

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2020

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-07782



Parsons Corporation

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or other jurisdiction of
incorporation or organization)
5875 Trinity Parkway #300
Centreville, Virginia
(Address of principal executive offices)

95-3232481
(I.R.S. Employer
Identification No.)

20120
(Zip Code)

Registrant's telephone number, including area code: (703) 988-8500

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, \$1 par value	PSN	New York Stock Exchange

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

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

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

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

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

As of October 28, 2020, the registrant had 100,727,119 shares of common stock, \$1.00 par value per share, outstanding.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements.

PARSONS CORPORATION AND SUBSIDIARIES
Consolidated Balance Sheets
(in thousands, except share information)
(Unaudited)

	<u>September 30, 2020</u>	<u>December 31, 2019</u>
Assets		
Current assets:		
Cash and cash equivalents (including \$50,585 and \$51,171 Cash of consolidated joint ventures)	\$ 614,031	\$ 182,688
Restricted cash and investments	3,726	12,686
Accounts receivable, net (including \$259,691 and \$166,355 Accounts receivable of consolidated joint ventures, net)	775,060	671,492
Contract assets (including \$29,054 and \$26,458 Contract assets of consolidated joint ventures)	610,893	575,089
Prepaid expenses and other current assets (including \$3,974 and \$11,182 Prepaid expenses and other current assets of consolidated joint ventures)	77,909	84,454
Total current assets	<u>2,081,619</u>	<u>1,526,409</u>
Property and equipment, net (including \$2,649 and \$2,945 Property and equipment of consolidated joint ventures, net)	121,486	122,751
Right of use assets, operating leases	212,592	233,415
Goodwill	1,046,453	1,047,425
Investments in and advances to unconsolidated joint ventures	71,289	68,620
Intangible assets, net	194,082	259,858
Deferred tax assets	130,904	130,401
Other noncurrent assets	60,336	61,489
Total assets	<u>\$ 3,918,761</u>	<u>\$ 3,450,368</u>
Liabilities and Shareholders' Equity (Deficit)		
Current liabilities:		
Accounts payable (including \$72,949 and \$85,869 Accounts payable of consolidated joint ventures)	\$ 208,307	\$ 216,613
Accrued expenses and other current liabilities (including \$141,476 and \$74,857 Accrued expenses and other current liabilities of consolidated joint ventures)	725,867	639,863
Contract liabilities (including \$44,267 and \$32,638 Contract liabilities of consolidated joint ventures)	212,373	230,681
Short-term lease liabilities, operating leases	48,661	49,994
Income taxes payable	1,342	7,231
Short-term debt	50,000	-
Total current liabilities	<u>1,246,550</u>	<u>1,144,382</u>
Long-term employee incentives	21,535	56,928
Long-term debt	537,119	249,353
Long-term lease liabilities, operating leases	189,319	203,624
Deferred tax liabilities	9,273	9,621
Other long-term liabilities	145,494	125,704
Total liabilities	<u>2,149,290</u>	<u>1,789,612</u>
Contingencies (Note 12)		
Shareholders' equity (deficit):		
Common stock, \$1 par value; authorized 1,000,000,000 shares; 146,498,582 and 146,440,701 shares issued; 24,637,043 and 21,772,888 public shares outstanding; 76,090,531 and 78,896,806 ESOP shares outstanding	146,498	146,441
Treasury stock, 45,771,008 shares at cost	(934,240)	(934,240)
Additional paid-in capital	2,675,383	2,649,975
Accumulated deficit	(142,095)	(218,025)
Accumulated other comprehensive loss	(18,049)	(14,261)
Total Parsons Corporation shareholders' equity	<u>1,727,497</u>	<u>1,629,890</u>
Noncontrolling interests	41,974	30,866
Total shareholders' equity	<u>1,769,471</u>	<u>1,660,756</u>
Total liabilities, redeemable common stock and shareholders' equity	<u>\$ 3,918,761</u>	<u>\$ 3,450,368</u>

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

PARSONS CORPORATION AND SUBSIDIARIES
Consolidated Statements of Income
(In thousands, except per share information)
(Unaudited)

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Revenue	\$ 1,004,236	\$ 1,023,277	\$ 2,954,688	\$ 2,917,424
Direct cost of contracts	788,769	798,552	2,307,725	2,297,512
Equity in earnings of unconsolidated joint ventures	16,741	7,274	26,624	29,305
Indirect, general and administrative expenses	165,937	178,550	537,351	581,428
Operating income	<u>66,271</u>	<u>53,449</u>	<u>136,236</u>	<u>67,789</u>
Interest income	88	427	512	1,129
Interest expense	(5,475)	(4,909)	(13,656)	(19,577)
Other income (expense), net	1,653	(3,127)	1,916	(1,580)
Total other income (expense)	<u>(3,734)</u>	<u>(7,609)</u>	<u>(11,228)</u>	<u>(20,028)</u>
Income before income tax expense	62,537	45,840	125,008	47,761
Income tax (expense) benefit	<u>(16,017)</u>	<u>15,453</u>	<u>(32,992)</u>	<u>67,063</u>
Net income including noncontrolling interests	46,520	61,293	92,016	114,824
Net income attributable to noncontrolling interests	<u>(5,862)</u>	<u>(4,481)</u>	<u>(15,086)</u>	<u>(8,012)</u>
Net income attributable to Parsons Corporation	<u>\$ 40,658</u>	<u>\$ 56,812</u>	<u>\$ 76,930</u>	<u>\$ 106,812</u>
Earnings per share:				
Basic	\$ 0.40	\$ 0.57	\$ 0.76	\$ 1.19
Diluted	\$ 0.40	\$ 0.57	\$ 0.76	\$ 1.19

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

PARSONS CORPORATION AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
(In thousands)
(Unaudited)

	<u>For the Three Months Ended</u>		<u>For the Nine Months Ended</u>	
	<u>September 30,</u> <u>2020</u>	<u>September 30,</u> <u>2019</u>	<u>September 30,</u> <u>2020</u>	<u>September 30,</u> <u>2019</u>
Net income including noncontrolling interests	\$ 46,520	\$ 61,293	\$ 92,016	\$ 114,824
Other comprehensive income (loss), net of tax				
Foreign currency translation adjustment, net of tax	1,926	171	(3,770)	4,958
Pension adjustments, net of tax	20	(9)	(18)	17
Comprehensive income including noncontrolling interests, net of tax	48,466	61,455	88,228	119,799
Comprehensive income attributable to noncontrolling interests, net of tax	(5,866)	(4,481)	(15,086)	(8,012)
Comprehensive income attributable to Parsons Corporation, net of tax	<u>\$ 42,600</u>	<u>\$ 56,974</u>	<u>\$ 73,142</u>	<u>\$ 111,787</u>

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

PARSONS CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	For the Nine Months Ended	
	September 30, 2020	September 30, 2019
Cash flows from operating activities:		
Net income including noncontrolling interests	\$ 92,016	\$ 114,824
Adjustments to reconcile net income to net cash used in operating activities		
Depreciation and amortization	95,442	92,692
Amortization of debt issue costs	760	802
Amortization of convertible notes discount	1,277	-
Gain on disposal of property and equipment	(22)	1,045
Provision for doubtful accounts	54	(964)
Deferred taxes	(763)	(105,161)
Foreign currency transaction gains and losses	431	1,689
Equity in earnings of unconsolidated joint ventures	(26,624)	(29,305)
Return on investments in unconsolidated joint ventures	31,189	32,848
Stock-based compensation	11,044	9,224
Contributions of treasury stock	42,006	36,779
Changes in assets and liabilities, net of acquisitions and newly consolidated joint ventures:		
Accounts receivable	(106,487)	(31,726)
Contract assets	(34,931)	(59,161)
Prepaid expenses and current assets	7,649	2,980
Accounts payable	(8,074)	(6,946)
Accrued expenses and other current liabilities	48,901	40,186
Contract liabilities	(18,094)	20,703
Income taxes	(6,761)	(3,019)
Other long-term liabilities	(15,574)	13,138
Net cash provided by operating activities	<u>113,439</u>	<u>130,628</u>
Cash flows from investing activities:		
Capital expenditures	(29,178)	(44,030)
Proceeds from sale of property and equipment	1,053	2,824
Payments for acquisitions, net of cash acquired	-	(495,690)
Investments in unconsolidated joint ventures	(7,969)	(11,446)
Return of investments in unconsolidated joint ventures	17	6,632
Net cash used in investing activities	<u>(36,077)</u>	<u>(541,710)</u>
Cash flows from financing activities:		
Proceeds from borrowings under credit agreement	212,900	530,000
Repayments of borrowings under credit agreement	(212,900)	(710,000)
Payments for debt costs and credit agreement	-	(286)
Proceeds from issuance of convertible notes	400,000	-
Payments for purchase of bond hedges	(54,968)	-
Proceeds from issuance of warrants	13,808	-
Transaction costs paid in connection with convertible notes issuance	(10,307)	-
Contributions by noncontrolling interests	491	8,999
Distributions to noncontrolling interests	(4,469)	(35,378)
Purchase of treasury stock	-	(819)
Taxes paid on vested stock	(1,149)	-
Proceeds from issuance of common stock	1,684	536,879
Dividend paid	-	(52,093)
Net cash provided by financing activities	<u>345,090</u>	<u>277,302</u>
Effect of exchange rate changes	(69)	(953)
Net increase (decrease) in cash, cash equivalents, and restricted cash	422,383	(134,733)
Cash, cash equivalents and restricted cash:		
Beginning of year	195,374	281,195
End of period	<u>\$ 617,757</u>	<u>\$ 146,462</u>

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

PARSONS CORPORATION AND SUBSIDIARIES
Consolidated Statements of Shareholders' Equity (Deficit)
For the Three Months Ended September 30, 2020 and September 30, 2019
(In thousands)
(Unaudited)

	Redeemable Common Stock	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Parsons Equity (Deficit)	Noncontrolling Interests	Total
Balance at June 30, 2020	\$ -	\$ 146,496	\$ (934,240)	\$ 2,658,036	\$ (182,753)	\$ (19,991)	\$ 1,667,548	\$ 38,704	\$ 1,706,252
Comprehensive income									
Net income	-	-	-	-	40,658	-	40,658	5,862	46,520
Foreign currency translation gain, net	-	-	-	-	-	1,922	1,922	4	1,926
Pension adjustments, net	-	-	-	-	-	20	20	-	20
Contributions	-	-	-	-	-	-	-	268	268
Distributions	-	-	-	-	-	-	-	(2,864)	(2,864)
Issuance of equity securities, net of retirements	-	2	-	(14)	-	-	(12)	-	(12)
Equity component value of convertible note issuance	-	-	-	53,552	-	-	53,552	-	53,552
Purchase of convertible note hedge	-	-	-	(54,611)	-	-	(54,611)	-	(54,611)
Sale of common stock warrants	-	-	-	13,808	-	-	13,808	-	13,808
Stock-based compensation	-	-	-	4,612	-	-	4,612	-	4,612
Balance at September 30, 2020	<u>\$ -</u>	<u>\$ 146,498</u>	<u>\$ (934,240)</u>	<u>\$ 2,675,383</u>	<u>\$ (142,095)</u>	<u>\$ (18,049)</u>	<u>\$ 1,727,497</u>	<u>\$ 41,974</u>	<u>\$ 1,769,471</u>
Balance at June 30, 2019	<u>\$ 2,880,189</u>	<u>\$ 21,296</u>	<u>\$ (957,844)</u>	<u>\$ -</u>	<u>\$ (424,886)</u>	<u>\$ (18,144)</u>	<u>\$ (1,379,578)</u>	<u>\$ 37,352</u>	<u>\$ (1,342,226)</u>
Comprehensive income									
Net income	-	-	-	-	56,812	-	56,812	4,481	61,293
Foreign currency translation gain, net	-	-	-	-	-	171	171	-	171
Pension adjustments, net	-	-	-	-	-	(9)	(9)	-	(9)
Contributions	-	-	-	-	-	-	-	852	852
Distributions	-	-	-	-	-	-	-	(14,591)	(14,591)
Stock-based compensation	-	-	-	9,224	-	-	9,224	-	9,224
IPO proceeds, net	-	-	-	(452)	-	-	(452)	-	(452)
ESOP shares at redemption value	(303,178)	-	-	-	303,178	-	303,178	-	303,178
Balance at September 30, 2019	<u>\$ 2,577,011</u>	<u>\$ 21,296</u>	<u>\$ (957,844)</u>	<u>\$ 8,772</u>	<u>\$ (64,896)</u>	<u>\$ (17,982)</u>	<u>\$ (1,010,654)</u>	<u>\$ 28,094</u>	<u>\$ (982,560)</u>

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

PARSONS CORPORATION AND SUBSIDIARIES
Consolidated Statements of Shareholders' Equity (Deficit)
For the Nine Months Ended September 30, 2020 and September 30, 2019
(In thousands)
(Unaudited)

	Redeemable Common Stock	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Parsons Deficit	Noncontrolling Interests	Total
Balance at December 31, 2019	\$ -	\$ 146,441	\$ (934,240)	\$ 2,649,975	\$ (218,025)	\$ (14,261)	\$ 1,629,890	\$ 30,866	\$ 1,660,756
Comprehensive income									
Net income	-	-	-	-	76,930	-	76,930	15,086	92,016
Foreign currency translation (loss), net	-	-	-	-	-	(3,770)	(3,770)	-	(3,770)
Pension adjustments, net	-	-	-	-	-	(18)	(18)	-	(18)
Adoption of ASU 2016-13	-	-	-	-	(1,000)	-	(1,000)	-	(1,000)
Contributions	-	-	-	-	-	-	-	491	491
Distributions	-	-	-	-	-	-	-	(4,469)	(4,469)
Issuance of equity securities, net of retirement	-	57	-	1,615	-	-	1,672	-	1,672
Equity component value of convertible note issuance	-	-	-	53,552	-	-	53,552	-	53,552
Purchase of convertible note hedge	-	-	-	(54,611)	-	-	(54,611)	-	(54,611)
Sale of common stock warrants	-	-	-	13,808	-	-	13,808	-	13,808
Stock-based compensation	-	-	-	11,044	-	-	11,044	-	11,044
Balance at September 30, 2020	<u>\$ -</u>	<u>\$ 146,498</u>	<u>\$ (934,240)</u>	<u>\$ 2,675,383</u>	<u>\$ (142,095)</u>	<u>\$ (18,049)</u>	<u>\$ 1,727,497</u>	<u>\$ 41,974</u>	<u>\$ 1,769,471</u>
Balance at December 31, 2018	<u>\$ 1,876,309</u>	<u>\$ -</u>	<u>\$ (957,025)</u>	<u>\$ -</u>	<u>\$ 12,445</u>	<u>\$ (22,957)</u>	<u>\$ (967,537)</u>	<u>\$ 46,461</u>	<u>\$ (921,076)</u>
Comprehensive income									
Net income	-	-	-	-	106,812	-	106,812	8,012	114,824
Foreign currency translation gain, net	-	-	-	-	-	4,958	4,958	-	4,958
Pension adjustments, net	-	-	-	-	-	17	17	-	17
ASC 842 Transition Adjustment	-	-	-	-	52,608	-	52,608	-	52,608
Purchase of treasury stock	(819)	-	(819)	-	819	-	-	-	-
Contributions	-	-	-	-	-	-	-	8,999	8,999
Distributions	-	-	-	-	-	-	-	(35,378)	(35,378)
Dividend paid	-	-	-	-	(52,093)	-	(52,093)	-	(52,093)
Stock-based compensation	-	-	-	9,224	-	-	9,224	-	9,224
Conversion of S-Corp to C-Corp	25,877	-	-	-	(25,877)	-	(25,877)	-	(25,877)
IPO proceeds, net	-	21,296	-	515,582	-	-	536,878	-	536,878
ESOP shares at redemption value	675,644	-	-	(516,034)	(159,610)	-	(675,644)	-	(675,644)
Balance at September 30, 2019	<u>\$ 2,577,011</u>	<u>\$ 21,296</u>	<u>\$ (957,844)</u>	<u>\$ 8,772</u>	<u>\$ (64,896)</u>	<u>\$ (17,982)</u>	<u>\$ (1,010,654)</u>	<u>\$ 28,094</u>	<u>\$ (982,560)</u>

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

1. Description of Operations

Organization

Parsons Corporation, a Delaware corporation, and its subsidiaries (collectively, the "Company") is a leading provider of technology-driven solutions in the defense, intelligence and critical infrastructure markets. We provide software and hardware products, technical services and integrated solutions to support our customers' missions. We have developed significant expertise and differentiated capabilities in key areas of cybersecurity, intelligence, missile defense, C5ISR, space, geospatial, and connected communities. By combining our talented team of professionals and advanced technology, we help solve complex technical challenges to enable a safer, smarter and more interconnected world.

Initial Public Offering

On May 8, 2019, the Company consummated its initial public offering ("IPO") whereby the Company sold 18,518,500 shares of common stock for \$27.00 per share. The underwriters exercised their option on May 14, 2019 to purchase an additional 2,777,775 shares at the net price of \$25.515 which was the IPO share price of \$27.00 less the underwriting discount of \$1.485 per share. The net proceeds of the IPO and the underwriters' option were \$536.9 million, after deducting underwriting discounts and other fees, and were used to fund an IPO dividend of \$52.1 million, repay the outstanding balance of \$150.0 million under our Term Loan, and repay outstanding indebtedness under our Revolving Credit Facility.

Stock Dividend

On April 15, 2019, the board of directors of the Company declared a common stock dividend in a ratio of two shares of common stock for every one share of common stock presently held by the Company's stockholder (the "Stock Dividend"). The record date of this common Stock Dividend was May 7, 2019, the day immediately prior to the consummation of the Company's IPO on May 8, 2019, and the payment date of the Stock Dividend was May 8, 2019. Purchasers of the Company's common stock in the Company's public offering were not entitled to receive any portion of the Stock Dividend.

2. Basis of Presentation and Principles of Consolidation

The accompanying unaudited consolidated financial statements and related notes of the Company have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") and pursuant to the interim period reporting requirements of Form 10-Q. They do not include all of the information and footnotes required by GAAP for complete financial statements and, therefore, should be read in conjunction with our consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2019.

In the opinion of management, the consolidated financial statements reflect all normal recurring adjustments necessary for a fair statement of the financial position, results of operations and cash flows for the interim periods presented. The results of operations and cash flows for any interim period are not necessarily indicative of results for the full year or for future years.

This Quarterly Report on Form 10-Q includes the accounts of Parsons Corporation and its subsidiaries and affiliates which it controls. Interests in joint ventures that are controlled by the Company, or for which the Company is otherwise deemed to be the primary beneficiary, are consolidated. For joint ventures in which the Company does not have a controlling interest, but exerts a significant influence, the Company applies the equity method of accounting. (see "Note 14 – Investments in and Advances to Joint Ventures" for further discussion). Intercompany accounts and transactions are eliminated in consolidation.

Use of Estimates

The preparation of the consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from those estimates. The Company's most significant estimates and judgments involve revenue recognition with respect to the determination of the costs to complete contracts and transaction price; determination of self-insurance reserves; useful lives of property and equipment and intangible assets; calculation of allowance for doubtful accounts; valuation of deferred income tax assets and uncertain tax positions, among others. Please see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates" and "Note 2—Summary of Significant Accounting Policies" in the notes to our consolidated financial statements included in the Company's Form 10-K for the year ended December 31, 2019, for a discussion of the significant estimates and assumptions affecting our consolidated financial statements. Estimates of costs to complete contracts are continually evaluated as work progresses and are revised when necessary. When a change in estimate is determined to have an impact on contract profit, the Company records a positive or negative adjustment to the consolidated statement of income.

Employee Stock Purchase Plan

During the second quarter of fiscal 2020, initial purchases of the Company's common Stock were made under the Parsons Employee Stock Purchase Program ("ESPP"). Under the ESPP, eligible employees who elect to participate are granted the right to purchase shares of the common stock of Parsons at a discount that is limited to 5% of the per-share market value on the day shares are sold to employees. Purchases of common stock under the ESPP are included in "proceeds from issuance of common stock" in cash flows from financing activities in the Consolidated Statements of Cash Flows.

3. New Accounting Pronouncements

In the first quarter of 2020, the Company adopted Accounting Standards Update ("ASU") 2016-13, "Measurement of Credit Losses on Financial Instruments." The amendments in ASU 2016-13 replace the incurred loss impairment methodology in current practice with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to estimate credit losses. The adoption of ASU 2016-13 did not have a material impact on the Company's consolidated financial statements.

In December 2019, the Financial Accounting Standards Board ("FASB") issued ASU No. 2019-12, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes ("ASU 2019-12"). ASU 2019-12 was issued as a means to reduce the complexity of accounting for income taxes for those entities that fall within the scope of the standard. The guidance is to be applied using a prospective method, excluding amendments related to franchise taxes, which should be applied on either a retrospective basis for all periods presented or a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption. ASU 2019-12 is effective for fiscal years beginning after December 15, 2020, with early adoption permitted. The Company does not expect this standard to have a material impact on its consolidated financial statements.

In August 2020, the FASB issued ASU 2020-06, Debt – Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging – Contracts in Entity's Own Equity (Subtopic 815-40). The update simplifies the accounting for convertible debt instruments and convertible preferred stock by reducing the number of accounting models and limiting the number of embedded conversion features separately recognized from the primary contract. The guidance also includes targeted improvements to the disclosures for convertible instruments and earnings per share. ASU 2020-06 is effective for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. Early adoption is permitted, but no earlier than fiscal years beginning after December 15, 2020. The Company expects to early adopt this standard using the modified retrospective method. The Company is evaluating the impact of the adoption on its consolidated financial statements, and expects it will result in a reduction in non-cash interest expense and a reclassification of the equity portion of the Convertible Senior Notes to liabilities on the consolidated balance sheet.

4. Acquisitions

OGSystems

On January 7, 2019, the Company acquired a 100% ownership interest in OGSystems, a privately-owned company, for \$292.4 million paid in cash. OGSystems provides geospatial intelligence, big data analytics and threat mitigation for defense and intelligence customers. The Company borrowed \$110 million under the Credit Agreement and \$150 million on a short-term loan, as described in “Note 10—Debt and Credit Facilities,” to partially fund the acquisition. In connection with this acquisition, the Company recognized \$5.4 million of acquisition-related expenses in “Indirect, general and administrative expense” in the consolidated statements of income for the year ended December 31, 2019, including legal fees, consulting fees, and other miscellaneous direct expenses associated with the acquisition. OGSystems enhances the Company’s artificial intelligence and data analytics expertise with new technologies and solutions. Customers of both companies will benefit from existing, complementary technologies and increased scale, enabling end-to-end solutions under the shared vision of rapid prototyping and agile development.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed based on the purchase price allocation as of the date of acquisition (in thousands):

	Amount
Cash and cash equivalents	\$ 5,772
Accounts receivable	9,904
Contract assets	9,747
Prepaid expenses and other current assets	4,307
Property and equipment	4,085
Right of use assets, operating leases	8,826
Goodwill	183,540
Intangible assets	92,300
Other noncurrent assets	10
Accounts payable	(5,450)
Accrued expenses and other current liabilities	(7,147)
Contract liabilities	(1,300)
Short-term lease liabilities, operating leases	(805)
Income tax payable	(1,178)
Deferred tax liabilities	(1,195)
Long-term lease liabilities, operating leases	(8,021)
Other long-term liabilities	(1,015)
Net assets acquired	\$ 292,380

Of the total purchase price, the following values were assigned to intangible assets (in thousands, except for years):

	Gross Carrying Amount	Amortization Period (in years)
Customer relationships	\$ 57,100	5
Backlog	27,700	3
Trade name	3,800	2
Non-compete agreements	2,400	3
Developed technologies	\$ 1,300	3

Amortization expense of \$5.9 million related to these intangible assets was recorded for the three months ended September 30, 2020 and September 30, 2019, respectively, and \$17.8 million for the nine months ended September 30, 2020 and September 30, 2019, respectively. The entire value of goodwill of \$183.5 million was assigned to the Federal Solutions reporting unit and represents synergies expected to be realized from this business combination. Goodwill of \$16 million is deductible for tax purposes.

The amount of revenue generated by OGSystems and included within consolidated revenues is \$46.2 million and \$33.7 million for the three months September 30, 2020 and September 30, 2019, respectively, and \$117.0 million and

\$108.7 million for the nine months ended September 30, 2020 and September 30, 2019, respectively. The Company has determined that the presentation of net income from the date of acquisition is impracticable due to the integration of general corporate functions upon acquisition.

Supplemental Pro Forma Information (Unaudited)

Supplemental information of unaudited pro forma operating results assuming the OGSystems acquisition had been consummated as of the beginning of fiscal year 2018 (December 30, 2017) (in thousands) is as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Pro forma revenue	\$ 1,004,236	\$ 1,023,277	\$ 2,954,688	\$ 2,919,379
Pro forma net income including noncontrolling interests	\$ 47,561	\$ 61,293	\$ 95,189	\$ 118,896

QRC Technologies

On July 31, 2019 the Company acquired a 100% ownership interest in QRC Technologies ("QRC"), a privately-owned company, for \$214.1 million in cash. QRC provides design and development of open-architecture radio-frequency products. The Company borrowed \$140.0 million under the Revolving Credit Facility to partially fund the transaction. In connection with this acquisition, the Company recognized \$4.9 million of acquisition-related expenses in "Indirect, general and administrative expense" in the consolidated statements of income for the fiscal year ended December 31, 2019, including legal fees, consulting fees, and other miscellaneous direct expenses associated with the acquisition. QRC is an agile, disruptive product company that specializes in radio frequency spectrum survey, record and playback; signals intelligence; and electronic warfare missions. QRC complements our existing portfolio, increases our presence in the high-growth markets of spectrum awareness and surveillance, and adds critical intellectual property that complements and expands the Company's available capabilities for the Special Operations and Intelligence Communities.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed based on the purchase price allocation as of the date of acquisition (in thousands):

	Amount
Cash and cash equivalents	\$ 5,925
Accounts receivable	5,587
Prepaid expenses and other current assets	5,727
Property and equipment	1,205
Right of use assets, operating leases	5,228
Goodwill	125,091
Intangible assets	76,200
Accounts payable	(1,567)
Accrued expenses and other current liabilities	(4,025)
Short-term lease liabilities, operating leases	(545)
Long-term lease liabilities, operating leases	(4,683)
Net assets acquired	<u>\$ 214,143</u>

Of the total purchase price, the following values were assigned to intangible assets (in thousands, except for years):

	<u>Gross Carrying Amount</u>	<u>Amortization Period</u> (in years)
Customer relationships	\$ 49,800	12
Developed technologies	21,800	3 to 5
In-process research and development	1,800	3 to 5
Non-compete agreements	1,200	4
Trade name	800	2
Backlog	800	1

Amortization expense of \$3.5 million and \$1.9 million related to these intangible assets was recorded for the three months ended September 30, 2020 and September 30, 2019, respectively, and \$10.6 million and \$1.9 million for the nine months ended September 30, 2020 and September 30, 2019, respectively. The entire value of goodwill of \$125.1 million was assigned to the Federal Solutions reporting unit and represents synergies expected to be realized from this business combination. Goodwill in its entirety is deductible for tax purposes.

The amount of revenue generated by QRC and included within consolidated revenues is \$12.6 million and \$5.6 million for the three months ended September 30, 2020 and September 30, 2019, respectively, and \$25.2 million and \$5.6 million for the nine months ended September 30, 2020 and September 30, 2019, respectively. The Company has determined that the presentation of net income from the date of acquisition is impracticable due to the integration of general corporate functions upon acquisition.

Supplemental Pro Forma Information

Supplemental information on an unaudited pro forma basis, assuming the QRC Technologies acquisition had been consummated as of the beginning of fiscal year 2018 (December 30, 2017) (in thousands) is as follows:

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30, 2020</u>	<u>September 30, 2019</u>	<u>September 30, 2020</u>	<u>September 30, 2019</u>
Pro forma revenue	\$ 1,004,236	\$ 1,026,831	\$ 2,954,688	\$ 2,938,973
Pro forma net income including noncontrolling interests	\$ 47,618	\$ 65,782	\$ 95,994	\$ 117,399

5. Contracts with Customers

Disaggregation of Revenue

The Company's contracts contain both fixed-price and cost reimbursable components. Contract types are based on the component that represents the majority of the contract. The following table presents revenue disaggregated by contract type (in thousands):

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30, 2020</u>	<u>September 30, 2019</u>	<u>September 30, 2020</u>	<u>September 30, 2019</u>
Fixed-Price	\$ 324,901	\$ 288,316	\$ 944,577	\$ 850,658
Time-and-Materials	265,987	285,586	777,807	810,656
Cost-Plus	413,348	449,375	1,232,304	1,256,110
Total	<u>\$ 1,004,236</u>	<u>\$ 1,023,277</u>	<u>\$ 2,954,688</u>	<u>\$ 2,917,424</u>

See "Note 18 – Segments Information" for the Company's revenues by business lines.

Contract Assets and Contract Liabilities

Contract assets and contract liabilities balances at September 30, 2020 and December 31, 2019 were as follows (in thousands):

	September 30, 2020	December 31, 2019	\$ change	% change
Contract assets	\$ 610,893	\$ 575,089	\$ 35,804	6.2%
Contract liabilities	212,373	230,681	(18,308)	-7.9%
Net contract assets (liabilities) (1)	<u>\$ 398,520</u>	<u>\$ 344,408</u>	<u>\$ 54,112</u>	<u>15.7%</u>

- (1) Total contract retentions included in net contract assets (liabilities) were \$89.8 million as of September 30, 2020, of which \$42.0 million are not expected to be paid in the next 12 months. Total contract retentions included in net contract assets (liabilities) were \$85.5 million as of December 31, 2019. Contract assets at September 30, 2020 and December 31, 2019 include \$96.2 million and \$73.0 million, respectively, related to unapproved change orders, claims, and requests for equitable adjustment. For the three and nine months ended September 30, 2020 and September 30, 2019, there were no material losses recognized related to the collectability of claims, unapproved change orders, and requests for equitable adjustment.

During the three months ended September 30, 2020 and September 30, 2019, the Company recognized revenue of \$9.5 million and \$2.1 million, respectively, and \$132.2 million and \$115.1 million during the nine months ended September 30, 2020 and September 30, 2019, respectively that was included in the corresponding contract liability balances at December 31, 2019 and December 31, 2018, respectively. Certain changes in contract assets and contract liabilities consisted of the following:

	September 30, 2020	December 31, 2019
Acquired contract assets	\$ -	\$ 9,747
Acquired contract liabilities	-	1,300
Change in the estimate of variable consideration	-	12,166

There was no significant impairment of contract assets recognized during the three and nine months ended September 30, 2020 and September 30, 2019.

Revisions in estimates, such as changes in estimated claims or incentives, related to performance obligations partially satisfied in previous periods that individually had an impact of \$5 million or more on revenue resulted in the following changes in revenue:

	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Revenue impact, net	\$ (134)	\$ 9,116	\$ 8,848	\$ 9,116

Accounts Receivable, net

Accounts receivable, net consisted of the following as of September 30, 2020 and December 31, 2019 (in thousands):

	September 30, 2020	December 31, 2019
Billed	\$ 527,654	\$ 475,528
Unbilled	252,963	201,461
Total accounts receivable, gross	780,617	676,989
Allowance for doubtful accounts	(5,557)	(5,497)
Total accounts receivable, net	<u>\$ 775,060</u>	<u>\$ 671,492</u>

Billed accounts receivable represents amounts billed to clients that have not been collected. Unbilled accounts receivable represents amounts where the Company has a present contractual right to bill but an invoice has not been issued to the customer at the period-end date.

In connection with the adoption of ASU 2016-13, we have modified the historical presentation of gross receivables and the allowance for doubtful accounts to reflect only expected credit losses in the allowance in conformity with the current period presentation.

The allowance for doubtful accounts was determined based on consideration of trends in actual and forecasted credit quality of clients, including delinquency and payment history, type of client, such as a government agency or commercial sector client, and general economic conditions and particular industry conditions that may affect a client's ability to pay. COVID-19 Impacts: We have not seen and do not expect there to be a risk of non-payment from either our government agency or commercial customers. We have experienced payment delays due to administrative limitations from both types of customers.

Transaction Price Allocated to the Remaining Unsatisfied Performance Obligations

The Company's remaining unsatisfied performance obligations ("RUPO") as of September 30, 2020 represent a measure of the total dollar value of work to be performed on contracts awarded and in-progress. The Company had \$5.0 billion in RUPO as of September 30, 2020.

RUPO will increase with awards of new contracts and decrease as the Company performs work and recognizes revenue on existing contracts. Projects are included within RUPO at such time the project is awarded and agreement on contract terms has been reached. The difference between RUPO and backlog relates to unexercised option years that are included within backlog and the value of Indefinite Delivery/Indefinite Quantity ("IDIQ") contracts included in backlog for which delivery orders have not been issued.

RUPO is comprised of: (a) original transaction price, (b) change orders for which written confirmations from our customers have been received, (c) pending change orders for which the Company expects to receive confirmations in the ordinary course of business, and (d) claim amounts that the Company has made against customers for which it has determined that it has a legal basis under existing contractual arrangements and a significant reversal of revenue is not probable, less revenue recognized to-date.

The Company expects to satisfy its RUPO as of September 30, 2020 over the following periods (in thousands):

Period RUPO Will Be Satisfied	Within One Year	Within One to Two Years	Thereafter
Federal Solutions	\$ 1,174,719	\$ 379,069	\$ 560,850
Critical Infrastructure	1,408,497	700,549	749,792
Total	\$ 2,583,216	\$ 1,079,618	\$ 1,310,642

6. Leases

The Company has operating and finance leases for corporate and project office spaces, vehicles, heavy machinery and office equipment. Our leases have remaining lease terms of one year to 10 years, some of which may include options to extend the leases for up to five years, and some of which may include options to terminate the leases up to the third year.

The components of lease costs for the three and nine months ended September 30, 2020 and September 30, 2019 are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Operating lease cost	\$ 15,919	\$ 17,969	\$ 48,945	\$ 53,835
Short-term lease cost	4,301	5,429	12,254	10,925
Amortization of right-of-use assets	531	120	1,036	455
Interest on lease liabilities	64	15	109	46
Sublease income	(959)	(712)	(2,771)	(2,727)
Total lease cost	\$ 19,856	\$ 22,821	\$ 59,573	\$ 62,534

Supplemental cash flow information related to leases for the nine months ended September 30, 2020 and September 30, 2019 is as follows (in thousands):

	Nine Months Ended	
	September 30, 2020	September 30, 2019
Operating cash flows for operating leases	\$ 45,343	\$ 52,056
Operating cash flows for financing activities	111	46
Financing cash flows from finance leases	1,080	524
Right-of-use assets obtained in exchange for new operating lease liabilities	19,587	274,212
Right-of-use assets obtained in exchange for new finance lease liabilities	\$ -	\$ 1,818

Supplemental balance sheet and other information related to leases as of September 30, 2020 and December 31, 2019 are as follows (in thousands):

	September 30, 2020	December 31, 2019
Operating Leases:		
Right-of-use assets	\$ 212,592	\$ 233,415
Lease liabilities:		
Current	\$ 48,661	\$ 49,994
Long-term	189,319	203,624
Total operating lease liabilities	<u>\$ 237,980</u>	<u>\$ 253,618</u>
Finance Leases:		
Other noncurrent assets	\$ 2,757	\$ 2,377
Accrued expenses and other current liabilities	\$ 1,345	\$ 1,075
Other long-term liabilities	\$ 1,247	\$ 1,202
Weighted Average Remaining Lease Term:		
Operating leases	5 years	6 years
Finance leases	2 years	3 years
Weighted Average Discount Rate:		
Operating leases	3.8%	4.0%
Finance leases	4.7%	4.5%

As of September 30, 2020, the Company has no operating leases that have not yet commenced.

A maturity analysis of the future undiscounted cash flows associated with the Company's operating and finance lease liabilities as of September 30, 2020 is as follows (in thousands):

	Operating Leases	Finance Leases
2020 (remaining)	\$ 11,735	\$ 381
2021	58,792	1,291
2022	53,521	735
2023	46,386	316
2024	36,502	8
Thereafter	55,471	-
Total lease payments	262,407	2,731
Less: imputed interest	(24,427)	(139)
Total present value of lease liabilities	<u>\$ 237,980</u>	<u>\$ 2,592</u>

7. Goodwill

The following table summarizes the changes in the carrying value of goodwill by reporting segment at September 30, 2020 and December 31, 2019 (in thousands):

	December 31, 2019	Foreign Exchange	September 30, 2020
Federal Solutions	\$ 975,405	\$ -	\$ 975,405
Critical Infrastructure	72,020	(972)	71,048
Total	\$ 1,047,425	\$ (972)	\$ 1,046,453

The ultimate impact from the COVID-19 pandemic is difficult to predict. While many uncertainties exist, we currently anticipate no material change in our financial condition or results of operations. Although the Company does not anticipate a material change to our financial condition or results of operations, the Company performed a qualitative triggering analysis and determined there was no triggering event indicating a potential impairment to the carrying value of its goodwill at September 30, 2020 and concluded there has not been an impairment.

8. Intangible Assets

The gross amount and accumulated amortization of intangible assets with finite useful lives included in "Intangible assets, net" on the consolidated balance sheets are as follows (in thousands except for years):

	September 30, 2020			December 31, 2019			Weighted Average Amortization Period (in years)
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	
Backlog	\$ 109,255	\$ (97,713)	\$ 11,542	\$ 109,255	\$ (87,510)	\$ 21,745	3
Customer relationships	228,529	(99,646)	128,883	228,529	(67,809)	160,720	7
Leases	670	(594)	76	670	(580)	90	5
Developed technology	110,939	(61,902)	49,037	110,939	(40,749)	70,190	4
Trade name	8,200	(7,392)	808	8,200	(5,667)	2,533	1
Non-compete agreements	3,600	(1,750)	1,850	3,600	(925)	2,675	3
In process research and development	1,800	-	1,800	1,800	-	1,800	n/a
Other intangibles	275	(189)	86	275	(170)	105	10
Total intangible assets	\$ 463,268	\$ (269,186)	\$ 194,082	\$ 463,268	\$ (203,410)	\$ 259,858	

The aggregate amortization expense of intangible assets for the three months ended September 30, 2020 and September 30, 2019 was \$20.9 million and \$22.1 million, respectively, and for the nine months ended September 30, 2020 and September 30, 2019 was \$65.7 million and \$64.5 million, respectively.

Estimated amortization expense for the remainder of the current fiscal year and in each of the next four years and beyond is as follows (in thousands):

	September 30, 2020
2020 (remaining)	\$ 20,820
2021	81,573
2022	36,098
2023	23,549
2024	9,098
Thereafter	21,144
Total	\$ 192,282

9. Property and Equipment, Net

Property and equipment consisted of the following at September 30, 2020 and December 31, 2019 (in thousands):

	September 30, 2020	December 31, 2019	Useful life (years)
Buildings and leasehold improvements	\$ 93,361	\$ 81,065	1-15
Furniture and equipment	92,199	91,720	3-10
Computer systems and equipment	173,606	164,161	3-10
Construction equipment	9,477	11,765	5-7
	<u>368,643</u>	<u>348,711</u>	
Accumulated depreciation	(247,157)	(225,960)	
Property and equipment, net	<u>\$ 121,486</u>	<u>\$ 122,751</u>	

Depreciation expense for the three months ended September 30, 2020 and September 30, 2019 was \$9.5 million and \$8.9 million, respectively, and \$28.9 million and \$28.2 million, respectively, for the nine months ended September 30, 2020 and September 30, 2019.

10. Debt and Credit Facilities

Debt consisted of the following (in thousands):

	September 30, 2020	December 31, 2019
Short-Term:		
Senior notes	\$ 50,000	\$ -
Total Short-Term	<u>50,000</u>	<u>-</u>
Long-Term:		
Senior notes	200,000	250,000
Convertible senior notes	400,000	-
Debt discount	(53,692)	-
Debt issuance costs	(9,189)	(647)
Total long-term	<u>537,119</u>	<u>249,353</u>
Total Debt	<u>\$ 587,119</u>	<u>\$ 249,353</u>

Revolving Credit Facility

In November 2017, the Company entered into an amended and restated Credit Agreement. The Company incurred \$2.0 million of costs in connection with this amendment. Under the agreement, the Company's revolving credit facility was increased from \$500 million to \$550 million and the term of the agreement was extended through November 2022. The borrowings under the Credit Agreement bear interest, at the Company's option, at either the Base Rate (as defined in the Credit Agreement), plus an applicable margin, or LIBOR plus an applicable margin. The applicable margin for Base Rate loans is a range of 0.125% to 1.00% and the applicable margin for LIBOR loans is a range of 1.125% to 2.00%, both based on the leverage ratio of the Company at the end of each fiscal quarter. The rates at September 30, 2020 and December 31, 2019 were 1.44% and 3.02%, respectively. Borrowings under this Credit Agreement are guaranteed by certain Company operating subsidiaries. Letters of credit commitments outstanding under this agreement aggregated to \$44.9 million and \$43.7 million at September 30, 2020 and December 31, 2019, respectively, which reduced borrowing limits available to the Company. Interest expense related to the Credit Agreement was \$0.2 million and \$0.9 million for the three and nine months ended September 30, 2020, respectively, and for the three and nine months ended September 30, 2019 was \$1.1 million and \$6.4 million, respectively. There were no loan amounts outstanding under the Credit Agreement at September 30, 2020.

Term Loan

In January 2019, the Company borrowed \$150.0 million under our Term Loan Agreement to partially finance the OGSystems acquisition. On May 10, 2019, the Company used proceeds from its May 8, 2019 IPO to repay the \$150.0 million outstanding balance under the Term Loan and this loan is now closed. Interest expense related to the Term Loan was \$0 and \$2.3 million for the three and nine months ended September 30, 2019, respectively. There were no amounts outstanding in fiscal 2020.

Private Placement

On July 1, 2014, the Company finalized a private placement whereby the Company raised an aggregate amount of \$250.0 million in debt as follows (in thousands):

Tranche	Debt Amount	Maturity Date	Interest Rates
Senior Note, Series A	\$ 50,000	July 15, 2021	4.44%
Senior Note, Series B	100,000	July 15, 2024	4.98%
Senior Note, Series C	60,000	July 15, 2026	5.13%
Senior Note, Series D	40,000	July 15, 2029	5.38%

The Company incurred \$1.1 million of debt issuance costs in connection with the private placement. On August 10, 2018, the Company finalized an amended and restated intercreditor agreement related to this private placement to more closely align certain covenants and definitions with the terms under the 2017 amended and restated Credit Agreement and incurred \$0.5 million of additional issuance costs. These costs are presented as a direct deduction from the debt on the face of the consolidated balance sheets. Interest expense related to the Senior Notes for both the three and nine months ended September 30, 2020 and September 30, 2019 was \$3.1 million and \$9.3 million, respectively. The amortization of debt issuance costs and interest expense are recorded in "Interest expense" on the consolidated statements of income. The Company made interest payments of \$6.2 million for both the three months ended September 30, 2020 and September 30, 2019. The Company made interest payments related to the Senior Notes for both the nine months ended September 30, 2020 and September 30, 2019 of \$12.4 million. Interest payable of \$2.4 million and \$2.6 million is recorded in "Accrued expenses and other current liabilities" on the consolidated balance sheets at September 30, 2020 and December 31, 2019, respectively, related to the Senior Notes.

The Credit Agreement and private placement includes various covenants, including restrictions on indebtedness, liens, acquisitions, investments or dispositions, payment of dividends and maintenance of certain financial ratios and conditions. The Company was in compliance with these covenants at September 30, 2020 and December 31, 2019.

The Company also has in place several secondary bank credit lines for issuing letters of credit, principally for foreign contracts, to support performance and completion guarantees. Letters of credit commitments outstanding under these bank lines aggregated \$198.0 million and \$197.3 million at September 30, 2020 and December 31, 2019, respectively.

Using a discounted cash flow technique that incorporates a market interest yield curve with adjustments for duration, optionality, and risk profile, the Company estimated the fair value (Level 2) of its senior notes at September 30, 2020 approximates \$277.6 million. See "Note 16 – Fair Value of Financial Instruments" for the definition of Level 2 of the fair value hierarchy.

Convertible Senior Notes

In August 2020, the Company issued an aggregate \$400.0 million of 0.25% Convertible Senior Notes due 2025, including the exercise of a \$50.0 million initial purchasers' option. The Company received proceeds from the issuance and sale of the Convertible Senior Notes of \$389.7 million, net of \$10.3 million of transaction fees and other third-party offering expenses. The Convertible Senior Notes accrue interest at a rate of 0.25% per annum, payable semi-annually on February 15 and August 15 of each year beginning on February 15, 2021, and will mature on August 15, 2025, unless earlier repurchased, redeemed or converted.

The Convertible Senior Notes are the Company's senior unsecured obligations and will rank senior in right of payment to any of the Company's indebtedness that is expressly subordinated in right of payment to the Notes; equal in right of payment to any of the Company's unsecured indebtedness that is not so subordinated; effectively junior in right of payment to any of the Company's secured indebtedness, to the extent of the value of the assets securing such indebtedness; and structurally junior to all indebtedness and other liabilities (including trade payables) of the Company's subsidiaries

Each \$1,000 of principal of the Notes will initially be convertible into 22.2913 shares of our common stock, which is equivalent to an initial conversion price of \$44.86 per share, subject to adjustment upon the occurrence of specified events. On or after March 15, 2025 until the close of business on the second scheduled trading day immediately preceding the maturity date of the Convertible Senior Notes, holders may convert all or a portion of their Convertible Senior Notes, regardless of the conditions below.

Prior to the close of business on the business day immediately preceding March 15, 2025, the Notes will be convertible at the option of the holders thereof only under the following circumstances:

- during any calendar quarter commencing after the calendar quarter ending on December 31, 2020, if the last reported sale price of the Company's common stock for at least 20 trading days, whether or not consecutive, during a period of 30 consecutive trading days ending on, and including the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;
- during the five business day period after any five consecutive trading day period in which, for each trading day of that period, the trading price per \$1,000 principal amount of Convertible Senior Notes for such trading day was less than 98% of the product of the last reported sale price of the Company's common stock and the conversion rate on each such trading day;
- if the Company calls such Convertible Senior Notes for redemption; or
- upon the occurrence of specified corporate events described in the Indenture.

. The Company may redeem all or any portion of the Convertible Senior Notes for cash, at its option, on or after August 21, 2023 and before the 51st scheduled trading day immediately before the maturity date at a redemption price equal to 100% of the principal amount of the Notes to be redeemed, plus accrued and unpaid interest, but only if the last reported sale price per share of the Company's common stock exceeds 130% of the conversion price for a specified period of time. In addition, calling any Convertible Senior Note for redemption will constitute a Make-Whole Fundamental Change with respect to that Convertible Senior Note, in which case the conversion rate applicable to the conversion of that Convertible Senior Note will be increased in certain circumstances if it is converted after it is called for redemption.

Upon the occurrence of a fundamental change prior to the maturity date of the Convertible Senior Notes, holders of the Convertible Senior Notes may require the Company to repurchase all or a portion of the Convertible Senior Notes for cash at a price equal to 100% of the principal amount of the Convertible Senior Notes to be repurchased, plus any accrued and unpaid interest to, but excluding, the fundamental change repurchase date.

Upon conversion, the Company may settle the Convertible Senior Notes for cash, shares of the Company's common stock, or a combination thereof, at the Company's option. If the Company satisfies its conversion obligation solely in cash or through payment and delivery of a combination of cash and shares of the Company's common stock, the

amount of cash and shares of common stock due upon conversion will be based on a daily conversion value calculated on a proportionate basis for each trading day in a 50-trading day observation period.

Under GAAP, convertible debt instruments that may be settled in cash on conversion are required to be separated into liability and equity components in a manner that reflects the issuer's non-convertible debt borrowing rate. The carrying amount of the liability component is based on the fair value of a similar instrument that does not contain an equity conversion option. The carrying amount allocated to the equity component, which is recognized as a debt discount, represents the difference between the proceeds from the issuance of the notes and the fair value of the liability component of the notes. Based on this debt to equity ratio, debt issuance costs are then allocated to the liability and equity components in a similar manner. Accordingly, at issuance the Company allocated \$336.1 million to the debt liability and \$53.6 million to additional paid in capital. The difference between the principal amount of the Convertible Senior Notes and the liability component, inclusive of issuance costs, represents the debt discount, which the Company amortizes to interest expense over the term of the Convertible Senior Notes using an effective interest rate of 3.25%. During the three and nine months ended September 30, 2020, the Company recognized interest expense of \$1.5 million related to the amortization of debt discount and issuance costs. As of September 30, 2020, the net carrying value of the Notes was \$337.6 million.

A summary as of September 30, 2020 of the gross carrying amount, unamortized debt discount including debt issuance costs, and net carrying value of the liability component of the Convertible Senior Notes is as follows:

	<u>September 30, 2020</u>	
Par value	\$	400,000
Debt discount	\$	(62,376)
Carrying amount	\$	337,624
Equity component	\$	53,552

Convertible Note Hedge and Warrant Transactions

In connection with the sale of the Convertible Senior Notes, the Company purchased a bond hedge designed to mitigate the potential dilution from the conversion of the Convertible Senior Notes. Under the five-year term of the bond hedge, upon a conversion of the bonds, the Company will receive the number of shares of common stock equal to the remaining common stock deliverable upon conversion of the Convertible Senior Notes if the conversion value exceeds the principal amount of the Notes. The aggregate number of shares that the Company could be obligated to issue upon conversion of the Convertible Senior Notes is approximately 8.9 million shares. The cost of the convertible note hedge transactions was \$55.0 million.

The cost of the convertible note hedge was partially offset by the Company's sale of warrants to acquire approximately 8.9 million shares of the Company's common stock. The warrants were initially exercisable at a price of at least \$66.46 per share and are subject to customary adjustments upon the occurrence of certain events, such as the payment of dividends. The Company received \$13.8 million in cash proceeds from the sales of these warrants.

The bond hedge and warrant transactions effectively increased the conversion price associated with the Convertible Senior Notes during the term of these transactions from 35%, or \$44.86, to 100%, or \$66.46, at their issuance, thereby reducing the dilutive economic effect to shareholders upon actual conversion.

The bond hedges and warrants are indexed to, and potentially settled in, shares of the Company's common stock. The net cost of \$41.2 million for the purchase of the bond hedges and sale of the warrants was recorded as a reduction to additional paid-in capital in the consolidated balance sheets.

At issuance, the Company recorded a deferred tax liability of \$16.2 million related to the Convertible Senior Notes debt discount and a deferred tax asset of \$16.5 million related to the convertible note hedge transactions. The deferred tax liability and deferred tax asset are included net in "Deferred tax assets" on the consolidated balance sheets

11. Income Taxes

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") was enacted in response to the COVID-19 pandemic. The CARES Act, among other things, permits Net Operating Loss ("NOL") carryovers to offset 100% of taxable income for tax years beginning before 2021. In addition, the CARES Act allows NOLs

incurred in 2018, 2019, and 2020 to be carried back to each of the five preceding tax years to generate a refund of previously paid income taxes. The CARES Act contains modifications on the limitation of business interest for tax years beginning in 2019 and 2020. The modifications to Section 163(j) increase the allowable business interest deduction from 30% of adjusted taxable income to 50% of adjusted taxable income. The CARES Act also accelerates the refund of alternative minimum tax (“AMT”) credits that were previously accumulated. The Company does not expect that the modifications on the limitation of business interest or AMT credits would have any impact to the Company. Under the NOL carryback provision, the Company carried back some of its NOLs claiming a tax refund of \$3.9 million relating to certain amounts associated with the acquisition of OGSystems which may be subject to certain shareholders’ claims.

On July 9, 2020, the U.S. Treasury Department issued final tax regulations related to the foreign-derived intangible income and global intangible low-taxed income (“GILTI”) provisions. Also, on July 20, 2020 the U.S. Treasury Department released final tax regulations permitting a taxpayer to elect to exclude from its GILTI inclusion items of income subject to a high effective rate of foreign tax. Additionally, on August 21, 2020, the U.S. Treasury Department finalized anti-abuse regulations limiting deductions of foreign-source dividends. Separately, on September 2, 2020, the U.S. Treasury Department finalized regulations on the base erosion anti-abuse tax (“BEAT”) under IRC Section 59A. The U.S. Treasury Department also finalized a second set of regulations on the allowance for the additional first-year depreciation deduction under IRC Section 168(k) on September 16, 2020, as amended by the Tax Cuts and Jobs Act (“TCJA”), for qualified property acquired and placed in service after September 27, 2017. Lastly, on September 29, 2020, the U.S. Treasury Department issued final tax regulations addressing various aspects of the foreign tax credit regime. The Company is currently assessing the impact of the new regulations to its consolidated financial statements but does not expect a material change of its income tax expense due to the new regulations.

Prior to the Company’s IPO, the Company had elected to be taxed under the provisions of Subchapter “S” of the Internal Revenue Code for federal tax purposes. As a result, income had not been subject to U.S. federal income taxes or state income taxes in those states where the “S” Corporation status is recognized. Therefore, previously, no provision or liability for federal or state income tax had been provided in the consolidated financial statements except for those states where the “S” Corporation status was not recognized, or where states imposed a tax on “S” Corporations. The provision for income tax in the historical periods prior to the IPO consists of these state taxes and taxes from certain foreign jurisdictions where the Company is subject to tax.

In connection with the Company’s IPO on May 8, 2019, the “S” Corporation status was terminated, and the Company is now treated as a “C” Corporation under the Code. The termination of the “S” Corporation election has had a material impact on the Company’s results of operations, financial condition, and cash flows as reflected in the September 30, 2020 consolidated financial statements. The effective tax rate has increased, and net income has decreased as compared to the Company’s “S” Corporation tax years, since the Company is now subject to both U.S. federal and state corporate income taxes on its earnings.

The Company’s effective tax rate was 25.61% and (33.71)% for the three months ended September 30, 2020 and 2019, respectively. The change in the effective tax rate was due primarily to nonrecurring tax items included in the third quarter 2019 income taxes associated with an additional \$29 million tax benefit from the remeasurement of deferred taxes associated with the Company’s change in “S” Corporation to “C” Corporation status. The Company’s effective tax rate for the nine months ended September 30, 2020 and 2019 was 26.39% and (140.42)%. The change in the effective tax rate was due primarily to the nonrecurring tax items included in 2019 for the remeasurement of deferred taxes associated with the change in tax status. The difference between the effective tax rate and the statutory U.S. Federal income tax rate of 21.0% for the quarter ended September 30, 2020 primarily relates to state income taxes and a recorded valuation allowance on foreign tax credits, partially offset by benefits related to income attributable to noncontrolling interest and federal research tax credits.

As of September 30, 2020, the Company’s deferred tax assets included a valuation allowance of \$17.5 million primarily related to foreign net operating loss carryforwards, foreign tax credit carryforwards, and capital losses that the Company has determined are not more-likely-than-not to be realized. The factors used to assess the likelihood of realization include: the past performance of the entities, forecasts of future taxable income, future reversals of existing taxable temporary differences, and available tax planning strategies that could be implemented to realize the deferred tax assets. The ability or failure to achieve the forecasted taxable income in these entities could affect the ultimate realization of deferred tax assets.

As of September 30, 2020 and December 31, 2019, the liability for income taxes associated with uncertain tax positions was \$14.7 million and \$15.5 million, respectively. It is reasonably possible that the Company may realize a decrease in our uncertain tax positions of approximately \$1.0 million during the next 12 months as a result of concluding various tax audits and closing tax years.

Although the Company believes its reserves for its tax positions are reasonable, the final outcome of tax audits could be materially different, both favorably and unfavorably. It is reasonably possible that certain audits may conclude in the next 12 months and that the unrecognized tax benefits the Company has recorded in relation to these tax years may change compared to the liabilities recorded for these periods. However, it is not currently possible to estimate the amount, if any, of such change.

12. Contingencies

The Company is subject to certain lawsuits, claims and assessments that arise in the ordinary course of business. Additionally, the Company has been named as a defendant in lawsuits alleging personal injuries as a result of contact with asbestos products at various project sites. Management believes that any significant costs relating to these claims will be reimbursed by applicable insurance and, although there can be no assurance that these matters will be resolved favorably, management believes that the ultimate resolution of any of these claims will not have a material adverse effect on our consolidated financial position, results of operations, or cash flows. A liability is recorded when it is both probable that a loss has been incurred and the amount of loss or range of loss can be reasonably estimated. When using a range of loss estimate, the Company records the liability using the low end of the range. The Company records a corresponding receivable for costs covered under its insurance policies. Management judgment is required to determine the outcome and the estimated amount of a loss related to such matters. Management believes that there are no claims or assessments outstanding which would materially affect the consolidated results of operations or the Company's financial position.

On or about March 1, 2017, the Peninsula Corridor Joint Powers Board, or the JPB, filed a lawsuit against Parsons Transportation Group, Inc., or PTG, in the Superior Court of California, County of San Mateo, in connection with a positive train control project on which PTG was engaged prior to termination of its contract by the JPB. PTG had previously filed a lawsuit against the JPB for breach of contract and wrongful termination. The JPB seeks damages in excess of \$100.0 million, which the Company is currently disputing. In addition to filing a complaint for breach of contract and wrongful termination, the Company has denied the allegations raised by the JPB and, accordingly, filed affirmative defenses. The Company is currently defending against the JPB's claims and the parties are still engaged in discovery. The Company also has a professional liability insurance policy to the extent the JPB proves any errors or omissions occurred. At this time, the Company is unable to determine the probability of the outcome of the litigation or determine a potential range of loss, if any. The Company has also filed a third-party claim against a subcontractor for indemnification in connection with this matter.

In September 2015, a former Parsons employee filed an action in the United States District Court for the Northern District of Alabama against us as a qui tam relator on behalf of the United States (the "Relator") alleging violation of the False Claims Act. The United States government did not intervene in this matter as it is allowed to do so under the statute. The Company filed a motion to dismiss the lawsuit on the grounds that the Relator did not meet the applicable statute of limitations. The District Court granted the motion to dismiss. The Relator's attorney appealed the decision to the United States Court of Appeals of the Eleventh Circuit, which ultimately ruled in favor of the Relator, and the Company petitioned the United States Supreme Court to review the decision. The Supreme Court reviewed the decision and accepted the position of the Relator. The case was thus remanded to the United States District Court for the Northern District of Alabama. The defendants, including Parsons, will file appropriate pleadings opposing the allegations. At this time, the Company is unable to determine the probability of the outcome of the litigation or determine a potential range of loss, if any.

On or about October 4, 2019, LBH Engineers, LLC (“LBH”) filed a lawsuit against Parsons, PTG, and various other parties in the US District Court of for the Northern District of Georgia, in connection with an alleged infringement of LBH’s patent. LBH seeks damages and costs incurred by LBH, a post-judgment royalty, treble damages if the infringement is found to be willful, among other damages, which the Company and the other defendants are currently disputing. At this time, the Company is unable to determine the probability of the outcome of the litigation or determine a potential range of loss, if any.

Federal government contracts are subject to audits, which are performed for the most part by the Defense Contract Audit Agency (“DCAA”). Audits by the DCAA and other agencies consist of reviews of our overhead rates, operating systems and cost proposals to ensure that we account for such costs in accordance with the Cost Accounting Standards (“CAS”). If the DCAA determines we have not accounted for such costs in accordance with the CAS, the DCAA may disallow these costs. The disallowance of such costs may result in a reduction of revenue and additional liability for the Company. Historically, the Company has not experienced any material disallowed costs as a result of government audits. However, the Company can provide no assurance that the DCAA or other government audits will not result in material disallowances for incurred costs in the future. All audits of costs incurred on work performed through 2010 have been closed, and years thereafter remain open.

Although there can be no assurance that these matters will be resolved favorably, management believes that their ultimate resolution will not have a material adverse impact on the Company’s consolidated financial position, results of operations, or cash flows.

13. Retirement Benefit Plan

The Company’s principal retirement benefit plan is the Parsons Employee Stock Ownership Plan (“ESOP”), a stock bonus plan, established in 1975 to cover eligible employees of the Company and certain affiliated companies. Contributions of treasury stock to the ESOP are made annually in amounts determined by the Company’s board of directors and are held in trust for the sole benefit of the participants. Shares allocated to a participant’s account are fully vested after three years of credited service, or in the event(s) of reaching age 65, death or disability while an active employee of the Company. As of September 30, 2020 and December 31, 2019, total shares of the Company’s common stock were 100,727,574 and 100,669,694, respectively, of which 76,090,531 and 78,896,806, respectively, were held by the ESOP.

A participant’s interest in their ESOP account is redeemable upon certain events, including retirement, death, termination due to permanent disability, a severe financial hardship following termination of employment, certain conflicts of interest following termination of employment, or the exercise of diversification rights. Distributions from the ESOP of participants’ interests are made in the Company’s common stock based on quoted prices of a share of the Company’s common stock on the NYSE. A participant will be able to sell such shares of common stock in the market, subject to any requirements of the federal securities laws.

Total ESOP contribution expense was \$12.5 million and \$12.3 million for the three months ended September 30, 2020 and September 30, 2019, respectively, and \$42.0 million and \$36.8 million for the nine months ended September 30, 2020 and September 30, 2019, respectively. The expense is recorded in “Direct costs of contracts” and “Indirect, general and administrative expense” in the consolidated statements of income. The fiscal 2020 ESOP contribution has not yet been made. The amount is currently included in accrued liabilities.

On April 3, 2019, the board of directors of the Company declared a cash dividend to the Company’s sole existing shareholder at that time, the ESOP, in the amount of \$2.00 per share, or \$52.1 million in the aggregate (the “IPO Dividend”). The IPO Dividend was paid on May 10, 2019. On April 15, 2019, the board of directors of the Company declared a common stock dividend in a ratio of two shares of common stock for every one share of common stock then held by the Company’s shareholder (the “Stock Dividend”). The record date of the Stock Dividend was May 7, 2019, the day immediately prior to the consummation of the Company’s IPO on May 8, 2019, and the payment date of the Stock Dividend was May 8, 2019. Purchasers of the Company’s common stock in the Company’s public offering were not entitled to receive any portion of the Stock Dividend.

14. Investments in and Advances to Joint Ventures

The Company participates in joint ventures to bid, negotiate and complete specific projects. The Company is required to consolidate these joint ventures if it holds the majority voting interest or if the Company meets the criteria under the consolidation model, as described below.

The Company performs an analysis to determine whether its variable interests give the Company a controlling financial interest in a Variable Interest Entity ("VIE") for which the Company is the primary beneficiary and should, therefore, be consolidated. Such analysis requires the Company to assess whether it has the power to direct the activities of the VIE and the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE.

The Company analyzed all of its joint ventures and classified them into two groups: (1) joint ventures that must be consolidated because they are either not VIEs and the Company holds the majority voting interest, or because they are VIEs and the Company is the primary beneficiary; and (2) joint ventures that do not need to be consolidated because they are either not VIEs and the Company holds a minority voting interest, or because they are VIEs and the Company is not the primary beneficiary.

Many of the Company's joint venture agreements provide for capital calls to fund operations, as necessary; however, such funding is infrequent and is not anticipated to be material.

Letters of credit outstanding described in "Note 10 – Debt and Credit Facilities" that relate to project ventures are \$59.9 million and \$55.0 million at September 30, 2020 and December 31, 2019, respectively.

In the table below, aggregated financial information relating to the Company's joint ventures is provided because their nature, risk and reward characteristics are similar. None of the Company's current joint ventures that meet the characteristics of a VIE are individually significant to the consolidated financial statements.

Consolidated Joint Ventures

The following represents financial information for consolidated joint ventures included in the consolidated financial statements (in thousands):

	September 30, 2020	December 31, 2019
Current assets	\$ 343,304	\$ 255,167
Noncurrent assets	2,935	2,860
Total assets	<u>346,239</u>	<u>258,027</u>
Current liabilities	260,175	193,583
Total liabilities	<u>260,175</u>	<u>193,583</u>
Total joint venture equity	<u>\$ 86,064</u>	<u>\$ 64,444</u>

	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Revenue	\$ 117,344	\$ 117,611	\$ 335,511	\$ 341,719
Costs	105,223	108,839	304,308	322,826
Net income	<u>\$ 12,121</u>	<u>\$ 8,772</u>	<u>\$ 31,203</u>	<u>\$ 18,893</u>
Net income attributable to noncontrolling interests	\$ 5,862	\$ 4,481	\$ 15,086	\$ 8,012

The assets of the consolidated joint ventures are restricted for use only by the particular joint venture and are not available for the Company's general operations.

Unconsolidated Joint Ventures

The Company accounts for its unconsolidated joint ventures using the equity method of accounting. Under this method, the Company recognizes its proportionate share of the net earnings of these joint ventures as "Equity in earnings (loss) of unconsolidated joint ventures" in the consolidated statements of income. The Company's maximum exposure to loss as a result of its investments in unconsolidated VIEs is typically limited to the aggregate of the carrying value of the investment and future funding commitments.

The following represents the financial information of the Company's unconsolidated joint ventures as presented in their unaudited financial statements (in thousands):

	September 30, 2020	December 31, 2019
Current assets	\$ 792,763	\$ 801,335
Noncurrent assets	567,919	564,160
Total assets	<u>1,360,682</u>	<u>1,365,495</u>
Current liabilities	753,623	655,495
Noncurrent liabilities	493,576	507,131
Total liabilities	<u>1,247,199</u>	<u>1,162,626</u>
Total joint venture equity	<u>\$ 113,483</u>	<u>\$ 202,869</u>
Investments in and advances to unconsolidated joint ventures	\$ 71,289	\$ 68,620

	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Revenue	\$ 594,640	\$ 474,600	\$ 1,286,087	\$ 1,225,284
Costs	551,624	452,001	1,202,315	1,166,008
Net income	<u>\$ 43,016</u>	<u>\$ 22,599</u>	<u>\$ 83,772</u>	<u>\$ 59,276</u>
Equity in earnings of unconsolidated joint ventures	\$ 16,741	\$ 7,274	\$ 26,624	\$ 29,305

The Company received net distributions from its unconsolidated joint ventures for the three months ended September 30, 2020 and September 30, 2019 of \$11.2 million and \$13.7 million, respectively, and for the nine months ended September 30, 2020 and September 30, 2019 of \$23.2 million and \$28.0 million, respectively.

15. Related Party Transactions

The Company often provides services to unconsolidated joint ventures and revenues include amounts related to recovering overhead costs for these services. Revenues related to services the Company provided to unconsolidated joint ventures for the three months ended September 30, 2020 and September 30, 2019 were \$42.0 million and \$28.8 million, respectively, and for the nine months ended September 30, 2020 and September 30, 2019 were \$124.7 million and \$113.1 million, respectively. For the three months ended September 30, 2020 and September 30, 2019, the Company incurred \$32.3 million and \$20.5 million, respectively, and for the nine months ended September 30, 2020 and September 30, 2019, \$98.3 million and \$86.3 million, respectively, of reimbursable costs. Amounts included in the consolidated balance sheets related to services the Company provided to unconsolidated joint ventures are as follows (in thousands):

	September 30, 2020	December 31, 2019
Accounts receivable	\$ 35,838	\$ 37,425
Contract assets	5,703	6,955
Contract liabilities	3,352	4,509

16. Fair Value of Financial Instruments

The authoritative guidance on fair value measurement defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (referred to as an "exit price"). At September 30, 2020 and December 31, 2019, the Company's financial instruments include cash, cash equivalents, accounts receivable, accounts payable, and other liabilities. The fair values of these financial instruments approximate their carrying values due to their short-term maturities.

Investments measured at fair value are based on one or more of the following three valuation techniques:

- *Market approach*—Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities;
- *Cost approach*—Amount that would be required to replace the service capacity of an asset (i.e., replacement cost); and
- *Income approach*—Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing models and lattice models).

In addition, the guidance establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted market prices in active markets for identical assets and liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are:

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

Level 2 Pricing inputs that include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the instrument; and

Level 3 Prices or valuations that require inputs that are both significant to the fair value measurements and unobservable.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Refer to Notes to Consolidated Financial Statements included in the Company's Form 10-K for the year ended December 31, 2019 for a more complete discussion of the various items within the consolidated financial statements measured at fair value and the methods used to determine fair value.

17. Earnings Per Share

The following tables reconcile the denominator and numerator used to compute basic earnings per share ("EPS") to the denominator and numerator used to compute diluted EPS for the three and nine months ended September 30, 2020 and September 30, 2019. Basic EPS is computed using the weighted average number of shares outstanding during the period and income available to shareholders. Diluted EPS is computed similar to basic EPS, except the income available to shareholders is adjusted to add back interest expense, after tax related to the Convertible Senior Note, and the weighted average number of shares outstanding is adjusted to reflect the dilutive effects of equity-based awards and shares underlying the Convertible Senior Note.

Convertible Senior Note dilution impact is calculated using the if-converted method which will be required upon adoption of ASU 2020-06. As a result, the Company elected to adopt the if-converted method under the present accounting. In connection with the offerings of our note, the Company entered into a convertible note hedge and warrants (see Note 10 Debt and Credit Facilities); however, the convertible note hedge is not considered when calculating dilutive shares given its impact is anti-dilutive. The impact of the bond hedge would offset the dilutive impact of the shares underlying the Convertible Senior Note. The warrants have a strike price above our average share price during the period and are out of the money and not included in the tables below.

Dilutive potential common shares include shares the Company could be obligated to issue from its Convertible Senior Notes and warrants (see Note 10 for further discussion) and equity-based awards. Shares to be provided to the Company from its bond hedge purchased concurrently with the issuance of Convertible Senior Notes are anti-dilutive and are not included in its diluted shares. Anti-dilutive equity-based awards excluded from the calculation of earnings per share for the three and nine months ended September 30, 2020 were 205 and 3,318, respectively.

The weighted average number of shares used to compute basic and diluted EPS were:

	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Basic weighted average number of shares outstanding	100,736,862	99,434,877	100,700,498	89,977,493
Equity-based awards	378,486	-	321,070	-
Convertible senior notes	4,458,265	-	-	-
Diluted weighted average number of shares outstanding	<u>105,573,613</u>	<u>99,434,877</u>	<u>101,021,568</u>	<u>89,977,493</u>

The net income available to shareholders to compute basic and diluted EPS were (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Net income attributable to Parsons Corporation	40,658	56,812	76,930	106,812
Convertible senior notes if-converted method interest adjustment	1,164	-	-	-
Diluted net income attributable to Parsons Corporation	<u>41,822</u>	<u>56,812</u>	<u>76,930</u>	<u>106,812</u>

18. Segment Information

The Company operates in two reportable segments: Federal Solutions and Critical Infrastructure.

The Federal Solutions segment provides advanced technical solutions to the U.S. government, delivering timely, cost-effective hardware, software and services for mission-critical projects. The segment provides advanced technologies, supporting national security missions in cybersecurity, missile defense, and military facility modernization, logistics support, hazardous material remediation and engineering services.

The Critical Infrastructure segment provides integrated engineering and management services for complex physical and digital infrastructure around the globe. The Critical Infrastructure segment is a technology innovator focused on next generation digital systems and complex structures. Industry leading capabilities in engineering and project management allow the Company to deliver significant value to customers by employing cutting-edge technologies, improving timelines and reducing costs.

The Company defines its reportable segments based on the way the chief operating decision maker ("CODM"), currently its Chairman and Chief Executive Officer, evaluates the performance of each segment and manages the operations of the Company for purposes of allocating resources among the segments. The CODM evaluates segment operating performance using segment Revenue and segment Adjusted EBITDA attributable to Parsons Corporation.

The following table summarizes business segment revenue for the periods presented (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Federal Solutions revenue	\$ 498,156	\$ 486,175	\$ 1,457,937	\$ 1,387,484
Critical Infrastructure revenue	506,080	537,102	1,496,751	1,529,940
Total revenue	<u>\$ 1,004,236</u>	<u>\$ 1,023,277</u>	<u>\$ 2,954,688</u>	<u>\$ 2,917,424</u>

The Company defines Adjusted EBITDA attributable to Parsons Corporation as Adjusted EBITDA excluding Adjusted EBITDA attributable to noncontrolling interests. The Company defines Adjusted EBITDA as net income (loss) attributable to Parsons Corporation, adjusted to include net income (loss) attributable to noncontrolling interests and to exclude interest expense (net of interest income), provision for income taxes, depreciation and amortization and certain other items that are not considered in the evaluation of ongoing operating performance. These other items include net

income (loss) attributable to noncontrolling interests, asset impairment charges, income and expense recognized on litigation matters, expenses incurred in connection with acquisitions and other non-recurring transaction costs and expenses related to our prior restructuring. The following table reconciles business segment Adjusted EBITDA attributable to Parsons Corporation to Net Income attributable to Parsons Corporation for the periods presented (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Adjusted EBITDA attributable to Parsons Corporation				
Federal Solutions	\$ 45,874	\$ 50,359	\$ 125,191	\$ 126,658
Critical Infrastructure	48,856	33,976	111,732	102,177
Adjusted EBITDA attributable to Parsons Corporation	94,730	84,335	236,923	228,835
Adjusted EBITDA attributable to noncontrolling interests	6,071	4,655	15,535	8,384
Depreciation and amortization	(30,952)	(31,027)	(95,442)	(92,692)
Interest expense, net	(5,387)	(4,482)	(13,144)	(18,448)
Income tax (expense) benefit	(16,017)	15,453	(32,992)	67,063
Equity-based compensation income (expense)	991	1,657	(4,142)	(45,504)
Transaction-related costs (a)	(2,411)	(9,891)	(11,937)	(26,961)
Restructuring expense (b)	(365)	(309)	(1,475)	(2,880)
Other (c)	(140)	902	(1,310)	(2,973)
Net income including noncontrolling interests	46,520	61,293	92,016	114,824
Net income attributable to noncontrolling interests	5,862	4,481	15,086	8,012
Net income attributable to Parsons Corporation	\$ 40,658	\$ 56,812	\$ 76,930	\$ 106,812

- (a) Reflects costs incurred in connection with acquisitions, the IPO, and other non-recurring transaction costs, primarily fees paid for professional services and employee retention.
- (b) Reflects costs associated with corporate restructuring initiatives.
- (c) Includes a combination of gain/loss related to sale of fixed assets, software implementation costs, and other individually insignificant items that are non-recurring in nature.

Asset information by segment is not a key measure of performance used by the CODM.

The following tables present revenues and property and equipment, net by geographic area (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Revenue				
North America	\$ 831,367	\$ 849,839	\$ 2,429,357	\$ 2,400,124
Middle East	168,043	169,028	511,591	504,604
Rest of World	4,826	4,410	13,740	12,696
Total Revenue	\$ 1,004,236	\$ 1,023,277	\$ 2,954,688	\$ 2,917,424

The geographic location of revenue is determined by the location of the customer.

	September 30, 2020	December 31, 2019
Property and Equipment, Net		
North America	\$ 116,805	\$ 117,606
Middle East	4,681	5,145
Total Property and Equipment, Net	\$ 121,486	\$ 122,751

North America includes revenue in the United States for the three months ended September 30, 2020 and September 30, 2019 of \$774.0 million and \$774.2 million, respectively, and for the nine months ended September 30, 2020 and September 30, 2019 of \$2.2 billion and \$2.2 billion, respectively. North America property and equipment, net

includes \$109.6 million and \$109.9 million of property and equipment, net in the United States at September 30, 2020 and December 31, 2019, respectively.

The following table presents revenues by business lines (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Revenue				
Space & Geospatial Solutions	\$ 68,354	\$ 49,944	\$ 177,609	\$ 161,469
Cyber & Intelligence	110,339	91,854	312,214	244,892
Engineered Systems	164,867	180,171	504,182	493,065
Missile Defense & C5ISR	154,596	164,206	463,932	488,058
Federal Solutions revenues	498,156	486,175	1,457,937	1,387,484
Mobility Solutions	389,714	435,749	1,180,125	1,211,571
Connected Communities	116,366	101,353	316,626	318,369
Critical Infrastructure revenues	506,080	537,102	1,496,751	1,529,940
Total Revenue	<u>\$ 1,004,236</u>	<u>\$ 1,023,277</u>	<u>\$ 2,954,688</u>	<u>\$ 2,917,424</u>

Effective January 1, 2020, the Company made changes to its business lines as described below. The prior year information in the table above has been reclassified to conform to the business line changes.

Federal Solutions Business Line Changes

As a result of the acquisitions of Polaris Alpha, OGSystems and QRC, we realigned the five business lines within our Federal Solutions segment into four business lines. We consolidated all space and geospatial programs from the former Geospatial Solutions, Defense and Cyber & Intelligence markets into a new Space & Geospatial Solutions business line to increase focus on the critical, evolving space market. This new business line better aligns capabilities and customers to drive growth and performance execution through improved agile, end-to-end solutions and dedicated customer focus.

Further, we re-named our Defense business line to Missile Defense & C5ISR. We moved our Missions Solutions business line into our Missile Defense & C5ISR, Engineered Systems and Cyber & Intelligence business lines, for better customer and capability alignment. These changes were the next logical step in our acquisition integration process, to optimize performance delivery and growth.

Critical Infrastructure Business Line Changes

We re-aligned our Critical Infrastructure segment from three markets to two markets. Industrial is now a part of Mobility Solutions and we moved all Middle East business into Mobility Solutions as well. We believe this will drive improved synergies among like-markets and increased collaboration in areas such as program and engineering management, civil and structural and water/wastewater treatment. We also moved Aviation to Connected Communities and consolidated the civil portion of rail and transit with the systems portion of rail and transit into a consolidated sub-market within Connected Communities to focus on growth in these critical market segments. In each, we are pursuing systems, software and hardware product advanced technology opportunities.

19. Subsequent Events

On October 29, 2020, the Company announced that it has entered into a definitive agreement to acquire Braxton Science & Technology Group, LLC (BSTG). BSTG operates at the forefront of satellite operations, ground system automation, flight dynamics, and spacecraft and antenna simulation for the U.S. Department of Defense and Intelligence Community. The purchase price is estimated to be \$300 million and the Company anticipates using all cash to fund the transaction.

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

The following discussion and analysis is intended to help investors understand our business, financial condition, results of operations, liquidity and capital resources. You should read this discussion together with our consolidated financial statements and related notes thereto included elsewhere in this Form 10-Q and in conjunction with the Company's Form 10-K for the year ended December 31, 2019.

The statements in this discussion regarding industry outlook, our expectations regarding our future performance, liquidity and capital resources and other non-historical statements in this discussion are forward-looking statements. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, the risks and uncertainties described in "Risk Factors" and "Special Note Regarding Forward-Looking Statements" in the Company's Form 10-K for the year ended December 31, 2019. We undertake no obligation to revise publicly any forward-looking statements. Actual results may differ materially from those contained in any forward-looking statements.

COVID-19 Pandemic

In response to the COVID-19 pandemic, the Company has taken certain actions to continue to execute under our contracts with customers and allow our people to work safely. A substantial majority of our work-force transitioned to work-from-home status during the latter part of the quarter ended March 31, 2020, and these practices remain in effect as of the date of this filing. To date, we have experienced no material disruption in our work as a consequence of these changes in our work practices.

The Company has experienced an impact in the volume of work in both the Federal Solutions and Critical Infrastructure segments where customers have restricted access to certain project sites. We have not seen any substantive cancellations of previously awarded contracts. In the Federal Solutions segment, we have had some existing contracts extended. We continue to see several potential contract awards pushed out to a future date.

The Company is receiving limited benefits associated with the CARES Act related to its work on certain US national security projects; however, the curtailment of work under these projects and the CARES Act benefits are not likely to have a material impact on our financial condition or results of operations.

The Company has provided additional disclosure around liquidity and capital resources which can be found in the "Liquidity and Capital Resources" section in Management's Discussion and Analysis of Financial Condition and Results of Operations in this Form 10-Q.

The Company anticipates substantially all of the Company's subcontractors and material suppliers will be able to fulfill their contractual obligations and we do not expect a material impact from non-performance.

The ultimate impact from the COVID-19 pandemic is difficult to predict. While many uncertainties exist, we currently anticipate no material change in our financial condition or results of operations.

PARSONS CORPORATION

Enabling a safer, smarter, and more interconnected world.

SEGMENTS



Federal Solutions

Technology-driven solutions for defense and intelligence customers



Critical Infrastructure

Engineered solutions for complex physical and digital infrastructure challenges

FINANCIAL SNAPSHOT



KEY FACTS AND FIGURES



75+

Years Of History



~16K

Employees



4%

Revenue Growth
Trailing 12-Months (Q3 2020)



1.0X

Book-To-Bill Ratio
Trailing 12-Months (Q3 2020)



\$7.8B

Backlog As Of
9/30/2020

Overview

We are a leading disruptive technology provider in the global defense, intelligence and critical infrastructure markets. We provide software and hardware products, technical services and integrated solutions to support our customers' missions. We have developed significant expertise and differentiated capabilities in key areas of cybersecurity, intelligence, missile defense, C5ISR, space, geospatial, and connected communities. By combining our talented team of professionals and advanced technology, we help solve complex technical challenges to enable a safer, smarter and more interconnected world.

We operate in two reporting segments, Federal Solutions and Critical Infrastructure. Our Federal Solutions business provides advanced technical solutions to the U.S. government. Our Critical Infrastructure business provides integrated engineering and management services for complex physical and digital infrastructure to state and local governments and large companies.

Our employees provide services pursuant to contracts that we are awarded by the customer and specific task orders relating to such contracts. These contracts are often multi-year, which provides us backlog and visibility on our revenues for future periods. Many of our contracts and task orders are subject to renewal and rebidding at the end of their term, and some are subject to the exercise of contract options and issuance of task orders by the applicable government entity. In addition to focusing on increasing our revenues through increased contract awards and backlog, we focus our financial performance on margin expansion and cash flow.

Key Metrics

We manage and assess the performance of our business by evaluating a variety of metrics. The following table sets forth selected key metrics (in thousands, except Book-to-Bill):

	September 30, 2020	September 30, 2019
Awards (year to date)	\$ 3,141,745	\$ 3,334,434
Backlog (1)	\$ 7,776,610	\$ 8,250,514
Book-to-Bill (year to date)	1.1	1.1

- (1) Difference between our backlog of \$7.8 billion and our remaining unsatisfied performance obligations, or RUPO, of \$5.0 billion, each as of September 30, 2020, is due to (i) unissued delivery orders and unexercised option years, to the extent their issuance or exercise is probable, as well as (ii) contract awards, to the extent we believe contract execution and funding is probable.

Awards

Awards generally represent the amount of revenue expected to be earned in the future from funded and unfunded contract awards received during the period. Contract awards include both new and re-compete contracts and task orders. Given that new contract awards generate growth, we closely track our new awards each year.

The following table summarizes the year to-date value of new awards for the periods presented below (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Federal Solutions	\$ 737,643	\$ 845,559	\$ 1,786,473	\$ 2,076,928
Critical Infrastructure	432,916	289,665	1,355,272	1,257,506
Total Awards	\$ 1,170,559	\$ 1,135,224	\$ 3,141,745	\$ 3,334,434

The change in new awards from year to year is primarily due to ordinary course fluctuations in our business. The volume of contract awards can fluctuate in any given period due to win rate and the timing and size of the awards issued by our customers. The change in new awards in our Federal Solutions segment for the nine months ended September 30, 2020 when compared to the corresponding period last year was impacted by two significant contracts awarded in the first quarter of 2019. The awards in Critical Infrastructure for the three and nine months ended September 30, 2020 were impacted by several large contracts awarded in the third quarter of 2020.

Backlog

We define backlog to include the following two components:

- **Funded**—Funded backlog represents the revenue value of orders for services under existing contracts for which funding is appropriated or otherwise authorized less revenue previously recognized on these contracts.
- **Unfunded**—Unfunded backlog represents the revenue value of orders for services under existing contracts for which funding has not been appropriated or otherwise authorized less revenue previously recognized on these contracts.

Backlog includes (i) unissued task orders and unexercised option years, to the extent their issuance or exercise is probable, as well as (ii) contract awards, to the extent we believe contract execution and funding is probable.

The following table summarizes the value of our backlog at the respective dates presented below: (in thousands):

	September 30, 2020	September 30, 2019
Federal Solutions:		
Funded	\$ 1,175,924	\$ 1,214,919
Unfunded	3,901,231	3,946,784
Total Federal Solutions	5,077,155	5,161,703
Critical Infrastructure:		
Funded	2,619,454	3,050,525
Unfunded	80,001	38,286
Total Critical Infrastructure (1)	2,699,455	3,088,811
Total Backlog (2)	\$ 7,776,610	\$ 8,250,514

- (1) As presented in the first quarter of 2019, funded backlog for the Critical Infrastructure segment was overstated by \$38.3 million with a corresponding understatement in unfunded backlog. There was no impact on total Critical Infrastructure backlog or total backlog for Parsons Corporation.
- (2) Difference between our backlog of \$7.8 billion and our RUPO of \$5.0 billion, each as of September 30, 2020, is due to (i) unissued task orders and unexercised option years, to the extent their issuance or exercise is probable, as well as (ii) contract awards, to the extent we believe contract execution and funding is probable.

Our backlog includes orders under contracts that in some cases extend for several years. For example, the U.S. Congress generally appropriates funds for our U.S. federal government customers on a yearly basis, even though their contracts with us may call for performance that is expected to take a number of years to complete. As a result, our federal contracts typically are only partially funded at any point during their term. All or some of the work to be performed under the contracts may remain unfunded unless and until the U.S. Congress makes subsequent appropriations and the procuring agency allocates funding to the contract.

We expect to recognize \$2.6 billion of our funded backlog at September 30, 2020 as revenues in the following twelve months. However, our U.S. federal government customers may cancel their contracts with us at any time through a termination for convenience or may elect to not exercise option periods under such contracts. In the case of a termination for convenience, we would not receive anticipated future revenues, but would generally be permitted to recover all or a portion of our incurred costs and fees for work performed. See “Risk Factors—Risk Relating to Our Business—We may not realize the full value of our backlog, which may result in lower than expected revenue” in the Company’s Form 10-K for the year ended December 31, 2019.

The changes in backlog in both the Federal Solutions and Critical Infrastructure segments were primarily from ordinary course fluctuations in our business and the impacts related to the Company’s awards discussed above.

Book-to-Bill

Book-to-bill is the ratio of total awards to total revenue recorded in the same period. Our management believes our book-to-bill ratio is a useful indicator of our potential future revenue growth in that it measures the rate at which we are generating new awards compared to the Company’s current revenue. To drive future revenue growth, our goal is for the level of awards in a given period to exceed the revenue booked. A book-to-bill ratio greater than 1.0 indicates that awards generated in a given period exceeded the revenue recognized in the same period, while a book-to-bill ratio of less than 1.0 indicates that awards generated in such period were less than the revenue recognized in such period. The following table sets forth the book-to-bill ratio for the periods presented below:

	Three months ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Federal Solutions	1.5	1.7	1.2	1.5
Critical Infrastructure	0.9	0.5	0.9	0.8
Overall	1.2	1.1	1.1	1.1

Factors and Trends Affecting Our Results of Operations

We believe that the financial performance of our business and our future success are dependent upon many factors, including those highlighted in this section. Our operating performance will depend upon many variables, including the success of our growth strategies and the timing and size of investments and expenditures that we choose to undertake, as well as market growth and other factors that are not within our control.

Government Spending

Changes in the relative mix of government spending and areas of spending growth, with shifts in priorities on homeland security, intelligence, defense-related programs, infrastructure and urbanization, and continued increased spending on technology and innovation, including cybersecurity, artificial intelligence, connected communities and physical infrastructure, could impact our business and results of operations. Cost-cutting and efficiency initiatives, current and future budget restrictions, spending cuts and other efforts to reduce government spending could cause our government customers to reduce or delay funding or invest appropriated funds on a less consistent basis or not at all, and demand for our solutions or services could diminish. Furthermore, any disruption in the functioning of government

agencies, including as a result of government closures and shutdowns, could have a negative impact on our operations and cause us to lose revenue or incur additional costs due to, among other things, our inability to deploy our staff to customer locations or facilities as a result of such disruptions.

Federal Budget Uncertainty

There is uncertainty around the timing, extent, nature and effect of Congressional and other U.S. government actions to address budgetary constraints, caps on the discretionary budget for defense and non-defense departments and agencies, and the ability of Congress to determine how to allocate the available budget authority and pass appropriations bills to fund both U.S. government departments and agencies that are, and those that are not, subject to the caps. Additionally, budget deficits and the growing U.S. national debt increase pressure on the U.S. government to reduce federal spending across all federal agencies, with uncertainty about the size and timing of those reductions. Furthermore, delays in the completion of future U.S. government budgets could in the future delay procurement of the federal government services we provide. A reduction in the amount of, or delays, or cancellations of funding for, services that we are contracted to provide to the U.S. government as a result of any of these impacts or related initiatives, legislation or otherwise could have a material adverse effect on our business and results of operations.

Regulations

Increased audit, review, investigation and general scrutiny by government agencies of performance under government contracts and compliance with the terms of those contracts and applicable laws could affect our operating results. Negative publicity and increased scrutiny of government contractors in general, including us, relating to government expenditures for contractor services and incidents involving the mishandling of sensitive or classified information, as well as the increasingly complex requirements of the U.S. Department of Defense and the U.S. Intelligence Community, including those related to cybersecurity, could impact our ability to perform in the markets we serve.

Competitive Markets

The industries we operate in consist of a large number of enterprises ranging from small, niche-oriented companies to multi-billion dollar corporations that serve many government and commercial customers. We compete on the basis of our technical expertise, technological innovation, our ability to deliver cost-effective multi-faceted services in a timely manner, our reputation and relationships with our customers, qualified and/or security-clearance personnel, and pricing. We believe that we are uniquely positioned to take advantage of the markets in which we operate because of our proven track record, long-term customer relationships, technology innovation, scalable and agile business offerings and world class talent. Our ability to effectively deliver on project engagements and successfully assist our customers affects our ability to win new contracts and drives our financial performance.

Acquired Operations

QRC Technologies

On July 31, 2019, the Company acquired QRC Technologies for \$214.1 million. QRC Technologies provides design and development of open-architecture radio-frequency products. The acquisition was funded by cash on-hand and borrowings under our Revolving Credit Facility. The financial results of QRC Technologies have been included in our consolidated results of operations from July 31, 2019 onward.

Seasonality

Our results may be affected by variances as a result of seasonality we experience across our businesses. This pattern is typically driven by the U.S. federal government fiscal year-end, September 30. While not certain, it is not uncommon for U.S. government agencies to award extra tasks or complete other contract actions in the weeks before the end of the U.S. federal government fiscal year in order to avoid the loss of unexpended fiscal year funds. In addition, we have also historically experienced higher bid and proposal costs in the months leading up to the U.S. federal government fiscal year-end as we pursue new contract opportunities expected to be awarded early in the following U.S. federal government fiscal year as a result of funding appropriated for that U.S. federal government fiscal year. Furthermore, many U.S. state governments with fiscal years ending on June 30 tend to accelerate spending during their first quarter, when new funding becomes available. We may continue to experience this seasonality in future periods, and our results of operations may be affected by it.

Taxes

Historically, the Company had elected to be taxed under the provisions of Subchapter “S” of the Internal Revenue Code for federal tax purposes. As a result, the Company’s income had not been subject to U.S. federal income taxes or state income taxes in those states where the “S” Corporation status was recognized. No provision or liability for federal or state income tax had been provided in the Company’s consolidated financial statements, prior to the IPO on May 8, 2019, except for those states where the “S” Corporation status was not recognized or where states imposed a tax on “S” Corporations. The provision for income tax in the historical periods prior to the IPO consists of these state taxes and from certain foreign jurisdictions where the Company is subject to tax.

In connection with the IPO, the Company’s “S” Corporation status terminated, and the Company is now treated as a “C” Corporation under Subchapter C of the Internal Revenue Code. The revocation of the Company’s “S” Corporation election had a material impact on the Company’s results of operations, financial condition and cash flows. The effective tax rate has increased, and net income has decreased as compared to the Company’s “S” Corporation tax years, since the Company is now subject to both U.S. federal and state corporate income taxes on its earnings.

Results of Operations

Revenue

Our revenue consists of both services provided by our employees and pass-through fees from subcontractors and other direct costs. Our Federal Solutions segment derives revenue primarily from the U.S. federal government and our Critical Infrastructure segment derives revenue primarily from government and commercial customers.

We recognize revenue for work performed under cost-plus, time-and-materials and fixed-price contracts as follows:

Under cost-plus contracts, we are reimbursed for allowable or otherwise defined costs incurred, plus a fee. The contracts may also include incentives for various performance criteria, including quality, timeliness, safety and cost-effectiveness. In addition, costs are generally subject to review by clients and regulatory audit agencies, and such reviews could result in costs being disputed as non-reimbursable under the terms of the contract.

Under time-and-materials contracts, hourly billing rates are negotiated and charged to clients based on the actual time spent on a project. In addition, clients reimburse actual out-of-pocket costs for other direct costs and expenses that are incurred in connection with the performance under the contract.

Under fixed-price contracts, clients pay an agreed fixed-amount negotiated in advance for a specified scope of work.

Please see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates” and “Note 2—Summary of Significant Accounting Policies” in the notes to our consolidated financial statements included in the Company’s Form 10-K for the year ended December 31, 2019 for a description of our policies on revenue recognition.

The table below presents the percentage of total revenue for each type of contract.

	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Fixed-price	32.4%	28.2%	32.0%	29.2%
Time-and-materials	26.5%	27.9%	26.3%	27.8%
Cost-plus	41.2%	43.9%	41.7%	43.1%

The amount of risk and potential reward varies under each type of contract. Under cost-plus contracts, there is limited financial risk, because we are reimbursed for all allowable costs up to a ceiling. However, profit margins on this type of contract tend to be lower than on time-and-materials and fixed-price contracts. Under time-and-materials contracts, we are reimbursed for the hours worked using the predetermined hourly rates for each labor category. In addition, we are typically reimbursed for other direct contract costs and expenses at cost. We assume financial risk on time-and-materials contracts because our labor costs may exceed the negotiated billing rates. Profit margins on well-managed time-and-materials contracts tend to be higher than profit margins on cost-plus contracts as long as we are able to staff those contracts with people who have an appropriate skill set. Under fixed-price contracts, we are required to deliver the objectives under the contract for a pre-determined price. Compared to time-and-materials and cost-plus contracts, fixed-price contracts generally offer higher profit margin opportunities because we receive the full benefit of any

cost savings, but they also generally involve greater financial risk because we bear the risk of any cost overruns. In the aggregate, the contract type mix in our revenue for any given period will affect that period's profitability. Over time, we have experienced a relatively stable contract mix.

Our recognition of profit on long-term contracts requires the use of assumptions related to transaction price and total cost of completion. Estimates are continually evaluated as work progresses and are revised when necessary. When a change in estimated cost or transaction price is determined to have an impact on contract profit, we record a positive or negative adjustment to revenue.

Joint Ventures

We conduct a portion of our business through joint ventures or similar partnership arrangements. For the joint ventures we control, we consolidate all the revenues and expenses in our consolidated statements of income (including revenues and expenses attributable to noncontrolling interests). For the joint ventures we do not control, we recognize equity in earnings (loss) of unconsolidated joint ventures. Our revenues included amounts related to services we provided to our unconsolidated joint ventures for the three months ended September 30, 2020 and September 30, 2019 of \$42.0 million and \$28.8 million, respectively, and for the nine months ended September 30, 2020 and September 30, 2019 of \$124.7 million and \$113.1 million, respectively.

Operating costs and expenses

Operating costs and expenses primarily include direct costs of contracts and indirect, general and administrative expenses. Costs associated with compensation-related expenses for our people and facilities, which includes ESOP contribution expenses, are the most significant component of our operating expenses. Total ESOP contribution expense for the three months ended September 30, 2020 and September 30, 2019 was \$12.5 million and \$12.3 million, respectively, and for the nine months ended September 30, 2020 and September 30, 2019 was \$42.0 million and \$36.8 million, respectively, and is recorded in "Direct cost of contracts" and "Indirect, general and administrative expenses." We expect operating expenses to increase due to our anticipated growth and the incremental costs associated with being a public company.

Direct costs of contracts consist of direct labor and associated fringe benefits, indirect overhead, subcontractor and materials ("pass-through costs"), travel expenses and other expenses incurred to perform on contracts.

Indirect, general and administrative expenses ("IG&A") include salaries and wages and fringe benefits of our employees not performing work directly for customers, facility costs and other costs related to these indirect functions.

Other income and expenses

Other income and expenses primarily consist of interest income, interest expense, other income, net and interest and other expense associated with claims on long-term contracts.

Interest income primarily consists of interest earned on U.S. government money market funds.

Interest expense consists of interest expense incurred under our Senior Notes, Convertible Senior Notes, and Credit Agreement.

Other income, net primarily consists of gain or loss on sale of assets, sublease income and transaction gain or loss related to movements in foreign currency exchange rates.

Adjusted EBITDA

The following table sets forth Adjusted EBITDA, Net Income Margin, and Adjusted EBITDA Margin for the three and nine months ended September 30, 2020 and September 30, 2019.

(U.S. dollars in thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Adjusted EBITDA (1)	\$ 100,801	\$ 88,990	\$ 252,458	\$ 237,219
Net Income Margin (2)	4.6%	6.0%	3.1%	3.9%
Adjusted EBITDA Margin (3)	10.0%	8.7%	8.5%	8.1%

- (1) A reconciliation of net income attributable to Parsons Corporation to Adjusted EBITDA is set forth below (in thousands).
- (2) Net Income Margin is calculated as net income including noncontrolling interest divided by revenue in the applicable period
- (3) Adjusted EBITDA Margin is calculated as Adjusted EBITDA divided by revenue in the applicable period.

	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Net income attributable to Parsons Corporation	\$ 40,658	\$ 56,812	\$ 76,930	\$ 106,812
Interest expense, net	5,387	4,482	13,144	18,448
Income tax expense (benefit)	16,017	(15,453)	32,992	(67,063)
Depreciation and amortization	30,952	31,027	95,442	92,692
Net income attributable to noncontrolling interests	5,862	4,481	15,086	8,012
Equity-based compensation	(991)	(1,657)	4,142	45,504
Transaction-related costs (a)	2,411	9,891	11,937	26,961
Restructuring (b)	365	309	1,475	2,880
Other (c)	140	(902)	1,310	2,973
Adjusted EBITDA	<u>\$ 100,801</u>	<u>\$ 88,990</u>	<u>\$ 252,458</u>	<u>\$ 237,219</u>

- (a) Reflects costs incurred in connection with acquisitions, IPO, and other non-recurring transaction costs, primarily fees paid for professional services and employee retention.
- (b) Reflects costs associated with our corporate restructuring initiatives.
- (c) Includes a combination of gain/loss related to sale of fixed assets, software implementation costs, and other individually insignificant items that are non-recurring in nature.

Adjusted EBITDA is a supplemental measure of our operating performance used by management and our board of directors to assess our financial performance both on a segment and on a consolidated basis. We discuss Adjusted EBITDA because our management uses this measure for business planning purposes, including to manage the business against internal projected results of operations and measure the performance of the business generally. Adjusted EBITDA is frequently used by analysts, investors and other interested parties to evaluate companies in our industry.

Adjusted EBITDA is not a GAAP measure of our financial performance or liquidity and should not be considered as an alternative to net income as a measure of financial performance or cash flows from operations as measures of liquidity, or any other performance measure derived in accordance with GAAP. We define Adjusted EBITDA as net income (loss) attributable to Parsons Corporation, adjusted to include net income (loss) attributable to noncontrolling interests and to exclude interest expense (net of interest income), provision for income taxes, depreciation and amortization and certain other items that we do not consider in our evaluation of ongoing operating performance. These other items include, among other things, impairment of goodwill, intangible and other assets, interest and other expenses recognized on litigation matters, amortization of deferred gain resulting from sale-leaseback transactions, expenses incurred in connection with acquisitions and other non-recurring transaction costs and expenses related to our corporate restructuring initiatives. Adjusted EBITDA should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items. Additionally, Adjusted EBITDA is not intended to be a measure of free cash flow for management's discretionary use, as it does not reflect tax payments, debt service requirements, capital expenditures and certain other cash costs that may recur in the future, including, among other things, cash requirements for working capital needs and cash costs to replace assets being depreciated and amortized. Management compensates for these limitations by relying on our GAAP results in addition to using Adjusted EBITDA supplementally. Our measure of Adjusted EBITDA is not necessarily comparable to similarly titled captions of other companies due to different methods of calculation.

The following table shows Adjusted EBITDA attributable to Parsons Corporation for each of our reportable segments and Adjusted EBITDA attributable to noncontrolling interests (in thousands):

	Three Months Ended		Variance		Nine Months Ended		Variance	
	September 30, 2020	September 30, 2019	Dollar	Percent	September 30, 2020	September 30, 2019	Dollar	Percent
Federal Solutions Adjusted EBITDA attributable to Parsons Corporation	\$ 45,874	\$ 50,359	\$ (4,485)	-8.9%	\$ 125,191	\$ 126,658	\$ (1,467)	-1.2%
Critical Infrastructure Adjusted EBITDA attributable to Parsons Corporation	48,856	33,976	14,880	43.8%	111,732	102,177	9,555	9.4%
Adjusted EBITDA attributable to noncontrolling interests	6,071	4,655	1,416	30.4%	15,535	8,384	7,151	85.3%
Total Adjusted EBITDA	<u>\$ 100,801</u>	<u>\$ 88,990</u>	<u>\$ 11,811</u>	<u>13.3%</u>	<u>\$ 252,458</u>	<u>\$ 237,219</u>	<u>\$ 15,239</u>	<u>6.4%</u>

The following table sets forth our results of operations for the three and nine months ended September 30, 2020 and September 30, 2019 as a percentage of revenue.

	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Revenues	100%	100%	100%	100%
Direct costs of contracts	78.5%	78.0%	78.1%	78.8%
Equity in earnings of unconsolidated joint ventures	1.7%	0.7%	0.9%	1.0%
Indirect, general and administrative expenses	16.5%	17.4%	18.2%	19.9%
Operating income (loss)	6.6%	5.2%	4.6%	2.3%
Interest income	0.0%	0.0%	0.0%	0.0%
Interest expense	-0.5%	-0.5%	-0.5%	-0.7%
Other income, net	0.2%	-0.3%	0.1%	-0.1%
(Interest and other expense) gain associated with claim on long-term contract	0.0%	0.0%	0.0%	0.0%
Total other income (expense)	-0.4%	-0.7%	-0.4%	-0.7%
Income (loss) before income tax expense	6.2%	4.5%	4.2%	1.6%
Income tax benefit (provision)	-1.6%	1.5%	-1.1%	2.3%
Net income including noncontrolling interests	4.6%	6.0%	3.1%	3.9%
Net income attributable to noncontrolling interests	-0.6%	-0.4%	-0.5%	-0.3%
Net income attributable to Parsons Corporation	<u>4.0%</u>	<u>5.6%</u>	<u>2.6%</u>	<u>3.7%</u>

Revenue

(U.S. dollars in thousands)	Three Months Ended		Variance		Nine Months Ended		Variance	
	September 30, 2020	September 30, 2019	Dollar	Percent	September 30, 2020	September 30, 2019	Dollar	Percent
Revenue	\$ 1,004,236	\$ 1,023,277	\$ (19,041)	-1.9%	\$ 2,954,688	\$ 2,917,424	\$ 37,264	1.3%

Revenue decreased \$19.0 million for the three months ended September 30, 2020 when compared to the corresponding period last year, primarily due to a decrease in revenue in our Critical Infrastructure segment of \$31.0 million, partially offset by an increase in our Federal Solutions segment of \$12.0 million. Revenue increased \$37.3 million for the nine months ended September 30, 2020 when compared to the corresponding period last year, primarily due to an increase in revenue in our Federal Solutions segment of \$70.5 million, offset by a decrease in our Critical Infrastructure segment of \$33.2 million. See "Segment Results" below for a further discussion.

Direct costs of contracts

(U.S. dollars in thousands)	Three Months Ended		Variance		Nine Months Ended		Variance	
	September 30, 2020	September 30, 2019	Dollar	Percent	September 30, 2020	September 30, 2019	Dollar	Percent
	Direct costs of contracts	\$ 788,769	\$ 798,552	\$ (9,783)	-1.2%	\$ 2,307,725	\$ 2,297,512	\$ 10,213

Direct cost of contracts decreased \$9.8 million for the three months ended September 30, 2020 when compared to the corresponding period last year, primarily due to a decrease of \$25.3 million in our Critical Infrastructure segment and an increase of \$15.5 million in our Federal Solutions segment. The decrease in our Critical Infrastructure segment was primarily due to programs with high levels of pass-through costs reaching substantial completion. The increase in our Federal Solutions segment was primarily due to an increase in business volume and increased pass-through costs.

Direct cost of contracts increased \$10.2 million for the nine months ended September 30, 2020 when compared to the corresponding period last year, primarily due to an increase of \$56.5 million in our Federal Solutions segment offset by a decrease of \$46.3 million in our Critical Infrastructure segment. The increase in our Federal Solutions segment was primarily from increased pass-through costs. The decrease in our Critical Infrastructure segment was primarily due to programs with high levels of pass-through costs reaching substantial completion.

Equity in earnings of unconsolidated joint ventures

(U.S. dollars in thousands)	Three Months Ended		Variance		Nine Months Ended		Variance	
	September 30, 2020	September 30, 2019	Dollar	Percent	September 30, 2020	September 30, 2019	Dollar	Percent
	Equity in earnings of unconsolidated joint ventures	\$ 16,741	\$ 7,274	\$ 9,467	130.1%	\$ 26,624	\$ 29,305	\$ (2,681)

Equity in earnings of unconsolidated joint ventures increased \$9.5 million for the three months ended September 30, 2020 compared to the corresponding period last year, primarily related to increased activity and margins in certain joint ventures, partially offset by reduction in activity on a significant joint venture that is substantially complete.

Equity in earnings of unconsolidated joint ventures decreased \$2.7 million for the nine months ended September 30, 2020 compared to the corresponding period last year, primarily due to reduction in activity on a significant joint venture that is substantially complete, partially offset by increased margins and activity in certain joint ventures.

Indirect, general and administrative expenses

(U.S. dollars in thousands)	Three Months Ended		Variance		Nine Months Ended		Variance	
	September 30, 2020	September 30, 2019	Dollar	Percent	September 30, 2020	September 30, 2019	Dollar	Percent
	Indirect, general and administrative expenses	\$ 165,937	\$ 178,550	\$ (12,613)	-7.1%	\$ 537,351	\$ 581,428	\$ (44,077)

Indirect, general and administrative expenses ("IG&A") for the three months ended September 30, 2020 and September 30, 2019 include \$(1.0) million and \$(1.7) million, respectively, and for the nine months ended September 30, 2020 and September 30, 2019 include \$4.1 million and \$45.5 million, respectively, of compensation cost (income) related to equity-based awards.

Equity awards issued prior to the Company's IPO settle in cash and are remeasured to an updated fair value at each reporting period until the award is settled. Compensation cost is trued-up at each reporting period for changes in fair value pro-rated for the portion of the requisite service period rendered. Prior to the IPO on May 8, 2019, the fair value of a share of the Company's common stock was established by the ESOP trustee. See "Note 19 – Fair Value of Financial Instruments" in the Company's Form 10-K for the year ended December 31, 2019 for a further discussion of how a share of the Company's common stock was valued prior to the IPO. Subsequent to the IPO, the share price of the Company's common stock is based on quoted prices on the New York Stock Exchange.

Excluding the compensation costs discussed above, IG&A for the three months ended September 30, 2020 and September 30, 2019 was \$166.9 million and \$180.2 million, respectively, and for the nine months ended September 30, 2020 and September 30, 2019 was \$533.2 million and \$535.9 million, respectively

The decrease in IG&A of \$13.3 million, exclusive of equity compensation cost, for the three months ended September 30, 2020 when compared to the corresponding period last year was primarily due to a \$6.5 million reduction in transaction-related costs, a \$2.5 million reduction in intangible asset amortization, and a \$6.9 million reduction in other overhead expenses. These decreases were partially offset by \$2.6 million increase in expenses associated with business acquisitions.

The decrease in IG&A of \$2.7 million, exclusive of equity compensation cost, for the nine months ended September 30, 2020 when compared to the corresponding period last year was primarily due to a \$20.4 million reduction in transaction-related costs, a \$7.1 million reduction in intangible asset amortization, and a \$3.2 million reduction in restructuring and other expenses. These decreases were partially offset by additional expenses of \$19.3 million associated with business acquisitions, \$3.7 million due to a tax law change, and \$5.0 million related to strategic growth initiatives and public company operating costs.

Total other income (expense)

(U.S. dollars in thousands)	Three Months Ended		Variance		Nine Months Ended		Variance	
	September 30, 2020	September 30, 2019	Dollar	Percent	September 30, 2020	September 30, 2019	Dollar	Percent
	Interest income	\$ 88	\$ 427	\$ (339)	-79.4%	\$ 512	\$ 1,129	\$ (617)
Interest expense	(5,475)	(4,909)	(566)	11.5%	(13,656)	(19,577)	5,921	-30.2%
Other income (expense), net	1,653	(3,127)	4,780	-152.9%	1,916	(1,580)	3,496	-221.3%
Total other income (expense)	<u>\$ (3,734)</u>	<u>\$ (7,609)</u>	<u>\$ 3,875</u>	<u>-50.9%</u>	<u>\$ (11,228)</u>	<u>\$ (20,028)</u>	<u>\$ 8,800</u>	<u>-43.9%</u>

Interest income is related to interest earned on cash balances held. Interest expense is primarily due to debt related to our business acquisitions and Convertible Senior Note. The amounts in other income (expense), net are primarily related to transaction gains and losses on foreign currency transactions and sublease income.

Income tax expense

(U.S. dollars in thousands)	Three Months Ended		Variance		Nine Months Ended		Variance	
	September 30, 2020	September 30, 2019	Dollar	Percent	September 30, 2020	September 30, 2019	Dollar	Percent
	Income tax expense	\$ 16,017	\$ (15,453)	\$ 31,470	-203.6%	\$ 32,992	\$ (67,063)	\$ 100,055

As described in "Note 11 – Income Taxes," in the notes to our consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q, in connection with the Company's IPO on May 8, 2019, the Company converted from an "S" Corporation to a "C" Corporation. On a pro forma basis, if the Company had been taxed as a "C" Corporation for the three months and nine months ended September 30, 2019, the pro forma effective tax rate would have been 35.14% and 41.40%, respectively, and the pro forma income tax expense would have been \$16.1 million and \$19.8 million, respectively. The Company's effective tax rate was 25.61% and 26.39% and income tax expense was \$16.0 million and \$33.0 million for the three months and nine months ended September 30, 2020, respectively. The most significant items contributing to the change in the effective tax rate relate to a nonrecurring item included in the third quarter of 2019 associated with equity compensation and a change in jurisdictional earnings. The difference between the statutory U.S. federal income tax rate of 21.0% and the effective tax rate for the quarter ended September 30, 2020 primarily relates to state income taxes and a recorded valuation allowance on foreign tax credits, partially offset by benefits related to income attributable to noncontrolling interest and federal research tax credits.

The termination of the "S" Corporation status was treated as a change in tax status for Accounting Standards Codification 740, Income Taxes. These rules require that the deferred tax effects of a change in tax status to be recorded to income from continuing operations on the date the "S" Corporation status terminates. At the quarter ended September

30, 2019, the Company had recorded \$85 million for the estimated effect of the change in tax status, relating to the recognition of net deferred tax assets for temporary differences in existence on the date of conversion to a "C" Corporation. This estimated amount was revised to \$93.9 million at December 31, 2019 and subsequently adjusted to \$93.2 million upon filing of the 2019 tax returns.

Segment Results

We evaluate segment operating performance using segment revenue and segment Adjusted EBITDA attributable to Parsons Corporation. Adjusted EBITDA attributable to Parsons Corporation is Adjusted EBITDA excluding Adjusted EBITDA attributable to noncontrolling interests. Presented above, in this Management's Discussion and Analysis of Financial Condition and Results of Operations, is a discussion of our definition of Adjusted EBITDA, how we use this metric, why we present this metric and the material limitations on the usefulness of this metric. See "Note 18—Segments Information" in the notes to the consolidated financial statements in this Form 10-Q for further discussion regarding our segment Adjusted EBITDA attributable to Parsons Corporation.

The following table shows Adjusted EBITDA attributable to Parsons Corporation for each of our reportable segments and Adjusted EBITDA attributable to noncontrolling interests:

(U.S. dollars in thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2020	September 30, 2019	September 30, 2020	September 30, 2019
Federal Solutions Adjusted EBITDA attributable to Parsons Corporation	\$ 45,874	\$ 50,359	\$ 125,191	\$ 126,658
Critical Infrastructure Adjusted EBITDA attributable to Parsons Corporation	48,856	33,976	111,732	102,177
Adjusted EBITDA attributable to noncontrolling interests	6,071	4,655	15,535	8,384
Total Adjusted EBITDA	<u>\$ 100,801</u>	<u>\$ 88,990</u>	<u>\$ 252,458</u>	<u>\$ 237,219</u>

Federal Solutions

(U.S. dollars in thousands)	Three Months Ended		Variance		Nine Months Ended		Variance	
	September 30, 2020	September 30, 2019	Dollar	Percent	September 30, 2020	September 30, 2019	Dollar	Percent
	Revenue	\$ 498,156	\$ 486,175	\$ 11,981	2.5%	\$ 1,457,937	\$ 1,387,484	\$ 70,453
Adjusted EBITDA attributable to Parsons Corporation	\$ 45,874	\$ 50,359	\$ (4,485)	-8.9%	\$ 125,191	\$ 126,658	\$ (1,467)	-1.2%

The increase in Federal Solutions revenue for the three and nine months ended September 30, 2020 compared to the corresponding periods last year was primarily due to an increase in business volume from new and existing contracts.

The decrease in Federal Solutions Adjusted EBITDA attributable to Parsons Corporation for the three months ended September 30, 2020 compared to the corresponding period last year was primarily due to generally lower profit margins driven by an increase in volume on contracts with pass-through costs.

The decrease in Federal Solutions Adjusted EBITDA attributable to Parsons Corporation for the nine months ended September 30, 2020 compared to the corresponding period last year was primarily due to an increase in IG&A from business acquisitions and lower margins, offset by an increase in business volume from new awards and business acquisitions.

Critical Infrastructure

(U.S. dollars in thousands)	Three Months Ended		Variance		Nine Months Ended		Variance	
	September 30, 2020	September 30, 2019	Dollar	Percent	September 30, 2020	September 30, 2019	Dollar	Percent
	Revenue	\$ 506,080	\$ 537,102	\$ (31,022)	-5.8%	\$ 1,496,751	\$ 1,529,940	\$ (33,189)
Adjusted EBITDA attributable to Parsons Corporation	\$ 48,856	\$ 33,976	\$ 14,880	43.8%	\$ 111,732	\$ 102,177	\$ 9,555	9.4%

The decrease in Critical Infrastructure revenue for the three and nine months ended September 30, 2020 compared to the corresponding periods last year was primarily due to a decrease in business volume on contracts with pass-through revenue.

The increase in Adjusted EBITDA attributable to Parsons Corporation in Critical Infrastructure for the three months ended September 30, 2020 was primarily related to an increase in equity in earnings of unconsolidated joint ventures and a decrease in IG&A.

The increase in Adjusted EBITDA attributable to Parsons Corporation in Critical Infrastructure for the nine months ended September 30, 2020 was primarily related to a decrease in IG&A and improved project margins. Offsetting the increase in Adjusted EBITDA attributable to Parsons Corporation was a decrease in equity in earnings.

Liquidity and Capital Resources

Historically, we have financed our operations and capital expenditures and satisfied redemptions of ESOP interests through a combination of internally generated cash from operations, our Senior Notes and from borrowings under our Revolving Credit Facility.

Generally, cash provided by operating activities has been adequate to fund our operations. Due to fluctuations in our cash flows and growth in our operations, it may be necessary from time to time in the future to borrow under our Credit Agreement to meet cash demands. Our management regularly monitors certain liquidity measures to monitor performance. We calculate our available liquidity as a sum of cash and cash equivalents from our consolidated balance sheet plus the amount available and unutilized on our Credit Agreement.

There are likely to be certain impacts in our ability to collect accounts receivable as a result of the economic impacts from the COVID-19 pandemic. Accounts receivable reflect amounts due from both commercial and government customers. Our commercial customers are comprised principally of large, well-known and well-established companies. Our government customers are comprised principally of national, state and local agencies in the U.S. and Middle East. We have not seen and do not expect there to be a risk of non-payment from either our government agency or commercial customers. We have experienced payment delays due to administrative limitations from both types of customers.

As of September 30, 2020, we believe we have adequate liquidity and capital resources to fund our operations, support our debt service and support our ongoing acquisition strategy for at least the next twelve months based on the liquidity from cash provided by our operating activities, cash and cash equivalents on-hand and our borrowing capacity under our Revolving Credit Facility, which totals \$505.1 million as of September 30, 2020. We do not currently anticipate that the COVID-19 pandemic related economic impacts will impair the Company's ability to continue to maintain compliance with its debt covenants or access available borrowing capacity from our banks.

Cash Flows

Cash received from customers, either from the payment of invoices for work performed or for advances in excess of revenue recognized, is our primary source of cash. We generally do not begin work on contracts until funding is appropriated by the customers. Billing timetables and payment terms on our contracts vary based on a number of factors, including whether the contract type is cost-plus, time-and-materials, or fixed-price. We generally bill and collect cash more frequently under cost-plus and time-and-materials contracts, as we are authorized to bill as the costs are incurred or work is performed. In contrast, we may be limited to bill certain fixed-price contracts only when specified milestones, including deliveries, are achieved. A number of our contracts may provide for performance-based payments, which allow us to bill and collect cash prior to completing the work.

Accounts receivable is the principal component of our working capital and is generally driven by revenue growth. Accounts receivable reflects amounts billed to our clients as of each balance sheet date and receivable amounts that are currently due but unbilled. The total amount of our accounts receivable can vary significantly over time, but is generally sensitive to revenue levels. Net days sales outstanding, which we refer to as net DSO, is calculated by dividing (i) (accounts receivable plus contract assets) less (contract liabilities plus accounts payable) by (ii) average revenue per day (calculated by dividing trailing twelve months revenue by the number of days in that period). We focus on collecting outstanding receivables to reduce Net DSO and working capital. Net DSO was 69 days at September 30, 2020 and 58 days at September 30, 2019. In addition to the COVID-19 impacts discussed above, the increase in DSO was also impacted by certain administrative activities by certain customers which have delayed the payment of invoices. Our

working capital (current assets less current liabilities) was \$835.1 million at September 30, 2020 and \$382.0 million at December 31, 2019.

Our cash, cash equivalents and restricted cash increased by \$422.4 million to \$617.8 million at September 30, 2020 from \$195.4 million at December 31, 2019.

The following table summarizes our sources and uses of cash over the periods presented (in thousands):

	Nine Months Ended	
	September 30, 2020	September 30, 2019
Net cash provided by operating activities	\$ 113,439	\$ 130,628
Net cash used in investing activities	(36,077)	(541,710)
Net cash provided by financing activities	345,090	277,302
Effect of exchange rate changes	(69)	(953)
Net increase (decrease) in cash and cash equivalents	<u>\$ 422,383</u>	<u>\$ (134,733)</u>

Operating Activities

Net cash provided by operating activities consists primarily of net income (loss) adjusted for noncash items, such as: equity in earnings (loss) of unconsolidated joint ventures, contributions of treasury stock, depreciation and amortization of property and equipment and intangible assets, and provisions for doubtful accounts. The timing between the conversion of our billed and unbilled receivables into cash from our customers and disbursements to our employees and vendors is the primary driver of changes in our working capital. Our operating cash flows are primarily affected by our ability to invoice and collect from our clients in a timely manner, our ability to manage our vendor payments and the overall profitability of our contracts.

Net cash provided by operating activities decreased \$17.2 million to \$113.4 million for the nine months ended September 30, 2020 compared to \$130.6 million of cash provided by operating activities for the nine months ended September 30, 2019. The change in net cash provided by operating activities is primarily from a \$92.3 million increase in net income after adjusting for non-cash items, more than offset by a change of \$28.7 million in other long-term liabilities, primarily driven by the payment of long-term employee incentives offset by the deferral of social security payroll taxes as described below and a \$80.8 million increase in cash outflows from our working capital accounts (primarily from accounts receivable and contract liabilities offset by accrued expenses and contract assets).

Under the CARES Act, the Company has been provided a net cash benefit of \$26.2 million from the deferral of social security taxes otherwise due from April 10, 2020 through the quarter ended September 30, 2020 and will continue to defer employer social security taxes otherwise due for the remaining of the calendar year 2020; one-half of which are due December 31, 2021 and the second-half which are due December 31, 2022.

Investing Activities

Net cash used in investing activities consists primarily of cash flows associated with capital expenditures and business acquisitions.

Net cash used in investing activities decreased \$505.6 million to \$36.1 million for the nine months ended September 30, 2020, when compared to \$541.7 million for the nine months ended September 30, 2019, primarily due to the use of \$287.5 million, net of cash acquired, for the acquisition of OGSystems on January 7, 2019, and the use of \$208.2 million, net of cash acquired, for the acquisition of QRC Technologies on July 31, 2019. The Company had no business acquisitions activity during the nine months ended September 30, 2020.

Financing Activities

Net cash provided by financing activities is primarily associated with proceeds from debt, the repayment thereof, and distributions to noncontrolling interests.

Net cash provided by financing activities increased \$67.8 million to \$345.1 million for the nine months ended September 2020 compared to \$277.3 million in net cash provided by financing activities for the nine months ended September 30, 2019. The change in cash flows from financing activities is primarily due to \$348.5 million of net proceeds from the issuance of Convertible Senior Notes during the nine months ended September 30, 2020 compared to \$536.9 million of IPO proceeds offset in part by net repayments of borrowings of \$180 million and a dividend payment of \$52.1 million during the nine months ended September 30, 2019.

Letters of Credit

We also have in place several secondary bank credit lines for issuing letters of credit, principally for foreign contracts, to support performance and completion guarantees. Letters of credit commitments outstanding under these bank lines aggregated \$198.0 million as of September 30, 2020, including \$44.9 million of letters of credit outstanding under the Credit Agreement. Total letters of credit outstanding at September 30, 2020 are \$242.9 million.

Recent Accounting Pronouncements

See the information set forth in “Note 3—Summary of Significant Accounting Policies—Recently Adopted Accounting Pronouncements” in the notes to our consolidated financial statements.

Off-Balance Sheet Arrangements

As of September 30, 2020, we have no off-balance sheet arrangements that have or are reasonably likely to have a material current or future effect on our financial condition, changes in financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Interest Rate Risk

We are exposed to interest rate risks related to the Company’s Revolving Credit Facility. As of September 30, 2020, there were no amounts outstanding under the Revolving Credit Facility. Borrowings under the Credit Facility bear interest, at the Company’s option, at either the Base Rate (as defined in the Credit Agreement), plus an applicable margin, or LIBOR plus an applicable margin. The applicable margin for Base Rate loans is a range of 0.125% to 1.00% and the applicable margin for LIBOR loans is a range of 1.125% to 2.00%, both based on the leverage ratio of the Company at the end of each fiscal quarter. The rates at September 30, 2020 and December 31, 2019 were 1.44% and 3.02%, respectively.

Foreign Currency Exchange Risk

We are exposed to foreign currency exchange rate risk resulting from our operations outside of the U.S. We limit exposure to foreign currency fluctuations in most of our contracts through provisions that require client payments in currencies corresponding to the currency in which costs are incurred. As a result of this natural hedge, we generally do not need to hedge foreign currency cash flows for contract work performed.

Item 4. Controls and Procedures.

Evaluation of Disclosure Control and Procedures

Our management carried out, as of September 30, 2020, with the participation of our Chief Executive Officer and our Chief Financial Officer, an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2020, our disclosure controls and procedures were effective to provide reasonable assurance that material information required to be disclosed by us in reports we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms and that information required to be disclosed by us in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

During the third quarter of 2020, there were no changes to our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

The information required by this Item 1 is included in “Note 12 – Contingencies” included in the Notes to Consolidated Financial Statements appearing under Part I, Item 1 of this Form 10-Q which is incorporated herein by reference.

Item 1A. Risk Factors.

There have been no material changes from our Risk Factors disclosed in the Company’s Form 10-K for the year ended December 31, 2019 other than as set forth below. See also our updates for the COVID-19 pandemic included in Management’s Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-Q.

Our business, results of operations, financial condition, cash flows and stock price can be adversely affected by pandemics, epidemics or other public health emergencies, such as the recent outbreak of COVID-19.

Our business, results of operations, financial condition, cash flows and stock price can be adversely affected by pandemics, epidemics or other public health emergencies, such as the recent outbreak of COVID-19 which has spread from China to many other countries including the United States. In March 2020, the World Health Organization characterized COVID-19 as a pandemic, and the President of the United States declared the COVID-19 outbreak a national emergency. The outbreak has resulted in governments around the world implementing increasingly stringent measures to help control the spread of the virus, including quarantines, “shelter in place” and “stay at home” orders, travel restrictions, business curtailments, school closures, and other measures. In addition, governments and central banks in several parts of the world have enacted fiscal and monetary stimulus measures to counteract the impacts of COVID-19.

Although we have continued our operations consistent with federal guidelines and state and local orders, the outbreak of COVID-19 and any preventive or protective actions taken by governmental authorities may have a material adverse effect on our operations, employees and customers, including business shutdowns or disruptions. The extent to which COVID-19 may adversely impact our business depends on future developments, which are highly uncertain and unpredictable, depending upon the severity and duration of the outbreak and the effectiveness of actions taken globally to contain or mitigate its effects. Any resulting financial impact cannot be estimated reasonably at this time but may materially adversely affect our ability to collect accounts receivables and our business, results of operations, financial condition and cash flows. Even after the COVID-19 pandemic has subsided, we may experience materially adverse impacts to our business due to any resulting economic recession or depression. Additionally, concerns over the economic impact of COVID-19 have caused extreme volatility in financial and other capital markets which has and may continue to adversely impact our stock price and our ability to access capital markets. To the extent the COVID-19 pandemic adversely affects our business and financial results, it may also have the effect of heightening many of the other risks described in our Form 10-K for the year ended December 31, 2019, such as those relating to government spending and priorities.

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

None

Item 3. Defaults Upon Senior Securities.

None

Item 4. Mine Safety Disclosures.

Not Applicable

Item 5. Other Information.

None

Item 6. Exhibits.

Exhibit Number	Description
31.1*	<u>Certification of Principal Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
31.2*	<u>Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
32.1*	<u>Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.2*	<u>Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101	The following financial statements from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2020, formatted in Inline XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Earnings, (iii) Consolidated Statements of Comprehensive Income (Loss), (iv) Consolidated Statements of Stockholders' Equity, (v) Consolidated Statements of Cash Flows and (vi) Notes to Consolidated Financial Statements, tagged as blocks of text and including detailed tags.
104	Cover Page Interactive Data File (formatted as inline XBRL with applicable taxonomy extension information contained in Exhibits 101).

* Filed herewith.

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.

Parsons Corporation

Date: November 4, 2020

By: _____ /s/ George L. Ball
George L. Ball
Chief Financial Officer
(Principal Financial Officer)

**CERTIFICATION PURSUANT TO
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Charles L. Harrington, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Parsons Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 4, 2020

By: _____ /s/ Charles L. Harrington

Charles L. Harrington
Chief Executive Officer

**CERTIFICATION PURSUANT TO
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, George L. Ball, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Parsons Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 4, 2020

By: _____ /s/ George L. Ball
George L. Ball
Chief Financial Officer

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

In connection with the Quarterly Report of Parsons Corporation (the "Company") on Form 10-Q for the period ending September 30, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Charles L. Harrington, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: November 4, 2020

By: _____ /s/ Charles L. Harrington

Charles L. Harrington
Chief Executive Officer

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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

In connection with the Quarterly Report of Parsons Corporation (the "Company") on Form 10-Q for the period ending September 30, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, George L. Ball, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: November 4, 2020

By: _____ /s/ George L. Ball
George L. Ball
Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.