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

FORM 10-Q

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

For the quarterly period ended: June 30, 1999

[ ] 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.)
19886 Ashburn Road, Ashburn, Virginia	20147-2358
(Address of principal executive offices)	(Zip Code)

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

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

As of August 9, 1999, the registrant had 21,241,980 shares of Class A Common Stock, no par value, and 4,037,628 shares of Class B Common Stock, no par value; and 3,185,586 shares of 12% Cumulative Exchangeable Redeemable Preferred Stock par value $.01 per share, outstanding.

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

Number of pages in this report (excluding exhibits): 18

TELOS CORPORATION AND SUBSIDIARIES

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PART I - FINANCIAL INFORMATION

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	1999	1998	1999	1998
Sales				
Systems and Support Services	$ 25,958	$ 27,024	$47,890	$53,324
Products	30,182	18,153	46,881	34,346
Enterworks, Inc.	1,771	1,532	3,689	2,833
	57,911	46,709	98,460	90,503
Costs and expenses				
Cost of sales	48,033	39,735	83,881	80,115
Selling,general and administrative expenses	9,110	6,330	17,510	12,673
Goodwill amortization	132	132	264	325
Operating income (loss)	636	512	(3,195)	(2,610)
Other income (expenses)				
Gain on sale of assets	--	--	--	5,683
Other income	21	6	55	26
Interest expense	(1,733)	(1,537)	(3,536)	(3,316)
Loss before taxes	(1,076)	(1,019)	(6,676)	(217)
Income tax benefit (provision)	71	(686)	1,548	(811)
Net loss	$ (1,005)	$ (1,705)	$(5,128)	$(1,028)

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

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

ASSETS

	June 30, 1999 (unaudited)	December 31, 1998
Current assets		
Cash and cash equivalents (includes restricted cash of $160 at June 30, 1999 and December 31, 1998)	$ 752	$ 408
Accounts receivable, net	39,020	56,783
Inventories, net	6,975	8,662
Deferred income taxes	5,486	4,164
Other current assets	978	707
Total current assets	53,211	70,724
Property and equipment, net of accumulated depreciation of $24,998 and $24,159, respectively	13,718	14,321
Goodwill, net	6,631	6,896
Other assets	3,235	3,310
	$76,795	$ 95,251

LIABILITIES AND STOCKHOLDERS' INVESTMENT

	June 30, 1999 (unaudited)	December 31, 1998
Current liabilities		
Accounts payable	$19,480	$25,206
Other current liabilities	7,640	4,845
Accrued compensation and benefits	7,659	7,400
Total current liabilities	34,779	37,451
Senior credit facility	25,471	36,159
Senior subordinated notes	18,693	18,492
Capital lease obligations	11,560	11,710
Total liabilities	90,503	103,812
Redeemable preferred stock		
Senior redeemable preferred stock	5,841	5,631
Redeemable preferred stock	34,351	31,729
Total preferred stock	40,192	37,360
Stockholders' investment		
Common stock	78	78
Capital in excess of par	0	2,116
Retained deficit	(53,978)	(48,115)
Total stockholders' investment (deficit)	(53,900)	(45,921)
	$76,795	$ 95,251

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

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

	Six Months Ended June 30, 1999	Six Months Ended June 30, 1998
Operating activities:		
Net loss	$(5,128)	$(1,028)
Adjustments to reconcile net loss to cash provided by operating activities:		
Gain on sale of fixed assets	(88)	--
Gain on sale of assets	--	(5,683)
Depreciation and amortization	2,146	1,668
Goodwill amortization	264	325
Other noncash items	1,003	381
Changes in assets and liabilities	14,283	12,541
Cash provided by operating activities	12,480	8,204
Investing activities:		
Proceeds from sale of fixed assets	171	--
Proceeds from sale of assets	--	14,675
Investment in capitalized software and other assets	(762)	(1,111)
Purchase of property and equipment	(666)	(790)
Cash (used in) provided by investing activities	(1,257)	12,774
Financing activities:		
Repayment of borrowings under senior credit facility	(10,688)	(16,195)
Payments under capital leases	(191)	(229)
Retirement of Class B redeemable preferred stock	--	(5,000)
Cash used in financing activities	(10,879)	(21,424)
Increase(decrease) in cash and cash equivalents	344	(446)
Cash and cash equivalents at beginning of period	408	587
Cash and cash equivalents at end of period	$ 752	$ 141

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

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

Note 1. General

The accompanying condensed consolidated financial statements are unaudited and include the accounts of Telos Corporation ("Telos") and its wholly owned subsidiaries, Telos Corporation (California), Telos Field Engineering, Inc., Telos International Corporation and its majority owned subsidiary, Enterworks, Inc. (collectively, the "Company"). Significant intercompany transactions have been eliminated. In the opinion of the Company, the accompanying financial statements reflect all adjustments and reclassifications (which include only normal recurring adjustments) necessary for their fair presentation in conformity with generally accepted accounting principles. Interim results are not necessarily indicative of fiscal year performance because of the impact of seasonal and short-term variations. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the fiscal year ended December 31, 1998.

The accompanying condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. However, the Company incurred a net loss of $9.2 million during 1998 and a net loss of $5.1 million for the first six months of 1999. In addition, the Company was not in compliance with several covenants of its Senior Credit Facility at December 31, 1998 and June 30, 1999. The lender has provided waivers for the violations at December 31, 1998, as well as waivers through June 30, 1999. Future financial covenants have been amended to conform to the Company's 1999 budget expectations. Based on its budget, the Company anticipates a need for approximately $10 million of additional financing for the second half of 1999. These factors, including the uncertainty surrounding whether and when the additional financing will be secured, and whether the Company will meet its budget expectations and bank covenants in the second half of 1999, indicate that the Company may be unable to continue as a going concern for a reasonable period of time. The financial statements do not include any adjustments relating to the recoverability of assets and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. The Company's continuation as a going concern is dependent on its ability to obtain the additional financing required, meet its 1999 budgeted cash flow objectives, and comply with the terms of its Senior Credit Facility.

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

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

Note 2. Sale of Assets

On February 28, 1998, Telos sold substantially all of the net assets of one of its divisions, Telos Information Systems ("TIS"), to NYMA, Inc., a subsidiary of Federal Data Corporation of Bethesda, Maryland for approximately $14.7 million in cash. The Company has recorded a gain of $5.7 million in its condensed consolidated statement of operations for the six months ended June 30, 1998.

Note 3. Debt Obligations

Senior Credit Facility

The Company has a $45 million Senior Credit Facility ("Facility") with a bank which matures on July 1, 2000. As of July 1, 1999, the Facility will be classified as a current liability as the Facility will have a term of less than one year. Borrowings under the Facility are collateralized by a majority of the Company's assets including accounts receivable, inventory, and Telos' stock in Enterworks, Inc.. The amount of available borrowings fluctuates based on the underlying asset borrowing base. At June 30, 1999, the Company was not in compliance with several financial covenants contained within the Facility, including covenants relating to certain leverage, net worth, tangible capital and fixed charge coverage goals. The bank has waived this noncompliance.

Senior Subordinated Notes

In 1995 the Company issued Senior Subordinated Notes ("Notes") to certain shareholders. The Notes are classified as either Series B or Series C. Series B Notes, which total $6.5 million at June 30, 1999 and December 31, 1998, are collateralized by fixed assets of the Company. Series C Notes, which total $7.9 million at June 30, 1999 and December 31, 1998, are unsecured. Both the Series B and Series C Notes have a maturity date of October 1, 2000 and have interest rates ranging from 14% to 17%. Interest is paid quarterly on January 1, April 1, July 1, and October 1 of each year. The Notes can be prepaid at the Company's option. Additionally, these Notes have a cumulative payment premium of 13.5% per annum payable only upon certain circumstances. These circumstances include an initial public offering of the Company's common stock or a significant refinancing, to the extent that net proceeds from either of the above events are received and are sufficient to pay the premium. Due to the contingent nature of the premium payment, the associated premium expense will only be recorded after the occurrence of a triggering event. At June 30, 1999 the prepayment premium that would be due upon a triggering event is $9,099,000.

In November 1998, the Company issued additional Senior Subordinated Notes to certain shareholders which are classified as Series D. The Series D Notes total $1.8 million and are unsecured. The Series D Notes have a maturity date of October 1, 2000 and bear interest at 14% per annum. Interest is paid quarterly on January 1, April 1, July 1, and October 1 of each year. The notes can be prepaid at the Company's option. These Notes contain the same payment premium provisions as the Series B and Series C notes (see above). At June 30, 1999, the prepayment premium that would be due upon a triggering event is $151,000. In connection with the debt, the Company issued 1,500,000 warrants to purchase shares of the Company's Class A Common Stock. The warrants have an exercise price of $.01 and an exercise period of 22 months. The Company has assigned a value to the warrants of $420,000 which has been included in capital in excess of par. The amount outstanding of the subordinated debt was approximately $1,492,000 at June 30, 1999.

Enterworks Subordinated Notes

During 1996, the Company completed a private financing whereby $3,277,960 of 8% subordinated debt of Enterworks was issued. Investors included certain members of the Board of Directors and management and certain shareholders of the Company. The subordinated debt has a five year maturity. Interest is paid quarterly, beginning January 1, 1998, on the first of January, April, July and October each year. In connection with the debt, the Company issued 2,048,725 warrants to purchase shares of Enterworks common stock. The warrants have an exercise price of one dollar and an exercise period of ten years. The Company has assigned a value to the warrants of $921,926 which has been included in capital in excess of par. The amount outstanding of this subordinated debt was approximately $2,818,000 and $2,723,000 at June 30, 1999 and December 31, 1998, respectively.

Note 4. Preferred Stock

Senior Redeemable Preferred Stock

The components of the senior redeemable preferred stock are Series A-1 and Series A-2, each with $.01 par value and 1,250 and 1,750 shares authorized, issued and outstanding, respectively. The Series A-1 and Series A-2 each carry a cumulative per annum dividend rate of 14.125% of their liquidation value of $1,000 per share. The dividends are payable semi-annually on June 30 and December 31 of each year. The liquidation preference of the senior preferred stock is the face amount of the Series A-1 and A-2 ($1,000 per share), plus all accrued and unpaid dividends. The Company is required to redeem all of the outstanding shares of the stock on December 31, 2001, subject to the legal availability of funds. Mandatory redemptions are required from excess cash flows, as defined in the stock agreements. The Series A-1 and A-2 Preferred Stock is senior to all other present and future equity of the Company. The Series A-1 is senior to the Series A-2. The Company has not declared dividends on its senior redeemable preferred stock since its issuance. At June 30, 1999 and December 31, 1998 cumulative undeclared, unpaid dividends relating to Series A-1 and A-2 redeemable preferred stock totaled $2,841,000 and $2,631,000 respectively.

12% Cumulative Exchangeable Redeemable Preferred Stock

A maximum of 6,000,000 shares of 12% Cumulative Exchangeable Redeemable Preferred Stock (the "Public Preferred Stock"), par value $.01 per share, has been authorized for issuance. The Company initially issued 2,858,723 shares of the Public Preferred Stock pursuant to the acquisition of the Company during fiscal year 1990. The Public Preferred Stock was recorded at fair value on the date of original issue, November 21, 1989, and the Company is making periodic accretions under the interest method of the excess of the redemption value over the recorded value. Accretion for the six months ended June 30, 1999 was $710,000. The Company declared stock dividends totaling 736,863 shares in 1990 and 1991.

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

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

The Public Preferred Stock accrues a semi-annual dividend at the 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 were paid at the rate of 6% of a share 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 and is able to pay dividends under its charter and other corporate documents, 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 these dividends on a cash basis, the total amount accrued would have been $15,101,000. For the cash dividends payable since December 1, 1995, the Company has accrued $16,766,000.

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

Note 5. Reportable Business Segments

The Company adopted SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information", in 1998 which changes the way the Company reports information about its operating segments.

The Company has three reportable segments: Systems and Support Services, Products, and Enterworks, Inc. The Company evaluates the performance of its operating segments based on revenue, gross profit and income before goodwill amortization, income taxes, non-recurring items and interest income or expense.

Summarized financial information concerning the Company's reportable segments for the three months ended June 30, 1999 and 1998 is shown in the following table. The "other" column includes corporate related items.

	Systems and Support Services	Products	Enterwerks	Other (1)	Total
June 30, 1999					
External Revenues	$25,958	$30,182	$ 1,771	$ --	$57,911
Intersegment Revenues	151	--	101	--	252
Gross Profit	5,472	4,250	156	--	9,878
Segment profit(loss)(3)	4,101	1,548	(4,881)	--	768
Total assets	31,746	12,457	6,190	26,402	76,795
Capital Expenditures	34	3	133	114	284
Depreciation & Amortization(2)	$ 237	$ 56	$ 635	$ 323	$ 1,251
June 30, 1998					
External Revenues	$27,024	$18,153	$ 1,532	$ --	$46,709
Intersegment Revenues	208	619	--	--	827
Gross Profit	4,789	1,947	238	--	6,974
Segment profit(loss)(3)	3,398	(546)	(2,208)	--	644
Total assets	39,638	5,758	7,325	31,827	84,548
Capital Expenditures	24	--	137	85	246
Depreciation & Amortization(2)	$ (61)	$ 133	$ 434	$ 397	$ 903

(1) Corporate assets are principally property and equipment, cash and other assets.
(2) Depreciation and amortization includes amounts relating to property and equipment, goodwill, deferred software costs and spare parts inventory.
(3) Segment profit (loss) represents operating income (loss) before goodwill amortization.

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

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

General

Sales for the first six months of 1999 were $98.5 million, an increase of $8.0 million or 8.8% as compared to the same 1998 period. This increase was primarily attributable to a $12.5 million increase in sales from the Company's Products Group which experienced increased sales from its Joint Recruitive Information Support Services Blanket Purchase Agreement. The increase in sales was also attributable to sales from the Company's Enterworks Group, which increased its sales by $856,000 over 1998. These increases were partially offset by decreases in sales in the Systems and Support Services Group of approximately $5.4 million. This decrease is due to the sale of the Company's Information Systems division ("TIS") in February 1998, as well as decreased sales under the Artillery Training Simulation devices product line.

Operating losses through the first six months of 1999 were $3.2 million as compared to an operating loss of $2.6 million during the same 1998 period. Operating profitability declined principally as a result of increased investments by the Company in sales and marketing and research and development in its Enterworks subsidiary.

Total backlog from existing contracts was approximately $712.8 million and $923.3 million as of June 30, 1999 and December 31, 1998, respectively. The decrease in total backlog is due to the expiration of the Company's SMCII contract in April of 1999, which was previously disclosed in the Company's Form 10-K for the year ended December 31, 1998. As of June 30, 1999, the funded backlog of the Company totaled $86.1 million, an increase of $29.6 million from December 31, 1998. Funded backlog represents 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.

Results of Operations

The condensed consolidated statements of operations include the results of operations of Telos Corporation and its wholly owned subsidiaries Telos Corporation (California), Telos Field Engineering Inc. ("TFE"), Telos International Corporation ("TIC"), and it majority owned subsidiary Enterworks, Inc. ("Enterworks") ("the Company"). The major elements of the Company's operating expenses as a percentage of sales for the three and six month periods ended June 30, 1999 and 1998 are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	1999	1998	1999	1998
Sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	82.9	85.1	85.2	88.5
SG&A expenses	15.7	13.5	17.8	14.0
Goodwill amortization	0.2	0.3	0.2	0.4
Operating income (loss)	1.2	1.1	(3.2)	(2.9)
Other income	--	--	--	--
Gain on sale of assets	--	--	--	6.3
Interest expense	(3.0)	(3.3)	(3.6)	(3.6)
Income tax benefit (provision)	0.1	(1.5)	1.6	(0.9)
Net loss	(1.7)%	3.7)%	(5.2)%	(1.1)%

Financial Data by Market Segment

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	1999	1998	1999	1998
	(amounts in thousands)			
Sales:				
Systems and Support Services	$25,958	$27,024	$47,890	$53,324
Products	30,182	18,153	46,881	34,346
Enterworks, Inc.	1,771	1,532	3,689	2,833
Total	$57,911	$46,709	$98,460	$90,503
Gross Profit:				
Systems and Support Services	$ 5,472	$ 4,789	$ 9,109	$ 7,650
Products	4,250	1,947	5,068	2,111
Enterworks, Inc.	156	238	402	627
Total	$ 9,878	$ 6,974	$14,579	$10,388
Gross Margin:				
Systems and Support Services	21.1%	17.7%	19.0%	14.3%
Products	14.1%	10.7%	10.8%	6.1%
Enterworks, Inc.	8.8%	15.5%	10.9%	22.1%
Total	17.1%	14.9%	14.8%	11.5%

For the three month period ended June 30, 1999, sales increased by $11.2 million, or 24.0% to $57.9 million from $46.7 million for the comparable 1998 period. Of the $11.2 million increase, $12.0 million was attributable to the Products Group, which experienced increased sales from its Joint Recruitive Information Support Services Blanket Purchase Agreement ("JRISS BPA"). The overall increase in the revenue was also enhanced by an increase of $239,000 in Enterworks revenue for the second quarter of 1999 compared to the second quarter of 1998. The increase is primarily due to sales of the Group's Process Manager product. Offsetting these increases was a decrease in Systems and Support Services revenue of $1.1 million from second quarter 1999 compared to second quarter 1998. This decrease is primarily due to a decline in revenue under the Artillery Training Simulation devices product line. This decline in revenue was partially offset by an increase in sales from the Company's data integration, information security, advanced message handling system solutions and enterprise management business areas. The decline in revenue was also partially offset by the revenue generated from a subcontract to the Consolidated Space Operations Contract, a subcontract awarded to the company's hardware services division by Lockheed Martin Corporation.

Sales increased $8.0 million or 8.8% to $98.5 million for the six months ended June 30, 1999, from $90.5 million for the comparable 1998 period. The increase for the six month period includes a $12.5 million increase in Product sales and a $856,000 increase in Enterworks sales, partially offset by a decrease of $5.4 million in Systems and Support Services revenue. This increase in the six month revenue is primarily due to the increase in revenue from the JRISS BPA. These increases were slightly offset by decreased sales under the Artillery Training Simulation Devices product line of $3.0 million, and the sale of the Company's Information Systems division ("TIS") in February, 1998. The TIS division generated sales of $4.0 million prior to being sold.

Cost of sales was 82.9% of sales for the quarter and 85.2% of sales for the six months ended June 30, 1999, as compared to 85.1% and 88.5% for the same periods in 1998. The decreases in cost of sales as a percentage of sales are primarily attributable to favorable changes in contract mix within the Systems and Support Services Group, as well as a high margin transaction with one of the Company's partners.

Gross profit increased $2.9 million in the three month period to $9.9 million in 1999, from $7.0 million in the comparable 1998 period. Gross margins were 17.1% and 14.8%, respectively, for the three and six month periods of 1999 as compared to 14.9% and 11.5%, respectively, for the comparable periods of 1998.

Selling, general, and administrative expense ("SG&A") increased by approximately $2.8 million or 43.9%, to $9.1 million in the second quarter of 1999 from $6.3 million in the comparable period of 1998. For the six month period of 1999, SG&A increased $4.8 million to $17.5 million from $12.7 million in 1998. These increases are due primarily to the Company's increased investment in research and development and sales and marketing for Enterworks. Excluding the additional expense incurred for Enterworks research and development of $2.2 million and Enterworks sales and marketing costs of $2.8 million, selling general and administrative expense decreased $200,000 for the six months ended June 30, 1999 compared to the same period in 1998.

SG&A as a percentage of revenues increased to 15.7% for the second quarter of 1999 from 13.5% in the comparable 1998 period. SG&A as a percentage of revenues for the six month period ended June 30, 1999 increased to 17.8% from 14.0% compared to the same period in 1998.

Goodwill amortization expense remained the same for the comparative three month periods of 1999 and 1998, and decreased by $61,000 to $264,000 for the six months ended June 30, 1999 compared to the same period in 1998. This reduction is due to a decrease in the goodwill balance associated with the sale of TIS in early 1998.

Operating income increased by $124,000 to $636,000 in the three month period ended June 30, 1999 from $512,000 of operating profit in the comparable 1998 period. Operating income decreased $585,000 to a $3.2 million operating loss for the six months ended June 30, 1999 from a $2.6 million operating loss for the six month period ended June 30, 1998. The increase in operating profit for the three month period is mostly attributable to the increase in gross profit. The six month decrease resulted from the aforementioned increases in SG&A.

Telos sold substantially all of the net assets of one of its divisions, TIS, in the first quarter of 1998. The transaction generated approximately $14.7 million in cash proceeds and a gain of $5.7 million was recorded in the six months ended June 30, 1998.

Interest expense increased approximately $196,000 to $1.7 million in the second quarter of 1999 from $1.5 million in the comparable 1998 period, and increased approximately $220,000 to $3.5 million for the six months ended June 30, 1999 from $3.3 million for the comparable 1998 period. These increases are due to increased debt levels in 1999.

The income tax benefit was $71,000 and $1.5 million for the three and six months ended June 30, 1999, respectively. These tax benefits were principally due to the net operating loss carryforwards generated during the first quarter. The Company's net deferred tax asset includes substantial amounts of net operating loss carryforwards. Failure to achieve forecasted taxable income may affect the ultimate realization of the net deferred tax assets. Management's tax strategy contemplates the generation of taxable income in excess of operating losses sufficient in amounts to realize the net deferred tax assets. The Company recorded an income tax provision of $686,000 and $811,000 for the three and six months ended June 30, 1998, respectively. These tax provisions were primarily attributable to provisions for state income taxes and increases in allowances relating to the recoverability of deferred tax assets.

Liquidity and Capital Resources

For the six months ended June 30, 1999, the Company provided $12.5 million of cash in its operating activities. This cash was provided by reductions of accounts receivable of $17.7 million, offset by decreases in accounts payable of $5.7 million and losses incurred in operations. Cash used in investing activities was $1.3 million. Cash was used by financing activities during the quarter to pay down approximately $10.7 million of the Senior Credit Facility balance.

At June 30, 1999, the Company had outstanding debt and long term obligations of $55.7 million, consisting of $25.5 million under the secured senior credit facility, $18.7 million in subordinated debt, and $11.6 million in capital lease obligations.

At June 30, 1999, the Company had an outstanding balance of $25.5 million on its $45 million Senior Credit Facility (the "Facility"). The Facility matures on July 1, 2000 and is collateralized by a majority of the Company's assets (including inventory, accounts receivable and Telos' stock in Enterworks). The amount of borrowings fluctuates based on the underlying asset borrowing base as well as the Company's working capital requirements. At June 30, 1999, the Company, under its borrowing base formula, had $3.4 million of unused availability. Because the Facility matures on July 1, 2000 and therefore will have a term of less than one year, the Facility will be classified as a current liability on the Company's condensed consolidated balance sheet as of July 1, 1999. The Facility has various covenants that may, among other things, restrict the ability of the Company to merge with another entity, sell or transfer certain assets, pay dividends and make other distributions beyond certain limitations. The Facility also requires the Company to meet certain leverage, net worth, interest coverage and operating goals. At June 30, 1999, the Company was not in compliance with several covenants contained in the Facility; however, the bank has waived this non-compliance.

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. However, the Company incurred a net loss of $9.2 million during 1998 and a net loss of $5.1 million for the first six months of 1999. In addition, the Company was not in compliance with several covenants of its Senior Credit Facility at December 31, 1998 and June 30, 1999. The lender has provided waivers for the violations at December 31, 1998, as well as waivers through June 30, 1999. Future financial covenants have been amended to conform to the Company's 1999 budget expectations. Based on its budget, the Company anticipates a need for approximately $10 million of additional financing for the second half of 1999. These factors, including the uncertainty surrounding whether and when the additional financing will be secured, and whether the Company will meet its budget expectations and bank covenants in the second half of 1999, indicate that the Company may be unable to continue as a going concern for a reasonable period of time. The financial statements do not include any adjustments relating to the recoverability of assets and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. The Company's continuation as a going concern is dependent on its ability to obtain the additional financing required, meet its 1999 budgeted cash flow objectives, and comply with the terms of its Senior Credit Facility.

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

Year 2000

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

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

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

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

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

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

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

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects" and similar expressions are intended to identify forward-looking statements. There are a number of important factors that could cause the Company's actual results to differ materially from those indicated by such forward-looking statements. These factors include, without limitation, those set forth 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 Quarterly Report on Form 10-Q 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 at its convenience. Should this occur, the Company's operating results could be adversely impacted.

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

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. However, the Company incurred a net loss of $9.2 million during 1998 and a net loss of $5.1 million for the first six months of 1999. In addition, the Company was not in compliance with several covenants of its Senior Credit Facility at December 31, 1998 and June 30, 1999. The lender has provided waivers for the violations at December 31, 1998, as well as waivers through June 30, 1999. Future financial covenants have been amended to conform to the Company's 1999 budget expectations. Based on its budget, the Company anticipates a need for approximately $10 million of additional financing for second half of 1999. These factors, including the uncertainty surrounding whether and when the additional financing will be secured, and whether the Company will meet its budget expectations and bank covenants in the second half of 1999, indicate that the Company may be unable to continue as a going concern for a reasonable period of time. The financial statements do not include any adjustments relating to the recoverability of assets and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. The Company's continuation as a going concern is dependent on its ability to obtain the additional financing required, meet its 1999 budgeted cash flow objectives, and comply with the terms of its Senior Credit Facility.

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's long-term debt obligations. The Company is exposed to interest rate volatility with regard to its variable rate debt obligations under its Senior Credit Facility. This facility bears interest at 1.00%, subject to certain adjustments, over the bank's base rate. The weighted average interest rate for the first six months of 1999 was 9.04%. This facility expires on July 1, 2000 and has outstanding balance of $25.5 million at June 30, 1999.

The Company's other long-term debt at June 30, 1999 consists of Senior Subordinated Notes B, C, and D which bear interest at fixed rates ranging from 14% to 17%. The Senior Subordinated Notes mature as to principal in the aggregate amount of $16,173,000 on October 1, 2000. Additionally, the Company has subordinated debt issued by their majority owned subsidiary, Enterworks, which bears interest at a fixed rate of 8%. The Enterworks Notes mature as to principal in the aggregate amount of $3,277,960 in July 2001. The Company has no cash flow exposure due to rate changes for its Senior Subordinated or Enterworks Notes.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 3. Defaults Upon Senior Securities

Senior Redeemable Preferred Stock

The Company has not declared dividends on its Senior Redeemable Preferred Stock, Series A-1 and A-2, since their issuance. Total undeclared unpaid dividends accrued for financial reporting purposes are $2,841,000 for the Series A-1 and A-2 Preferred Stock at June 30, 1999.

12% Cumulative Exchangeable Redeemable Preferred Stock

Through November 21, 1995, the Company had the option to pay dividends in additional shares of Preferred Stock in lieu of cash (provided there were no blocks on payment as further discussed below). Dividends are payable by the Company, provided the Company has legally available funds under Maryland law and is able to pay dividends under its charter and other corporate documents, when and if declared by the Board of Directors, commencing June 1, 1990, and on each six month anniversary thereof. Dividends in additional shares of the Preferred Stock were paid at the rate of 0.06 of a share for each $.60 of such dividends not paid in cash. Cumulative undeclared dividends as of June 30, 1999 accrued for financial reporting purposes totaled $20,716,000. Dividends for the years 1992 through 1994 and for the dividend payable June 1, 1995 were accrued under the assumption that the dividend will be paid in additional shares of preferred stock and are valued at $3,950,000. Had the Company accrued these dividends on a cash basis, the total amount accrued would have been $15,101,000. For the cash dividends payable since December 1, 1995 the Company has accrued $16,766,000.

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

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

27 Financial Data Schedule

(b) Reports on Form 8-K: None.

Items 2, 4, and 5 are not applicable and have been omitted.

SIGNATURES

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

DATE: Telos Corporation

August 16, 1999

/s/ Lorenzo Tellez

Lorenzo Tellez
(Principal Financial Officer &
Principal Accounting Officer)

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE CONSOLIDATED BALANCE SHEETS AND STATEMENTS OF OPERATIONS FOR TELOS CORPORATION AND ITS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

0000320121
TELOS CORPORATION

6-MOS
DEC-31-1999
JAN-01-1999
JUN-30-1999
752,000
0
39,847,000
827,000
6,975,000
53,211,000
38,716,000
24,998,000
76,795,000
34,779,000
44,164,000
40,192,000
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76,795,000
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98,460,000
83,881,000
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93,000
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(6,676,000)
(1,548,000)
(5,128,000)
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0
0
(5,128,000)
0
0