Wood became employees of the Company in 1992 and currently serve as a Director, and President, Chief Executive Officer and Director, respectively. Mr. Beninati served as Chairman of the Board for the majority of 1994 before resigning January 5, 1995 and the Company will pay him \$165,000 annually subject to a three year employment agreement beginning in 1995. Prior to 1992 they provided consulting services to the Company through their firm, Beninati & Wood, Inc. for which unpaid advisory fees at December 31, 1995 totaled \$525,000. During 1993, \$132,000 in legal costs were paid by the Company on behalf of Mr. Beninati and Mr. Wood in connection with the Settlement Agreement, pursuant to indemnification provisions of the Company's bylaws.

Mr. Fred Knoll, former Chairman of the Board of Directors of the Company, and various related entities, were paid \$759,000 in 1993 for reimbursement of expenses. Amounts reimbursed in fiscal year 1993 include \$612,000 of legal fees and other costs incurred in connection with the Settlement Agreement, pursuant to indemnification provisions of the Company's bylaws.

Mr. Porter has a consulting agreement with the Company whereby he will be compensated \$200,000 a year for specified services. Mr. Porter has not requested payment under this agreement in 1995 or 1994.

Mr. Byers, a director of the Company, has a consulting agreement with the Company to help the Company expand its business operations into the international marketplace. Under this agreement Mr. Byers is compensated \$8,000 per month for his services, as well as \$500 per day for overseas travel undertaken on behalf of the Company. In 1995, Mr. Byers was compensated \$121,500.

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. The exhibits marked with (2\*) are incorporated by reference to the Company's Amendment No. 1 to Schedule 14D-9 filed on December 2, 1988. 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. Exhibits marked with (5\*) are incorporated by reference to the Company's Form 10-K report for the fiscal year ended March 31, 1990. Exhibits marked with (6\*) are management contracts or compensatory plans or arrangements required to be filed by Item 14(c) of Form 10K. 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, 460 Herndon Parkway, Herndon, Virginia 22070-5201.

- 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)
- 10.10 (3\*) Lease Agreement for the Herndon Facility.
- 10.11 (4\*) Amended Lease Agreement - Herndon Facility.
- 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)
- 10.41 September 27, 1993 Letter Agreement among C3, Inc., Knoll Capital Management, Inc. and Telos Corporation regarding deferred Telos Corporation fees. (Incorporated by reference to C3, Inc. Form 8-K filed October 18, 1993)
- 10.43 Amendment to Revolving and Reducing Senior Credit Facility dated as of December 31, 1993 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.44 Amendment to Revolving and Reducing Senior Credit Facility dated as of April 11, 1994 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.45 Amendment to Revolving and Reducing Senior Credit Facility dated as of June 8, 1994 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.46 Amendment to Revolving and Reducing Senior Credit Facility dated as of October 7, 1994 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.47 October 7, 1994 Letter Agreement among C3, Inc., Toxford Corporation, and NationsBank, N.A. regarding cash collateral held on behalf of the Company.
- 10.48 October 25, 1994 General Release and Settlement memorandum among Sapiens International Corporation N.V., Sapiens International Corporation B.V., Sapiens U.S.A., Inc., C3, Inc. and Telos Corporation.
- 10.49 Amendment to Revolving and Reducing Senior Credit Facility dated as of January 5, 1995 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.50 Amendment to Revolving and Reducing Senior Credit Facility dated as of January 12, 1995 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.51 Waiver and Amendment to Revolving and Reducing Senior Credit Facility dated as of April 17, 1995 among C3, Inc., Telos Corporation and NationsBank, N.A.
- 10.52 Subordinated Bridge Note/Promissory Note as of June 8, 1995 between Telos Corporation (Maryland) and Drayton English and International Investment Trust
- 10.53 Subordinated Bridge Note/Promissory Note as of June 8, 1995 between Telos Corporation (Maryland) and J. O. Hambro Investment Management, Ltd.

- 10.54 Subordinated Bridge Note/Promissory Note as of June 8, 1995 between Telos Corporation (Maryland) and North Atlantic Smaller Companies Investment Trust, PLC
- 10.55 Subordinated Bridge Note/Promissory Note as of June 8, 1995 between Telos Corporation (Maryland) and Mr. John R.C. Porter
- 10.56 Subordinated Bridge Note/Promissory Note as of June 8, 1995 between Telos Corporation (Maryland) and Sir Leslie Porter
- 10.57 Subordinated Bridge Note/Promissory Note as of June 8, 1995 between Telos Corporation (Maryland) and Second Consolidated Trust, PLC
- 10.58 Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Drayton English and International Investment Trust
- 10.59 Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and J. O. Hambro Investment Management, Ltd.
- 10.60 Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and North Atlantic Smaller Companies Investment Trust, PLC
- 10.61 Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Mr. John R.C. Porter
- 10.62 Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Sir Leslie Porter
- 10.63 Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Second Consolidated Trust, PLC
- 10.64 Series B Senior Subordinated Secured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Toxford Corp.
- 10.65 Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Drayton English and International Investment Trust
- 10.66 Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and J.O. Hambro Investment Management, Ltd.
- 10.67 Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and North Atlantic Smaller Companies Investment Trust, PLC
- 10.68 Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Mr. John R.C. Porter

- 10.69 Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Sir Leslie Porter
- 10.70 Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Second Consolidated Trust, PLC
- 10.71 Series C Senior Subordinated Unsecured Note due October 1, 2000 as of October 13, 1995 between Telos Corporation (Maryland) and Toxford Corp.
- 10.72 Amendment to Revolving and Reducing Senior Credit Facility dated as of August 4, 1995 Telos Corporation (Maryland), Telos Corporation (California) and NationsBank N.A.
- 10.73 Amendment to Revolving and Reducing Senior Credit Facility dated as of October 13, 1995 Telos Corporation (Maryland), Telos Corporation (California) and NationsBank N.A.
- 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: /s/John B. Wood

-----  
 President and  
 Chief Executive Officer

Date: March 29, 1996

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

Signature -----	Title -----	Date -----
/s/ Fred Charles Ikl'e ----- Fred Charles Ikl'e	Chairman of the Board of Directors	March 29, 1996
/s/ John B. Wood ----- John B. Wood	President, Chief Executive Officer & Director (Principal Executive Officer)	March 29, 1996
/s/ Stephen D. Bryen ----- Stephen D. Bryen	Director	March 29, 1996
/s/ Norman P. Byers ----- Norman P. Byers	Director	March 29, 1996
/s/ Joseph P. Beninati ----- Joseph P. Beninati	Director	March 29, 1996
/s/ Lorenzo Tellez ----- Lorenzo Tellez	Chief Financial Officer (Principal Financial Officer & Principal Accounting Officer)	March 29, 1996

Telos Corporation  
Exhibit Index

Exhibit Number -----	Exhibit Name -----
3.7	Articles of Amendment of C3, Inc. dated April 13, 1995
10.72	Amendment to Revolving and Reducing Senior Credit Facility dated as of August 4, 1995 Telos Corporation (Maryland), Telos Corporation (California) and NationsBank N.A.
10.73	Amendment to Revolving and Reducing Senior Credit Facility dated as of October 13, 1995 Telos Corporation (Maryland), Telos Corporation (California) and NationsBank N.A.
21	Schedule of Subsidiaries
27	Financial Data Schedule





ARTICLES OF AMENDMENT

THIS IS TO CERTIFY THAT:

FIRST: The charter of C3, Inc., a Maryland corporation (the "Corporation"), is hereby amended by deleting existing Article FIRST in its entirety and substituting in lieu thereof a new article to read as follows:

FIRST: The name of the corporation  
(which is hereafter called the "Corporation") is:

Telos Corporation

SECOND: The amendment to the charter of the Corporation as set forth above has been duly advised by the Board of Directors and approved by the stockholders of the Corporation as required by Law.

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

IN WITNESS WHEREOF, the Corporation has caused these Articles to be signed in its name and on its behalf by its Vice President and attested to by its Secretary on this 13th day of April, 1995.

ATTEST: C3, INC.

/s/ Gerald D. Calhoun  
-----  
Secretary

By: /s/ William L.P. Brownley (SEAL)  
-----  
Vice President

THIS FOURTEENTH AMENDMENT TO CREDIT AGREEMENT (this "Amendment") is made and entered into as of the 4th day of August 1995, by and among Telos Corporation, a Maryland corporation (formerly known as C3, Inc., a Maryland corporation), Telos Corporation, a California corporation (individually "Borrower" and collectively "Borrowers") and NationsBank, N.A., successor by merger to American Security Bank, N.A. (the "Bank" or "Agent").

WITNESSETH:

A. Borrowers, the Bank and the Agent entered into that certain Revolving and Reducing Senior Facility Credit Agreement, dated as of January 14, 1992 (the "Original Credit Agreement").

B. Borrowers, the Bank and the Agent entered into an Agreement and Waiver dated as of July 20, 1992, an Amendment dated as of October 1, 1992, an Amendment dated as of January 15, 1993, an Amendment dated as of June 30, 1993, an Amendment dated as of August 31, 1993, an Amendment dated as of October 5, 1993, an Amendment dated as of December 31, 1993, an Amendment dated as of April 11, 1994, an Amendment dated as of June 8, 1994, an Amendment dated as of October 7, 1994, an Amendment dated as of January 5, 1995, an Amendment dated as of January 12, 1995 and an Amendment and Waiver dated as of April 17, 1995, whereby Borrowers, the Agent and the Bank agreed, among other things, to amend certain provisions of the Original Credit Agreement (the Original Credit Agreement, as so amended, shall be hereinafter referred to as the "Credit Agreement").

C. Borrowers, the Agent and the Bank further desire, pursuant to Section 11.1 of the Credit Agreement, to amend certain provisions of the Credit Agreement to enable the Bank, upon request of Borrowers, to issue standby letters of credit, all on the terms and conditions set forth below.

NOW THEREFORE, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties, intending to be legally bound, hereby agree as follows:

Section 1. Definitions. All terms used in this Amendment and not otherwise defined shall have the meanings ascribed to such terms in the Credit Agreement.

Section 2. Amendment to Definitions. Section 1.2 of the Credit Agreement is hereby amended by the addition of the following definition in the appropriate places in such section:

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"Application: The meaning specified in Section 2A(a).

Issuance Effective Date: The meaning specified in Section 2A(b).

Letter of Credit: The meaning specified in Section 2A(a).

Periodic LC Fee: The meaning specified in Section 2A(b).

Section 3. Letters of Credit. The Credit Agreement is hereby amended by adding an Article IIA to the Credit Agreement after Article II, which shall read as follows:

#### "ARTICLE IIA

##### LETTERS OF CREDIT

(a) Issuance. Borrowers and the Bank acknowledge that from time to time Borrowers may request that the Bank issue a standby letter or letters of credit (each being herein referred to as a "Letter of Credit"), in connection with Borrowers' business operations. Any such request by Borrowers shall be made by Borrowers submitting to the Bank an Application and Agreement for Standby Letter of Credit (each being herein referred to as an "Application") on the Bank's standard form, which Application shall be executed by authorized officers of each Borrower, and be accompanied by such other supporting documentation and information, borrowing and other corporate resolutions and opinions of counsel as the Bank may from time to time request. Each Application shall be deemed to govern the terms of issuance of the subject Letter of Credit; it being understood, however, that the fees for issuance thereof shall be as set forth in Section 2A(b).

(b) Fees. In addition to the payment of all fees as set forth in Section 2.6, Borrowers shall pay to the Bank the following for each Letter of Credit issued by the Bank for the benefit of Borrowers: (i) a one-time origination fee in the amount of Three Hundred Dollars (\$300.00), payable upon the issuance of each such Letter of Credit, and (ii) for each three (3) month period (or partial three (3) month period) during which such Letter of Credit remains outstanding, a fee (the "Periodic LC Fee") in the amount of 1/2 of 1% of the original face amount of such Letter of Credit, with the first Periodic LC Fee payment being payable on the date of issuance of such Letter of Credit, and each subsequent Periodic LC Fee payment being payable in advance on the first Banking Day of each and every successive third (3rd) calendar month after the Issuance Effective Date until such Letter of Credit is canceled or expires. For purposes of this Section 2A(b), the "Issuance Effective Date" shall be deemed to be the first day of the calendar month in which a Letter of Credit is issued

(irrespective of the actual date of issuance). Notwithstanding the foregoing, it is expressly understood and agreed that the Bank shall not issue any Letters of Credit having an expiration date beyond the Maturity Date.

(c) Other Matters. In the event the Bank issues any Letter(s) of Credit, (i) the maximum amount of credit available under the Commitment shall be reduced by the face amount of each Letter of Credit (so long as such Letter of Credit remains outstanding), and (ii) any amounts drawn under any Letter of Credit shall be deemed a Loan and shall be deemed to be an advance under the Note, shall bear interest and be payable in accordance with the terms of the Note and shall be secured by the Security Documents (in the same manner as all other sums advanced under the Note). It is expressly understood and agreed that all obligations and liabilities of Borrowers to the Bank in connection with any such Letter(s) of Credit shall be deemed to be Obligations, and the Bank shall have no obligation to release its rights under the Security Documents until the Note and all other sums due to the Bank in connection with the Loans have been paid and satisfied in full, all Letters of Credit have been canceled or expired (i.e., none are outstanding), and the Bank has no further obligation or responsibility to make additional Loans or issue additional Letters of Credit. Furthermore, in no event whatsoever shall the Bank have any obligation to issue any Letter of Credit which would cause the face amount of all then outstanding Letters of Credit issued by the Bank for the benefit of Borrowers to exceed, in the aggregate, Three Hundred Thousand Dollars (\$300,000.00)."

Section 4. Conditions Precedent to this Amendment. The provisions of this Amendment are conditioned upon, and shall not become effective until the occurrence of, each of the following:

- (a) Borrowers shall have delivered to the Agent certified corporate resolutions approving the transaction described herein, which shall be satisfactory to the Agent in its sole and absolute discretion.
- (b) No litigation, proceeding or any other action shall have been filed, or threatened to be filed, by any party which challenges, seeks to enjoin, restrain or prohibit or to obtain damages in respect of or which is related to the transactions contemplated by this Amendment.

Section 5. No Waiver. Notwithstanding execution of this Amendment and the extension of Loans by the Bank to Borrowers in accordance with the provisions hereof, neither the Bank nor the Agent is waiving, and shall not be deemed to have waived, any of their respective rights under any provisions of the Credit Agreement, the Note or the other Revolving Loan Documents. The Bank's or the Agent's failure to insist upon the strict performance of any term, condition, or other provision of the Credit Agreement, the Note or the other Revolving Loan Documents or to exercise any right or remedy hereunder or thereunder shall not constitute a waiver by the Bank or the Agent of any such term, condition or other provision or default or Event of

Default in connection therewith.

Section 9. Continued Effect of Credit Agreement. Except as specifically amended herein, the Credit Agreement is and shall continue to be in full force and effect and is hereby ratified and confirmed in all respects.

Section 10. Counterparts. This Amendment may be executed in one or more counterparts, all of which shall be considered one and the same Amendment, and shall become effective when one or more of the same counterparts have been signed by each of the parties to this Amendment and delivered (by facsimile or otherwise) to the other parties, it being understood that each party need not sign the same counterpart.

IN WITNESS WHEREOF, the Bank, the Agent, and Borrowers have each executed this Amendment as of the date first written above.

NATIONSBANK, N.A.

By: /s/ Catherine S. Grimm

-----  
Name: Catherine S. Grimm

-----  
Title: VP

-----  
NATIONSBANK, N.A., as the Agent

By: /s/ Catherine S. Grimm

-----  
Name: Catherine S. Grimm

-----  
Title: VP

-----  
TELOS CORPORATION, formerly known as  
C3, Inc.

By: /s/ Gerald D. Calhoun

-----  
Name: Gerald D. Calhoun

-----  
Title: Vice President Corporate Secretary

-----  
TELOS CORPORATION

By: /s/ Gerald D. Calhoun

-----  
Name: Gerald D. Calhoun

-----  
Title: Vice President Corporate Secretary





THIS FIFTEENTH AMENDMENT TO CREDIT AGREEMENT (this "Amendment") is made and entered into as of the 13th day of October 1995, by and among Telos Corporation, a Maryland corporation (formerly known as C3, Inc., a Maryland corporation), Telos Corporation, a California corporation (individually "Borrower" and collectively "Borrowers") and NationsBank, N.A., successor by merger to American Security Bank, N.A. (the "Bank" or "Agent").

WITNESSETH:

A. Borrowers, the Bank and the Agent entered into that certain Revolving and Reducing Senior Facility Credit Agreement, dated as of January 14, 1992 (the "Original Credit Agreement").

B. Borrowers, the Bank and the Agent entered into an Agreement and Waiver dated as of July 20, 1992, an Amendment dated as of October 1, 1992, an Amendment dated as of January 15, 1993, an Amendment dated as of June 30, 1993, an Amendment dated as of August 31, 1993, an Amendment dated as of October 5, 1993, an Amendment dated as of December 31, 1993, an Amendment dated as of April 11, 1994, an Amendment dated as of June 8, 1994, an Amendment dated as of October 7, 1994, an Amendment dated as of January 5, 1995, an Amendment dated as of January 12, 1995, an Amendment and Waiver dated as of April 17, 1995, and an Amendment dated as of August 4, 1995, whereby Borrowers, the Agent and the Bank agreed, among other things, to amend certain provisions of the Original Credit Agreement (the Original Credit Agreement, as so amended, shall be hereinafter referred to as the "Credit Agreement").

C. Borrowers, the Agent and the Bank now desire, pursuant to Section 11.1 of the Credit Agreement, to amend certain other provisions of the Credit Agreement on the terms and conditions set forth below.

NOW THEREFORE, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties, intending to be legally bound, hereby agree as follows:

Section 1. Definitions. All terms used in this Amendment and not otherwise defined shall have the meanings ascribed to such terms in the Credit Agreement.

Section 2. Amendment to Definitions.  
-----

(a) Pursuant to Section 11.1 of the Credit Agreement, Section 1.2 of the Credit Agreement is hereby amended by the addition of the following definitions in the appropriate place therein:

"Investor Notes: collectively, those certain Series B Senior

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Subordinated Secured Notes Due October 1, 2000 and those certain Series C Senior Subordinated Unsecured Notes Due October 1, 2000, each dated October 13, 1995 and subordinated in right of payment in the manner and to the extent set forth in the Investor Subordination Agreement."

"Investor Subordination Agreement: that certain Subordination Agreement dated as of October 13, 1995 among the Bank, Borrowers and each of the holders of the Investor Notes."

(b) The definition of "Subordinated Debt" in the Credit Agreement is hereby amended to include the Investor Notes and any and all extensions, renewals, replacements, refinancings and refundings of the same. All references to "Subordinated Debt" in the Credit Agreement shall be deemed to include the debt evidenced by the Investor Notes and any such extensions, renewals, replacements, refinancings and refundings of the same.

Section 3. Amendments Regarding Overadvance Amount.  
-----

(a) Pursuant to Section 11.1 of the Credit Agreement, Section 2.1(a)(ii) is hereby deleted and amended in its entirety to read as follows:

"The Commitment shall include an overadvance amount of \$4,000,000 which amount shall be automatically reduced to \$2,000,000 on February 1, 1996 (the "Overadvance Amount"). The Overadvance Amount is an incremental borrowing availability under the Commitment in addition to the Borrowing Base. The availability of Loans under the Overadvance Amount is subject to and conditioned upon the commencement of that certain Army contract #DAHC94-95-D-0010 and continued delivery order activity thereunder, as determined by the Bank in its sole discretion, based upon Borrowers' quarterly backlog reports and other information available to the Bank."

(b) Pursuant to Section 11.1 of the Credit Agreement, the second sentence of Section 2.1(d) of the Credit Agreement is hereby deleted and amended in its entirety to read as follows:

"Loans evidencing any or all of the Overadvance Amount shall mature on June 30, 1996 or on such earlier date on which the Loans evidencing the Overadvance Amount become due and payable as otherwise herein provided, whether by declaration of acceleration, optional or mandatory prepayment or otherwise (the "Overadvance Maturity Date")."

Section 4. Additional Fees.

-----

Pursuant to Section 11.1 of the Credit Agreement, Section 2.6 of the Credit Agreement is hereby amended by the addition of the following subsections (k) and (l):

"(k) Overadvance Extension Fee. On or before October 13, 1995, Borrowers shall pay to the Agent an overadvance extension fee equal to \$25,000.

(l) Underwriting Fee. On or before October 13, 1995, Borrowers shall pay to the Agent an underwriting fee equal to \$10,000.

Section 5. Amendment to Mandatory Prepayments.

Pursuant to Section 11.1 of the Credit Agreement, Section 2.8 of the Credit Agreement is hereby amended by the addition of the following subsection (f):

"(f) At the option of the Agent, there shall be a mandatory prepayment of the Loans in full in the event that any prepayment, or any event which causes a prepayment, of all or any portion of the outstanding principal amount of the Investor Notes occurs, including, but not limited to: (i) the distribution and sale of common stock of either Borrower pursuant to an effective registration statement (some of the proceeds of which sale are available to such Borrower) in one or more public offerings (other than a registration statement on Form S-4 or Form S-8) which has been filed with the Commission and has become effective; (ii) any sale of securities of either Borrower, which results in net cash proceeds to such Borrower in excess of \$1,000,000, other than (A) obligations for borrowed money due within one year and (B) other obligations for money borrowed from the Bank and/or its successors, substitutes and participants and their respective assigns and any refinancing thereof; or (iii) any Merger. For purposes of this Section 2.8(f), "Merger" shall mean a merger consolidation or other combination to which either Borrower is a party, in which such Borrower is not a surviving corporation or which results in the acquisition of "beneficial ownership" of securities of such Borrower representing 50% or more of the total number of votes that may be cast for the election of directors by any "person" or "group" (as such terms are defined in Rule 13(d) promulgated under the Exchange Act), or a sale by such Borrower of all or substantially all of its assets."

Section 6. Amendment to Negative Covenants.

(a) Pursuant to Section 11.1 of the Credit Agreement, Section 6.2 of the Credit Agreement is hereby amended by the addition of the following subsection

(j):

"(j) the PP&E Lien referred to in the Investor Subordination Agreement, subject, however, to the prior approval by the Bank of any security agreement, collateral assignment, mortgage or other agreement or instrument giving rise to such Lien and all related documents and instruments, including, without limitation, financing statements.

(b) Pursuant to Section 11.1 of the Credit Agreement, Article VI of the Credit Agreement is amended by the addition of the following Section 6.19:

"6.19 Prior Approval of Security Agreements.  
-----

Neither Borrower nor any Subsidiary shall enter into any security agreement collateral assignment, mortgage or other agreement, instrument or document (including, without limitation, financing statements) which gives rise to, creates or perfects a Lien against either Borrower or a Subsidiary, unless the Bank approves, in its sole discretion, the form and substance of such agreement, instrument or other document."

Section 7. Amendment to Financial Covenants.  
-----

(a) Pursuant to Section 11.1 of the Credit Agreement, Section 7.2 of the Credit Agreement is hereby deleted and amended in its entirety to read as follows:

"7.2 Minimum Tangible Capital Funds. On a consolidated basis, Tangible Capital Funds shall not be less than the following during the periods described below:

Period -----	Required Amount -----
October 13, 1995 through December 30, 1995	(\$9,250,000)
December 30, 1995 through the Maturity Date"	(\$8,500,000)

(b) Pursuant to Section 11.1 of the Credit Agreement, Section 7.4 is hereby deleted and amended in its entirety to read as follows:

"7.4. Leverage Ratio. On a consolidated basis, the ratio of Total Liabilities minus Subordinated Debt to Net Worth plus Subordinated Debt will not at any time exceed 5.0 :1."

Section 8. Confidentiality Provisions.  
-----

In connection with this Amendment and the execution and delivery by Telos Corporation (formerly C3) of the Investor Notes, the Bank may request access to confidential opinions, analyses and advice furnished to Borrowers or their Board of Directors by outside accountants and other financial advisors. In the event that the Bank receives access to such information, the Bank agrees to keep such information in confidence and shall not disclose, communicate or divulge such information to any other party, and shall not use such information for any other purpose, except

that the Bank may share such information, to the extent necessary or appropriate, with its outside legal counsel, auditors and regulators.

Section 9. Conditions Precedent to the Effectiveness of this Amendment.

-----  
The provisions of this Amendment are conditioned upon, and shall not become effective until the occurrence of, each of the following:

(a) Borrowers shall have delivered to the Agent certified corporate resolutions approving the transactions described herein, the form and substance of which shall be satisfactory to the Agent in its sole and absolute discretion.

(b) The Agent shall have received the opinion of Borrowers' counsel regarding the Investor Subordination Agreement, the form and substance of which shall be satisfactory to the Agent in its sole and absolute discretion.

(c) The Agent shall have received evidence of authority and incumbency for each of the holders of the Investor Notes, the form and substance of which shall be satisfactory to the Agent in its sole and absolute discretion.

(d) The Agent shall have received from Borrowers and/or their outside auditors assurances satisfactory to Agent, in its sole and absolute discretion, regarding the accounting treatment applicable to the Investor Notes and the payment obligations evidenced thereby.

(e) Borrowers shall have paid to the Agent all fees due and payable on and as of the date hereof.

(f) No litigation, proceeding or any other action shall have been filed, or threatened to be filed, by any party which challenges, seeks to enjoin, restrain or prohibit or to obtain damages in respect of or which is related to the transactions contemplated by this Amendment.

Section 10. No Waiver.  
-----

Notwithstanding execution of this Amendment and the extension of Loans by the Bank to Borrowers in accordance with the provisions hereof, neither the Bank nor the Agent is waiving, and shall not be deemed to have waived, any of their respective rights under any provisions of the Credit Agreement, the Note or the other Revolving Loan Documents. The Bank's or the Agent's failure to insist upon the strict performance of any term, condition, or other provision of the Credit Agreement, the Note or the other Revolving Loan Documents or to exercise any right or remedy hereunder or thereunder shall not constitute a waiver by the Bank or the Agent of any such term, condition or other provision or default or Event of Default in connection therewith.

Section 11. Continued Effect of Credit Agreement.  
-----

Except as specifically amended herein, the Credit Agreement is and shall continue to be in full force and effect and is hereby ratified and confirmed in all respects.

Section 12. Counterparts.  
-----

This Amendment may be executed in one or more counterparts, all of which shall be considered one and the same Amendment, and shall become effective when one or more of the same counterparts have been signed by each of the parties to this Amendment and delivered (by facsimile or otherwise) to the other parties, it being understood that each party need not sign the same counterpart.

IN WITNESS WHEREOF, the Bank, the Agent, and Borrowers have each executed this Amendment as of the date first written above.

NATIONSBANK, N.A.

By: /s/ Catherine S. Grimm  
-----  
Name: Catherine S. Grimm  
-----  
Title: VP  
-----

NATIONSBANK, N.A., as the Agent

By: /s/ Catherine S. Grimm  
-----  
Name: Catherine S. Grimm  
-----  
Title: VP  
-----

TELOS CORPORATION, formerly known as  
C3, Inc.

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

TELOS CORPORATION

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





TELOS CORPORATION AND SUBSIDIARIES

Form 10-K

SCHEDULE OF SUBSIDIARIES

Telos Corporation, Santa Monica, California

Incorporated: California, April 11, 1969

Telos Field Engineering, Inc., Delaware

Incorporated: Delaware, February 25, 1994

Telos International Corporation, Delaware

Incorporated: Delaware, May 16, 1995

1  
US DOLLARS

	12-MOS
	DEC-31-1995
	JAN-01-1995
	DEC-31-1995
	1
	735,000
	0
	44,836,000
	724,000
	15,877,000
	62,645,000
	21,271,000
	18,600,000
	94,492,000
42,284,000	
	47,316,000
	78,000
33,393,000	
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	(29,687,000)
94,492,000	
	69,593,000
	202,828,000
	54,843,000
	167,578,000
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	103,000
	5,491,000
	1,090,000
	75,000
1,015,000	
	0
	0
	0
	1,015,000
	0
	0