UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 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: June 27, 2021

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: 1-38643

PAE INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware	**82-3173473**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

7799 Leesburg Pike, Suite 300 North, Falls Church, Virginia 22043
(Address of principal executive offices) (Zip Code)

(703) 717-6000
(Registrant's telephone number, including area code)

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

Title of each class	Trading Symbols	Name of each exchange on which registered
Class A Common Stock	PAE	Nasdaq Stock Market
Warrants	PAEWW	Nasdaq Stock Market

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

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

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

Large accelerated filer	☐	Accelerated filer	☒
Non-accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

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

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

The number of shares of the registrant's common stock outstanding as of August 3, 2021 was 93,069,815

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PAE Incorporated
Condensed Consolidated Statements of Operations (Unaudited)
(In thousands, except share and per share data)

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Revenues	$ 747,198	$ 643,303	$ 1,495,765	$ 1,260,556
Cost of revenues	564,952	496,678	1,131,618	961,886
Selling, general and administrative expenses	142,776	105,451	288,067	242,777
Amortization of intangible assets	12,631	8,047	24,846	16,094
Total operating expenses	720,359	610,176	1,444,531	1,220,757
Program profit	26,839	33,127	51,234	39,799
Other operating income, net	3,922	1,168	5,723	1,954
Operating income	30,761	34,295	56,957	41,753
Interest expense, net	(13,160)	(13,757)	(25,674)	(34,705)
Other (loss) income, net	(66)	(19,467)	1,134	10,645
Income before income taxes	17,535	1,071	32,417	17,693
Expense (benefit) from income taxes	2,626	3,752	5,235	(5,776)
Net income (loss)	14,909	(2,681)	27,182	23,469
Noncontrolling interest in earnings of ventures	559	765	(552)	931
Net income (loss) attributed to PAE Incorporated	$ 14,350	$ (3,446)	$ 27,734	$ 22,538
Net income (loss) per share attributed to PAE Incorporated:				
Basic	$ 0.15	$ (0.04)	$ 0.30	$ 0.30
Diluted	$ 0.15	$ (0.04)	$ 0.29	$ 0.30
Weighted average shares outstanding:				
Basic	93,097,652	92,044,098	92,860,800	75,890,028
Diluted	95,511,269	92,787,379	95,193,549	76,273,931

See accompanying notes to condensed consolidated financial statements

PAE Incorporated
Condensed Consolidated Statements of Comprehensive Income (Loss) (Unaudited)
(In thousands)

	Three Months Ended		Six Months Ended	
	June 27, 2021	**June 28, 2020**	**June 27, 2021**	**June 28, 2020**
Net income (loss)	$ 14,909	$ (2,681)	$ 27,182	$ 23,469
Other comprehensive income (loss):				
Change in foreign currency translation adjustment, net of tax	629	59	(365)	(917)
Other, net	—	142	(1)	424
Other comprehensive income (loss)	629	201	(366)	(493)
Comprehensive income (loss)	15,538	(2,480)	26,816	22,976
Comprehensive income (loss) attributed to noncontrolling interests	552	284	(702)	781
Comprehensive income (loss) attributed to PAE Incorporated	$ 14,986	$ (2,764)	$ 27,518	$ 22,195

See accompanying notes to condensed consolidated financial statements

PAE Incorporated
Condensed Consolidated Balance Sheets (Unaudited)
(In thousands, except share and par value amounts)

	June 27, 2021	December 31, 2020
Assets		
Current assets:		
Cash and cash equivalents	$ 94,710	$ 85,908
Accounts receivable, net	605,060	585,511
Prepaid expenses and other current assets	63,367	61,607
Total current assets	763,137	733,026
Property and equipment, net	38,229	27,615
Investments	20,361	18,272
Goodwill	593,171	590,668
Intangible assets, net	233,364	258,210
Operating lease right-of-use assets, net	195,245	191,370
Other noncurrent assets	12,938	10,209
Total assets	$ 1,856,445	$ 1,829,370
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 174,651	$ 152,962
Accrued expenses	118,918	114,222
Customer advances and billings in excess of costs	88,903	106,475
Salaries, benefits and payroll taxes	145,905	145,186
Accrued taxes	11,689	15,582
Current portion of long-term debt, net	6,611	5,961
Operating lease liabilities, current portion	47,257	46,756
Other current liabilities	39,615	45,037
Total current liabilities	633,549	632,181
Deferred income taxes, net	10,324	4,389
Long-term debt, net	863,893	860,306
Long-term operating lease liabilities	150,824	145,569
Warrant liability	49,333	50,467
Other long-term liabilities	31,932	30,273
Total liabilities	1,739,855	1,723,185
Stockholders' equity:		
Preferred stock, $0.0001 par value per share, 1,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $0.0001 par value per share: 210,000,000 shares authorized; 93,069,815 and 92,040,654 shares issued and outstanding as of June 27, 2021 and December 31, 2020, respectively	9	9
Additional paid-in capital	170,245	188,685
Accumulated deficit	(88,887)	(116,621)
Accumulated other comprehensive income	1,510	1,876
Total PAE Incorporated stockholders' equity	82,877	73,949
Noncontrolling interests	33,713	32,236
Total liabilities and stockholders' equity	$ 1,856,445	$ 1,829,370

See accompanying notes to condensed consolidated financial statements

PAE Incorporated
Condensed Consolidated Statements of Stockholders’ Equity (Unaudited)
(In thousands, except share data)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive (Loss) / Income	Total PAE Incorporated Stockholders’ Equity	Noncontrolling Interests	Total Stockholders’ Equity
	Shares	Amount						
Balance at December 31, 2019	282,047	$ 3	$ 101,742	$ (145,371)	$ (134)	$ (43,760)	$ 31,851	$ (11,909)
Retrospective application of the Recapitalization	20,845,776	(1)	1		—	—	—	—
Adjusted balance at December 31, 2019	21,127,823	2	101,743	(145,371)	(134)	(43,760)	31,851	(11,909)
Net income	—	—	—	25,984	—	25,984	166	26,150
Other comprehensive loss, net	—	—	—	—	(695)	(695)	—	(695)
Distributions to venture partners and other	—	—	—	—	—	—	—	—
Equity contributions from venture partners	—	—	13	—	—	13	152	165
Equity infusion from Gores	46,999,787	5	307,936	—	—	307,941	—	307,941
Private placement	23,913,044	2	212,908	—	—	212,910	—	212,910
Payment to Shay stockholders	—	—	(424,243)	—	—	(424,243)	—	(424,243)
Balance at March 29, 2020	92,040,654	$ 9	$ 198,357	$ (119,387)	$ (829)	$ 78,150	$ 32,169	$ 110,319
Net (loss) income	—	—	—	(3,446)	—	(3,446)	765	(2,681)
Other comprehensive income, net	—	—	—	—	201	201	—	201
Distributions to venture partners and other	—	—	—	—	—	—	(443)	(443)
Equity contributions from venture partners	—	—	—	—	—	—	1,939	1,939
Equity infusion from Gores	—	—	—	—	—	—	—	—
Private placement	—	—	—	—	—	—	—	—
Payment to Shay stockholders	—	—	(20,169)	—	—	(20,169)	—	(20,169)
Stock-based Compensation	—	—	3,700	—	—	3,700	—	3,700
Balance at June 28, 2020	92,040,654	$ 9	$ 181,888	$ (122,833)	$ (628)	$ 58,436	$ 34,430	$ 92,866

PAE Incorporated
Condensed Consolidated Statements of Stockholders' Equity (Unaudited)
(In thousands, except share data)

	Common Stock		*Additional Paid-in Capital*	*Accumulated Deficit*	*Accumulated Other Comprehensive (Loss) / Income*	*Total PAE Incorporated Stockholders' Equity*	*Noncontrolling Interests*	*Total Stockholders' Equity*
	Shares	*Amount*						
Balance at December 31, 2020	92,040,654	$ 9	$ 188,685	$ (116,621)	$ 1,876	$ 73,949	$ 32,236	$ 106,185
Net income (loss)	—	—	—	13,384	—	13,384	(1,111)	12,273
Other comprehensive loss, net	—	—	—	—	(995)	(995)	—	(995)
Equity contributions from venture partners	—	—	—	—	—	—	467	467
Deconsolidation of venture	—	—	—	—	—	—	188	188
Purchase of noncontrolling interest	—	—	(17,398)	—	—	(17,398)	2,224	(15,174)
Stock-based compensation tax withholding obligation	—	—	(5,659)	—	—	(5,659)		(5,659)
Stock-based compensation	—	—	2,270	—	—	2,270	—	2,270
Balance at March 28, 2021	92,040,654	$ 9	$ 167,898	$ (103,237)	$ 881	$ 65,551	$ 34,004	$ 99,555
Net income	—	—	—	14,350	—	14,350	559	14,909
Other comprehensive income, net	—	—	—	—	629	629	—	629
Distributions to venture partners	—	—	—	—	—	—	(850)	(850)
Purchase of noncontrolling interest	—	—	(8)	—	—	(8)	—	(8)
Stock-based compensation	—	—	2,355	—	—	2,355	—	2,355
Balance at June 27, 2021	92,040,654	$ 9	$ 170,245	$ (88,887)	$ 1,510	$ 82,877	$ 33,713	$ 116,590

See accompanying notes to condensed consolidated financial statements

PAE Incorporated
Condensed Consolidated Statements of Cash Flows (Unaudited)
(In thousands)

	Six Months Ended	
	June 27, 2021	June 28, 2020
Operating activities		
Net income	$ 27,182	$ 23,469
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of property and equipment	4,747	5,072
Amortization of intangible assets	24,846	16,094
Amortization of debt issuance cost	1,572	7,821
Stock-based compensation	4,625	3,700
Net undistributed income from unconsolidated ventures	(6,568)	(1,739)
Deferred income taxes, net	6,557	(14,110)
Change in fair value of warrant liability	(1,133)	(14,132)
Other non-cash activities, net	(810)	404
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable, net	(20,000)	9,607
Accounts payable	21,838	(17,547)
Accrued expenses	5,002	9,845
Customer advances and billings in excess of costs	(17,571)	19,282
Salaries, benefits and payroll taxes	1,000	4,310
Prepaid expenses and other current assets	(2,910)	(841)
Other current and noncurrent liabilities	528	(5,101)
Investments	4,758	1,701
Other noncurrent assets	(6,237)	11,600
Accrued taxes	(3,889)	(3,847)
Net cash provided by operating activities	43,537	55,588
Investing activities		
Expenditures for property and equipment	(14,400)	(1,597)
Proceeds from sales of property	231	—
Acquisition of CENTRA Technology, Inc., net of acquired cash	(1,441)	—
Acquisition of Metis Solutions Corporation, net of acquired cash	(521)	—
Acquisition of noncontrolling interest	(14,308)	—
Other investing activities, net	(373)	37
Net cash used in investing activities	(30,812)	(1,560)
Financing activities		
Net contributions from noncontrolling interests	490	1,950
Borrowings on long-term debt	125,383	60,468
Repayments on long-term debt	(122,584)	(204,464)
Payment of debt issuance costs	—	(964)
Recapitalization from merger with Gores Holdings III, Inc.	—	605,713
Payment of underwriting and transaction costs	—	(27,267)
Distribution to selling stockholders	—	(419,548)
Stock-based compensation tax withholding obligation	(5,659)	—
Other financing activities, net	(825)	(292)
Net cash (used in) provided by financing activities	(3,195)	15,596
Effect of exchange rate changes on cash and cash equivalents	(728)	810
Net increase in cash and cash equivalents	8,802	70,434
Cash and cash equivalents at beginning of period	85,908	68,035
Cash and cash equivalents at end of period	$ 94,710	$ 138,469
Supplemental cash flow information		
Cash paid for interest	$ 27,846	$ 23,278
Cash paid for taxes	$ 7,273	$ 2,796

See accompanying notes to condensed consolidated financial statements

1. Description of Business

PAE Incorporated, formerly known as Gores Holdings III, Inc. (“Gores III”), was originally incorporated in Delaware on October 23, 2017 as a special purpose acquisition company formed for the purpose of effecting a merger, capital stock exchange, asset acquisition, stock purchase, reorganization, or other similar business combination with one or more target businesses. On September 11, 2018, Gores III consummated its initial public offering (the “IPO”), following which our shares began trading on the Nasdaq Stock Market (“Nasdaq”). Unless the context otherwise indicates, references herein to the “Company" or “PAE” refer to PAE Incorporated and its consolidated subsidiaries.

On February 10, 2020 (the “Closing Date”), the Company completed the previously announced business combination (the “Business Combination”) in which Shay Holding Corporation (“Shay”) was acquired by Gores III. The transaction was completed in a multi-step process pursuant to which Shay ultimately merged with and into a wholly-owned subsidiary of Gores III, with the Gores III subsidiary continuing as the surviving company. As a result of the Business Combination, each share of common stock of Shay was cancelled and converted into the right to receive a portion of the consideration payable in connection with the transaction and Gores III acquired Shay (as it existed immediately prior to the Second Merger, as such term is defined in that certain Agreement and Plan of Merger, dated November 1, 2019, by and among Gores III, EAP Merger Sub, Inc., EAP Merger Sub II, LLC, Shay, and Platinum Equity Advisors, LLC (in its capacity as the stockholder representative) (the “Merger Agreement”)) and its subsidiaries. Additionally, the stockholders of Shay as of immediately prior to the transaction held a portion of the common stock of the Company.

For accounting purposes, the Business Combination is treated as a reverse acquisition and recapitalization (the “Recapitalization”), in which Shay is considered the accounting acquirer (and legal acquiree) and Gores III is considered the accounting acquiree (and legal acquirer).

Accordingly, as of the Closing Date, Shay’s historical results of operations replaced Gores III’s historical results of operations for periods prior to the Business Combination and the results of operations of both companies are included in the accompanying condensed consolidated financial statements for periods following the Closing Date. See Note 6 - “Business Combinations and Acquisitions” for additional information.

PAE provides a wide variety of integrated support solutions, including defense and military readiness, diplomacy, intelligence support, business process outsourcing, counter-terrorism solutions, peacekeeping, development, host nation capacity building, aircraft and ground equipment maintenance and logistics, and operations and maintenance of facilities and infrastructure. Customers include agencies of the U.S. Government, such as the Department of Defense (“DoD”) and Department of State (“DoS”), the National Aeronautics and Space Administration (“NASA”), Department of Homeland Security, intelligence community agencies and other civilian agencies, as well as allied foreign governments and international organizations.

The Company’s operations are currently organized into the following two reportable segments:

- **Global Mission Services (“GMS”):** GMS provides infrastructure and logistics management, international logistics and stabilization support, and aircraft and vehicle readiness and sustainment support. The segment focuses on customer relationships with DoD, DoS, NASA, and other government agencies for work both in the United States and outside of the United States.

- **National Security Solutions (“NSS”):** NSS provides counter-threat solutions, business process outsourcing, adjudication support services and full life cycle support for complex legal matters. NSS focuses on customer relationships in the areas of intelligence, defense and security, and with civilian agencies.

The Company separately presents the costs associated with certain corporate functions as “Corporate”, which primarily include costs that are not reimbursed by the Company’s U.S. Government customers.

2. Significant Accounting Principles and Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) and the rules and regulations of the U.S. Securities and Exchange Commission (the “SEC”) for annual financial information. In management’s opinion, all adjustments, consisting of only normal recurring adjustments, considered necessary for a fair presentation have been included.

The Company closes its books and records on the last Sunday of the calendar quarter to align its financial closing with its business process, which were on June 27, 2021 and June 28, 2020, respectively. The condensed consolidated financial statements and disclosures included herein are labeled based on that convention. This practice only affects interim periods, as the Company’s fiscal year ends on December 31.

The condensed consolidated financial statements include the accounts of PAE Incorporated and subsidiaries and ventures in which the Company owns more than 50% or otherwise controls. All intercompany amounts have been eliminated in consolidation.

Use of Estimates

These condensed consolidated financial statements are prepared in conformity with U.S. GAAP, which requires the use of estimates and assumptions, including assumptions to determine the fair value of acquired assets and liabilities, recoverability of long-lived assets, goodwill, valuation allowances on deferred taxes, inputs used in stock based compensation, inputs in the valuation of the warrants liability and anticipated contract costs and revenues utilized in the earnings recognition process, which affect the reported amounts in the condensed consolidated financial statements and accompanying notes. Due to the size and nature of many of the Company’s programs, the estimation of total revenues and cost at completion is subject to a wide range of variables, including assumptions for timing and risks. Actual results may differ from management’s estimates and changes in these estimates are recorded when known.

Update to Significant Accounting Policies

There have been no material changes to the Company’s significant accounting policies described in the Company’s Form 10-K/A filed with the SEC on May 7, 2021.

3. Recent Accounting Pronouncements

Accounting Pronouncements Adopted

In December 2019, the FASB issued ASU 2019-12, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes. ASU 2019-12 simplifies the accounting for income taxes by eliminating certain exceptions to the guidance in ASC 740 related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period and the recognition of deferred tax liabilities for outside basis differences. ASU 2019-12 is effective in 2021 and interim periods within that year and permits for an early adoption. The Company adopted ASU 2019-12 effective January 1, 2021. The adoption of the guidance did not have a material impact on its financial statements and related disclosures.

Accounting Pronouncements Not Yet Adopted

In March 2020, the FASB issued ASU 2020-04 Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting, which provides optional expedients and exceptions for applying U.S. GAAP to contracts, hedging relationships, and other transactions affected by the reference rate reform. The amendments in ASU 2020-04 are effective for all entities as of March 12, 2020 through December 31, 2022. The Company is currently evaluating the impact this guidance will have on its condensed consolidated financial statements and related disclosures.

4. Revenues

Disaggregated Revenues

Disaggregated revenues by customer type were as follows (*in thousands*):

	Three Months Ended June 27, 2021		
	GMS	**NSS**	**Total**
DoD	$ 194,598	$ 81,621	$ 276,219
Other U.S. government agencies	267,592	131,848	399,440
Commercial and non-U.S. customers	49,153	22,386	71,539
Total	$ 511,343	$ 235,855	$ 747,198

	Six Months Ended June 27, 2021		
	GMS	**NSS**	**Total**
DoD	$ 357,031	$ 163,821	$ 520,852
Other U.S. government agencies	536,377	251,943	788,320
Commercial and non-U.S. customers	139,496	47,097	186,593
Total	$ 1,032,904	$ 462,861	$ 1,495,765

	Three Months Ended June 28, 2020		
	GMS	NSS	Total
DoD	$ 204,634	$ 62,096	$ 266,730
Other U.S. government agencies	260,714	49,434	310,148
Commercial and non-U.S. customers	42,506	23,919	66,425
Total	$ 507,854	$ 135,449	$ 643,303

	Six Months Ended June 28, 2020		
	GMS	NSS	Total
DoD	$ 392,240	$ 129,275	$ 521,515
Other U.S. government agencies	510,660	120,156	630,816
Commercial and non-U.S. customers	62,398	45,827	108,225
Total	$ 965,298	$ 295,258	$ 1,260,556

Revenues by contract type were as follows (*in thousands*):

	Three Months Ended June 27, 2021		
	GMS	NSS	Total
Cost-reimbursable	$ 285,552	$ 93,653	$ 379,205
Fixed-price	159,955	79,036	238,991
Time and materials	65,836	63,166	129,002
Total	$ 511,343	$ 235,855	$ 747,198

	Six Months Ended June 27, 2021		
	GMS	NSS	Total
Cost-reimbursable	$ 546,472	$ 183,747	$ 730,219
Fixed-price	341,259	161,553	502,812
Time and materials	145,173	117,561	262,734
Total	$ 1,032,904	$ 462,861	$ 1,495,765

	Three Months Ended June 28, 2020		
	GMS	NSS	Total
Cost-reimbursable	$ 299,906	$ 34,288	$ 334,194
Fixed-price	158,247	53,693	211,940
Time and materials	49,701	47,468	97,169
Total	$ 507,854	$ 135,449	$ 643,303

	Six Months Ended June 28, 2020					
	GMS		NSS		Total	
Cost-reimbursable	$	565,986	$	71,192	$	637,178
Fixed-price		320,285		122,650		442,935
Time and materials		79,027		101,416		180,443
Total	$	965,298	$	295,258	$	1,260,556

Disaggregated revenues by geographic location were as follows (*in thousands*):

	Three Months Ended June 27, 2021					
	GMS		NSS		Total	
United States	$	266,268	$	234,706	$	500,974
International		245,075		1,149		246,224
Total	$	511,343	$	235,855	$	747,198
	Six Months Ended June 27, 2021					
	GMS		**NSS**		**Total**	
United States	$	555,040	$	460,576	$	1,015,616
International		477,864		2,285		480,149
Total	$	1,032,904	$	462,861	$	1,495,765

	Three Months Ended June 28, 2020					
	GMS		NSS		Total	
United States	$	277,536	$	133,875	$	411,411
International		230,318		1,574		231,892
Total	$	507,854	$	135,449	$	643,303
	Six Months Ended June 28, 2020					
	GMS		**NSS**		**Total**	
United States	$	526,446	$	292,014	$	818,460
International		438,852		3,244		442,096
Total	$	965,298	$	295,258	$	1,260,556

Remaining Performance Obligations

The Company’s remaining performance obligations balance represents the expected revenue to be recognized for the satisfaction of remaining performance obligations on existing contracts. This balance excludes unexercised contract option years and task orders that may be issued underneath an indefinite delivery, indefinite quantity contract. The remaining performance obligations balance as of June 27, 2021 and December 31, 2020 was $1,497.4 million and $1,722.0 million, respectively.

As of June 27, 2021, the Company expects to recognize approximately 89.2% and 10.8% of the remaining performance obligations balance as revenue over the next year and thereafter, respectively.

5. Contract Assets and Contract Liabilities

Contract assets consist of unbilled receivables, which represent rights to payment for work or services completed but not billed as of the reporting date. Contract assets are recorded as unbilled receivables within accounts receivable, net on the condensed consolidated balance sheets.

Contract liabilities are advances and milestone payments from customers on certain contracts that exceed revenue earned to date. Contract liabilities are recorded as customer advances and billings in excess of costs on the condensed consolidated balance sheets.

Contract assets and contract liabilities consisted of the following as of the dates presented (*in thousands*):

	June 27, 2021	December 31, 2020
Contract assets	$ 376,154	$ 360,552
Contract liabilities	$ 88,903	$ 106,475

The increase in contract assets of $15.6 million during the six months ended June 27, 2021 was primarily due to the timing of billings, partially offset by revenue recognized related to the satisfaction of performance obligations.

The decrease in contract liabilities of $17.6 million during the six months ended June 27, 2021 was primarily due to the timing of advance payments from customers offset by revenue recognized during the period.

The Company recognized $87.9 million and $33.4 million during the six months ended June 27, 2021 and June 28, 2020, respectively, relating to amounts that were included in the beginning balance of contract liabilities for each of the periods. The Company recognized $3.4 million and $1.1 million during the three months ended June 27, 2021 and June 28, 2020, respectively, relating to amounts that were included in the beginning balance of contract liabilities for each of the periods.

6. Business Combinations and Acquisitions

As described in Note 1 - “Description of Business,” the Business Combination was consummated on February 10, 2020. For financial accounting and reporting purposes under U.S. GAAP, the Business Combination was accounted for as a reverse acquisition and recapitalization, with no goodwill or other intangible asset recorded. Under this method of accounting, Gores III (legal acquirer) is treated as the acquired entity and Shay (legal acquiree) is deemed to have issued common stock for the net assets and equity of Gores III consisting of mainly cash, accompanied simultaneously by the Recapitalization. The net assets of Gores III are stated at historical cost, and accordingly the equity and net assets of Shay have not been adjusted to fair value. Consequently, the consolidated assets, liabilities and results of operations of Shay are the historical financial statements of PAE Incorporated and the Gores III assets, liabilities and results of operations are consolidated with the assets, liabilities and results of operations of Shay beginning on the Closing Date. Shares and earnings per share information prior to the Business Combination have been retroactively restated to reflect the exchange ratio established in the Recapitalization.

Other than professional fees paid to consummate the transaction, the Business Combination primarily involved the exchange of cash and equity between Gores III, Shay and the stockholders of the respective companies. The aggregate proceeds paid to the Shay Stockholders (as defined below) on the Closing Date was approximately $424.2 million. The remainder of the consideration paid to the Shay Stockholders consisted of 21,127,823 newly issued shares of Class A Common Stock of PAE Incorporated, par value $0.0001 per share (“Class A Common Stock”).

In addition to the foregoing consideration paid on the Closing Date, former stockholders of Shay are entitled to receive additional Earn-Out Shares from PAE of up to an aggregate of 4,000,000 shares of Class A Common Stock if the price of Class A Common Stock trading on the Nasdaq exceeds certain thresholds during the five-year period following the completion of the Business Combination. See Note 11 - “Stockholders’ Equity - Earn-Out Agreement” for additional information.

The Company also has certain warrants issued by Gores III that remain outstanding after the Business Combination.

In connection with the Business Combination, the Company recorded $18.2 million, net of tax as a reduction to additional paid in capital related to the transaction costs. These costs were directly attributable to the Recapitalization. In addition, the Company recorded $3.4 million of transaction costs related to the warrants as non-operating expense in the consolidated statement of operations.

During the third quarter of 2020, pursuant to the post-closing adjustment provisions contained in the Merger Agreement, the Company made a post-closing adjustment payment of $20.2 million to the Shay Stockholders. In addition, the Company paid $1.0 million to certain members of PAE management in connection with the post-closing adjustment, and such amount was recorded as compensation expense.

CENTRA Technology, Inc.

On November 20, 2020, the Company acquired 100% of the capital stock of CENTRA Technology, Inc. (“CENTRA”) for a consideration paid of $225.3 million, net. The results of CENTRA’s operations have been included in the Company’s condensed consolidated financial statements since that date. This business combination expands and differentiates PAE's capabilities in intelligence analysis, communication systems integration and research and development services for intelligence and defense customers.

During the second quarter of 2021, the Company made a payment of $1.4 million related to the working capital adjustment, pursuant to the Stock Purchase Agreement (as defined below).

The Company has completed the purchase accounting valuation for this acquisition and recorded final purchase accounting adjustments. As a result, the Company recognized fair values of assets acquired of $177.4 million and assumed liabilities of $77.2 million allocating $126.4 million to goodwill and $74.1 million to intangible assets. The goodwill of $126.4 million arising from the acquisition relates primarily to revenue and cost synergies. This goodwill is not deductible for tax purposes.

Metis Solutions Corporation

On November 23, 2020, the Company completed the acquisition of 100% of the capital stock of Metis Solutions Corporation (“Metis”) for a consideration paid of $95.7 million in cash. The results of Metis’s operations have been included in the condensed consolidated financial statements since that date. This business combination expands and differentiates PAE's capabilities in intelligence analysis, training and program support for intelligence and defense customers.

During the second quarter of 2021, pursuant to the purchase price adjustment provisions of the Metis Merger Agreement (as defined below), the Company made a payment of $0.5 million to the option holders as a result of a closing adjustment.

The Company has completed the purchase accounting valuation for this acquisition and recorded final purchase accounting adjustments. As a result, the Company recognized fair values of assets acquired of $60.4 million and assumed liabilities of $20.7 million allocating $56.5 million to goodwill and $37.8 million to intangible assets. The goodwill of $56.5 million arising from the acquisition relates primarily to revenue and cost synergies. This goodwill is not deductible for tax purposes.

7. Accounts Receivable, net

The components of accounts receivable, net consisted of the following as of the dates presented *(in thousands):*

	June 27, 2021	December 31, 2020
Billed receivables	$ 234,660	$ 227,787
Unbilled receivables	374,209	360,552
Less allowance for credit losses	(3,809)	(2,828)
Total accounts receivables, net	$ 605,060	$ 585,511

As of June 27, 2021 approximately 93.6% of the Company’s accounts receivable are with the U.S. government.

8. Goodwill and Intangible Assets, net

Goodwill

There was no impairment for the three month and six month periods ended June 27, 2021 and June 28, 2020, respectively.

Intangible Assets, net

The components of intangible assets, net consisted of the following as of the dates presented *(in thousands):*

	June 27, 2021		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	$ 390,900	$ (172,534)	$ 218,366
Technology	1,700	(1,700)	—
Trade name	24,800	(9,802)	14,998
Total	$ 417,400	$ (184,036)	$ 233,364

	December 31, 2020		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	$ 390,900	$ (149,163)	$ 241,737
Technology	1,700	(1,700)	—
Trade name	24,800	(8,327)	16,473
Total	$ 417,400	$ (159,190)	$ 258,210

As of the six months period ended June 27, 2021, customer relationships and trade name intangibles had weighted average remaining useful lives of 7.8 years and 5.5 years, respectively.

For the six months ended June 27, 2021 and June 28, 2020, amortization expense was approximately $24.8 million and $16.1 million, respectively. For the three months ended June 27, 2021 and June 28, 2020, amortization expense was approximately $12.6 million and $8.0 million, respectively.

Estimated amortization expense in future years is expected to be:

	As of June 27, 2021
Remainder of 2021	$ 25,261
2022	50,089
2023	40,666
2024	33,782
2025	28,015
Thereafter	55,551
Total	$ 233,364

9. Consolidated Ventures

The Company consolidates an investment when it has determined that the investment is a variable interest entity ("VIE") and that the Company is the primary beneficiary. As the primary beneficiary, the Company has a risk and obligation to absorb any losses significant to the VIE and the power, through voting rights or similar rights, to direct the activities that could impact economic performance of the VIE. The use of the assets of the VIEs to settle the Company's liabilities is subject to the approval of the managing body of each VIE.

The cash flows generated by these VIEs are included within the Company's condensed consolidated statements of cash flows. The condensed consolidated balance sheets include the following amounts from these consolidated VIEs as of the dates presented (*in thousands*):

	June 27, 2021	December 31, 2020
Assets		
Total assets	$ 148,480	$ 145,664
Liabilities and equity		
Total liabilities	$ 100,732	$ 96,318
Total equity	47,748	49,346
Total liabilities and equity	$ 148,480	$ 145,664

The condensed consolidated statements of operations include the following amounts from consolidated VIEs for the periods presented (*in thousands*):

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Income statements				
Revenues	$ 111,486	$ 94,454	$ 203,013	$ 181,644
Cost of revenues	90,989	76,634	166,100	145,159
Selling, general and administrative expenses	18,793	15,864	36,291	33,881
Total operating expenses	109,783	92,498	202,391	179,040
Program (loss) income	1,703	1,956	622	2,604
Other (loss) income, net	(395)	840	(619)	(209)
Net income	$ 1,308	$ 2,796	$ 3	$ 2,395

DZSP 21 LLC

On January 31, 2021, the Company, acquired the 49.0% minority interest in the DZSP 21 LLC ("DZSP") joint venture from Parsons Government Services, Inc. for total consideration of $15.8 million. Following the completion of this transaction, the Company owns 100% of DZSP.

10. Debt

Long-term debt consisted of the following as of the dates presented (*in thousands*):

	June 27, 2021	December 31, 2020
First Term Loan	$ 887,775	$ 890,000
Other debt	$ 5,024	$ —
Total debt	892,799	890,000
Unamortized discount and debt issuance costs	(22,295)	(23,733)
Total debt, net of discount and debt issuance costs	870,504	866,267
Less current maturities of long-term debt	(6,611)	(5,961)
Total long-term debt, net of current	$ 863,893	$ 860,306

Credit Agreements

Term Loan

On October 19, 2020, the Company refinanced the 2016 credit agreements (comprised of (i) a first lien term loan credit agreement, as amended; (ii) a second lien term loan credit agreement, as amended; and (iii) a revolving credit facility, as amended, each dated as of October 26, 2016) (the “2016 Credit Agreements”) and entered into new senior secured credit facilities (the “2020 Credit Agreements”). The 2020 Credit Agreements provide for borrowings up to $890.0 million. The 2020 Credit Agreements established a $740.0 million term loan facility maturing in October 2027 priced at LIBOR plus a spread of 4.5%, a $150.0 million delayed draw term loan facility maturing in October 2027 priced at LIBOR plus a spread of 4.5% (together the “First Term Loan”), and a $175.0 million senior secured revolving credit facility (the “2020 ABL Credit Agreement”) maturing in October 2025 priced at LIBOR plus a spread of 1.8% to 2.3%.

The 2020 Credit Agreements require the Company to comply with specified financial covenants under certain circumstances, including the maintenance of certain leverage ratios.

The 2020 Credit Agreements also contain various non-financial covenants, including affirmative covenants with respect to reporting requirements and maintenance of business activities, and negative covenants that, among other things, may limit or impose restrictions on the Company’s ability to alter the character of the business, consolidate, merge, or sell assets, incur liens or additional indebtedness, make investments, and undertake certain additional actions.

PAE was in compliance with the financial covenants under the 2020 Credit Agreements as of June 27, 2021 and December 31, 2020, respectively.

Equipment Note

The Company, through DZSP, entered into a line of credit with Bank of America for the financing of program specific equipment through the issuance of secured loan notes. Each note represents a separate and independent financing of equipment. As of June 27, 2021, PAE has one outstanding equipment loan note (the “Equipment Note”) totaling to $5.0 million with a maturity date of March 2028.

The interest rate per annum applicable to the Equipment Note is equal to a fixed rate of 2.8%.

Future principal maturities of the Company’s long-term debt are summarized as follows (*in thousands*):

	As of June 27, 2021
Remainder of 2021	$ 7,067
2022	9,587
2023	9,607
2024	9,627
2025	9,648
Thereafter	847,263
Total	$ 892,799

As of June 27, 2021 and December 31, 2020, the available borrowing capacity under the 2020 ABL Credit Agreement was approximately $151.6 million and $132.8 million, respectively.

Interest Rates on Credit Agreements

The interest rate per annum applicable to amounts borrowed under the First Term Loan is equal to either the Base Rate (as defined below) or the LIBO Rate (as defined below), in either case, plus (i) 4.5% in the case of the Base Rate loans and (ii) 3.5% in the case of LIBO Rate loans.

The “Base Rate” is defined as a fluctuating rate per annum equal to the highest of (a) the Federal Funds Rate plus one half of one percent, (b) the rate of interest in effect for such day as publicly announced from time to time by Bank of America (“BofA”) as its “prime rate,” and (c) the LIBO Rate for a LIBO Rate Term Loan with a one month interest period commencing on such day plus 1.0%. The “prime rate” is a rate set by BofA based upon various factors including BofA’s costs and desired return, general economic conditions and other factors. The “LIBO Rate” is defined as the rate per annum equal to the London Interbank Offered Rate or a comparable or successor rate, whichever rate is approved by the Administrative Agent (as that term is defined in the 2020 Credit Agreements).

As of June 27, 2021 and December 31, 2020, the applicable interest rate on the amounts borrowed under the First Term Loan was 5.3% for each period, respectively.

The interest rate per annum applicable to the 2020 Credit Agreements is equal to either a Base Rate or a LIBO Rate plus (i) a range of 0.8% to 1.3% in the case of Base Rate loans and (ii) a range of 1.8% to 2.3% in the case of LIBO Rate loans, each based on average availability as of the first day of each quarter.

As of June 27, 2021 and December 31, 2020, the applicable interest rate on amounts borrowed under the 2020 Revolving Credit Facility was 4.0% for each period, respectively.

In addition, the LIBO Rate is the subject of recent national, international, and other regulatory guidance and proposals for reform and replacement. In July 2017, the Chief Executive of the U.K. Financial Conduct Authority (the “U.K. FCA”), which regulates LIBO Rate, announced that the U.K. FCA will no longer persuade or compel banks to submit rates for the calculation of the LIBO Rate benchmark after 2021. This announcement indicates that the continuation of LIBO Rate on the current basis cannot and will not be guaranteed after 2021, and it appears likely that LIBO Rate will be discontinued or modified. The consequences of the discontinuance of the

LIBO Rate benchmark cannot be entirely predicted but could include an increase in the cost of our variable rate indebtedness.

Letters of Credit

The Company had ten outstanding letters of credit for program and insurance requirements totaling approximately $23.4 million as of June 27, 2021 and 13 outstanding letters of credit for program and insurance requirements totaling approximately $23.9 million as of December 31, 2020.

11. Stockholders' Equity

Authorized and Outstanding Stock

In connection with the Business Combination, the Company made changes to its capital stock. The Company's amended and restated certificate of incorporation authorizes the issuance of 211,000,000 shares of capital stock, par value of $0.0001 per share, consisting of (a) 210,000,000 shares of Class A common stock, and (b) 1,000,000 shares of preferred stock.

As a result of the Business Combination, the shares issued to Shay Stockholders are reflected as if they were issued and outstanding as of the earliest reported period to reflect the new capital structure.

Earn-Out Agreement

In connection with the Business Combination, stockholders of Shay immediately prior to the transaction (which stockholders consisted of certain affiliates of Platinum Equity, LLC and members of PAE management (the "Shay Stockholders")) are entitled to receive up to an aggregate of 4,000,000 additional shares of Class A Common Stock (the "Earn-Out Shares") if at any time during the five-year period following the Closing Date (the "Earn-Out Period") the volume weighted average closing sale price of one share of Class A Common Stock on the Nasdaq (or the exchange which shares of Class A Common Stock are then listed) for a period of at least 10 days out of 20 consecutive trading days (the "Common Share Price") exceeds certain thresholds, as described below.

The thresholds (each a "Triggering Event") causing the Earn-Out Shares to be issued by the Company to the Shay Stockholders is any such event that occurs within the Earn-Out period as follows: (i) a one-time issuance of 1,000,000 shares if the Common Share Price is greater than $13.00; (ii) a one-time issuance of 1,000,000 shares if the Common Share Price is greater than $15.50; (iii) a one-time issuance of 1,000,000 shares if the Common Share Price is greater than $18.00; and (iv) a one-time issuance of 1,000,000 shares if the Common Share Price is greater than $20.50.

Further, if during the Earn-Out Period there is a change in control (as defined in the Merger Agreement) that results in the holders of Class A Common Stock receiving a per share price in respect of their Class A Common Stock that is equal to or greater than the applicable Common Share Price required in connection with any Triggering Event (an "Acceleration Event"), then any such Triggering Event that has not previously occurred will be deemed to have occurred, and the Company must issue Earn-Out Shares accordingly.

If no Triggering Event is achieved within the Earn-Out Period, the Company will not be required to issue the Earn-Out Shares. No Triggering Event was achieved during the three month and six month periods ended June 27, 2021.

Any transactions related to Earn-Out Shares are recorded within the stockholders' equity section of the Company's condensed consolidated financial statements. Earn-Out Shares will be recognized as stock dividends and recorded at fair value when they are effective upon achievement of a Triggering Event.

12. Net Income (loss) Per Share

Basic net income (loss) per common share is determined by dividing the net income (loss) attributed to stockholders by the weighted average number of common shares outstanding during the period presented. Diluted income (loss) per share is determined by adjusting the weighted average number of shares of common stock and common stock equivalents outstanding for the dilutive effect of common stock equivalents for the periods presented.

The following table sets forth the computation of basic and diluted income (loss) per share attributable to the Company's common stockholders for the periods presented (*in thousands, except shares and per share amounts*):

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Numerator:				
Net income (loss) attributed to PAE Incorporated	$ 14,350	$ (3,446)	$ 27,734	$ 22,538
Denominator:				
Basic weighted average shares	93,097,652	92,044,098	92,860,800	75,890,028
Diluted weighted average shares	95,511,269	92,787,379	95,193,549	76,273,931
Basic income (loss) per share	$ 0.15	$ (0.04)	$ 0.30	$ 0.30
Diluted income (loss) per share	$ 0.15	$ (0.04)	$ 0.29	$ 0.30

The Company has not included the effect of 19,999,985 shares of Common Stock issuable upon the exercise of warrants in the calculation of diluted net income (loss) per share for the three months and six months ended June 27, 2021. Warrants are excluded when the exercise price exceeds the average market value of the Company's common stock price during the applicable period.

The Company has not included the effect of 4,000,000 Earn-Out Shares in the calculation of basic and diluted net income (loss) per share for the three months and six months ended June 27, 2021. The condition for the issuance of these shares is based on the weighted average closing sale price of the Company's Class A Common Stock and such condition has not been met as of June 27, 2021.

Unvested RSUs and PSUs will not impact the calculation of basic earnings per share ("EPS") until vested, in which case they would be included in the total weighted average number of shares. All potential dilutive securities, which include unvested RSUs, are included in the diluted EPS calculation. Unvested PSUs are included in the calculation of diluted EPS to the extent that the performance criteria have been achieved.

13. Leases

As of June 27, 2021, the Company had right-of-use (“ROU”) assets, net of $195.2 million and lease liabilities of $198.1 million recorded on the condensed consolidated balance sheet.

The Company rents certain facilities and equipment under operating leases. The Company’s total lease cost is recorded primarily within selling, general and administrative expenses on the condensed consolidated statements of operations. Rents which are directly chargeable to a project are charged to cost of revenues.

During the three month and six month periods ended June 27, 2021, the Company recognized operating lease costs of approximately $15.2 million and $30.8 million, respectively.

The Company’s future minimum operating lease payments for noncancelable operating leases were as follows (*in thousands*):

		June 27, 2021
Remainder of 2021	$	24,623
2022		47,194
2023		42,678
2024		34,600
2025		28,185
Thereafter		61,793
Total future minimum lease payments		239,073
Less imputed interest		40,992
Present value of minimum lease payments		198,081
Less current maturities of lease liabilities		47,257
Long-term lease liabilities	$	150,824

The weighted-average remaining lease term and the weighted-average discount rate for the Company’s operating leases were approximately 6.5 years and 6.1%, respectively, at June 27, 2021.

The Company made cash payments of approximately $12.2 million and $24.2 million for operating leases for the three month and six month periods ended June 27, 2021, which are included in cash flows from operating activities in the condensed consolidated statement of cash flows.

14. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between marketplace participants at the measurement date. The valuation techniques the Company utilizes to measure the fair value of financial instruments are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect internal market assumptions.

These two types of inputs create the following fair value hierarchy:

- Level 1 – Quoted prices for identical instruments in observable active markets.
- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.
- Level 3 – Significant inputs to the valuation model are unobservable and reflect the Company's own estimates and assumptions.

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable, and amounts included in other current assets and current liabilities that meet the definition of a financial instrument approximate fair value because of the short-term nature of these amounts.

The carrying value of the Company's outstanding debt obligations approximates its fair value. The fair value of long-term debt is calculated using Level 2 inputs, based on interest rates available for debt with terms and maturities similar to the Company's 2020 Credit Agreements.

The warrant liability is measured at fair value at each reporting period and changes in fair value are recorded in other income, net. The public warrants liability is measured using Level 1 inputs based on observable active markets. The private placement warrants liability is measured using Level 3 inputs using the Black-Scholes option pricing model. The significant assumptions the Company used in the model are:

Valuation Inputs	**June 27, 2021**	**December 31, 2020**
Asset price	$ 9.1	$ 9.2
Exercise price	$ 11.5	$ 11.5
Contractual term	3.6	4.1
Volatility	50.0 %	50.0 %
Risk-free rate of return	0.6 %	0.3 %
Dividend yield	— %	— %

Details of the changes in fair value for the public warrants and private placement warrants are as follows:

Public warrant liability	**June 27, 2021**
Public warrant liability as of December 31	$ 30,667
Changes in fair value	399
Ending public warrant liability	$ 31,066

Private warrant liability	**June 27, 2021**
Private warrant liability as of December 31	$ 19,800
Changes in fair value	(1,533)
Ending private warrant liability	$ 18,267

15. Legal Proceedings, Commitments, and Contingencies

The Company is a party to, or has property subject to, litigation and other proceedings. Management believes the probability is remote that the outcome of the matters will have a material adverse effect on its operations as a whole, notwithstanding that the unfavorable resolution of any matter may have a material effect on net earnings in a future period. The Company cannot predict the outcome of legal proceedings and loss or range of loss contingencies with certainty.

16. Segment Reporting

The Company's operations and reportable segments are organized around the nature of the services and products provided to customers. The Company defines its reportable segments based on the way the CODM manages the operations of the Company for purposes of allocating resources and assessing performance.

The GMS operating segment provides support to the U.S. Government and its partners within and outside the United States providing sustainment, training and readiness support and advancing foreign policy objectives. The NSS operating segment provides a wide-ranging portfolio of offerings that support all facets of national security, including intelligence, homeland security and civil government missions.

While the CODM uses a variety of different measures to evaluate the Company’s segments, the primary measures used to evaluate segment performance and allocate resources are revenues and operating income. As a result, interest expense, net and provision for income taxes as recorded on the condensed consolidated statements of operations are not allocated to the Company’s operating segments.

The following table shows information by reportable segment for the periods presented (in thousands):

	Three Months Ended		Six Months Ended	
	June 27, 2021	June 28, 2020	June 27, 2021	June 28, 2020
Revenues				
GMS	$ 511,343	$ 507,854	$ 1,032,904	$ 965,298
NSS	235,855	135,449	462,861	295,258
Corporate	—	—	—	—
Total revenues	$ 747,198	$ 643,303	$ 1,495,765	$ 1,260,556
Operating income (loss)				
GMS	$ 28,700	$ 31,537	$ 53,214	$ 44,140
NSS	9,248	7,725	20,638	12,092
Corporate	(7,187)	(4,967)	(16,895)	(14,479)
Total operating income	$ 30,761	$ 34,295	$ 56,957	$ 41,753
Amortization of intangible assets				
GMS	$ 4,161	$ 4,115	$ 8,322	$ 8,231
NSS	8,470	3,932	16,524	7,863
Corporate	—	—	—	—
Total amortization of intangible assets	$ 12,631	$ 8,047	$ 24,846	$ 16,094

Under U.S. Government cost accounting standards, indirect costs including depreciation expense are collected in numerous indirect cost pools, which are then collectively allocated to the Company's reportable segments based on a representative causal or beneficial relationship of the costs in the pool to the costs in the base. While depreciation expense is a component of the allocated costs, the allocation process precludes depreciation expense from being specifically identified by the Company's individual reportable segments. For this reason, depreciation expense by reportable segment is not presented separately above.

Asset information by segment is not a key measure of performance used by the CODM and therefore segment assets are not presented.

Less than 10.0% of the Company's revenues and tangible long-lived assets are generated by or owned by entities outside of the United States. Therefore, additional segment financial information by geographic location is not presented.

17. Related-Party Transactions

Tax Overpayment/Underpayment Amount

In connection with the Business Combination, the Shay Stockholders are entitled to a payment of the net cash savings in U.S. federal, state and local income tax that the post-closing company actually realizes (or is deemed to realize in certain circumstances) in periods after the Closing

Date. The liability for this estimated payment and the corresponding charge to equity of $4.7 million are reflected in the Company’s consolidated balance sheet as of June 27, 2021.

Advisory Services

During the six months ended June 27, 2021, there were no management fees, transaction and advisory fee recognized related to any of the Company’s affiliates. During the six months ended June 28, 2020, the Company recognized management fees, transaction and advisory fees, and related expenses of approximately $15.8 million. These expenses were for services rendered by one or more affiliates of Platinum Equity, LLC. As a result of the Business Combination, $15.0 million was included with other similar transactional expenses and recorded as a reduction to the recapitalized equity and $0.8 million was recorded in selling, general and administrative expenses.

18. Income Taxes

The Company’s provision for income tax expense (benefits) was approximately $2.6 million and $5.2 million and its effective income tax rates were 15.0% and 16.1% for the three months and six months period ended June 27, 2021. The Company’s provision for income tax expense (benefits) were approximately $3.8 million, and $(5.8) million and its effective income tax rates were 350.3% and (32.6)% for the three months and six months periods ended June 28, 2020, respectively.

The provision for income taxes for the period ended June 27, 2021 differed from the U.S. federal statutory rate computed by applying the U.S. federal statutory rate to income or loss before income taxes primarily due to the benefit of Foreign Derived Intangible Income (“FDII”), nontaxable income including the fair value adjustment for warrants, offset by the effect of foreign operations. The provision for income taxes for the period ended June 28, 2020 differed from the U.S. federal statutory rate computed by applying the U.S. federal statutory rate to income or loss before income taxes primarily due to the benefit of FDII, increased prior year interest deduction under the Coronavirus Aid, Relief and Economic Security Act (as amended, the “CARES Act”) adjustments, nontaxable income including the fair value adjustment for warrants, and settlement of foreign taxes, offset by disallowed compensation deduction under Internal Revenue Code Section 162(m) and disallowed transaction costs.

On March 27, 2020, the CARES Act was signed into law. Under the CARES Act, the Company deferred $37.0 million of employer share of Social Security tax that will be paid equally by December 31, 2021 and 2022.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) is designed to provide a reader of our financial statements with a narrative from the perspective of management on the Company’s financial condition, results of operations, liquidity and certain other factors that may affect future results. The following discussion of the Company’s financial condition and results of operations should be read in conjunction with the MD&A and the consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K/A for the fiscal year ended December 31, 2020, which was filed with the Securities and Exchange Commission (the “SEC”) on May 7, 2021 and the unaudited condensed consolidated financial statements and related notes contained in this Quarterly Report on Form 10-Q. Certain information contained in the discussion and analysis set forth below includes forward-looking statements. Unless otherwise noted, the MD&A compares the three month and six month periods ended June 27, 2021 to the three month and six month periods ended June 28, 2020.

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). These forward-looking statements include information concerning the Company’s plans, objectives, goals, strategies, future events, future revenues, performance, capital expenditures, financing needs and other information that is not historical information. Many of these statements appear, in particular, in the MD&A. When used in this Quarterly Report on Form 10-Q, the words “anticipates,” “assumes,” “believes,” “estimates,” “expects,” “intends,” “may,” “plans,” “projects,” “seeks,” “should,” and variations of such words or similar expressions, or the negatives thereof, are intended to identify forward-looking statements. All forward-looking statements, including, without limitation, those based on the Company’s examination of historical operating trends, are based upon the Company’s current expectations and various assumptions. The Company believes there is a reasonable basis for its expectations and assumptions, but there can be no assurance that the Company will realize its expectations or that the Company’s assumptions will prove correct.

There are a number of risks and uncertainties that could cause the Company’s actual results to differ materially from the forward-looking statements contained in this Quarterly Report. Important factors that could cause the Company’s actual results to differ materially from those expressed as forward-looking statements are set forth in the Company’s 2020 Annual Report on Form 10-K/A in Part I, Item 1A under the heading Risk Factors. Such risks, uncertainties and other important factors include, among others, risks related to:

- a loss of contracts with the U.S. Government or its agencies or other state, local or foreign governments or agencies, including as a result of a reduction in government spending or changes in government spending;
- service failures or failures to properly manage projects;
- issues that damage our professional reputation;
- disruptions in or changes to prices relating to our supply chain, including as a result of difficulties in the supplier qualification process;
- failures on the part of our subcontractors or joint venture partners to perform their contractual obligations;
- failures to maintain strong relationships with other contractors;
- the impact of a negative audit or other investigation;
- failure to comply with numerous laws and regulations regarding procurement, anti-bribery and organizational conflicts of interest;
- failure to comply with the laws and other security requirements governing access to classified information;
- inability to share information from classified contracts with investors;
- impact of implementing various data privacy and cybersecurity laws;
- costs and liabilities arising under various environmental laws and regulations;
- various claims, litigation and other disputes that could be resolved against PAE;
- delays, contract terminations or cancellations caused by competitors’ protests of major contract awards received by us;
- risks related to mergers and acquisitions, including our ability to realize the benefits of any such transactions in a manner consistent with our expectations and integration risks;
- risks from operating internationally;

- the effects of COVID-19 and other pandemics or health epidemics, including disruptions to our workforce and the impact on government spending;
- disruptions caused by natural or environmental disasters, terrorist activities or other events outside our control;
- issues arising from cybersecurity threats or intellectual property infringement claims;
- the loss of members of senior management;
- the inability to attract, train or retain employees with the requisite skills, experience and security clearances;
- the impact of the expiration of our collective bargaining agreements;
- legislative or regulatory changes or changes in accounting principles, policies or guidelines; and
- other risks and uncertainties described in this Form 10-Q and our 2020 Annual Report on Form 10-K/A, including under the section entitled "Risk Factors," and described in our other reports filed with the SEC.

There may be other factors that may cause the Company's actual results to differ materially from those expressed in these forward-looking statements. Except as may be required by law, the Company undertakes no obligation to publicly update or revise forward-looking statements that may be made to reflect events or circumstances after the date made or to reflect the occurrence of unanticipated events.

Stockholders of the Company should read the following discussion and analysis of our financial condition and results of operations together with the condensed consolidated financial statements and related notes that are included elsewhere in this Quarterly Report on Form 10-Q.

This MD&A generally discusses 2021 and 2020 items and year-over-year comparisons between 2021 and 2020. Discussions of 2019 items and year-to-year comparisons between 2020 and 2019 that are not included in this Form 10-Q can be found in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Quarterly Report on Form 10-Q for the quarter ended June 28, 2020. As used in this MD&A, unless the context indicates otherwise, the financial information relating to the three month and six month periods ended June 28, 2020, are those of Shay and its subsidiaries for the period prior to the Closing and the financial information and data of PAE Incorporated and its subsidiaries for the period subsequent to the Closing, and the financial information and data for the three month and six month periods ended June 27, 2021 includes the financial information and data of PAE Incorporated and its subsidiaries. See Note 1 - "Description of Business" and Note 6 - "Business Combinations and Acquisitions" for additional information.

Business Overview

PAE is a leading, highly diversified, global company that provides a broad range of operational solutions and outsourced services to meet the critical enduring needs of the U.S. government, other allied governments, international organizations and companies. PAE merges technology with advanced business practices to deliver faster, smarter and more efficient managed services. Whether clients require high-profile support to operate the largest U.S. embassies around the world or need technical solutions for programs that monitor bioterrorism agents, PAE delivers for its customers. PAE leverages its scale, over 65 years of experience and talented global workforce of approximately 20,000 to provide the essential services PAE's clients need to tackle some of the world's toughest challenges.

Basis of Presentation

PAE provides a wide variety of integrated support solutions, including defense and military readiness, diplomacy, intelligence support, business process outsourcing, counter-terrorism solutions, peacekeeping, development, host nation capacity building, aircraft and ground equipment maintenance and logistics, and operations and maintenance of facilities and infrastructure. Customers include agencies of the U.S. Government, such as the Department of Defense (“DoD”) and Department of State (“DoS”), the National Aeronautics and Space Administration (“NASA”), Department of Homeland Security, intelligence community agencies and other civilian agencies, as well as allied foreign governments and international organizations.

PAE’s operations are currently organized into two reportable segments, Global Mission Services (“GMS”) and National Security Solutions (“NSS”).

- The GMS segment generates revenues through contracts under which PAE provides customers with logistics and stability operations, force readiness and infrastructure management.
- The NSS segment generates revenues through contracts under which PAE provides customers with counter-threat solutions, intelligence solutions and information optimization.

Segment performance is based on consolidated revenues and consolidated operating income. For additional information regarding PAE’s reportable segments, refer to Note 16 - “Segment Reporting” of the notes to PAE’s condensed consolidated financial statements.

Factors Affecting PAE’s Operating Results

Business Combinations and Acquisitions

Business Combination

Merger Consideration

As described in Note 1 - “Description of Business” and Note 6 - “Business Combinations and Acquisitions” of the notes to the consolidated financial statements, the Company completed the Business Combination on February 10, 2020. Pursuant to the terms of the Merger Agreement, the aggregate merger consideration paid for the Business Combination was approximately $1,427.0 million. The consideration paid to the Shay Stockholders consisted of a combination of cash and stock consideration. The aggregate cash consideration paid to the Shay Stockholders at the Closing was approximately $424.2 million, consisting of (a) approximately $408.0 million of cash available to Gores III from its trust account, after giving effect to income and franchise taxes payable in respect of interest income earned in the trust account and redemptions that were elected by Gores III’s public stockholders, plus (b) all of Gores III’s other cash and cash equivalents, plus (c) gross proceeds of approximately $220.0 million from a private placement offering conducted by Gores III in which investors purchased an aggregate of 23,913,044 shares of Class A Common Stock for $9.20 per share, less (d) certain transaction fees and expenses, including the payment of deferred underwriting commissions agreed to at the time of Gores III’s initial public offering, less (e) certain payments to participants in the 2016 Participation Plan, less (f) approximately $136.5 million used to repay a portion of the indebtedness of Shay immediately prior to the Closing, less (g) approximately $33.8 million of transaction fees and expenses of Shay. The remainder of the consideration paid to the Shay Stockholders consisted of 21,127,823 newly issued shares of Class A Common Stock.

In addition to the foregoing consideration paid on the Closing Date, Shay Stockholders are entitled to receive additional Earn-Out Shares (as both terms are defined in Note 11 - “Stockholders’ Equity - Earn Out Agreement” of the notes to the condensed consolidated financial statements) of up to an aggregate of four million shares of Class A Common Stock, if the price of Class A Common Stock trading on the Nasdaq exceeds certain thresholds during the five-year period following the completion of the Business Combination or if there is an Acceleration Event, as defined in Note 11 - “Stockholders’ Equity - Earn-Out Agreement” of the notes to the condensed consolidated financial statements.

During the third quarter of 2020, pursuant to the post-closing adjustment provisions contained in the Merger Agreement, the Company made a post-closing adjustment payment of $20.2 million to the Shay Stockholders. In addition, the Company paid $1.0 million to certain members of PAE management in connection with the post-closing adjustment, and such amount was recorded as compensation expense.

Incentive Plan

Prior to the closing of the Business Combination, the Gores III Board of Directors and stockholders approved the PAE Incorporated 2020 Equity Incentive Plan (the “2020 Incentive Plan”). The 2020 Incentive Plan provides for the grant of stock options, stock appreciation rights, restricted stock units (RSUs) and other stock or cash-based awards.

Debt

In connection with the Business Combination, Shay was required to amend its 2016 Credit Agreements and reduce its outstanding indebtedness under its credit facilities such that the total indebtedness under the facilities, minus cash on hand at the consummation of the transaction would not be greater than $572.1 million. Immediately after the closing of the Business Combination, Shay reduced the outstanding balance on the 2016 Credit Agreements by approximately $136.5 million to a principal balance of $128.8 million.

CENTRA Technology, Inc. Business Acquisition

On October 26, 2020, Pacific Architects and Engineers, LLC, a Delaware limited liability company (“PAE, LLC”), an indirect wholly owned subsidiary of the Company, entered into a stock purchase agreement (the “Stock Purchase Agreement”) by and among PAE, LLC, CENTRA Technology, Inc., a Maryland corporation (“CENTRA”), certain stockholders of CENTRA, and Barbara Rosenbaum as the sellers’ representative. CENTRA provides mission critical services to the U.S. intelligence community and other U.S. national and homeland security customers. The Company completed the acquisition on November 20, 2020. Pursuant to the Stock Purchase Agreement, the consideration paid to acquire all of the shares of CENTRA was approximately $208.0 million (net of tax benefits) in cash, subject to customary purchase price adjustments as set forth in the Stock Purchase Agreement.

The Stock Purchase Agreement contains customary representations, warranties and covenants of the parties. The Stock Purchase Agreement also contains customary indemnities, and PAE, LLC has obtained representation and warranty insurance, subject to exclusions, policy limits and certain other terms and conditions, to obtain coverage for losses that may result from a breach of certain representations and warranties made by the sellers in the Stock Purchase Agreement. An aggregate of $5.0 million of the purchase price was deposited into an escrow account to satisfy purchase price adjustments, if any.

CENTRA’s financial results have been included in our condensed consolidated financial statements commencing on November 20, 2020.

On April 16, 2021, PAE, LLC made a payment of $1.4 million related to the working capital adjustment, pursuant to the Stock Purchase Agreement.

<u>Metis Solutions Corporation Business Acquisition</u>

On November 16, 2020, PAE, LLC entered into an Agreement and Plan of Merger (the “Metis Merger Agreement”) by and among PAE, LLC, Metis Solutions Corporation, a Delaware corporation (“Metis”), Rising Tide Merger Sub, Inc., a Delaware corporation, and Christopher Wynes, solely in his capacity as the representative of the sellers. Metis provides services focused on supporting intelligence community, security and defense customers. The Company completed the acquisition on November 23, 2020. Pursuant to the Metis Merger Agreement, the consideration paid to acquire Metis was approximately $92.0 million in cash, subject to customary purchase price adjustments as set forth in the Metis Merger Agreement.

The Metis Merger Agreement contains customary representations, warranties and covenants of the parties. The Metis Merger Agreement also contains customary indemnities, and PAE, LLC has obtained representation and warranty insurance, subject to exclusions, policy limits and certain other terms and conditions, to obtain coverage for losses that may result from a breach of certain representations and warranties made by the sellers in the Metis Merger Agreement. An aggregate of $2.5 million of the purchase price was deposited into an escrow account to satisfy purchase price adjustments, if any.

Metis’ financial results have been included in our condensed consolidated financial statements commencing on November 23, 2020.

On March 30, 2021, pursuant to the purchase price adjustment provisions of the Metis Merger Agreement, $2.5 million of the purchase price that was in an escrow account was released in accordance with the directions specified by the representative of the sellers for distribution to the sellers. In addition, the Company made a payment of $0.5 million to the option holders as a result of a closing adjustment.

<u>DZSP 21 LLC Minority Interest Acquisition</u>

On January 31, 2021, PAE Aviation and Technical Services LLC, a Delaware limited liability company (“PAE AvTech”), an indirect wholly owned subsidiary of the Company, acquired from Parsons Government Services, Inc. its 49% minority interest in the DZSP 21 LLC (“DZSP”) joint venture for a purchase price of $15.8 million. Following the completion of this transaction, the Company owns 100% of DZSP and all the rights, duties and obligations under the DZSP operating agreement and the Guam contracts, all as set forth in the purchase agreement.

Financial and Other Highlights

From December 31, 2020 to June 27, 2021, PAE’s overall contract backlog decreased by 6.0% from $7,915.4 million to $7,443.0 million, of which $1,176.9 million was funded as of June 27, 2021. Backlog is an operational measure representing PAE’s estimate of the amount of revenue that it expects to realize over the remaining life of awarded contracts and task orders; the funded backlog refers to the value on contracts for which funding is appropriated less revenues previously recognized on these contracts. Unfunded backlog represents the estimated future revenues to be earned from negotiated contracts for which funding has not been appropriated or authorized, and unexercised priced contract options. The total backlog consists of remaining performance obligations plus unexercised options. PAE believes backlog is a useful metric for investors because it is an important measure of business development performance and revenue growth. This metric is used by management to conduct and evaluate its business during its regular review of operating results for the periods presented. See Note 4 - “Revenues" of the notes to the condensed consolidated financial statements for more information.

The estimated value of PAE's total backlog was as follows *(in thousands)*:

	As of June 27, 2021	As of December 31, 2020
Global Mission Services:		
Funded GMS backlog	$ 498,080	$ 946,711
Unfunded GMS backlog	4,215,995	4,445,442
Total GMS backlog	$ 4,714,075	$ 5,392,153
National Security Solutions:		
Funded NSS backlog	$ 678,799	$ 476,618
Unfunded NSS backlog	2,050,131	2,046,634
Total NSS backlog	$ 2,728,930	$ 2,523,252
Total:		
Funded backlog	$ 1,176,879	$ 1,423,329
Unfunded backlog	6,266,126	6,492,076
Total backlog	$ 7,443,005	$ 7,915,405

Trends and Factors Affecting PAE's Future Performance

External Factors

PAE's business primarily focuses on providing services to the U.S. Government and allied nations and organizations; PAE's performance is inherently linked to governmental missions and goals. We have concentrated our business efforts on those missions and goals that are enduring and that have limited exposure to abrupt policy changes. For example, PAE has supported U.S. embassies since the 1970s. We are also trusted by our customers to support them on major policy initiatives that require immediate response to solve an acute crisis. Examples of this work include our rapid establishment and operation of Ebola treatment units in Liberia in 2015 and our work beginning in 2020 supporting COVID-19 testing and care, including on behalf of the state of Georgia converting a convention center to a COVID-19 treatment center in less than one week, mobilizing trained-and-ready test teams to conduct COVID-19 testing for the Southeastern Conference of the National Collegiate Athletic Association, and serving as the joint logistics and medical integrator for the Navajo Nation Department of Health's COVID-19 response.

Over most of the last two decades, the U.S. Government has increased its reliance on the private sector for a wide range of professional and support services. This development has been driven by a variety of factors, including lean-government initiatives launched in the 1990s, surges in demand during times of national crisis, the increased complexity of missions conducted by the U.S. military and the DoS, increased focus of the U.S. military on war-fighting efforts and loss of skills within the government caused by workforce reductions and retirements.

Although the size of future U.S. Government department and agency budgets remains subject to change, current indications are that overall U.S. Government spending will remain largely consistent with current spending levels. PAE believes the following industry trends will result in continued strong demand in the target markets for the types of services it provides:

- new U.S. Government policies and programs, both within the United States and overseas, to provide services to address health and other social issues;
- the continued transformation of military forces, leading to continued performance of non-combat functions by government contractors, including life-cycle asset management functions ranging from organizational to depot level maintenance;
- an increased level of coordination between the DoS and DoD on key national security initiatives and foreign policies;
- increased maintenance, overhaul and upgrade needs to support aging military platforms; and
- the on-going evolution of international relations that may require enhanced or new policy initiatives.

Current Economic Conditions

PAE believes that its industry and customer base are less likely to be affected by many of the factors generally affecting business and consumer spending. PAE's contract awards typically extend to five years, including options, and it has a strong history of being awarded a majority of these contract options. Additionally, since PAE's primary customers are departments and agencies within the U.S. Government, it has not historically had significant issues collecting its receivables. However, the economic environment, government debt levels, public policy decisions or other factors could adversely impact PAE's business, financial condition or results of operations in the future. A recent example of this was the U.S. Government's April 2021 decision to withdraw U.S. troops and contractor personnel from Afghanistan. This decision impacted the Company's work in Afghanistan, including the National Maintenance Strategy program, which is one of PAE's larger contracts and is expected to conclude in the third quarter of 2021. Although PAE is working with its customers to assess and mitigate any impacts from the withdrawal, PAE cannot be certain whether other work in Afghanistan will not be adversely impacted in the future.

Impact of COVID-19

As the COVID-19 pandemic has evolved, we have worked with our stakeholders (including customers, employees, suppliers and local communities) to address the issues it has raised. Due to the widespread availability of vaccines and based on the guidance from local jurisdictions, many of our operating locations have now re-opened fully or partially.

Due to the gradual and varied nature of re-opening in different jurisdictions, COVID-19 has had a marginally unfavorable impact on the Company's results of operations for the three month and six month periods ended June 27, 2021. Although our operations have been disrupted by the COVID-19 pandemic, the impact has been mitigated due to the nature of our business. In particular, our U.S. Government customers have taken steps to ensure the continuance of many of the services provided by us and other contractors, including, but not limited to, designating certain PAE contracts as essential for continued performance and authorizing remote work for contractor personnel that cannot access worksites. In addition, the impact may be further mitigated by Section 3610 of the CARES Act, which allows U.S. government agencies to reimburse contractors such as us at the minimum applicable contract billing rate for costs of certain paid leave for employees who cannot access work sites or telework through September 30, 2021. However, some U.S. Government customers have suspended or reduced work under certain of our contracts.

COVID-19 related costs for us and our subcontractors could be significant, and we are seeking reimbursement of such costs under our U.S. Government contracts through a combination of contract actions and reimbursement of costs under Section 3610 of the CARES Act. Reimbursement of any costs under Section 3610 is not expected to include profit or fee. Costs for employees whose jobs cannot be performed remotely may not be fully recoverable under our contracts. We also have no assurance that Congress will appropriate funds to cover the reimbursement of contractors authorized by the CARES Act.

Management expects that the impact of COVID-19 will be marginally unfavorable on our full year results based on information known to us at this time. Since our primary customers are departments and agencies within the U.S. Government, we have not historically had significant issues collecting our receivables and do not foresee issues collecting our receivables in the foreseeable future. In addition, our contract awards typically extend to at least five years, including options, and we have a strong history of being awarded a majority of these contract options; we do not anticipate that the pandemic will have a materially adverse impact on such awards.

Our liquidity position has not been materially impacted by COVID-19, and we continue to believe that we have adequate liquidity to fund our operations and meet our debt service obligations for the foreseeable future. However, we cannot predict the future course of COVID-19 or whether jurisdictions may impose additional or new restrictions on business operations that could have an adverse impact on our financial condition, results of operations, and/or cash flows.

Inflation and Pricing

Most of PAE’s contracts provide for estimates of future labor costs to be escalated for any option periods, while the non-labor costs in its contracts are normally considered reimbursable at cost. PAE’s property and equipment consists principally of computer systems equipment, machinery and transportation equipment, leasehold improvements, and furniture and fixtures. PAE does not expect the overall impact of inflation on replacement costs of its property and equipment to be material to its future results of operations or financial condition.

Primary Components of Operating Results

Revenues

The majority of PAE’s revenues are generated from contracts with the U.S. Government and its agencies. PAE enters into a variety of contract types, including fixed price, cost reimbursable, and time and materials contracts.

Cost of revenues

Cost of revenues includes costs related to labor, material, subcontract labor and other costs that are allowable and allocable to contracts under federal procurement standards.

Selling, general and administrative expenses

Selling, general and administrative expenses primarily consist of (i) fringe benefits related to the contract costs; (ii) salaries and wages plus associated fringe benefits and occupancy costs related to executive and senior management, business development, bid and proposal, contracts administration, finance and accounting, human resources, recruiting, information systems support, legal and corporate governance; and (iii) unallowable costs under applicable procurement standards that are not allocable to contracts for billing purposes. Unallowable costs do not generate revenue but are necessary for business operations.

Results of Operations

Comparison of Results for the Three Months Ended June 27, 2021 (unaudited) and June 28, 2020 (unaudited) (in thousands):

	Three Months Ended			
	June 27, 2021	June 28, 2020	Dollar Change	Percent Change %
Revenues	$ 747,198	$ 643,303	$ 103,895	16.2
Cost of revenues	564,952	496,678	68,274	13.7
Selling, general and administrative expenses	142,776	105,451	37,325	35.4
Amortization of intangible assets	12,631	8,047	4,584	57.0
Total operating expenses	720,359	610,176	110,183	18.1
Program profit (loss)	26,839	33,127	(6,288)	(19.0)
Other operating income, net	3,922	1,168	2,754	235.8
Operating income	30,761	34,295	(3,534)	31.1
Interest expense, net	(13,160)	(13,757)	597	(4.3)
Other income, net	(66)	(19,467)	19,401	(99.7)
Income (loss) before income taxes	17,535	1,071	16,464	1537.3
Expense from income taxes	2,626	3,752	(1,126)	(30.0)
Net income (loss)	14,909	(2,681)	17,590	(656.1)
Noncontrolling interest in earnings of ventures	559	765	(206)	(26.9)
Net income (loss) attributed to PAE Incorporated	$ 14,350	$ (3,446)	$ 17,796	(516.4)

Revenues

Revenues for the three months ended June 27, 2021, increased by approximately $103.9 million, or 16.2%, from the comparable period in 2020. The increase was attributable to $93.1 million of revenue from recent acquisitions, and by a $10.8 million net increase from new business awards and other changes in contract volume.

Cost of revenues

Cost of revenues for the three months ended June 27, 2021, increased by approximately $68.3 million, or 13.7%, from the comparable period in 2020. The increase in cost of revenues was primarily driven by contract volume partially offset by higher participation of non-labor revenue.

Selling, general and administrative expenses

Selling, general and administrative expense for the three months ended June 27, 2021, increased by approximately $37.3 million, or 35.4%, from the comparable period in 2020. The increase in selling, general and administrative expenses was primarily driven by the acceleration of bid and proposal costs during the second quarter.

Amortization of intangible assets

Amortization of intangible assets for the three months ended June 27, 2021, increased by approximately $4.6 million, or 57.0%, from the comparable period in 2020. The increase was associated with the acquisitions of CENTRA and Metis.

Other operating income, net

Other operating income, net for the three months ended June 27, 2021, increased by approximately $2.8 million, from the comparable period in 2020. The increase was driven by higher equity investments income.

Operating income

Operating income for the three months ended June 27, 2021, decreased by approximately $3.5 million, from the comparable period in 2020. The decrease resulted from higher selling, general and administrative expenses and increased amortization of intangible assets, partially offset by higher revenue volume.

Interest expense, net

Interest expense, net for the three months ended June 27, 2021, decreased by approximately $0.6 million, or 4.3%, from the comparable period in 2020. The decrease was primarily driven by lower cost of debt from refinancing in the fourth quarter of 2020, partially offset by higher borrowings.

Other income, net

Other income, net for the three months ended June 27, 2021, decreased by approximately $19.4 million driven by the changes in fair value related to the accounting for our public warrants and private placement warrants.

Net income

Net income attributed to PAE for the three months ended June 27, 2021 was $14.4 million compared with a net loss attributed to PAE of approximately $(3.4) million in the comparable period in 2020. The increase in net income for the three-month period ended June 27, 2021, was primarily driven by higher revenue volume partially offset by the factors impacting operating income.

Results of Operations

Comparison of Results for the Six Months Ended June 27, 2021 and June 28, 2020 (in thousands):

	Six Months Ended			
	June 27, 2021	June 28, 2020	Dollar Change	Percent Change
Revenues	$ 1,495,765	$ 1,260,556	$ 235,209	18.7 %
Cost of revenues	1,131,618	961,886	169,732	17.6
Selling, general and administrative expenses	288,067	242,777	45,290	18.7
Amortization of intangible assets	24,846	16,094	8,752	54.4
Total operating expenses	1,444,531	1,220,757	223,774	18.3
Program profit	51,234	39,799	11,435	28.7
Other operating income, net	5,723	1,954	3,769	192.9
Operating income	56,957	41,753	15,204	36.4
Interest expense, net	(25,674)	(34,705)	9,031	(26.0)
Other income, net	1,134	10,645	(9,511)	(89.3)
Income before income taxes	32,417	17,693	14,724	83.2
Expense (benefit) from income taxes	5,235	(5,776)	11,011	(190.6)
Net income	27,182	23,469	3,713	15.8
Noncontrolling interest in earnings of ventures	(552)	931	(1,483)	(159.3)
Net income attributed to PAE Incorporated	$ 27,734	$ 22,538	$ 5,196	23.1 %

Revenues

Revenues for the six months ended June 27, 2021, increased by approximately $235.2 million, or 18.7%, from the comparable period in 2020. The increase was attributable to $181.9 million of revenue from recent acquisitions, and by a $53.3 million net increase from new business awards and other changes in contract volume.

Cost of revenues

Cost of revenues for the six months ended June 27, 2021, increased by approximately $169.7 million, or 17.6%, from the comparable period in 2020. The increase in cost of revenues was primarily driven by lower non-labor revenue volume.

Selling, general and administrative expenses

Selling, general and administrative expenses for the six months ended June 27, 2021, increased by approximately $45.3 million, or 18.7%, from the comparable period in 2020. The increase in selling, general and administrative expenses was primarily driven by higher revenue volume.

Amortization of intangible assets

Amortization of intangible assets for the six months ended June 27, 2021, increased by approximately $8.8 million, or 54.4%, from the comparable period in 2020. The increase was associated with amortizing certain customer relationships, development technologies, and trade names.

Other operating income, net

Other operating income, net for the six months ended June 27, 2021, increased by approximately $3.8 million, or 192.9%, from the comparable period in 2020. This increase was primarily driven by increased equity investments income.

Operating income

Operating income for the six months ended June 27, 2021, increased by approximately $15.2 million, or 36.4%, from the comparable period in 2020. The increase resulted from higher non labor revenue volume and increased equity investments income, partially offset by higher amortization of intangible assets.

Interest expense, net

Interest expense, net for the six months ended June 27, 2021, decreased by approximately $9.0 million, or 26.0%, from the comparable period in 2020. This decrease was primarily driven by lower cost of debt from refinancing in the fourth quarter of 2020, partially offset by higher borrowings.

Other income, net

Other income, net for the six months ended June 27, 2021, decreased by approximately $9.5 million driven by the changes in fair value related to the accounting for our public warrants and private placement warrants.

Net income (loss)

Net income attributed to PAE for the six months ended June 27, 2021 was $27.7 million compared with a net income attributed to PAE of approximately $22.5 million in the comparable period in 2020. The increase in net income for the six months ended June 27, 2021, was primarily driven by higher revenue volume partially offset by higher selling, general and administrative expenses.

PAE's Segments

***Comparison of Results by Segments for the Three Months Ended June 27, 2021, and June 28, 2020 (Unaudited) (in thousands)*:**

	June 27, 2021		June 28, 2020	
	Revenues	% of Total Revenues	Revenues	% of Total Revenues
GMS	$ 511,343	68.4	$ 507,854	78.9
NSS	235,855	31.6	135,449	21.1
Corporate	—	—	—	—
Consolidated revenues	$ 747,198	100.0	$ 643,303	100.0

	Operating Income (Loss)	Profit Margin %	Operating Income (Loss)	Profit Margin %
GMS	$ 28,700	3.8	$ 31,537	4.9
NSS	9,248	1.2	7,725	1.2
Corporate	(7,187)		(4,967)	
Consolidated operating income	$ 30,761		$ 34,295	

Global Mission Services Segment Results

Revenues

Revenues for the three months ended June 27, 2021, increased by $3.5 million, or 0.7%, from the comparable period in 2020. The increase was attributable to new business awards which increase was partially offset by reductions in contract volume on certain programs.

Operating income

Operating income for the three months ended June 27, 2021 decreased by $2.8 million from the comparable period in 2020. This decrease was primarily driven by higher selling, general and administrative expenses, partially offset by higher revenue volume.

National Security Solutions Segment Results

Revenues

Revenues for the three months ended June 27, 2021 increased by $100.4 million, or 74.1%, from the comparable period in 2020. The increase was attributable to $93.1 million of revenue from recent acquisitions and by a $7.4 million net increase from contract volume.

Operating income

Operating income for the three months ended June 27, 2021 increased by $1.5 million from the comparable period in 2020. The increase was primarily due to increased revenue volume and improved program performance, partially offset by higher selling, general and administrative expenses and amortization of intangible assets.

PAE's Segments

***Comparison of Results by Segments for the Six Months Ended June 27, 2021, and June 28, 2020 (Unaudited) (in thousands)*:**

	June 27, 2021		June 28, 2020	
	Revenues	**% of Total Revenues**	**Revenues**	**% of Total Revenues**
GMS	$ 1,032,904	69.1 %	$ 965,298	76.6 %
NSS	462,861	30.9	295,258	23.4
Corporate	—	—	—	—
Consolidated revenues	$ 1,495,765	100.0 %	$ 1,260,556	100.0 %

	Operating Income (Loss)	**Profit Margin %**	**Operating Income (Loss)**	**Profit Margin %**
GMS	$ 53,214	3.6 %	$ 44,140	3.5 %
NSS	20,638	1.4	12,092	1.0
Corporate	(16,895)		(14,479)	
Consolidated operating income	$ 56,957		$ 41,753	

Global Mission Services Segment Results

Revenues

Revenues for the six months period ended June 27, 2021, increased by $67.6 million, or 7.0%, from the comparable period in 2020. This increase was attributable to new business awards, partially offset by a change in contract volume on certain programs.

Operating income

Operating income for the six months period ended June 27, 2021 increased by $9.1 million, or 20.6%, from the comparable period in 2020. The increase was driven by revenue volume and an increase in equity investments income.

National Security Solutions Segment Results

Revenues

Revenues for the six months period ended June 27, 2021 increased by $167.6 million, or 56.8%, from the comparable period in 2020. This increase was attributable to $181.9 million revenue from recent acquisitions partially offset by $14.3 million decrease from small business recompete losses and change in contract volume, net of new business wins.

Operating income

Operating income for the six months period ended June 27, 2021 increased by $8.5 million, or 70.7%, from the comparable period in 2020. The increase was primarily driven by higher revenue volume and improved program performance, partially offset by higher amortization of intangible assets.

Liquidity and Capital Resources

PAE's primary sources of liquidity are cash flow from operations and borrowings under its credit facility to provide capital necessary for financing working capital requirements, capital expenditures and making selective strategic acquisitions.

On October 19, 2020 the Company refinanced the 2016 Credit Agreements and entered into the 2020 Credit Agreements. The 2020 Credit Agreements provide a $740.0 million term loan facility maturing in October 2027, a $150.0 million delayed draw term loan facility maturing in October 2027, and a $175.0 million senior secured revolving credit facility (the "2020 ABL Credit Agreement") maturing in October 2025.

In addition, The Company, through its DZSP subsidiary, entered into a line of credit with Bank of America for the financing of program specific equipment. As of June 27, 2021, PAE has one outstanding equipment loan note ("Equipment Note") totaling $5.0 million with a maturity date of March 2028.

As of June 27, 2021, PAE had cash and cash equivalents totaling $94.7 million and the Company had no outstanding borrowings on its 2020 ABL Credit Agreement.

PAE expects the combination of its current cash, cash flow from operations, and the available borrowing capacity under the 2020 Credit Agreements to be sufficient to continue to meet its normal working capital requirements, capital expenditures and other cash requirements. However, significant increases or decreases in revenues, accounts receivable, accounts payable, and merger and acquisition activity could affect PAE's liquidity. PAE's accounts receivable and accounts payable levels can be affected by changes in the level of contract work it performs, by the timing of large materials purchases, and subcontractor efforts used in its contracts. Government funding delays can cause delays in PAE's ability to invoice for revenues earned, presenting a potential negative impact on liquidity. PAE's ability to generate sufficient cash flows from operations necessary to fulfill its obligations under the 2020 Credit Agreements and any other commitments will depend on future financial performance, which could be affected by financial market conditions.

See Note 10 - "Debt" of the notes to the condensed consolidated financial statements for further information on the terms and availability of PAE's credit facilities.

Cash Flows Analysis

***Comparison of Results for the Three Months Ended June 27, 2021 (Unaudited), and June 28, 2020 (Unaudited) (in thousands)*:**

	Three Months Ended		
	June 27, 2021	June 28, 2020	Dollar Change
Net cash (used in) provided by operating activities	(11,859)	44,675	$ (56,534)
Net cash used in investing activities	(13,928)	(1,156)	(12,772)
Net cash used in financing activities	1,974	(5,938)	7,912
Effect of exchange rate changes on cash and cash equivalents	373	1,098	(725)
Net (decrease) increase in cash and cash equivalents	$ (23,440)	$ 38,679	$ (62,119)

Net cash (used in) provided by operating activities

Net cash used in operating activities for the quarter of $(11.9) million, decreased by $56.5 million over the prior year period, primarily as a result of lower comparable cash collections, partially offset by customer advances and billings in excess of costs and net income growth.

Net cash used in investing activities

Cash used in investing activities for the three months ended June 27, 2021 increased from the comparable period in 2020, primarily driven by higher expenditures in property and equipment.

Net cash used in financing activities

Cash used in financing activities for the three months ended June 27, 2021 was $2.0 million, an improvement of $7.9 million from the comparable period in 2020. The improvement was primarily driven by lower net borrowings and repayment of long-term debt.

Cash Flows Analysis

***Comparison of Results for the Six Months Ended June 27, 2021 (Unaudited), and June 28, 2020 (Unaudited) (in thousands)*:**

	Six Months Ended		
	June 27, 2021	June 28, 2020	Dollar Change
Net cash provided by operating activities	$ 43,537	$ 55,588	$ (12,051)
Net cash used in investing activities	(30,812)	(1,560)	(29,252)
Net cash (used in) provided by financing activities	(3,195)	15,596	(18,791)
Effect of exchange rate changes on cash and cash equivalents	(728)	810	(1,538)
Net increase in cash and cash equivalents	$ 8,802	$ 70,434	$ (61,632)

Net cash provided by operating activities

Net cash provided by operating activities for the six months ended June 27, 2021 decreased by $12.1 million from the comparable period in 2020, driven primarily by lower cash collections, which decrease was partially offset by increases in accounts payable and accrued expenses in the current period.

Net cash used in investing activities

Cash used in investing activities for the six months ended June 27, 2021 increased by $29.3 million from the comparable period in 2020, primarily driven by the acquisition of the DZSP 49% minority interest from Parsons Government Services, Inc., closing purchase price adjustments related to the CENTRA and Metis acquisitions and higher expenditures in property, plant and equipment.

Net cash (used in) provided by financing activities

Cash provided by financing activities for the six months ended June 27, 2021 decreased by $18.8 million from the comparable period in 2020. The decrease was primarily driven by the Recapitalization.

For a discussion of the Recapitalization, see Note 6 – “Business Combinations and Acquisitions” of the notes to the condensed consolidated financial statements.

Financing

Long-term debt consisted of the following as of the dates presented *(in thousands)*:

	June 27, 2021	December 31, 2020
First Term Loan	$ 887,775	$ 890,000
Other debt	$ 5,024	$ —
Total debt	892,799	890,000
Unamortized discount and debt issuance costs	(22,295)	(23,733)
Total debt, net of discount and debt issuance costs	870,504	866,267
Less current maturities of long-term debt	(6,611)	(5,961)
Total long-term debt, net of current	$ 863,893	$ 860,306

During the fourth quarter of 2020, the Company refinanced the 2016 Credit Agreements and entered into the 2020 Credit Agreements, which provide for borrowings up to $890.0 million. The 2020 Credit Agreements establish a $740.0 million term loan facility maturing in October 2027 priced at LIBOR plus a spread of 4.5%, a $150.0 million delayed draw term loan facility maturing in October 2027 priced at LIBOR plus a spread of 4.5%, and a $175.0 million senior secured revolving credit facility maturing in October 2025 priced at LIBOR plus a spread of 1.8% to 2.3%.

The Company used the proceeds from the 2020 Credit Agreements to repay the amounts outstanding under its 2016 Credit Agreements, with the remaining amounts to be used for general corporate purposes, mergers and acquisitions, and transaction fees and expenses.

The loans under the 2020 Credit Agreements are secured by a first lien over substantially all of the Company's assets. The 2020 Credit Agreements also contain affirmative and negative covenants customary for transactions of this type, including (i) affirmative covenants requiring the Company to comply with specified financial covenants under certain circumstances, including the maintenance of certain leverage ratios; and (ii) various non-financial covenants, including affirmative covenants with respect to reporting requirements and maintenance of business activities, and negative covenants that, among other things, may limit or impose restrictions on the Company's ability to alter the character of the business, consolidate, merge, or sell assets, incur liens or additional indebtedness, make investments, and undertake certain additional actions.

PAE was in compliance with the financial covenants under the 2020 Credit Agreements as of June 27, 2021. See Note 10 - “Debt” of the notes to the condensed consolidated financial statements.

Off-Balance Sheet Arrangements

PAE has outstanding performance guarantees and cross-indemnity agreements in connection with certain aspects of its business. PAE also has letters of credit outstanding principally related to performance guarantees on contracts and surety bonds outstanding principally related to performance and subcontractor payment bonds as described in Note 10 - “Debt” of the notes to the condensed consolidated financial statements.

PAE has entered into various arrangements to provide program management, construction management and operations and maintenance services. The ownership percentage of these ventures is typically representative of the work to be performed or the amount of risk assumed by each venture partner. Some of these ventures are considered variable interest entities. PAE has consolidated all ventures over which it has control. For all others, PAE's portion of the earnings is recorded in equity in earnings of ventures. See Note 9 - "Consolidated Ventures" of the notes to the condensed consolidated financial statements.

PAE does not believe that it has any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that would be material to investors.

Recently Issued Accounting Pronouncements

For a description of recently announced accounting standards, including the expected dates of adoption and estimated effects, if any, on PAE's condensed consolidated financial statements, see Note 3 - "Recent Accounting Pronouncements" of the notes to the condensed consolidated financial statements.

Critical Accounting Policies

The preparation of condensed consolidated financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingencies, as well as the reported amounts of revenues, expenses, gains and losses during the reporting periods. Management evaluates these estimates and assumptions on an ongoing basis. These estimates may change in the future if underlying assumptions or factors change. Actual results could differ materially from our estimates under different assumptions, judgments or conditions. We consider certain policies to be critical because of their complexity and the high degree of judgment and assumptions involved. Our critical accounting policies and estimates are discussed in Part II, Item 7 - "Management's Discussion and Analysis of Financial Condition and Results of Operations" of our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2020 under "Critical Accounting Policies." There have been no changes to our existing critical accounting policies from those disclosed in our most recently filed Annual Report on Form 10-K/A.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have not been any material changes to the Company's market risk from those disclosed in our most recently filed Annual Report on Form 10-K/A. For additional information, refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in the Company's Annual Report on Form 10-K/A filed with the SEC on May 7, 2021.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in company reports filed or submitted under the Exchange Act is accumulated and communicated to management, including our Principal Executive Officer (“PEO”) and Principal Financial Officer (“PFO”), to allow timely decisions regarding required disclosure.

As required by Rules 13a-15 and 15d-15 under the Exchange Act, our PEO and PFO carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of June 27, 2021. Based upon our evaluation, the PEO and PFO concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) were not effective in our internal control over financial reporting related to the accounting for warrants. The material weakness is described in Item 9A - “Control and Procedures” on our amended Annual Form 10-K/A for the year ended December 31, 2020.

Remediation Efforts to Address Material Weakness in Internal Control over Financial Reporting

As described in Item 9A - “Controls and Procedures”, on our amended Annual Report on Form 10-K/A for the year ended December 31, 2020, a material weakness was identified in the accounting for warrants. This material weakness has not yet been remediated for the six months ended June 27, 2021. Management is continuing to take the necessary steps to address the causes of the material weakness in an effort to remediate this material weakness. The Company is performing the following remediation efforts to address the material weakness identified:

- Additional review procedures over complex financial instruments and accounting matters
- Additional training and enhancements to the accounting policy related to the accounting for complex financial instruments

The material weakness cannot be considered remediated until the controls operate for a sufficient period and management has concluded, through testing, that our internal controls are operating effectively.

Internal Control over Financial Reporting

We have evaluated our internal control over financial reporting for the six months ended June 27, 2021 and, in addition to the changes discussed above, the Company continued to make changes to certain internal controls to reflect the operations of PAE’s recent acquisitions of Metis and CENTRA. There have been no other changes in the Company’s internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

Part II. Other Information

ITEM 1. LEGAL PROCEEDINGS

PAE is involved in various legal proceedings, government audits, investigations, claims and disputes that arise in the normal course of business, including those related to employment matters, contractual relationships and other business matters. These legal proceedings seek various remedies, including claims for monetary damages in varying or unspecified amounts. In addition, awards of government contracts may be protested at the U.S. Government Accountability Office or the U.S. Court of Federal Claims; and conversely, PAE may from time to time protest awards made to other companies.

Although the outcome of any such matter is inherently uncertain and may be materially adverse, based on current information, PAE does not expect any of the currently ongoing audits, reviews, investigations, or litigation to have a material adverse effect on its financial condition or operating results. Its view of the matters not specifically disclosed could change in future periods as events unfold.

ITEM 1A. RISK FACTORS

For a discussion of risk factors that could significantly and negatively affect our business, financial condition, results of operations, cash flows and prospects, see the disclosure under Part I, Item 1A “Risk Factors” in the Company’s Annual Report on Form 10-K/A filed with the SEC on May 7, 2021. There have been no material changes from the risk factors set forth in Part I, Item 1A “Risk Factors” on Form 10-K/A for the year ended December 31, 2020, other than the additional risk factor provided below, which is an update to the risk factor included in Part II, item 1A of our Form 10-K/A for the year ended December 31, 2020.

PAE relies on contracts with U.S. Government entities for substantially all of its revenue. A loss of contracts, a failure to obtain new contracts or a reduction of services provided under existing contracts with the U.S. Government, including as a result of a reduction in U.S. Government spending, could adversely affect PAE’s operating performance and result in a loss of expected revenue.

Substantially all of PAE’s revenue is derived from services ultimately provided to the U.S. Government. For the year ended December 31, 2020, PAE generated approximately 89.5% of its total revenue from contracts with the U.S. Government, with 35.7% of its total revenue from the DoD and 18.7% of its total revenue from the DoS. For the six months ended June 27, 2021, PAE’s largest single contract accounts for approximately 8.8% of its total revenue. The remainder of its revenue is derived from other U.S. agencies, including DHS, National Aeronautics and Space Administration (“NASA”), U.S. intelligence agencies, the National Science Foundation, non-governmental organizations and U.S. Government allies. PAE expects that U.S. Government contracts will continue to be its primary source of revenue for the foreseeable future. The continuation and renewal of PAE’s existing U.S. Government contracts and entrance into new U.S. Government contracts are, among other things, contingent upon the availability of adequate funding for various U.S. Government agencies. Changes in U.S. Government spending could directly affect PAE’s operating performance and result in a loss of expected revenue. The loss or significant reduction in government funding of a program in which PAE participates could also result in a material decrease to PAE’s future sales, earnings and cash flows.

U.S. Government contracts are also conditioned upon the approval of spending by the U.S. Congress. In addition, Congress usually appropriates funds for a given program on a September 30 fiscal year basis, even though contract periods of performance may extend over many years. Consequently, at the beginning of a major program, the contract is usually partially funded and additional monies are normally committed to the contract by the procuring agency only as appropriations are made by Congress for future fiscal years. The factors that could impact U.S. Government spending and reduce PAE’s U.S. Government contracting business include: (i) policy and/or spending changes implemented by presidential administrations or Congress; (ii) a significant decline in, or reapportioning of, spending by the U.S. Government in general; (iii) changes, delays or cancellations of U.S. Government programs, requirements or policies; (iv) the adoption of new laws or regulations that affect companies that provide services to the U.S. Government; (v) U.S. Government shutdowns or other delays in the government appropriations process; (vi) changes in the political climate, including with regard to the funding or operation of the services PAE provides; and (vii) general economic conditions, including a slowdown in the economy or unstable economic conditions in the United States or in the countries in which PAE operates.

A change in any number of public policy objectives, including with respect to national security and foreign aid, could materially impact PAE’s business. For example, the U.S. Government’s April 2021 decision to withdraw U.S. troops and contractor personnel from Afghanistan has impacted the Company’s work in Afghanistan, including the National Maintenance Strategy program, which is one of PAE’s larger contracts and is expected to conclude in the third quarter of 2021. Also, by way of example, changes in immigration policy and border protection in the United States could negatively impact PAE’s business.

These or other factors could cause U.S. Government agencies to reduce their purchases under PAE’s contracts, to exercise their right to terminate PAE’s contracts in whole or in part, to issue temporary stop-work orders or to decline to exercise options to renew PAE’s contracts. The loss or significant curtailment of PAE’s material U.S. Government contracts, the decision by PAE’s customers not to renew existing contracts or a failure to enter into new contracts could adversely affect PAE’s operating performance and result in a loss of expected revenue.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

See the Exhibit Index below, which is incorporated by reference herein.

Exhibit Index

Exhibit No.	
10.1*	Retention Agreement with Clint Bickett, Interim President of Global Mission Services
31.1	Certification by the Principal Executive Officer and Principal Financial Officer of the Company Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by the Principal Executive Officer and Principal Financial Officer of the Company Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	Inline XBRL Instance Document
101.SCH	Inline XBRL Taxonomy Extension Schema Document
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	Inline XBRL Taxonomy Extension Labels Linkbase Document
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

*Management contract or compensatory plan or arrangement

SIGNATURES

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

Dated: Aug 5, 2021	**PAE Incorporated**	
	By:	/s/ Charles D. Peiffer
	Name:	Charles D. Peiffer
	Title:	Interim President & Chief Executive Officer Executive Vice President & Chief Financial Officer

June 24, 2021

Clint Bickett

Re: Retention Agreement

Dear Clint,

This letter agreement ("Agreement") is between PAE Shared Services LLC ("the Company") and Clint Bickett ("You" or "Your"). The Company is naming you Interim President of Global Mission Services ("Interim President"), to be effective July 6, 2021. In recognition of this increase of duties, Company will provide the additional consideration and compensation as set forth below.

You agree that you will serve in this role beginning July 6, 2021 until the Company designates an individual to serve as a permanent President of Global Services, or otherwise reorganizes the role and duties encompassed within and under the title President of Global Mission Services ("Term").

You acknowledge that this Agreement does not constitute a contract of employment or impose on the Company any obligation to retain You as an employee and that this Agreement does not prevent You from terminating Your employment. You understand and acknowledge that You are an employee at will and that either You or the Company may terminate the employment relationship at any time and for any reason.

1. **CONDITIONS FOR PAYMENT.**

   a. Conditions. You will receive the compensation described in Section 2 below if You satisfactorily perform Your assigned duties and remain in active full-time employment with the Company as set forth below. You will not be entitled to any compensation under this Agreement if, during the Term, you voluntarily terminate your employment or the Company terminates Your employment for Cause.

   b. Definitions.

      i. **Cause.** Termination of employment by the Company for Cause shall be deemed to have occurred only if such termination directly results from:

         1. Conviction of a crime (including conviction on a nolo contendere plea) involving the commission by You of a felony or of a criminal

act involving, in the good faith judgment of the Company, fraud, dishonesty, or moral turpitude; or

2. Failure or refusal to satisfactorily perform employment duties reasonably requested by the Company or an affiliate after ten (10) days' written notice of such failure to perform, specifying that the failure constitutes cause (other than as a result of vacation, sickness, illness, or injury); or

3. Mis-appropriation by You, for Your personal use, of the assets or business opportunities of the Company, or its affiliates; or

4. Fraud or embezzlement determined in accordance with the Company's normal, internal investigative procedures consistently applied in comparable circumstances; or

5. You knowingly allow any third party to commit any of the acts described in 3 or 4 above; or

6. Misconduct or negligence in connection with the business of the Company or an affiliate which has an adverse effect on the Company or the affiliate; or

7. Violation of any Company policies or procedures.

The Company retains sole discretion to determine Cause pursuant to this Agreement.

ii. **Total Disability.** Termination of employment by the Company for Total Disability shall be deemed to have occurred only if such termination directly results from Your becoming physically or mentally incapacitated so as to render You incapable of performing the essential functions of Your position without reasonable accommodation. Your receipt of disability benefits under the Company's long-term disability plan, if any, or receipt of Social Security disability benefits shall be deemed conclusive evidence of Total Disability for purposes of this Agreement; provided, however, that in the absence of Your receipt of such long-term disability benefits or Social Security benefits, the Company may, in its reasonable discretion (but based upon appropriate medical evidence), determine that You are Totally Disabled.

2. **Compensation.**

If You meet the conditions described in Section 1 above, and following the Company’s receipt of Your signed copy of this Agreement, You will be entitled to receive the following compensation:

a. Salary Bonus (“Salary Bonus”). For the period of the Term, Company will pay a Salary Bonus equal to a pro-rated amount of the difference between $450,000.00 and your current base salary. The Salary Bonus will be paid within 30 days following the end of the Term (“Payment Date 1”).

b. Leadership Incentive Compensation Plan Bonus (“LICP Bonus”).

i. For the period of the Term, your target LICP Bonus shall be increased to 75% of your current base salary.

ii. All other terms and conditions contained in the Company’s LICP will remain in full force and effect, including, but not limited to, eligibility, determination of amount of award, and the timing of any payments the Company may award to you.

iii. The LICP Bonus will be paid in accordance with regular company policies, practices and timelines (“Payment Date 2”).

c. If Your employment should end before the end of the Term due to termination by the Company without Cause or Your death or Total Disability (“Qualifying Termination”), You or Your estate or beneficiary, as provided in Section 7(c), shall receive a pro-ration of the bonuses described in 2(a) and (b).

i. Such bonuses will be paid at the same time (Payment Date 1 and Payment Date 2) as they would otherwise have been paid to You under Section 2(a).

ii. The pro rata amounts shall be calculated as follows: The Salary Bonus and the LICP Bonus shall each divided by the total number of days in the Term, multiplied by the total number of days between July 6, 2021 and the date of your Qualifying Termination.

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3. Confidentiality.

You agree that the terms of this Agreement shall remain strictly confidential at all times and agree not to disclose any information regarding the existence or terms of this Agreement, except to Your spouse, tax advisor, and/or attorney with whom You choose to consult regarding consideration of this Agreement.

4. **Section 409A.** To the extend any amounts payable hereunder are deferred compensation within the meaning of Section 409A, this Agreement is intended to comply with Section 409A, and the terms of this Agreement shall be applied consistent within the requirements of Section 409A. To the extent that any provision of this Agreement is or will be in violation of Section 409A, the Company and Employee agree to amend this Agreement so that it complies with Section 409A. If any amounts payable under this Agreement would be subject to any penalty tax by reason of the application of Section 409A, the Company will use commercially reasonable efforts to take such reasonable steps as it may determine to be necessary or desirable, with Employee's consent, to ensure that such amounts are not subject to such penalty tax. However, any such tax under Section 409A is ultimately the responsibility of the Employee and Employee is advised to seek tax advice and agrees to assume such personal tax liability as may be incurred under this Agreement. Each amount to be paid or benefit to be provided to Employee pursuant to the Agreement shall be construed as separate identified payment for purposes of Section 409A.

5. **Entire Agreement, Amendments and Waiver.**

   This Agreement constitutes the entire agreement between the Company and You concerning its subject matter and it supersedes all prior oral and written agreements, arrangements, understandings, warranties, representations, and statements between the parties concerning its subject matter. This Agreement may be amended only by agreement of the parties set forth in writing.

6. **Governing Law.** This Agreement shall be governed by the internal law of the Commonwealth of Virginia without reference to its choice of law rules. Any action, suit or other legal action arising under or relating to any provision of this Agreement shall be commenced only in a court of the Commonwealth of Virginia (or, if appropriate, a federal court located within Virginia), and You and the Company each consent to the jurisdiction of such a court. You and the Company each hereby irrevocably waives any right to a trial by jury in any action, suit or other legal proceeding arising under or relating to any provision of this Agreement.

7. **Miscellaneous.**

a. Except as otherwise provided for herein, nothing in this Agreement shall confer upon You any right to continued employment by the Company, nor does it limit in any way the right of the Company to terminate Your employment at any time or for any reason.

b. Your rights and interests under this Agreement may not be assigned or transferred in whole or in part either directly or by operation of law or otherwise (except in an event of Your death), including, but not limited to, by way of execution, levy, garnishment, attachment, pledge, bankruptcy or in any other manner, and Your rights or interests under this Agreement shall not be subject to any obligation or liability of other than any obligations or liabilities owed by You to the Company.

c. In the event of Your death or legal incapacity, payment will be made to a beneficiary (or beneficiaries) designed by You in the form and manner prescribed by the Company, or to Your legal representative. If You do not have a properly designated beneficiary, payment will be made to Your estate.

d. This Agreement may be executed in any number of counterparts, each of which so executed shall be deemed to be an original, and such counterparts will together constitute but one Agreement.

e. Any notices delivered under this Agreement shall be deemed duly delivered four business days after it is sent by registered or certified mail, return receipt requested, postage prepaid, or one business day after it is sent for next-business day delivery via a reputable nationwide overnight courier service, in each case to the address of the recipient set forth at the beginning of this Agreement. Either party may change the address to which notices are to be delivered by giving notice of such change to the other party. All notices to the Company shall be addressed to the General Counsel of Pacific Architects and Engineers Incorporated, at 7799 Leesburg Pike, Suite 300N, Falls Church VA, 22043.

f. The provisions, sections and paragraphs, and the specific terms set forth therein, of this Agreement are severable. If any provision, section or paragraph, or specific term contained therein, of this Agreement or the application thereof is determined by a court to be illegal, invalid, or unenforceable, that provision, section, paragraph, or term shall not be a part of this Agreement, and the legality, validity and enforceability of remaining provisions, sections and paragraphs, and all other terms therein, of this Agreement shall not be affected thereby.

PAE

If this letter correctly sets forth our agreement on the subject matter hereof, please sign and return to the Company the enclosed copy of this letter which will then constitute our agreement on this subject.

Very truly yours,

/s/ Patricia Munchel

By: Patricia Munchel
EVP, Chief Human Resources Officer

Agreed to this 24th day of June 2021.

/s/ Clint Bickett

By: Clint Bickett

Exhibit 31.1
Section 302 Certification

I, Charles D. Peiffer, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of PAE Incorporated (the “Registrant”);

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. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent function):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to 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 controls over financial reporting.

Date: Aug 5, 2021

/s/ Charles D. Peiffer

Charles D. Peiffer

Interim President & Chief Executive Officer Executive Vice President & Chief Financial Officer (Principal Executive Officer and Principal Financial Officer)

Exhibit 32.1

Section 906 Certification

In connection with the quarterly report on Form 10-Q of PAE Incorporated (the “Company”) for the period ended June 27, 2021, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), the undersigned President and Chief Executive Officer, Executive Vice President and Chief Financial Officer of the Company certifies, to the best of his knowledge and belief pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 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 results of operations of the Company.

Date: Aug 5, 2021

/s/ Charles D. Peiffer

Charles D. Peiffer

Interim President & Chief Executive Officer Executive Vice President & Chief Financial Officer (Principal Executive Officer and Principal Financial Officer)