DALEEN TECHNOLOGIES INC
Form 10-Q
August 16, 2004

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2004

OR

o **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: 0-27491

DALEEN TECHNOLOGIES, INC.

(Exact name of registrant as specified in Its charter)

Delaware (State or other Jurisdiction of incorporation or organization)	**65-0944514** (I.R.S. Employer Identification No.)
902 Clint Moore Road, Suite 230 **Boca Raton, Florida** (Address of principal executive offices)	**33487** (Zip Code)

Registrant s Telephone Number, Including Area Code: (561) 999-8000

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 þ No o

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes o No þ

As of July 31, 2004, the Registrant had outstanding 46,911,152 shares of common stock.

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DALEEN TECHNOLOGIES, INC. AND SUBSIDIARIES
FORM 10-Q

QUARTER ENDED JUNE 30, 2004

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements.

DALEEN TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED UNAUDITED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	December 31, 2003	June 30, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,497	$ 1,400
Restricted cash	561	347
Accounts receivable, less allowance for doubtful accounts of $887 at December 31, 2003 and $877 at June 30, 2004	610	996
Notes receivable		999
Costs in excess of billings	2,032	2,454
Unbilled revenue	392	844
Other current assets	487	376
Total current assets	6,579	7,416
Property and equipment, net	931	697
Goodwill	5,086	5,086
Other assets	430	310
Total assets	$ 13,026	$ 13,509
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 148	$ 400
Accrued payroll and other accrued expenses	2,267	4,175
Operating loan		657
Related party bridge loan		2,210
Billings in excess of costs	97	150
Deferred revenue	372	528
Other current liabilities	42	64

Total current liabilities	2,926	8,184
Other long term liabilities	5	
Total liabilities	2,931	8,184
Stockholders equity:		
Series F convertible Preferred Stock $.01 par value; 588,312 shares authorized ; 453,322 and 449,237 issued and outstanding at December 31, 2003 and June 30, 2004, respectively ($110.94 per share liquidation value equal to $50,291,543 and $49,838,353 at December 31, 2003 and June 30, 2004, respectively)	27,112	26,659
Common stock-$.01 par value; 200,000,000 shares authorized; 47,449,127 shares issued and 46,429,163 outstanding at December 31, 2003 and 47,949,336 shares issued and 46,911,152 outstanding at June 30, 2004	475	480
Additional paid-in capital	197,187	197,636
Accumulated deficit	(214,528)	(219,298)
Treasury stock at cost; 1,019,964 shares at December 31, 2003 and 1,038,184 at June 30, 2004	(151)	(152)
Total stockholders equity	10,095	5,325
Total liabilities and stockholders equity	$ 13,026	$ 13,509

See accompanying notes to condensed unaudited consolidated financial statements.

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DALEEN TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Three months ended June 30,		Six months ended June 30,	
	2003	**2004**	**2003**	**2004**
Revenue:				
Professional services and other	$ 3,982	$ 3,150	$ 7,809	$ 6,816
License fees	231	670	475	1,257
Total revenue	4,213	3,820	8,284	8,073
Cost of revenue:				
Professional services and other	1,109	1,344	2,165	2,928
License fees	165		468	
Total cost of revenue	1,274	1,344	2,633	2,928
Gross margin	2,939	2,476	5,651	5,145
Operating expenses:				
Sales and marketing	831	825	1,732	1,559
Research and development	1,602	1,455	3,284	3,107
General and administrative	1,517	1,630	3,129	3,069
Proposed transaction costs		2,005		2,189
Impairment of long lived assets	500		500	
Total operating expenses	4,450	5,915	8,645	9,924
Operating loss	(1,511)	(3,439)	(2,994)	(4,779)
Other Income (expense):				
Interest income and interest expense, net	99	(28)	163	9

Total other income (expense), net	99	(28)	163	9
Net loss applicable to common stockholders	$ (1,412)	$ (3,467)	$ (2,831)	$ (4,770)
Net loss applicable to common stockholders per share -basic and diluted	$ (0.03)	$ (0.07)	$ (0.06)	$ (0.10)
Weighted average shares outstanding- basic and diluted	45,829	46,923	45,829	46,891

See accompanying notes to condensed unaudited consolidated financial statements.

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DALEEN TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Six Months Ended	
	June 30, 2003	**June 30, 2004**
Cash flows from operating activities:		
Net loss	$(2,831)	$(4,770)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,311	1,307
Loss on disposal of property and equipment	14	21
Bad debt expense	96	27
Impairment of long lived assets	500	
Interest income on stockholders notes receivable	(2)	
Changes in assets and liabilities		
Restricted cash		214
Accounts receivable	589	(380)
Costs in excess of billings	(380)	(422)
Unbilled revenue	(126)	(452)
Other current assets	(583)	(799)
Other assets	(4)	47
Accounts payable	60	253
Accrued payroll and other accrued expenses	(387)	1,911
Billings in excess of costs	(142)	53
Deferred revenue	(407)	160
Other current liabilities	(44)	(10)
Other liabilities		54
Net cash used in operating activities	(1,336)	(2,786)
Cash flows (used in) provided by financing activities:		
Payment of capital lease	(110)	(26)
Proceeds from operating loan		657
Proceeds from bridge loan		2,210
Net cash (used in) provided by financing activities	(110)	2,841
Cash flows used in investing activities:		
Issuance of notes receivable		(999)

Repayment of stockholder s notes receivable	30	8
Payments related to the Abiliti acquisition	(262)	
Capital expenditures	(205)	(154)
Net cash used in investing activities	(437)	(1,145)
Effect of exchange rates on cash and cash equivalents	(24)	(7)
Net decrease in cash and cash equivalents	(1,907)	(1,097)
Cash and cash equivalents-beginning of period	6,589	2,497
Cash and cash equivalents-end of period	$ 4,682	$ 1,400

See accompanying notes to condensed unaudited consolidated financial statements.

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Daleen Technologies, Inc. and Subsidiaries

Notes to Condensed Unaudited Consolidated Financial Statements
June 30, 2004

(1) Basis of Presentation

The accompanying condensed unaudited consolidated financial statements for Daleen Technologies, Inc. and subsidiaries (collectively referred to as Daleen or the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these financial statements do not include all of the information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with generally accepted accounting principles. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the results for the periods presented have been included. The condensed unaudited consolidated balance sheet at December 31, 2003 has been derived from the Company s audited consolidated financial statements at that date. These condensed unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2003, included in the Company s annual report on Form 10-K as of and for the year ended December 31, 2003, filed with the Securities and Exchange Commission (the SEC) on March 19, 2004.

The results of operations for the three or six months ended June 30, 2004 are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year.

(2) Principles of Consolidation and Reclassifications

The accompanying financial statements include the accounts and operations of Daleen Technologies, Inc. and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

(3) Basic and Diluted Net Loss Per Share

Basic and diluted net loss per share was computed by dividing net loss applicable to common stockholders by the weighted average number of shares of common stock outstanding for each period presented. Common stock equivalents were not considered since their effect would be antidilutive. Common stock equivalents amounted to 55,931,354 and 56,171,248 shares for the three and six months ended June 30, 2004, respectively. Common stock equivalents were 56,262,532 shares and 56,179,467 shares for the three and six months ended June 30, 2003, respectively.

(4) Liquidity

The Company incurred a net loss of approximately $4.8 million for the six months ended June 30, 2004 and had an accumulated deficit of $219.3 million at June 30, 2004. Cash and cash equivalents and restricted cash at June 30, 2004 were $1.7 million. Cash used in operations for the six months ended June 30, 2004 was $2.8 million. The Company continued to provide outsourcing services to Allegiance Telecom Company Worldwide (Allegiance) pursuant to an agreement expiring on December 31, 2004. Allegiance assigned the agreement to XO Communications, Inc. (XO) on July 23, 2004. Allegiance accounted for 17.1% and 21.2% of total revenue for the three and six months ended June 30, 2004, respectively. There are no minimum revenues under this agreement. Allegiance s use of the Company s services declined significantly this year as it migrated data to another software system. We expect that XO will continue the migration of data and will ultimately discontinue use of the Company s services.

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As a result of the Company s business concentration risk, past recurring losses from operations and accumulated deficit, it raises substantial doubt about the Company s ability to continue as a going concern.

In February 2004, the Company closed a revolving loan facility (the Operating Loan) with Silicon Valley Bank (SVB) and guaranteed by EXIM Bank. (See Note 5 for a description of terms and financial covenant requirements). Total funding under the Operating Loan is $2,700,000. The Company can borrow up to an additional $143,000 in the third and fourth quarters of the year against the Operating Loan based on estimated funding dates and may have outstanding borrowings at any given time of up to $2,000,000. The balance on the Operating Loan as of June 30, 2004 was $657,000. At June 30, 2004, $209,000 was available for additional borrowing as needed.

On May 7, 2004 definitive agreements were signed by affiliates of Quadrangle Capital Partners L.P. (Quadrangle) and Behrman Capital (Behrman) for investments of $25 million and $5 million, respectively, into Daleen Holdings, Inc. (DHI) a newly formed holding company that will simultaneously acquire Daleen and Protek Telecommunications Solutions Limited (Protek), (the Investment and Acquisition Transactions). As part of the Investment and Acquisition Transactions, Daleen will become a private company subject to the approval of the company s stockholders. The Investment and Acquisition Transactions are subject to the satisfaction of customary closing conditions including the approval of Daleen stockholders. Upon signing the definitive agreements, Behrman entered into a $5.1 million bridge loan facility (the Bridge Loan Facility). The aggregate principal amount outstanding under the Bridge Loan Facility will be credited against Behrman s commitment under the Investment and Acquisition Transactions. The balance on the Bridge Loan Facility as of June 30, 2004 was $2.2 million (See notes 5 and 6 for a description of the terms of the Investment and Acquisition Transactions and Bridge Loan Facility). In August 2004, the Company made an additional draw of $400,000, so the maximum remaining balance that may be available is $2.5 million.

The Company believes the cash and cash equivalents at June 30, 2004, together with the Operating Loan proceeds, Bridge Loan Facility proceeds, provided that Behrman continues to make additional draws available, and the additional funding resulting from the closing of the Investment and Acquisition Transactions, may be sufficient to fund operations for the foreseeable future. The Company does not believe that its cash and cash equivalents at June 30, 2004 will be sufficient to fund operations and that it will be required to further reduce operations and/or seek additional financing if the Investment and Acquisition Transactions are not completed. The Investment and Acquisition Transactions are subject to a number of closing conditions, including the approval of the Company s stockholders, and there can be no assurance that the transactions will be consummated. If the investment by Quadrangle and Behrman does not close by September 30, 2004, the Investment Agreement will automatically terminate unless extended by agreement of Quadrangle, Behrman and the Company. If the transactions are not consummated, it is highly unlikely that the Company would continue to operate its business substantially as presently operated. The remainder of the Bridge Loan Facility may be made available to the Company by Behrman, at its discretion, to fund the Company s ordinary course working capital needs prior to the closing of the Investment and Acquisition Transactions and to pay costs incurred in connection with the Bridge Loan Facility and Investment and Acquisition Transactions. There can be no assurance that Behrman will continue to make additional draws available or that other financing will be available, or that, if available, the financing will be obtainable on terms acceptable to the Company or that additional financing would not be substantially dilutive to the Company s existing stockholders. Although the Company is precluded from considering other strategic alternatives pending completion or termination of the Investment and Acquisition Transactions, if the transactions are not completed, the Company will consider other strategic alternatives. There can be no assurance that any other strategic alternatives will be available, or if available, will be on terms acceptable to the Company, or all of its stockholders. Failure of Behrman to make additional draws available or failure to consummate the Investment and Acquisition Transactions will have a material adverse affect on the Company s ability to operate as a going concern, which may result in filing for bankruptcy protection, winding down operations and/or liquidation of assets. The condensed unaudited consolidated financial statements have been prepared assuming that the Company will continue as a going concern, and do not include any adjustments that might result from the outcome of this uncertainty.

(5) Operating Loan

In February 2004, the Company closed the Operating Loan with SVB and guaranteed by EXIM Bank. The term of the Operating Loan is fifteen months. Total funding under the Operating Loan is $2.7 million. The Company can borrow up to an additional $143,000 in the third and fourth quarters of the year against the Operating Loan based on estimated funding dates and may have outstanding borrowings at any given time of up to $2,000,000. The proceeds of the Operating Loan will be used for operating costs associated with its contract with Empresa de Telecomunicaciones de Bogotá (ETB), (the ETB Contract). The Company intends to repay the Operating Loan solely from revenues received from the ETB Contract. Interest accrues at the rate of prime plus 2% (minimum 4%) per annum. SVB has a first priority security interest and EXIM Bank has a second priority security interest in substantially all of the Company s assets until the Operating Loan is paid in full. The Operating Loan contains customary representations and warranties and covenants including maintaining a tangible net worth requirement of $4.0 million. In May 2004, the Operating Loan was amended to change the tangible net worth requirement to $3.0 million and to waive any default existing prior to the amendment. On June 30, 2004 the Loan was further amended to waive the tangible net worth covenant violations, and SVB agreed to forbear any exercise of its rights under the agreement through July 31, 2004. The balance on the Operating Loan as of June 30, 2004 was $657,000. Approximately $1.3 million of the then outstanding amount was repaid in the second quarter of 2004. In July 2004, an additional $209,000 was borrowed and approximately $653,000 was repaid in August, 2004.

(6) Investment and Acquisition Transactions

On May 7, 2004 affiliates of Quadrangle and Behrman signed definitive agreements to invest $25 million and $5 million, respectively, into DHI, a newly formed subsidiary of the Company, that, subject to shareholder approval, will simultaneously acquire the Company and Protek.

Quadrangle and Behrman will receive senior convertible redeemable preferred stock in DHI (DHI Preferred) in consideration for their investment. The DHI Preferred will have a dividend of 8% per annum, payable in kind or in cash at DHI s election. The DHI Preferred will also carry the right to the issuance of additional shares of preferred equity should DHI not attain certain specified financial targets.

DHI will acquire Protek by purchase of stock from its shareholders and conversion of outstanding options, for aggregate consideration of up to $20 million, consisting of up to $13 million in cash, $5 million in common stock of DHI (the DHI Common), and contingent earn-outs consisting of $1 million in cash and $1 million of DHI Common. The purchase price will be subject to reduction in respect of closing date debt and working capital shortfalls.

In connection with the Investment and Acquisition Transactions, Daleen will become a private company. All outstanding shares of Daleen common stock will be purchased for $0.0384 per share in cash. The per share purchase price is based on an aggregate amount equal to approximately ten percent of the total value received by Daleen stockholders. In addition, as a condition of closing the Investment and Acquisition Transactions, holders of Daleen Series F convertible preferred stock (Series F preferred stock) will be required to waive the $49.8 million redemption value of the Series F preferred stock. These stockholders will receive an aggregate of $15.4 million in cash and securities, with the cash component limited to a maximum of $2.8 million. Immediately prior to the consummation of the Investment and Acquisition Transactions, Behrman will be contractually obligated to exchange its shares of Series F preferred stock for $5 million in DHI Preferred plus the remaining value of its shares of Series F preferred stock in DHI Common. Other holders of Series F preferred stock will receive a combination of (a) an aggregate of $2.8 million in value of DHI Common and (b) the remaining value of their Series F preferred stock in DHI Common; however, holders of Series F preferred stock will be permitted to convert all of their Series F preferred stock into DHI Common.

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(7) Notes Receivable Loan

On May 7, 2004 the Company entered into a working capital facility agreement with Protek Network Management (U.K.) Limited (PNML). Under the terms of the agreement, the Company agreed to make available to PNML up to $1.5 million to be used for PNML s working capital needs (PNML Loan). The PNML Loan carries interest of 6% per year payable monthly in arrears on the last Business Day of each month. Loan repayment is the earlier of the closing of the proposed Investment and Acquisition Transactions, the 30th day after termination of the stock purchase agreement (where no act of default has occurred) or March 31, 2005. When the PNML Loan is due to be repaid, if there is no material breach of the stock purchase agreement by Protek or any of its shareholders, the Company will release and discharge the obligation to repay $500,000. The PNML Loan is secured by liens on all of PNML s and Protek s assets, subject solely to any first liens already existing in favor of PNML s creditors. The Company was also granted certain warrants for the stock of Protek exercisable in the event of certain defaults. At June 30, 2004 the outstanding balance of the PNML Loan was $1.0 million.

(8) Revenue Recognition

The Company recognizes revenue related to outsourcing services under Emerging Issues Task Force Issue 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables* (EITF 00-21). EITF 00-21 relates to accounting for multiple-deliverable arrangements and specifies circumstances under which a revenue arrangement should be separated into different revenue-generating deliverables or units of accounting and how the revenue arrangement should be allocated to the different deliverables or units of accounting.

Revenue related to outsourcing services consists of (1) discovery work and (2) monthly processing fees generated from the Company s provision of billing and event management services. These two deliverables are considered separate units of accounting because these elements can and have been sold separately and they create stand-alone value for the customer. The revenue associated with discovery work is recognized on a time and materials basis as the work is performed. The monthly processing fees are recognized as the related services are rendered and are billed monthly based on transaction volume processed, percentage of revenue billed on behalf of customers or monthly minimum charges per contractual arrangements.

The Company primarily recognizes revenue related to site license and services agreements under Statement of Position 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions* (SOP 98-9). SOP 98-9 requires recognition of revenue using the residual method when (1) there is vendor-specific objective evidence (VSOE) of the fair values of all undelivered elements in a multiple-element arrangement that is not accounted for using long-term contract accounting, (2) VSOE of fair value does not exist for one or more of the delivered elements in the arrangement, and (3) all revenue recognition criteria in Statement of Position 97-2, *Software Revenue Recognition* (SOP 97-2) other than the requirement for VSOE of the fair value of each delivered element of the arrangement are satisfied.

The following elements could be included in the Company s software license arrangements with its customers:

Software license

Maintenance and support

Professional services

Third party software licenses and maintenance

Training

VSOE exists for all of these elements except for the software license. The software license is delivered upon the execution of the license agreement. Based on this delivery and the fact that VSOE exists for all other elements, the Company recognizes revenue under SOP 98-9 as long as all other revenue recognition criteria in SOP 97-2 are satisfied.

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Under SOP 98-9, the arrangement fee is recognized as follows: (1) the total fair value of the undelivered elements, as indicated by VSOE, is deferred and subsequently recognized in accordance with the relevant sections of SOP 97-2 and as described below and (2) the difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements.

Revenue related to delivered elements of the arrangement is recognized when persuasive evidence of an arrangement exists, the software has been delivered, the fee is fixed and determinable and collectibility is probable.

Revenue related to undelivered elements of the arrangement is valued by the price charged when the element is sold separately and is recognized as follows:

Revenue related to customer maintenance agreements is deferred and recognized ratably using the straight-line method basis over the applicable maintenance period. The VSOE of maintenance is determined using the rate at which maintenance is renewed each year and is dependent on the amount of the license fee as well as the type of maintenance the customer chooses.

Professional service fees are recognized separately from the license fee since the services are not considered significant to the functionality of the software and the software does not require significant modification, production or customization. In instances when the services performed in conjunction with certain contracts are significant to the functionality of the software and the software requires significant modification and customization at the customer s site, the Company recognizes the total license and services amount together.
There are two types of service contracts that are entered into with customers: fixed fee and time and materials. The Company recognizes revenue from fixed fee contracts using the percentage of completion method, based on the ratio of total hours incurred to date to total estimated labor hours. Changes in job performance, job conditions, estimated profitability and final contract settlement may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor and supplies. These costs are readily determinable since the Company uses the costs that would have been charged if the contract was a time and materials contract. Provisions for estimated losses on uncompleted contracts are recorded in the period in which losses are determined. Amounts billed in excess of revenue recognized to date are classified as Billings in excess of costs , whereas revenue recognized in excess of amounts billed are classified as Costs in excess of billings in the accompanying condensed unaudited consolidated balance sheets.

Revenue under a time and materials arrangement is recognized as services are performed.

Third party software is recognized when delivered to the customer. The value of third party software is based on the Company s acquisition cost plus a reasonable margin and is readily determinable since the Company frequently sells these licenses separate of the other elements.

Training revenue is recognized when training is provided to customers and is based on the amount charged for training when it is sold separately.

The Company typically receives 25 percent of the license fee as a down payment and the balance is typically due between three and nine months from contract execution. In limited situations, the Company enters into extended payment terms with certain customers if the Company believes it is a good business opportunity. When it enters into these arrangements, the Company evaluates each arrangement individually to determine whether collectibility is

probable and the fees are fixed and determinable. An arrangement fee is not presumed to be fixed and determinable if payment of a significant portion of the license fee is due after the normal and customary terms usually offered to customers by the Company. Revenue related to arrangements containing extended payment terms where the fees are not considered fixed and determinable is deferred until payments are due.

In order to ensure that collectibility is probable, the Company performs credit reviews on each customer. If collectibility is determined to not be probable upon contract execution, revenue is recognized when cash is received.

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of customers to make required payments. The Company continuously monitors collections and payments from customers and the allowance for doubtful accounts is based on historical experience and any specific customer collection issues that have been identified. If the financial condition of customers were to continue to deteriorate resulting in an impairment of their ability to make payments, additional allowances may be required. Where an allowance for doubtful accounts has been established with respect to customer receivables, as payments are made on such receivables or if the customer goes out of business with no chance of collection, the allowances will decrease with a corresponding adjustment to accounts receivable as deemed appropriate.

In October 2003, the SEC issued Staff Accounting Bulletin No. 104, *Revenue Recognition,* (SAB No. 104) which was effective as of December 31, 2003. The Company s revenue recognition policies described above are in compliance with SAB No. 104.

In the second quarter of 2003 Daleen signed the ETB Contract. The total contract price is $10,515,526, but the amount the Company will receive and recognize as revenue is a net amount of $7,636,863, after Colombian withholding taxes. Revenue is recognized on a percentage of completion basis under SOP 81-1 for licenses, third party software and professional services because the services are significant to the functionality of the software and there is significant modification of the software. Training revenue is recognized as services are rendered. ETB is invoiced for licenses, professional services and third party software as milestones of the project are completed. These milestones are defined by the contract as three main phases and three sub-phases within each phase. The phase 1 milestone required a replacement of the customer s legacy system with RevChain including a conversion and debugging plan; phase 2 requires implementation of RevChain in all functionality to replace the legacy billing system for all call detail record based services; and phase 3 requires the implementation of RevChain to replace the legacy billing system of all ETB services.

(9) Stock-Based Compensation

The Company applies the intrinsic-value based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* and related interpretations including Financial Accounting Standards Board (FASB) Interpretation No. 44 *Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB No. 25,* issued in March 2000, to account for its fixed plan stock options. Under this method, compensation expense is recorded on the date of the grant only if the current price of the underlying stock exceeds the exercise price. Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation,* (SFAS No. 123) established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS No. 123. The fair value of each option granted to employees is estimated on the date of grant using the Black Scholes option pricing model with the following assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	**2004**	**2003**	**2004**
Expected life	5 years	5 years	5 years	5 years
Risk-free interest rate	2.46%	3.81%	2.46%	3.81%
Volatility	141.14%	154.22%	141.14%	154.22%
Dividends	None	None	None	None

Had compensation expense for the Company s plans been determined consistent with SFAS No. 123, the Company s net loss and net loss per share would have been increased to proforma amounts indicated below (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2003	**2004**	**2003**	**2004**
Net loss, as reported	$ (1412)	(3,467)	$(2,831)	(4770)
Deduct: Additional stock-based employee compensation expense determined under the fair value based method for all awards	(822)	(56)	(1,618)	(382)
Pro forma net loss	$(2,234)	(3,523)	$(4,449)	(5152)
Loss per share:				
Basic and diluted as reported	$ (.03)	(.07)	$ (.06)	(.10)
Basic and diluted pro forma	$ (.05)	(.08)	$ (.10)	(.11)

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(10) Goodwill

At December 31, 2003 and June 30, 2004, goodwill represents the excess of costs over the fair value of assets related to the Abiliti Acquisition. The Company follows the provisions of Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142). Goodwill and other intangible assets acquired in a purchase business combination and determined to have an infinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets* . There has been no impairment to date related to the goodwill recorded in connection with the Abiliti Acquisition.

(11) Business and Credit Concentrations

During the three months ended June 30, 2004, 56.8 percent of the Company s total revenue was attributed to three customers. Sales to these three customers accounted for 26.9 percent, 17.1 percent, and 12.8 percent of the total revenue for the three months ended June 30, 2004. During the three months ended June 30, 2003, 64.4 percent of the Company s total revenue was attributable to three customers. Sales to these three customers accounted for 40.7 percent, 13.0 percent and 10.7 percent of the total revenue for the three months ended June 30, 2004.

During the six months ended June 30, 2004, 61.3 percent of the Company s total revenue was attributed to three customers. Sales to these customers accounted for 28.6 percent, 21.2 percent and 11.6 percent of the total revenue for the six months ended June 30, 2004. During the six months ended June 30, 2003, 69.7 percent of the Company s total revenue was attributed to three customers. Sales to these customers accounted for 44.1 percent, 12.9 percent and 12.7 percent of the revenue for the six months ended June 30, 2003.

Three customers accounted for 66.7 percent and 45.7 percent of total accounts receivable at June 30, 2004 and December 31, 2003, respectively.

(12) Related Party Transactions

Science Applications International Corporation (SAIC) through its subsidiary SAIC Venture Capital Corporation is a significant stockholder of the Company. Revenue related to SAIC for the three and six months ended June 30, 2004 was $7,500 and $15,000, respectively. Revenues related to SAIC for the three and six months ended June 30, 2003 was $35,000 and $49,000 respectively. SAIC owns 49 percent of the voting stock of Danet, Inc.

(Danet), 100 percent of the voting stock of Telcordia Technologies, Inc. (Telcordia) and 60 percent of the voting stock of Intesacol. Danet is a customer and a subcontractor of the Company s product. There was no revenue recognized related to Danet for the three months ended June 30, 2004 and 2003. In the three and six months ended June 30, 2004, we paid Danet $5,000 and $35,000, respectively, related to professional services. In the three and six months ended June 30, 2003, we paid Danet $75,000 and $178,000, respectively related to professional services. The Company has an OEM License Agreement with Telcordia. No revenue related to Telcordia was recognized for the three and six months ended June 30, 2004. Revenue related to Telcordia for the three and six months ended June 30, 2003 was $0 and $4,000, respectively.

Intesacol became a subcontractor of the Company for services in Bogotá, Colombia in June 2003. In the three and six months ended June 30, 2004, we paid Intesacol $176,100, and $0, respectively.

On May 7, 2004, the Company entered into the Bridge Loan Facility with Behrman. The Bridge Loan Facility is for a maximum principal amount of $5.1 million, bearing interest at the rate of 6% per annum (plus a penalty at and after an event of default). The Company has drawn $1 million of this amount to fund a working capital facility that it is providing to Protek in connection with the Investment and Acquisition Transactions, and $100,000 to fund a facility fee paid to Behrman. In addition, the Company has drawn $1.1 million to fund its working capital requirements. The total amount drawn as of August 12, 2004, is $2.6 million leaving an amount of $2.5 million available for future use if needed prior to the closing of the Investment and Acquisition Transactions, subject to Behrman s discretion. It is expected that the full remaining permitted principal amount of the Bridge Loan Facility will be drawn immediately prior to the closing of the Investment and Acquisition Transactions. At closing, the Bridge Loan Facility note will be guaranteed by DHI by offset of the principal amount thereof against the $5 million commitment of Behrman, plus a cash payment in respect of accrued but unpaid interest. The Bridge Loan Facility is secured by a lien on all assets of the Company, subordinated to the interests of SVB and EXIM Bank.

(13) Legal Proceedings

Fazari v. Daleen Technologies, Inc.

On December 5, 2001, a class action complaint was filed in the United States District Court for the Southern District of New York. On April 22, 2002 an amended complaint was filed by two plaintiffs purportedly on behalf of persons purchasing the Company s common stock between September 20, 1999 and December 6, 2000. The complaint is styled as *Angelo Fazari, on behalf of himself and all others similarly situated, vs. Daleen Technologies, Inc., BancBoston Robertson Stephens Inc., Hambrecht & Quist LLC, Salomon Smith Barney Inc., James Daleen, David B. Corey and Richard A. Schell*. The individual defendants, Messrs. Corey, Schell and Daleen, have entered into tolling agreements with the plaintiffs resulting in their dismissal from the case without prejudice. The remaining defendants include us and certain of the underwriters from the Company s initial public offering (IPO). More than 300 similar class action lawsuits filed in the Southern District of New York against numerous companies and their underwriters have been consolidated for pretrial purposes before one judge under the caption In re Initial Public Offering Securities Litigation.

The complaint includes allegations of violations of (i) Section 11 of the Securities Act of 1933 by all named defendants, (ii) Section 15 of the Securities Act of 1933 by the individual defendants and (iii) Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder by the underwriter defendants. Specifically, the plaintiffs allege in the complaint that, in connection with the IPO, the defendants failed to disclose excessive commissions purportedly solicited by and paid to the underwriter defendants in exchange for allocating shares of the Company s common stock in the IPO to the underwriter defendants preferred customers. Plaintiffs further allege that the underwriter defendants had agreements with preferred customers tying the allocation of shares sold in the IPO to the preferred customers agreements to make additional aftermarket purchases at pre-determined prices. Plaintiffs

further allege that the underwriters used their analysts to issue favorable reports about the Company

to further inflate the Company s share price following the IPO. Plaintiffs claim that the defendants knew or should have known of the underwriters actions and that the failure to disclose these alleged arrangements rendered the prospectus included in the Company s registration statement on Form S-1 filed with the SEC in September 1999 materially false and misleading. Plaintiffs seek unspecified damages and other relief.

In June 2004, the Stipulation and Agreement of Settlement with Defendant Issuers and Individuals was signed on the Company s behalf. Court approval of the settlement is required. Under the terms of the settlement, there would be no liability to be recorded by the Company. There is no assurance the settlement will be finalized. In the event that the settlement is not finalized and approved by the court, the Company intends to defend vigorously against the plaintiffs claims. The Company believes that it is entitled to indemnification by the underwriters under the terms of the underwriting agreements. The Company has notified the underwriters of the action, but the underwriters have not yet agreed to indemnify the Company. The lead underwriter, BancBoston Robertson Stephens Inc., has ceased doing business and there is no assurance it will have the financial resources to provide indemnification. Currently the amount of a loss, if any, cannot be determined and, accordingly no amounts have been recorded by the Company in the accompanying unaudited condensed consolidated financial statements with respect to this litigation.

Kops Investment Advisors LLC v. Daleen Technologies, Inc., et al.

On or about April 7, 2004, a purported class action complaint was filed in the Court of Chancery of the State of Delaware in and for New Castle County by an individual holder of shares of Common Stock of the Company. The complaint is styled *Kops Investment Advisors LLC v. Daleen Technologies, Inc., James Daleen, Gordon Quick, Ofer Nemirovsky, Daniel J. Foreman, Dennis G. Sisco, Stephen J. Getsy, and John S. McCarthy, Behrman Brothers, L.L.C., Behrman Capital II, L.P., Strategic Entrepreneur Fund II, L.P.* On June 21, 2004, the plaintiff filed an amended complaint alleging that the merger transaction contemplated as part of the Investment and Acquisition Transactions (Merger) is a freeze-out of Common Stock by the Series F Preferred stockholders through unfair dealing by the defendants and that the defendants have breached and continue to breach their fiduciary duties of loyalty, care and good faith to the plaintiff and other members of the class. The amended complaint seeks for the Merger, if consummated, to be rescinded and rescissory damages to be awarded to the class; for the defendants to be directed to account to the class for all profit received by the defendants and all damages sustained by the class; and for costs of the action including attorney s and experts fees to be awarded to the plaintiff. This case is in the initial stages and the amount of exposure, if any, is not determinable at this time.

Kurt Feierbend v. James Daleen, et al.

On May 12, 2004 a purported class action complaint was filed in the Court of Chancery of the State of Delaware in and for New Castle County by an individual holder of the Common Stock of the Company. The complaint is styled *Kurt Feierbend v. James Daleen, Gordon Quick, Daniel J. Foreman, Stephen J. Getsy, John S. McCarthy, Dennis G. Sisco, Ofer Nemirovsky, Daleen Technologies, Inc., Quadrangle Group LLC, Quadrangle Capital Partners LP, Behrman Capital and Behrman Brothers, L.L.C.* The complaint, which is purported to be brought on behalf of the public holders of the Common Stock with respect to the Merger, generally alleges that the Company and our directors breached their fiduciary duties; that the consideration offered by Quadrangle Capital Partners LP and Behrman Capital is inadequate and that the transaction was a result of unfair dealing; that Behrman Capital, as controlling stockholder, breached its fiduciary duty to our minority stockholders by acting to further its own interests at the expense of our minority stockholders; and that Behrman Brothers, Quadrangle Group and Quadrangle Capital Partners LP knowingly aided and abetted Behrman Capital s violations of fiduciary duty. The complaint seeks to enjoin the Merger and related transactions, or if the Merger and related transactions are consummated, to rescind them; to recover damages in an unstated amount and to recover costs including attorney s fees associated with the lawsuit. This case is in the initial stages and the amount of exposure, if any, is not determinable at this time.

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Russell Winter v. James Daleen, et al.

On June 24, 2004, a purported class action complaint virtually identical to the complaint filed by Feierbend was filed in the Court of Chancery of the State of Delaware in and for New Castle County by another individual holder of the Common Stock of the Company. The complaint is styled *Russell Winter v. James Daleen, Gordon Quick, Daniel J. Foreman, Stephen J. Getsy, John S. McCarthy, Dennis G. Sisco, Ofer Nemirovsky, Daleen Technologies, Inc., Quadrangle Group LLC, Quadrangle Capital Partners LP, Behrman Capital and Behrman Brothers, L.L.C.* The complaint, which is purported to be brought on behalf of the public holders of the Common Stock, generally alleges that the Company and our directors breached their fiduciary duties; that the consideration offered by Quadrangle Capital Partners LP and Behrman Capital is inadequate and that the transaction was a result of unfair dealing; that Behrman Capital, as controlling stockholder, breached its fiduciary duty to our minority stockholders by acting to further its own interests at the expense of our minority stockholders; and that Behrman Brothers, Quadrangle Group and Quadrangle Capital Partners LP knowingly aided and abetted Behrman Capital s violations of fiduciary duty. The complaint seeks to enjoin the Merger and related transactions, or if the Merger and related transactions are consummated, to rescind them; to recover damages in an unstated amount and to recover costs including attorney s fees associated with the lawsuit. This case is in the initial stages and the amount of exposure, if any, is not determinable at this time.

Abiliti-Related Litigation

On August 1, 2003, a First Amended Petition, styled as *James E. Kientzy and David K. Wilson vs. Abiliti Solutions, Inc., a corporation, and Daleen Technologies, Inc., a corporation, and Daleen Solutions, Inc., a corporation and wholly-owned subsidiary of Daleen*, was filed in the Circuit Court of the County of St. Louis, State of Missouri. The First Amended Petition added Daleen Technologies and Daleen Solutions as defendants in the named action. The First Amended Petition contained certain allegations against Abiliti related to the non-payment of certain promissory notes in the aggregate principal amount of $1.2 million. In May, 2004, the Company reached a settlement with the plaintiffs and the Company made payments to the plaintiffs totaling $250,000. On June 28, 2004, the action was dismissed with prejudice.

On October 14, 2003, the Company, Daleen Solutions and Albacore filed a declaratory judgment action against Houlihan Lokey Howard & Zukin Capital, Inc. and Houlihan Lokey Howard & Zukin Financial Advisors, Inc. (Houlihan) seeking a declaration that they are not liable to Houlihan for fees under an engagement letter between Abiliti Solutions, Inc. and Houlihan (a liability Daleen assumed in the acquisition of Abiliti). Houlihan filed a counterclaim for fees in excess of $800,000. The parties agreed to a settlement and the Company paid Houlihan $55,000 on April 1, 2004. This amount was recorded in accrued payroll and other accrued expenses at March 31, 2004 in the accompanying unaudited condensed balance sheet.

On December 24, 2003, Daleen Solutions filed a collection action against Data Integration Systems, Inc. (DIS) seeking payment of license fees, services fees and equipment in the amount of $694,600 (which includes DIS obligation to make future payments under the contract). On January 30, 2004, DIS filed a cross-complaint against Daleen Solutions alleging damages of $1,500,000. This case is in the discovery stage of the proceeding. A loss and its effect on the Company, if any, cannot be determined with respect to this litigation and, accordingly, no amounts have been recorded in the accompanying unaudited condensed financial statements with respect to this litigation.

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General litigation

On August 5, 2003, the Company reached a settlement in satisfaction of an outstanding obligation with a customer under a software license agreement. Under the terms of the settlement, this customer satisfied their obligations by agreeing to make payments in cash of $365,000 plus interest. The Company received $250,000 on August 20, 2003, and $57,500 plus interest on November 5, 2003 and received $57,500 plus interest in February 2004. In accordance with SOP 97-2, the revenue related to the contractual agreement with this customer is recognized on a cash basis. Therefore, the Company recorded $57,500 as license revenue in the six months ended June 30, 2004.

The Company is involved in other lawsuits and claims incidental to its ordinary course of business. Management does not believe the outcome of any of these other activities would have a material adverse effect on the Company s financial position or results of operations.

(14) Capital and Operating Leases

The Company signed a lease agreement renewal in Boca Raton, Florida in January 2004, which was effective March 1, 2004. This operating lease expires on February 28, 2009. The Company also signed a lease agreement renewal in Chesterfield, Missouri on March 25, 2004. The operating lease becomes effective October 1, 2004 and expires October 31, 2009. In March 2004, the Company also entered into a lease agreement with a co-location facility in St. Louis, Missouri to house its data center. The operating lease is effective June 1, 2004 and expires June 30, 2007. The Company also has an agreement to lease office facilities in Atlanta, Georgia. This lease expires in August 2004.

The Abiliti Acquisition included certain computer hardware and furniture and equipment that are under capital leases, the only remaining lease expires in August 2004. Future minimum lease payments under non cancelable operating leases (with initial or remaining lease terms in excess of one year) and future minimum capital lease payments as of June 30, 2004 are as follows (in thousands):

Year Ending December 31:	Capital Leases	Operating Leases
2004	$ 2	$ 376
2005		697
2006		721
2007		644
2008 and thereafter		883
Total minimum lease payments	2	3,321
Less amount representing interest		
Present value of minimum capital lease payments	2	
Less current installment of obligations under capital lease payments	2	

Obligation under capital leases, excluding current installment	$ —

The Company subleases office space in Atlanta and in St. Louis. The amounts of minimum operating lease payments reflected in the above table are offset by future minimum rental receipts from sublessees of $38,435 in 2004.

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(15) New Accounting Pronouncements

In November 2002, the FASB issued Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others,* (FIN 45). FIN 45 provides additional guidance on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. As an element of standard commercial terms in the Company s standard sales contracts, the Company often includes an indemnification clause that indemnifies the customer against liability and damages arising from any claims of patent, copyright, or other proprietary rights of any third party. Due to the nature of the indemnification provided to its customers, the Company can not estimate the fair value, nor determine the total nominal amount of the indemnification. The Company evaluates estimated losses for such indemnifications under SFAS No. 5, Accounting for Contingencies, as interpreted by FIN 45, considering such factors as the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. To date, the Company has not encountered any costs as a result of such obligations and has not accrued any liabilities related to such indemnifications in its unaudited consolidated financial statements.

In December 2003, the FASB issued Interpretation No. 46 (FIN 46R) (revised December 2003), Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51 (ARB 51), which addresses how a business enterprise should evaluate whether it has a controlling interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces FASB Interpretation No. 46 (FIN 46), which was issued in January 2003. Before concluding that it is appropriate to apply ARB 51 voting interest consolidation model to an entity, an enterprise must first determine that the entity is not a variable interest entity (VIE). As of the effective date of FIN 46R, an enterprise must evaluate its involvement with all entities or legal structures created before February 1, 2003, to determine whether consolidation requirements of FIN 46R apply to those entities. There is no grandfathering of existing entities. Public companies must apply either FIN 46 or FIN 46R immediately to entities created after January 31, 2003 and no later than the end of the first reporting period that ends after March 15, 2004. The adoption of FIN 46 did not have an impact on the Company s consolidated financial position and results of operations.

In October 2003, the Emerging Issues Task Force (EITF) reached a consensus on its tentative conclusions for EITF 03-05, *Applicability of SOP 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software* (EITF 03-05). EITF 03-05 discusses that software deliverables are within the scope of SOP 97-2 as are non-software deliverables. The Company is required to adopt this consensus for fiscal periods beginning after August 2003. The adoption of EITF 03-05 did not have an impact on the Company s consolidated financial statements.

In March 2004, the FASB issued a proposed Statement, *Share-Based Payment*, that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise s equity instruments or that may be settled by the issuance of such equity instruments. The proposed Statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, Accounting for Stock Issued to Employees, and generally would require instead that such transactions be accounted for using a fair-value based method. The proposed Statement is effective for awards granted, modified, or settled in fiscal years beginning after December 15, 2004, for public entitles that used the fair-value based method of accounting under the original provisions of SFAS No. 123, Accounting for Stock-Based Compensation for recognition or pro forma disclosure purposes. The Company is currently evaluating the impact the proposed Statement may have on its consolidated financial position, cash flows and results of operations.

In April 2004, the Emerging Issues Task Force issued Statement No. 03-06 Participating Securities and the Two-Class Method Under FASB Statement No. 128, Earnings Per Share (EITF 03-06). EITF 03-06 addresses a

number of questions regarding the computation of earnings per share by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the company when, and if, it declares dividends on its common stock. The issue also provides further guidance in applying the two-class method of calculating earnings per share, clarifying what constitutes a participating security and how to apply the two-class method of computing earnings per share once it is determined that a security is participating, including how to allocate undistributed earnings to such a security. EITF 03-06 is effective for fiscal periods beginning after March 31, 2004. The adoption of EITF 03-06 did not have an impact on the Company s consolidated financial position and results of operations.

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

The following should be read in conjunction with the condensed unaudited consolidated financial statements, and the related notes thereto, included elsewhere in this Quarterly Report on Form 10-Q. In addition, reference should be made to our audited consolidated financial statements and notes thereto, and related Management s Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2003.

Forward-Looking Statements

This report contains forward-looking statements within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934, as amended by the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not historical facts but are the intent, belief or current expectations, of our business and industry, and the assumptions upon which these statements are based. Words such as anticipates , expects , intends , will , could , would , should , may , plans , believes , seeks , estimates and variations of these words and t thereof and similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties, and other factors, some of which are beyond our control, are difficult to predict, and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. These risks and uncertainties include those described in Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report and in the Company s Annual Report on Form 10-K for the year ended December 31, 2003 filed with the SEC. Forward-looking statements that were true at the time made may ultimately prove to be incorrect or false. Readers are cautioned to not place undue reliance on forward-looking statements, which reflect our management s view only as of the date of this report. We undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results.

You should be aware that some of these statements are subject to known and unknown risks, uncertainties and other factors, including those discussed in the section of this report entitled Risk Factors, that could cause the actual results to differ materially from those suggested by the forward-looking statements.

Overview

From our founding in 1989 and through 1996, we operated as a software consulting company, performing contract consulting and software development services in a contract placement and staffing business. We sold the contract placement and staffing business to a third party in 1996. Since 1996, we have been a provider of software solutions and have evolved to become a global provider of advanced billing and customer care, event management and revenue assurance software for traditional and next generation communication service providers and other technology solutions providers. As we grew in size and geography, we added new customer care and management products to enhance our billing applications. We further expanded our product offerings as a result of the acquisition of Abiliti Solutions, Inc. in December 2002 (the Abiliti Acquisition), adding a proven event management software platform and a carrier-class outsourcing operation. In June 2003, we launched a new revenue assurance product. Our expanded product suite and flexible delivery channels allow us to serve a broader range of customer needs in a variety of markets. In addition to our products and applications, we offer professional consulting services, training, maintenance, support and third party software fulfillment, in each case related to the products we develop.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations included herein are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to our allowance for doubtful accounts, investments, goodwill impairment, income taxes, restructuring, long-term service contracts, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. We discuss below the critical accounting policies that affect our more significant judgments and estimates used in the preparation of our unaudited condensed financial statements. Actual results may differ from these estimates under different assumptions or conditions. For further information on the critical accounting policies, see Note 1 to our Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2003 filed with the SEC.

We believe that the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition

Revenue related to outsourcing services consists of (1) discovery work and (2) monthly processing fees generated from the Company s provision of billing and event management services. These two deliverables are considered separate units of accounting because these elements can and have been sold separately and they create stand alone value for the customer. The revenue associated with discovery work is recognized on a time and materials basis as the work is performed. The monthly processing fees are recognized as the related services are rendered and are billed monthly based on transaction volume processed, percentage of revenue billed on behalf of customers or monthly minimum charges per contractual arrangements.

Revenue from site license fees is based on the size of the customers authorized system, such as number of authorized users and computer processors, revenue billed through the system, or other factors. We receive license fees from our customers upon signing of the license agreement. In some cases we expect to receive additional license fees as our customers grow and add additional subscribers, or increase their revenue billed through the system. We also derive license fee revenue from existing customers who purchase additional products from us to increase the functionality of their current system. We expect to receive recurring license fees from these activities in the future.

Revenue from license fees is recognized when persuasive evidence of an arrangement exists, the software is shipped, the fee is fixed and determinable and collectibility is probable. An arrangement fee is generally not presumed to be fixed or determinable if payment of a significant portion of the license fee is not due until after expiration of the license or due after the normal and customary terms usually given to our customers. At times, we enter into extended payment terms with certain customers if we believe it is a good business opportunity. Revenue related to arrangements containing extended payment terms where the fees are not considered fixed and determinable is deferred until payments are due. Granting extended payment terms results in a longer collection period for accounts receivable and slower cash inflows from operations. If collectibility is not considered probable, revenue is recognized when the fee is collected.

Professional service fees are primarily recognized separately from the license fee since the services are not considered significant to the functionality of the software and the software does not require significant modification,

production or customization. In instances when the services performed in conjunction with certain contracts are

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significant to the functionality of the software and the software requires significant modification and customization at the customer site, the Company recognizes the total license and services amount together. There are two types of service contracts that are entered into with customers: fixed fee and time and materials.

We recognize revenue on fixed fee contracts using the percentage of completion method. The percentage of completion method relies on estimates of total expected contract revenue and costs. We follow this method since reasonably dependable estimates of the revenue and costs can be made. Recognized revenues and profits are subject to revisions as the contract progresses to completion. Revisions in profit estimates are charged to income in the period in which the facts that give rise to the revision become known. We recognize revenue related to professional services under a time and materials arrangement as services are performed.

Revenue related to customer maintenance agreements is deferred and recognized ratably on a straight-line basis over the maintenance period. Maintenance is renewable annually and we expect to receive annual maintenance fees from these activities in the future.

Accounts Receivable

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. We continuously monitor collections and payments from our customers and the allowance for doubtful accounts is based on historical experience and any specific customer collection issues that we have identified. If the financial condition of our customers were to continue to deteriorate resulting in an impairment of their ability to make payments, additional allowances may be required. As payments are made from our customers related to old receivables or if the customer goes out of business with no chance of collection, the allowances will decrease with corresponding receivables as deemed appropriate.

Accounting for Income Taxes

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. We believe that it is more likely than not that the deferred tax assets will not be realized and therefore we have established a valuation allowance for the entire deferred tax assets, net of deferred tax liabilities. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event we were to determine that we would be able to realize its deferred tax assets in the future in excess of its net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made.

Goodwill

In 2002, the Company adopted the provisions of Statement of Financial Accounting Standards No. 142 *Goodwill and Other Intangible Assets.* Goodwill is no longer amortized but tested for impairment at least annually. At December 31, 2003 and June 30, 2004 the goodwill balance was related to the Abiliti Acquisition.

At December 31, 2003 we evaluated goodwill for impairment and determined that goodwill was not impaired. In performing this impairment assessment, management made judgments regarding the anticipated future cash flows from the Abiliti Acquisition. Different assumptions in this assessment could have led to a different result, which could have had a material effect on our reported earnings. The conditions that could trigger an impairment write-down in the future include a significant downward trend in our operating results or cash flow of Daleen Solutions, Inc., a decrease in demand for BillingCentral services, a change in the competitive environment and other economic factors.

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Results of Operations

In December 2002, we acquired substantially all of the assets and assumed certain liabilities of Abiliti Solutions, Inc. (Abiliti). The Abiliti Acquisition created an additional revenue stream to our business that helped position us to be a long-standing competitor in the marketplace. In addition to licensing our software, we now offer a comprehensive outsourcing solution through our BillingCentral carrier-class data center. The recurring revenue from BillingCentral is significant to our ongoing operations. Additionally, as a result of the Abiliti Acquisition, we expanded our product suite to include event management and revenue assurance applications that compliment our RevChain billing and customer management products. RevChain and Asuriti are offered as licensed software and outsourced solutions.

In 2003, we continued to be a competitor in the billing and OSS market while managing our costs and use of cash to the lowest levels in our history. We focused on achieving growth by selling additional services and upgrades to our installed base of customers and offering our total solutions portfolio to new and existing customers. In May 2003, we signed the largest customer contract in our history when we executed a three-year license and services agreement with a customer in Bogotá, Colombia (the ETB Contract). The ongoing project implementation in connection with the ETB Contract is close to anticipated schedule and work on Phase II has begun.

Although revenues from new sales declined in the first half 2004, we expanded our relationship with several existing customers. One customer renewed its contract for outsourced billing services through BillingCentral through 2009. Another existing customer purchased our Asuriti event management and revenue assurance software. This was offset by a decline in revenue from Allegiance Telecom Company Worldwide (Allegiance). Allegiance assigned the agreement to XO Communications, Inc. (XO) on July 23, 2004. We expect XO will continue the migration of data and will ultimately discontinue use of the Company s services.

Recent Developments

Investment and Acquisition Transactions

On May 7, 2004 definitive agreements were signed by Quadrangle Capital Partners LP, Quadrangle Select Partners LP, Quadrangle Capital Partners-A LP (Quadrangle) and Behrman Capital II, L.P. and Strategic Entrepreneur Fund II, L.P. (Behrman) for investments of $25 million and $5 million, respectively, into Daleen Holdings, Inc. (DHI) a newly formed subsidiary of the Company that, subject to stockholder approval, will simultaneously acquire Daleen and Protek Telecommunications Solutions Limited (Protek), (the Investment and Acquisition Transactions).

Quadrangle and Behrman will receive senior convertible redeemable preferred stock in DHI (DHI Preferred) in consideration for their investment. The DHI Preferred will have a dividend of 8% per annum, payable in kind or in cash at DHI s election. The DHI Preferred will also carry the right to the issuance of additional shares of preferred equity should DHI not attain certain specified financial targets.

DHI will acquire Protek by purchase of stock from its shareholders and conversion of outstanding options, for aggregate consideration of up to $20 million, consisting of up to $13 million in cash, $5 million in common stock of DHI (the DHI Common), and contingent earn-out consisting of $1 million in cash and $1 million of DHI Common. The purchase price will be subject to reduction in respect of closing date debt and working capital shortfalls.

In connection with the Investment and Acquisition Transactions, we will become a private company. All outstanding shares of our common stock will be purchased for $0.0384 per share in cash. The per share purchase price is based on an aggregate amount equal to approximately ten percent of the total value received by our stockholders. In addition, as a condition of closing the Investment and Acquisition Transactions, holders of our Series F convertible preferred stock (Series F preferred stock) will be required to waive the $49.8 million redemption value of the Series F

preferred stock. These stockholders will receive an aggregate of $15.4 million in cash and securities, with the cash component limited to a maximum of $2.8 million. Immediately prior to the

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consummation of the Investment and Acquisition Transactions, Behrman will be contractually obligated to exchange its shares of Series F preferred stock for $5 million in DHI Preferred plus the remaining value of its shares of Series F preferred stock in DHI Common. Other holders of Series F preferred stock will receive a combination of (a) an aggregate of $2.8 million in value of DHI Common and (b) the remaining value of their Series F preferred stock in DHI Common; however, holders of Series F preferred stock will be permitted to convert all of their Series F preferred stock into DHI Common.

Despite the decrease in revenue in the first half of 2004, we expect to be positioned to grow in the second half of 2004 due to an increased penetration in sales activity and the improved financial condition that is expected as a result of the completion of the Investment and Acquisition Transactions. However, we believe that in the future our results of operations could be adversely affected by various factors, including:

continued decline in business from our three significant customers;

the inability to close the Investment and Acquisition Transactions;

whether we succeed in merging the operations of Protek and Daleen;

lack of market acceptance of new products, upgrades and services;

general economic or political condition in Colombia;

difficulties in implementing strategic alliances;

inability to retain key personnel;

changes in accounting rules such as expensing of stock options;

downward trends in the telecommunications industry;

introduction of products and services by existing and new competitors; and

the inability to terminate our public company status.

Three Months Ended June 30, 2004 Compared to Three Months Ended June 30, 2003

Total Revenue. Total revenue, which includes professional services and other revenue and license revenue, decreased $393,000, or 9.3% to $3.8 million in the three months ended June 30, 2004, from $4.2 million for the same period in 2003. The primary reason for the decrease in revenue related to the decrease in outsourced services revenue as a result of the continuing decrease in the revenue from Allegiance which was offset by a slight increase in license revenue, and increased training revenue related to Empresa de Telecomunicaciones de Bogotá (ETB).

Professional Services and Other. Our professional services and other revenue consists of revenue from professional consulting services, training, maintenance and support, and third-party software fulfillment, all related to the software products we develop. In addition, these revenues include the BillingCentral outsourcing operation. Consulting services are offered on a fixed fee basis and on a time and materials basis. Third-party software fulfillment is offered on a cost plus basis. Outsourced services are billed monthly and recognized as services are rendered. Professional services and other revenue decreased $832,000, or 20.9%, to $3.1 million in the three months ended June 30, 2004 from $4.0 million for the same period in 2003. The decrease was primarily related to the decrease in outsourced services revenue related to Allegiance, slightly offset by increased training revenue and third party

software sales related to ETB. Professional services and other revenue decreased to 82.5% of total revenue in the three months ended June 30, 2004, compared to 94.5% in the same period in 2003. This decrease in percentage is due to an increase in license revenue in the three months ended June 30, 2004.

License Fees. Our license fees are derived from licensing our software products. License fees increased $439,000, or 190.3%, in the three months ended June 30, 2004 to $670,000, from $231,000 for the same period in 2003. In the three months ended June 30, 2004 we recognized additional license fees from existing customers related to the licensing of additional software products. License fees constituted 17.5% of total revenue in the three months ended June 30, 2004, compared to 5.5% in the same period in 2003. The increase in license fees as a percentage

of total revenue is due to the decrease in professional services and other revenue in the three months ended June 30, 2004 as well as an increase in license revenue compared to the same period in 2003.

Cost of Revenue. Cost of revenue increased $70,000, or 5.5%, to $1.3 million in the three months ended June 30, 2004 from $1.3 million in the same period in 2003. The cost of revenue includes both cost of professional services and other and cost of license fees. These components include the cost of direct labor, benefits, third-party software license payments, third-party software maintenance, overhead and materials associated with the fulfillment and delivery of license products and related corporate overhead costs to provide professional services to customers including the delivery of outsourcing services. The total costs increased due to the increase in third party subcontracting costs associated with the ETB Contract and third party software associated with the increase in third party software revenue. These were partly offset by a decrease in the cost of sales related to our license revenue. The total cost of revenue as a percentage of total revenue increased to 35.2% in the three months ended June 30, 2004 from 30.2% in the same period in 2003. The increase as a percentage of total revenue is due to a decrease in total revenue with no decrease in costs in the three months ended June 30, 2004.

Cost of Professional Services and Other. Cost of professional services and other includes cost of direct labor, benefits, third-party software maintenance and related costs to provide professional services, maintenance and training to our customers. Cost of professional services and other increased $235,000, or 21.2%, to $1.3, in the three months ended June 30, 2004 from $1.1 million in the same period in 2003 mainly due to the increase in direct costs and third party software costs in the three months ended June 30, 2003. Cost of professional services and other increased to 42.7% of professional services and other revenue in the three months ended June 30, 2004, compared to 27.9% for the same period in 2003. The increase as a percentage of professional services and other revenue is due to the decrease in professional services and other revenue in the three months ended June 30, 2004.

Cost of License Fees. Cost of license fees includes direct cost of labor, benefits, packaging material for fulfillment and shipment of our software products and integrated third party software license payments. Cost of license fees decreased $165,000, or 100%, to $0 in the three months ended June 30, 2004 from $165,000 in the same period in 2003. The total costs decreased primarily due to the write off of a prepaid license that was no longer available for integration with our product. Cost of license fees as a percentage of license revenue decreased to 0% in the three months ended June 30, 2004, compared to 71.4% in the same period in 2003.

Sales and Marketing. Sales and marketing expenses consist primarily of salaries, benefits and commissions earned by sales, marketing and partner management personnel, travel and entertainment, trade show and marketing program costs, promotional and related corporate overhead costs. These expenses decreased $6,000, or 0.7%, to $825,000 in the three months ended June 30, 2004, compared to $831,000 in the same period in 2003. As a percentage of total revenue, these expenses increased to 21.6% in the three months ended June 30, 2004 compared to the 19.7%, for same period in 2003.

Research and Development. Research and development expenses consist primarily of salaries and benefits for software developers, product testing and benchmarking, management and quality assurance personnel, subcontractor costs and related corporate overhead costs. Our research and development expenses decreased $147,000, or 9.2%, to $1.5 million for the three months ended June 30, 2004, from $1.6 million in the same period in 2003. The decrease was primarily due to a decrease in labor costs associated with personnel decreases. As a percentage of revenue, these expenses increased to 38.1% in the three months ended June 30, 2004 compared to 38.0% in the same period in 2003. The increase as a percentage of total revenue is due to the decrease in total revenue in the three months ended June 30, 2004.

General and Administrative. General and administrative expenses consist primarily of salaries, benefits and related costs for our executive, finance and accounting, administrative, facilities, human resources and information systems

personnel. Our general and administrative costs increased $113,000, or 7.4%, to $1.6 million in the three months ended June 30, 2004, from $1.5 million in the same period in 2003. This increase was

primarily due to an increase of approximately $30,000 in compensation to our board of directors for their attendance at an increased number of Board of Directors meetings associated with the proposed Investment and Acquisition Transactions, and an increase in bad debt expense due to a recovery of $77,000 in the three months ended June, 2003. As a percentage of total revenue, these expenses increased to 42.7% in the three months ended June 30, 2004 as compared to 36.0% in the same period in 2003. The increase as a percentage of total revenue is due to the decrease in total revenue in the three months ended June 30, 2004.

Proposed transaction costs. Proposed transaction costs consist of those costs that are incurred as a result of the proposed Investment and Acquisition Transactions. The costs include legal and accounting fees, investment banking fees, and any other qualified expenses. These costs amounted to $2.0 million in the three months ended June 30, 2004. There were no comparable costs in the three months ended June 30, 2003.

Impairment of Long Lived Assets. Impairment charges decreased $500,000, or 100%, to $0 in the three months ended June 30, 2004 from $500,000 for the same period in 2003. Impairment charges consisted of an impairment of an investment in a third party technology company due to decline in fair value which was other than temporary. This investment was fully written off at June 30, 2003.

Other Income/Expenses. Other income/expenses decreased $127,000, or 127.9%, to negative $28,000 in the three months ended June 30, 2004, from $99,000 for the same period in 2003. The decrease was a result of the decrease in our cash balance and an increase in interest expenses associated with the revolving loan facility with Silicon Valley Bank (SVB) (the Operating Loan) and the Behrman $5.1 million bridge loan facility (Bridge Loan Facility) in 2004.

Six Months Ended June 30, 2004 Compared To Six Months Ended June 30, 2003

Total Revenue. Total revenue, which includes professional services and other revenue and license revenue, decreased $211,000 or 2.5%, to $8.1 million in the six months ended June 30, 2004 from $8.3 million for the same period in 2003. The primary reason for the decrease in revenue is related to the reduction in outsourcing services revenue.

Professional Services and Other. Our professional services and other consists of revenue from professional consulting services, training, maintenance and support, and third-party software fulfillment, all related to the software products we develop. In addition, these revenues include the BillingCentral outsourcing operation. Consulting services are offered on a fixed fee basis and on a time and materials basis. Third-party software fulfillment is offered on a cost plus basis. Outsourced services are billed monthly and recognized as services are rendered. Professional services and other revenue decreased $993,000, or 12.7%, in the six months ended June 30, 2004 to $6.8 million, compared to $7.8 million in the same period in 2003. The decrease was primarily related to a decrease in revenue earned by our outsourcing services. Professional services and other revenue constituted 84.4% of total revenue in the six months ended June 30, 2004, compared to 94.3% for the same period in 2003. The decrease as a percentage of total revenue is due to an increase in license revenue in the six months ended June 30, 2004.

License Fees. Our license fees are derived from licensing our software products. License fees increased $782,000, or 164.4%, in the six months ended June 30, 2004 to $1.3 million from $475,000 for the same period in 2003. License fees constituted 15.6% of total revenue in the six months ended June 30, 2004, compared to 5.7% in the same period in 2003.

Cost of Revenue. Cost of revenue increased $295,000, or 11.2%, to $2.9 million in the six months ended June 30, 2004, from $2.6 million in the same period in 2003. The cost of revenue includes both cost of professional services and other and cost of license fees. These components include the cost of direct labor, benefits, overhead and materials associated with the fulfillment and delivery of licensed products, amortization expense related to

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prepaid third-party licenses and related corporate overhead costs to provide professional services to our customers. These costs increased due to an increase in third party subcontracting for work performed under the ETB Contract and an increase in third party software costs related to an increase in third party software revenue. The total cost of revenue as a percentage of total revenue increased to 36.3% in the six months ended June 30, 2004, compared to 31.8% in the same period in 2003. This increase in the cost of revenue as a percentage of total revenue resulted from the decrease in total revenue in the six months ended June 30, 2004.

Cost of Professional Services and Other. Cost of professional services and other includes cost of direct labor, benefits, third-party software and related corporate overhead costs to provide professional services and training to our customers. Cost of professional services and other increased $763,000, or 35.2%, to $2.9 million in the six months ended June 30, 2004, from $2.2 million in the same period in 2003. These costs increased mainly due to the increase in subcontracting costs for work performed under the ETB Contract and third party software costs related to the increase in third party software revenue. Cost of professional services and other increased to 43.0% of professional services and other revenue in the six months ended June 30, 2004, compared to 27.7% for the same period in 2003 due to the decrease in professional services and other revenue.

Cost of License Fees. Cost of license fees includes direct cost of labor, benefits and packaging material for fulfillment and shipment of our software products and amortization expense related to prepaid third-party licenses. Cost of license fees decreased $468,000 or 100% to $0, in the six months ended June 30, 2004, from $468,000 in the same period in 2003 due to the $202,000 write-off of prepaid third-party software license costs in addition to a stamp tax expense in Colombia related to the ETB Contract. Cost of license fees decreased to 0% of license revenue in the six months ended June 30, 2004, compared to 98.5% for the same period in 2003.

Sales and Marketing. Sales and marketing expenses consist primarily of salaries, commissions and bonuses earned by sales, marketing and partner management personnel, travel and entertainment, trade show and marketing program costs, promotional and related corporate overhead costs. These expenses decreased $173,000, or 10.0%, to $1.6 million in the six months ended June 30, 2004, from $1.7 million for the same period in 2003. As a percentage of total revenue, these expenses decreased to 19.3% in the six months ended June 30, 2004 compared to 20.9% for the same period in 2003.

Research and Development. Research and development expenses consist primarily of salaries and benefits for software developers, product testing and benchmarking, management and quality assurance personnel, subcontractor costs and related corporate overhead costs. Our research and development expenses decreased $176,000, or 5.4%, to $3.1 million in the six months ended June 30, 2004, from $3.3 million for the same period in 2003. As a percentage of revenue, these expenses decreased to 38.5% in the six months ended June 30, 2004 compared to 39.6% for the same period in 2003.

General and Administrative. General and administrative expenses consist primarily of salaries, benefits and related costs for our executive, finance and accounting, facilities, human resources and information systems personnel, and related corporate overhead costs. Our general and administrative expenses decreased $60,000, or 1.9%, to $3.1 million in the six months ended June 30, 2004, from $3.1 million in the same period in 2003. The decrease was primarily due to decreases in rental expenses associated with expired leases and reduced depreciation expenses which are the result of disposals of assets and the increase in fully depreciated assets. These decreases were offset by the settlement of Abiliti litigation for $250,000, an increase in compensation to the Board of Directors, and an increase in bad debt expense. As a percentage of revenue, general and administrative expenses increased to 38.0% in the six months ended June 30, 2004 from 37.8% in the same period in 2003.

Proposed transaction costs. Proposed transaction costs consist of those costs that are incurred as a result of the proposed Investment and Acquisition Transactions. The costs include legal and accounting fees, investment banking

fees, and any other qualified expenses. These costs amounted to $2.2 million in the six months ended June 30, 2004. There were no comparable costs in the six months ended June 30, 2003.

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Impairment of Long-Lived Assets. Impairment charges decreased $500,000, or 100%, to $0 in the six months ended June 30, 2004, from $500,000 for the same period in 2003. Impairment charges consisted of the impairment of an investment in a third-party technology company due to a decline in fair value which was other than temporary. This investment was fully written off at June 30, 2003.

Other Income/Expenses. Other income/expenses decreased $154,000 or 94.5%, to $9,000 in the six months ended June 30, 2004 from $163,000 for the same period in 2003. The decrease was due partially to the addition of interest expense associated with the Operating Loan and the Bridge Loan Facility as well as the decrease in investment earnings due to the decrease in interest rates in 2004 compared to 2003.

Off Balance Sheet Arrangements

We had no off-balance sheet arrangements as of and for the three months ended June 30, 2004.

Liquidity And Capital Resources

The following table provides information relating to our material contractual obligations at June 30, 2004.

	Payment Due By Period (in thousands)				
Contractual Obligations	**Total**	**Less Than 1 Year**	**1-3 Years**	**3-5 Years**	**More Than 5 years**
Capital leases	$ 2	2			
Operating leases	3,321	763	1383	1069	106
Purchase obligations					
Total	$3,323	765	1383	1069	106

Net cash used in operating activities was $2.8 million for the six months ended June 30, 2004, compared to $1.3 million for the six months ended June 30, 2003. The principal use of cash for both periods was to fund our losses from operations.

Net cash provided by financing activities was $2.8 million for the six months ended June 30, 2004, compared to $110,000 used in financing activities for the six months ended June 30, 2003. In 2003, the cash used was related to payments made under capital leases. In 2004, the cash provided was related to the borrowing against the Operating Loan and the Bridge Loan Facility.

Net cash used in investing activities was $1.1 for the six months ended June 30, 2004 compared to $437,000 for the six months ended June 30, 2003. The cash used in investing activities in 2003 was mainly related to transaction costs related to the Abiliti Acquisition and capital expenditures. The cash used in 2004 was primarily related to the PNML Loan.

We incurred net losses of approximately $4.8 million for the six months ended June 30, 2004 and had an accumulated deficit of $219 million at June 30, 2004. Cash and cash equivalents and restricted cash at June 30, 2004 were $1.7million. Cash used in operations for the six months ended June 30, 2004 was $2.8 million. We continued to provide outsourcing services to Allegiance pursuant to an agreement expiring on December 31, 2004. Allegiance accounted for 21.2% of total revenue for the six months ended June 30, 2004. There are no minimum revenues from Allegiance under this agreement. Allegiance assigned the Agreement to XO Communications, Inc. (XO) on July 23, 2004. We expect that XO Communications, Inc. will continue the migration of data and will ultimately discontinue use of the Company s services.

As a result of our business concentration risk, past recurring losses from operations and accumulated deficit, our accountants have raised substantial doubt about our ability to continue as a going concern.

In May 2003, we executed a license and services agreement with ETB for our RevChain products. The project is expected to provide more than $7.6 million in additional revenues. The first significant payments were received in the fourth quarter of 2003 for approximately $787,000. We also received approximately $1.3 million in the second quarter of 2004. Payments are expected in the third and fourth quarters of 2004 in the amounts of $878,000 million and $3.1 million respectively. The final large payment of $1.1 million is expected in the first quarter of 2005 with smaller payments due throughout the term of the contract. Payments the company makes to subcontractors supporting the ETB Contract are paid within two weeks of receipt of the corresponding payments from ETB.

In February 2004, we closed a revolving loan facility (the Operating Loan) with Silicon Valley Bank (SVB) and guaranteed by EXIM Bank. (See Note 5 of the condensed unaudited consolidated financial statements in Item 1 for a description of terms). Total funding under the Operating Loan is $2,700,000. The Company can borrow against the Operating Loan based on estimated funding dates and may have outstanding borrowings at any given time of up to $2,000,000. The proceeds of the Operating Loan will be used for operating costs associated with the ETB Contract. The balance on the Operating Loan as of June 30, 2004 was $657,000. Approximately $1.3 million of the Operating Loan was repaid in May 2004.

On May 7, 2004 we announced the Investment and Acquisition Transactions. As part of the Investment and Acquisition Transactions, subject to Company shareholder approval, we will become a private company. The Investment and Acquisition Transactions are subject to the satisfaction of customary closing conditions including the approval of our stockholders.

In May 2004, the Company entered into the Bridge Loan Facility with Behrman. The Bridge Loan Facility is for a maximum principal amount of $5.1 million, bearing interest at the rate of 6% per annum (plus a penalty at and after an event of default). The Company has drawn $1,000,000 million of this amount to fund a working capital facility that it is providing to Protek in connection with the Investment and Acquisition Transactions, and $100,000 to fund a facility fee paid to Behrman. In addition, the Company has drawn $1.1 million to fund its working capital requirements. The total amount drawn as of August 12, 2004, is $2.6 million leaving an amount of $2.5 million available for future use if needed prior to the closing of the Investment and Acquisition Transactions, subject to Behrman s discretion. It is expected that the full remaining permitted principal amount of the Bridge Loan Facility will be drawn immediately prior to the closing of the Investment and Acquisition Transactions. At closing, the Bridge Loan Facility note will be guaranteed by DHI by offset of the principal amount thereof against the $5 million commitment of Behrman, plus a cash payment in respect of accrued but unpaid interest. The Bridge Loan Facility is secured by a lien on all assets of the Company, subordinated to the interests of SVB and EXIM Bank.

We believe the cash and cash equivalents at June 30, 2004, together with the Operating Loan proceeds, Bridge Loan Facility proceeds, provided that Behrman continues to make additional draws available, and the additional funding resulting from the closing of the Investment and Acquisition Transactions, may be sufficient to fund operations for the foreseeable future. We do not believe that our cash and cash equivalents at June 30, 2004 will be sufficient to fund our operations and that we will be required to further reduce operations and/or seek additional financing if the Investment and Acquisition Transactions are not completed. The Investment and Acquisition Transactions are subject to a number of closing conditions, including the approval of our stockholders, and there can be no assurance that the transactions will be consummated. If the investment by Quadrangle and Behrman does not close by September 30, 2004, the Investment Agreement will automatically terminate unless extended by agreement of Quadrangle, Behrman and us. If the Investment and Acquisition Transactions are not consummated, it is highly unlikely that we would continue to operate our business substantially as presently operated. The remainder of the Bridge Loan Facility may be made available to us by Behrman, at its discretion, to fund our ordinary course working

capital needs prior to the closing of the

Investment and Acquisition Transactions and to pay costs we incur in connection with the Bridge Loan Facility and Investment and Acquisition Transactions. There can be no assurance that Behrman will continue to make additional draws available or that other financing will be available, or that, if available, the financing will be obtainable on terms acceptable to us or that additional financing would not be substantially dilutive to our existing stockholders. Although we are precluded from considering other strategic alternatives pending completion or termination of the Investment and Acquisition Transactions, if the transactions are not completed, we will consider other strategic alternatives. There can be no assurance that any other strategic alternatives will be available, or if available, will be on terms acceptable to us, or all of our stockholders. Failure of Behrman to make additional draws available or failure to consummate the Investment and Acquisition Transactions will have a material adverse affect on our ability to operate as a going concern, which may result in filing for bankruptcy protection, winding down operations and/or liquidation of assets. The condensed unaudited financial statements have been prepared assuming that we will continue as a going concern, and do not include any adjustments that might result from the outcome of this uncertainty.

New Accounting Pronouncements

See Note 15 to our condensed unaudited consolidated financial statements in Part I Item 1 to this Form 10-Q for certain new accounting pronouncements.

RISKS ASSOCIATED WITH DALEEN S BUSINESS AND FUTURE OPERATING RESULTS

RISK FACTORS

Our future operating results may vary substantially from period to period. The price of our common stock will fluctuate in the future, and an investment in our common stock is subject to a variety of risks, including but not limited to the specific risks identified below. In addition to risk factors associated with our business and operations, risk factors relating to our outstanding Series F preferred stock are set forth below under the caption Risks Associated with our Series F Preferred Stock and risk factors associated with the Investment and Acquisition Transactions are also set forth below. Inevitably, some investors in our securities will experience gains while others will experience losses depending on the prices at which they purchase and sell securities. Prospective and existing investors are strongly urged to carefully consider the various cautionary statements and risks set forth in this report.

Risks Associated with the Investment and Acquisition Transactions

If the Investment and Acquisition Transactions do not close, we will not have sufficient funds to continue to operations and we will not have sufficient funds to pay our transaction expenses.

If the Investment and Acquisition Transactions are not completed, it is highly unlikely that we would have sufficient funds to continue to operate our business substantially as presently operated and we would be required to further reduce operations and/or seek additional financing. The Investment and Acquisition Transactions are subject to a number of closing conditions, including the approval of our stockholders, and there can be no assurance that the transactions will be consummated. If the investment by Quadrangle and Behrman does not close by September 30, 2004, the Investment Agreement will automatically terminate unless extended by agreement of Quadrangle, Behrman and the Company. There can be no assurance that financing will be available, or that, if available, the financing will be obtainable on terms acceptable to us or that additional financing would not be substantially dilutive to our existing stockholders. Although we are precluded from considering other strategic alternatives pending completion or termination of the Investment and Acquisition Transactions, if the transactions are not completed, we will consider other strategic alternatives. There can be no assurance that any other strategic alternatives will be available, or if available, will be on terms acceptable to us, or all of our stockholders. Failure of Behrman to make additional draws available or failure to consummate the Investment

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and Acquisition Transactions will have a material adverse affect on our ability to operate as a going concern, which may result in filing for bankruptcy protection, winding down operations and/or liquidation of assets.

If the Investment and Acquisition Transactions do not close, we are unlikely to have the resources needed to fund our transaction-related expenses, including without limitation the requirement that we pay Quadrangle s expenses upon any termination. We may also owe more than $2.6 million to Behrman for advances on the Bridge Loan Facility with no guarantee of recovery of up to $1.0 million advanced to Protek. In addition, it is likely that our own transaction expenses will exceed cash and cash equivalents on hand at the time of termination and we will not have sufficient working capital to repay the Bridge Loan Facility.

We are the target of three securities class action lawsuits related to the proposed Merger which could result in substantial costs and divert management attention and resources.

On or about April 7, 2004, a purported class action complaint was filed and on June 21, 2004, the plaintiff filed an amended complaint alleging that the merger transaction contemplated as part of the Investment and Acquisition Transactions (Merger) is a freeze out of Common Stock by the Series F Preferred stockholders through unfair dealing by the defendants and that the defendants have breached and continue to breach their fiduciary duties of loyalty, care and good faith to the plaintiff and other members of the class. The amended complaint seeks for the Merger, if consummated, to be rescinded and set aside or for rescissory damages to be awarded to the class; for the defendants to be directed to account to the class for all profit received by the defendants and all damages sustained by the class; and for costs of the action including attorney s and experts fees to be awarded to the plaintiff. On May 12, 2004 and June 24, 2004, two additional purported class action complaints were filed by individual shareholders. These complaints generally allege that the Company and our directors breached their fiduciary duties; that the consideration offered by Quadrangle Capital Partners LP and Behrman Capital is inadequate and that the transaction was a result of unfair dealing; that Behrman Capital, as controlling stockholder, breached its fiduciary duty to our minority stockholders by acting to further its own interests at the expense of our minority stockholders; and that Behrman Brothers, Quadrangle Group and Quadrangle Capital Partners LP knowingly aided and abetted Behrman Capital s violations of fiduciary duty. The complaints seek to enjoin the Merger and related transactions, or if the Merger and related transactions are consummated, to rescind them; to recover damages in an unstated amount and to recover costs including attorney s fees associated with the lawsuit. We intend to vigorously defend against the plaintiffs claims, but any such defense may result in substantial costs and divert management s attention, which may adversely affect our business and results of operations. Even if we ultimately were to prevail on the merits, given our limited and declining cash position, if these lawsuits result in a significant delay in the Merger, the effect could be to deprive our stockholders of value. If any of these litigations were to result in a permanent injunction against consummation of the Merger or related transactions, the Merger Agreement and related transaction agreements would be subject to termination as contemplated by the Transaction Support Agreement. See Risks Associated with the Investment and Acquisition Transactions If the Investment and Acquisition Transactions do not close, our transaction expenses may exceed cash and cash equivalents on hand at the time of termination and Risks Associated with our Business and Operations Our cash position has deteriorated and if we are unable to obtain sufficient working capital, we may be unable to meet ordinary course obligations as they become due.

Risks Associated with our Business and Operations

Our cash position has deteriorated and if we are unable to obtain sufficient working capital, we may be unable to meet ordinary course obligations as they become due.

The deterioration of our cash position has continued and we are increasingly exposed to the risk of cash flow mismatches. Should such cash flow incidents occur prior to closing of the Investment and Acquisition Transactions, we expect to seek Behrman s agreement to permit us to make additional draws on our Bridge Loan Facility. Behrman

has indicated to us that it will monitor our financial condition with care and that it currently

intends to assist us with additional draws under the Bridge Loan Facility as events warrant; however, Behrman has provided no contractual or other commitment to make such funds available. If we are unable to obtain additional draws under the Bridge Loan Facility, we may be unable to meet ordinary course obligations as they come due.

Our business relies in part on a limited number of customers and unfavorable developments in relation to a major customer may adversely affect our revenues, operating results and cash flows.

Three customers accounted for an aggregate of 61.3% of our total revenue for the six months ended June 30, 2004, with ETB accounting for 28.6%, Allegiance, accounting for 21.2%, and SBC accounting for 11.6% of our total revenue for the six months ended June 30, 2004. If an unfavorable development occurs with respect to any significant customer it would likely materially adversely impact our total revenues and financial results. We provide outsourcing services to our largest customer, Allegiance, pursuant to a contract expiring on December 31, 2004. There are no minimum revenues from Allegiance under this agreement. Allegiance has been migrating data to another software system and intends to discontinue use of our services.

In addition, we entered into the ETB Contract in May 2003. ETB may terminate the ETB Contract at anytime for any reason. If ETB terminates the ETB Contract for any reason, other than our breach of the contract, ETB must pay the proportionate fees for services performed and licenses provided prior to the date of termination. The project is divided into phases and invoicing is tied to performance milestones. There can be no assurance that we will achieve anticipated revenues or receive prompt payments from ETB throughout the contract period.

Additional capital and/or strategic alternatives may be required for us to continue our operations and as a result, our independent registered public accounting firm has expressed doubts over our ability to continue as a going concern.

We incurred net losses of approximately $4.8 million for the six months ended June 30, 2004, and we had an accumulated deficit of approximately $219 million as of June 30, 2004. Our cash and cash equivalents and restricted cash at June 30, 2004 were $1.7 million. Cash used in operations for the six months ended June 30, 2004 was $2.8 million. As a result of our business concentration risk, our past recurring losses from operations and our accumulated deficit, the independent registered public accounting firm s report included in our December 31, 2003 consolidated financial statements contains an explanatory paragraph that states that our recurring losses from operations and accumulated deficit raised substantial doubt about our ability to continue as a going concern.

Net cash used in operating activities was $2.8 million for the six months ended June 30, 2004, compared to $1.3 for the six months ended June 30, 2003. The principal use of cash for both periods was to fund our losses from operations.

Net cash provided by financing activities was $2.8 million for the six months ended June 30, 2004, compared to $110,000 used in financing activities for the six months ended June 30, 2003. In 2003 the cash used was related to payments made under capital leases. In 2004, the cash provided was related to the borrowing against an Operating Loan established with SVB and the Bridge Loan Facility.

Net cash used in investing activities was $1.1 million for the six months ended June 30, 2004 compared to $437,000 for the six months ended June 30, 2003. The cash used in investing activities in 2003 consisted mainly of transaction costs related to the Abiliti Acquisition and capital expenditures. The cash used in 2004 was primarily related to the PNML Loan.

There is no assurance that we can effectively implement our aggregation strategy and even if we can, it might not be successful and could be dilutive to our existing stockholders.

We intend to augment our growth through targeted aggregations, including but not limited to mergers, acquisitions or other strategic transactions pursuant to which we would combine some or all of our resources with other billing and OSS companies. If we fail to properly evaluate and execute aggregations, our business and prospects may be seriously harmed. To successfully complete any particular aggregation transaction, we must properly evaluate the technology; accurately forecast the financial impact of the transaction, including accounting charges and transaction expenses; integrate and retain personnel; combine potentially different corporate cultures; and effectively integrate products and services, research and development, sales and marketing and support operations. Pursuit of our aggregation strategy may distract management from day-to-day operations and may be disruptive to our ongoing business. Further, our ability to implement our aggregation strategy may be limited by the availability of suitable candidates and our ability to obtain sufficient additional capital to pursue this strategy. There can be no assurance that we will be able to identify suitable candidates or have capital available to us to complete any aggregation transactions, or that the terms of any such transaction or additional capital will be acceptable to us.

Additionally, the terms of any aggregation transaction or capital raising transaction may require us to issue additional shares of our common stock or securities convertible into our common stock, which would be dilutive to our existing stockholders, and which could materially and adversely affect the market price of our common stock, or an aggregation may result in a change in the character of your investment. Any aggregation transaction may result in additional costs, expenses and other obligations, and could result in additional ongoing capital needs, all of which could materially and adversely affect our results of operations and financial condition.

We have not achieved profitability in the past and may continue to incur net losses.

We incurred net losses of approximately $4.8 million for the six months ended June 30, 2004. As of June 30, 2004, we had an accumulated deficit of approximately $219 million. We have not achieved profitability to date and may not do so in the foreseeable future.

In order to achieve profitability, we may need to further reduce our operations, seek additional financing and/or pursue other strategic alternatives. There are no assurances that we will achieve profitability in the future and, even if we do, we may not be able to sustain or increase profitability on a quarterly or annual basis.

If we default on the Operating Loan, SVB may hold our accounts or take possession of the collateral, including without limitation our intellectual property.

In February, 2004, we entered into an Operating Loan with SVB that permits us to have outstanding borrowings at any given time up to $2,000,000. The Operating Loan is subject to representations and warranties and covenants and includes numerous events of default including maintaining a tangible net worth requirement of $3,000,000. This requirement has been waived until July 31, 2004. If we were to breach any of the other representations and warranties or covenants or in the event we trigger an event of default, SVB may institute a hold on our operating account and may seek to take possession of the collateral, including without limitation our intellectual property. We expect to be in default under one of the financial covenants of the Operating Loan for July 2004. SVB has granted us a forbearance from enforcement of its rights in respect of such default through July 31, 2004. If we are in default for July 2004, and no further forbearance is granted, SVB will be entitled to exercise its rights under the Operating Loan. The Operating Loan is secured by a first priority lien on all of our assets.

Many of our customers and potential customers lack financial resources, and if they cannot secure adequate financing, we may lose or fail to obtain their business, which would adversely affect our revenues, operating results and cash flows.

Many of our customers and potential customers lack significant financial resources or are experiencing liquidity difficulties as a result of the tightening of the financial markets and the prolonged weakness in the U.S. economy in recent years. Further, this general economic weakness has resulted in delays or reductions in expenditures for information technology, which has, and may continue to adversely affect demand for our products and services.

The adverse conditions being experienced by customers for our products could adversely affect their ability to purchase additional products, renew maintenance and support agreements, obtain outsourcing services from us or meet their financial obligations to us in a timely manner. Also, our business, operating results, and cash flows may be adversely affected to the extent that any of our customers seeks bankruptcy protection or cease operations, and by the consolidation of companies within the technology sector. Any of these factors may adversely affect our collections of accounts receivable from our customers, and may affect the timing of our revenue recognition where we provide financing to our customers. See Risk Factors Our business relies in part on a limited number of customers and unfavorable developments in relation to a major customer may adversely affect our revenues, operating results and cash flows.

Our expansion into select international markets may not succeed as a result of legal, business and economic risks specific to international operations.

Our expansion into select international markets is subject to risks generally associated with international operations and our future international operations might not succeed for a number of reasons, including but not limited to dependence on third-party systems integrators; difficulties in staffing and managing foreign operations; language barriers; difficulties in localizing products and supporting customers in foreign countries; reduced protection for intellectual property rights in some countries; greater difficulty in collecting accounts receivable; local standards of contracting and doing business, including performance bond requirements and penalty clauses, and uncertainties inherent in transnational operations such as export and import regulations and other local laws, taxation issues, tariffs, trade barriers and fluctuations in currency conversion rates. To the extent that we are unable to successfully manage expansion of our business into these international markets due to any of the foregoing factors, our business could be adversely affected.

Our future success will depend in part upon our ability to continually enhance our product and service offerings to meet the changing needs of our customers, and if we are not able to do so, we will lose future business to our competitors.

We believe that our future success will depend to a significant extent upon our ability to enhance our product and service offerings to meet the requirements of our customers in a rapidly developing and evolving market. Since 2001, we have significantly reduced the amount of cash we expend for research and development. This reduction may make it more difficult to enhance future product and service offerings. If we are unable to anticipate or respond adequately to customer needs, our business and financial performance will be adversely affected.

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Design defects or software errors in our products could adversely affect our business due to costly redesigns, production delays and customer dissatisfaction.

Design defects or software errors in our products may result in costly redesigns, cause delays in product introductions, or cause customer dissatisfaction, any of which could seriously harm our business. Our software products are highly complex and may, from time to time, contain design defects or software errors that may be difficult to detect and correct. Although we have license agreements with our customers that contain provisions designed to limit our exposure to potential claims and liabilities arising from customer problems, these provisions may not effectively protect us against all claims. In addition, claims and liabilities arising from customer problems could significantly damage our reputation and adversely affect our business and results of operations.

If we cannot continue to obtain or implement the third-party software that we incorporate into our products, we may have to delay our product development or redesign efforts, which could adversely affect our revenues and results of operations.

Our products involve integration with products and systems developed by third parties. If any of these third-party products should become unavailable for any reason, fail under operation with our products, or fail to be supported by their vendors, it would be necessary for us to redesign our products. We might encounter difficulties in accomplishing any necessary redesign in a cost-effective or timely manner. We also could experience difficulties integrating our products with other hardware and software. Furthermore, if new releases of third-party products and systems occur before we develop products compatible with these new releases, we could experience a decline in demand for our products or services, which could adversely affect our business and financial performance.

We permit certain third parties to sell and implement our products, and any failure by these parties to successfully implement or support our products may reflect negatively on our products.

Third parties such as systems integration firms and OEM partners help us to market, sell, implement and support our products. If these third parties discontinue their relationship with us, or fail to adequately implement and support our products, we may experience increased difficulty in attracting and retaining customers, or incur unanticipated costs and expenses necessary to satisfy customer needs, and it may reflect negatively on our reputation in the marketplace for our products.

We face significant competition from companies that have greater resources than we do and the markets in which we compete are relatively new, intensely competitive, highly fragmented and rapidly changing.

The market for our products and services is highly competitive. We directly compete with both independent providers of products and services and in-house systems developed by existing and potential clients. In addition, some independent providers are entering into strategic alliances with other independent providers, resulting in new competitors or competitors with greater resources. Many of our current and potential competitors have significantly greater financial, marketing, technical, and other competitive resources, many with significant and well-established international operations. In addition, our competitors may be able to adapt more quickly than we can to new or emerging technologies and changes in customer needs, or to devote more resources to promoting and selling their products. There can be no assurance that we will be able to adapt to market demands or compete successfully with existing and new competitors.

We may be unable to protect our proprietary technology, and our competitors may infringe on our technology, or develop competitive technology, any one of which could harm the value of our proprietary technology.

We regard a substantial portion of our software product as proprietary and rely on a combination of patent, copyright, trademark and trade secret laws, customer license agreements and employee and third-party agreements to protect our proprietary rights. There can be no assurance, however, that these protections will prevent misappropriation of our intellectual property, particularly in foreign countries where intellectual property

laws may not protect proprietary rights as fully as the laws of the United States. If we have to resort to legal proceedings to enforce our intellectual property rights, the proceedings could be burdensome and expensive and the outcome uncertain. Also, our competitors could independently develop similar or superior technology without violating our proprietary rights. Any misappropriation of our technology or development of competing technology could seriously harm our business and could materially and adversely affect our financial performance.

Claims by others that we infringe their proprietary technology could be costly and harm our business.

Third parties could claim that our products or technology infringes on their proprietary rights. An infringement claim against us could be costly even if the claim is invalid, and could distract our management from the operation of our business. Furthermore, a judgment against us could require us to pay substantial damages and could also include an injunction or other court order that could prevent us from selling our products. If we faced a claim relating to proprietary technology, we may need to incur additional costs and expenses to license such technology, or to develop non-infringing technology in order to sell our affected products, which could adversely affect our financial performance.

Loss of our senior management or other key personnel would harm our business if we are unable to hire suitable replacements.

Our future success depends to a significant extent on the continued services of our senior management and other key personnel. If we lost the services of our key employees and we were unable to hire suitable replacements, it would harm our business. We have employment and non-compete agreements with our executive officers. However, these agreements do not obligate them to continue working for us. Our success also depends in large part on our ability to motivate and retain highly skilled information technology professionals, software programmers, and sales and marketing professionals. Our recent restructurings and cost reductions may create uncertainties that could adversely affect our ability to retain our employees. Significant turnover of our personnel could hinder our ability to effectively serve our existing customers and in competing for new business, either of which could adversely affect our business and results of operations.

The price of our common stock has been, and will continue to be volatile, which increases the risk of an investment in our common stock.

The trading price of our common stock has been volatile due in part to the volatility in the communications and technology areas of the equity securities markets, and our results of operations. We anticipate that the trading price for our common stock will continue to experience volatility in the future. Factors that may affect the fluctuation in the trading price of our common stock may include but are not limited to: quarter-to-quarter variations in our operating results; our ability to raise additional capital and/or engage in strategic alternatives; failure to meet market expectations of our performance; announcements and technological innovations or new products by us or our competitors; the projected level of business activity or perceived growth (or the lack thereof) in the market; increased price competition; and general conditions in the Internet, technology and the telecommunications industries.

We are the target of a securities class action lawsuit related to our IPO and the volatility of our stock price may lead to additional legal proceedings being brought against us which could result in substantial costs and divert management attention and resources.

In December 2001, a class action complaint was filed and is pending in the United States District Court for the Southern District of New York against us and certain of the underwriters of our initial public offering. The complaint alleges that the defendants failed to disclose excessive commissions paid to the underwriters in exchange for allocating shares to preferred customers, and that the underwriters had agreements with preferred customers tying the

allocation of shares to the preferred customers agreements to make additional aftermarket

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purchases at pre-determined prices. The complaint alleges that the failure to disclose these alleged arrangements made our prospectus materially false and misleading. Plaintiffs seek unspecified damages and other relief.

We have approved the terms of a proposed settlement involving the plaintiffs, the insurance companies and numerous issuers, including us and the individual defendants, that includes a waiver by the insurance companies of any retention amounts under the policies. However, court approval of the settlement will be required and there can be no assurance that the settlement will be finalized. We intend to vigorously defend against the plaintiffs claims if settlement discussions are unsuccessful. Any such defense may result in substantial costs and divert management s attention, which may adversely affect our business and results of operations. While we believe that we are entitled to be indemnified by the underwriters under the terms of the underwriting agreement, there can be no assurance that indemnification will be available to us, or the amount of any such indemnification. Furthermore, BancBoston Robertson Stephens Inc., the lead underwriter in our initial public offering, has ceased doing business. See Part II Item 1 Legal Proceedings in this report for a more complete discussion concerning this litigation.

In addition, in the past, other types of securities class action litigation have often been brought against companies following periods of volatility in the market price of its securities. We may in the future be the target of similar litigation. Any securities litigation may result in substantial costs and divert management s attention and resources, which may seriously harm our business.

Claims related to the liabilities retained by Abiliti in the Abiliti Acquisition remain unresolved and because Abiliti has exhausted its remaining assets, we will be forced to pay the costs of defending such claims, and settlement or judgment amounts, if any.

Certain claims related to the liabilities retained by Abiliti in the Abiliti Acquisition remain unresolved. Abiliti is obligated to indemnify us for all such claims and is currently defending us in the action *Tamara Cooper v. Albacore Holdings, Inc. b/d/a Abiliti Solutions, Inc., Daleen Solutions, Inc. and Gordon Quick.* Albacore has notified its insurance carrier and the insurance carrier has accepted responsibility for a portion of the defense costs, subject to a retention amount. Albacore has notified us that it does not have the financial resources to defend and/or settle the claim, pay any judgment ultimately obtained by plaintiffs, or continue to provide indemnification in connection with this matter. Accordingly, we are forced to pay the costs of defense, including the balance of the retention amount and the portion of the defense costs rejected not covered by the insurance carrier, and settlement or judgment amounts, if any.

Delaware law, our certificate of incorporation and our bylaws contain anti-takeover provisions that may delay, deter or prevent a change of control.

Certain provisions of Delaware law, our certificate of incorporation and our bylaws contain provisions that could delay, deter or prevent a change of control of Daleen. Our certificate of incorporation and bylaws, among other things, provide for a classified board of directors, restrict the ability of stockholders to call stockholders meetings, preclude stockholders from raising new business for consideration at stockholder meetings unless the proponent has provided us with timely advance notice of the new business, and limit business that may be conducted at stockholder meetings to those matters properly specified in notices delivered to us. Moreover, we have not opted out of Section 203 of the Delaware General Corporation Law, which generally prohibits mergers, sales of material assets and some types of self-dealing transactions between a corporation and a holder of 15% or more of the corporation s outstanding voting stock for a period of three years following the date the stockholder became a 15% holder. These provisions do not apply to the holders of our Series F preferred stock.

Risks Associated with our Series F Preferred Stock

The holders of our Series F preferred stock have rights that are senior to those of the holders of our common stock in the event of the sale of our Company or in the event of our liquidation, dissolution or winding up.

The holders of the Series F preferred stock will have a claim against our assets senior to the claim of the holders of our common stock in the event of our liquidation, dissolution or winding up. The aggregate amount of that senior claim will be at least $110.94 per share of Series F preferred stock (the Preferential Amount), or approximately $49.8 million based on the number of shares of Series F preferred stock outstanding at May 1, 2004.

Additionally, unless otherwise agreed by the holders of at least a majority of the outstanding shares of Series F preferred stock, in the event of a Sale of the Company, we are required to redeem all of the issued and outstanding shares of Series F preferred stock for the Preferential Amount per share. A Sale of the Company means, with certain limited exceptions: (i) the acquisition by another entity by means of merger or consolidation resulting in the exchange of at least 50% of the outstanding shares of our capital stock for securities issued or other consideration paid by the acquiring entity or any parent subsidiary thereof; or (ii) the sale or other disposition by us of substantially all of our assets. As a result, in the event of a Sale of the Company, the holders of the Series F preferred stock will be entitled to the first $49.8 million of the transaction value based on the Series F preferred stock outstanding at May 1, 2004.

The holders of our Series F preferred stock have significant voting rights that are senior to those of the holders of our common stock.

The holders of the Series F preferred stock have voting rights entitling them to vote together with the holders of our common stock as a single class and on the basis of 100 votes per share of Series F preferred stock held by such holder, subject to certain anti-dilution adjustments. As of May 1, 2004, the voting power of the holders of the currently outstanding shares of Series F preferred stock constitutes approximately 49.0% of the entire voting class of common stock, without giving effect to the shares of our common stock currently owned by the holders of the Series F preferred stock, or the exercise of warrants to acquire our common stock and warrants to acquire our Series F preferred stock (Series F Warrants) held by such holders, or 55.39% if the warrant holders exercise their Series F Warrants.

Additionally, certain holders of our Series F preferred stock beneficially own a significant number of shares of our outstanding common stock. When combined with the shares of common stock that they beneficially own, the holders of our outstanding shares of Series F preferred stock control approximately 78.15% of the vote on any proposal submitted to the holders of our common stock, or 89.83% of the vote if the holders of the Series F preferred stock exercise their Series F Warrants and their warrants to purchase common stock. When considering both the Series F preferred stock and shares of our common stock owned, the three largest beneficial owners of our Series F preferred stock, Behrman, HarbourVest Partners V Direct Fund L.P. and HarbourVest VI Direct Fund L.P. (collectively HarbourVest) and SAIC Venture Capital Corporation control 47.89%, 13.97% and 9.81%, respectively, or in the aggregate, approximately 71.67% of the voting power on matters submitted to our common stockholders. This combined voting power would generally give these stockholders the power to control the outcome on most important corporate decisions, including but not limited to the Reverse Split, election of directors, mergers, acquisitions and other significant corporate transactions and amendments to our certificate of incorporation, if such beneficial owners act together or in common on any particular matter.

In the event that we seek stockholder approval of a transaction or action involving the Sale of the Company and/or the liquidation, dissolution or winding up of the Company, or other transaction, the holders of the Series F preferred stock will control a majority of the vote and, as a result, would control or significantly influence the outcome of a proposal with respect to such a transaction or action, whether or not the holders of our common stock support or

oppose the proposal.

In the event of conversion of the Series F preferred stock, the holders are entitled to vote the number of shares of common stock issued upon conversion. Each share of outstanding Series F preferred stock is currently convertible into 122.4503 shares of common stock, or an aggregate of approximately 55 million shares of common stock assuming the conversion of all of the shares of Series F preferred stock outstanding as of May 1, 2004.

Additionally, the holders of the Series F preferred stock are entitled to vote as a separate class on certain matters, including:

- the authorization or issuance of any other class or series of preferred stock ranking senior to or equal with the Series F preferred stock as to payment of amounts distributable upon our dissolution, liquidation or winding up;
- the issuance of any additional shares of Series F preferred stock;
- the reclassification of any capital stock into shares having preferences or priorities senior to or equal with the Series F preferred stock;
- the amendment, alteration, or repeal of any rights of the Series F preferred stock; and
- the payment of dividends on any other class or series of our capital stock, including the payment of dividends on our common stock.

Our Series F preferred stock provides for anti-dilution adjustments to the Series F preferred stock conversion price, which could result in a reduction of the conversion price.

Subject to certain exceptions, the conversion price of the Series F preferred stock will be reduced each time, if any, that we issue common stock, convertible preferred stock, options, warrants or other rights to acquire common stock at a price per share of common stock that is less than the conversion price of the Series F preferred stock then in effect. A reduction in the conversion price of the Series F preferred stock will increase the number of shares of common stock issuable upon conversion of the Series F preferred stock.

The Series F preferred stock is automatically convertible only in limited circumstances and, as a result could be outstanding indefinitely.

The Series F preferred stock will convert automatically into common stock only if the closing price of our common stock on The Nasdaq National Market or a national securities exchange is at least $3.3282 per share for ten out of any 20 trading day period. Otherwise, the shares of Series F preferred stock are convertible only at the option of the holder. Further, the Series F preferred stock is not subject to automatic conversion if our common stock is not then listed for trading on The Nasdaq National Market or a national securities exchange. Each Series F Warrant is exercisable for Series F preferred stock in whole or in part at any time during a five-year exercise period at the sole discretion of the Series F Warrant holder and will not be convertible or callable at our election. As a result of these provisions, the Series F preferred stock may remain outstanding indefinitely.

Item 3. Quantitative And Qualitative Disclosures About Market Risk.

Our financial instruments consist of cash that is invested in institutional money market accounts and less than 90-day securities invested in corporate fixed income bonds. We do not use derivative financial instruments in our operations or investments and do not have significant operations subject to fluctuations in commodities prices or foreign currency exchange rates.

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Item 4. Controls and Procedures.

Our management, under the supervision and with the participation of our Chief Executive Officer (CEO) who is also our principal financial and accounting officer, performed an evaluation of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report on Form 10-Q. Based upon that evaluation, the CEO concluded that our disclosure controls and procedures were effective as of the end of such period.

There were no changes in our internal control over financial reporting identified in connection with the evaluation of such internal control that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II

OTHER INFORMATION

Item 1. Legal Proceedings

Stockholder Litigation

Fazari vs. Daleen Technologies, Inc., et al.: On December 5, 2001, a class action complaint was filed in the United States District Court for the Southern District of New York. On April 22, 2002 an amended complaint was filed by two plaintiffs purportedly on behalf of persons purchasing the Company s common stock between September 20, 1999 and December 6, 2000. The complaint is styled as *Angelo Fazari, on behalf of himself and all others similarly situated, vs. Daleen Technologies, Inc., BancBoston Robertson Stephens Inc., Hambrecht & Quist LLC, Salomon Smith Barney Inc., James Daleen, David B. Corey and Richard A. Schell*. The individual defendants, Messrs. Corey, Schell and Daleen, have entered into tolling agreements with the plaintiffs resulting in their dismissal from the case without prejudice. The remaining defendants include us and certain of the underwriters from the Company s initial public offering (IPO). More than 300 similar class action lawsuits filed in the Southern District of New York against numerous companies and their underwriters have been consolidated for pretrial purposes before one judge under the caption In re Initial Public Offering Securities Litigation.

The complaint includes allegations of violations of (i) Section 11 of the Securities Act of 1933 by all named defendants, (ii) Section 15 of the Securities Act of 1933 by the individual defendants and (iii) Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder by the underwriter defendants. Specifically, the plaintiffs allege in the complaint that, in connection with the IPO, the defendants failed to disclose excessive commissions purportedly solicited by and paid to the underwriter defendants in exchange for allocating shares of the Company s common stock in the IPO to the underwriter defendants preferred customers. Plaintiffs further allege that the underwriter defendants had agreements with preferred customers tying the allocation of shares sold in the IPO to the preferred customers agreements to make additional aftermarket purchases at pre-determined prices. Plaintiffs further allege that the underwriters used their analysts to issue favorable reports about the Company to further inflate the Company s share price following the IPO. Plaintiffs claim that the defendants knew or should have known of the underwriters actions and that the failure to disclose these alleged arrangements rendered the prospectus included in the Company s registration statement on Form S-1 filed with the SEC in September 1999 materially false and misleading. Plaintiffs seek unspecified damages and other relief.

In June, 2004, the Stipulation and Agreement of Settlement with Defendant Issuers and Individuals has been signed on the Company s behalf. Court approval of the settlement is required. Under the terms of the settlement, there would be no liability to be recorded by us. There is no assurance that the settlement will be finalized. In the event that the settlement is not finalized and approved by the court, we intend to defend vigorously against the plaintiffs claims. We believe that we are entitled to indemnification by the underwriters under the terms of the underwriting agreements. We have notified the underwriters of the action, but the underwriters have not yet agreed to indemnify the Company. The lead underwriter, BancBoston Robertson Stephens Inc., has ceased doing business and there is no assurance it will have the financial resources to provide indemnification. Currently the amount of a loss, if any, cannot be determined. In the event that the court does not approve the settlement, we intend to defend vigorously against the plaintiffs claims.

Kops Investment Advisors LLC v. Daleen Technologies, Inc., et al.

On or about April 7, 2004, a purported class action complaint was filed in the Court of Chancery of the State of Delaware in and for New Castle County by an individual holder of shares of Common Stock of the Company. The complaint is styled *Kops Investment Advisors LLC v. Daleen Technologies, Inc., James Daleen, Gordon Quick, Ofer Nemirovsky, Daniel J. Foreman, Dennis G. Sisco, Stephen J. Getsy, and John S. McCarthy, Behrman Brothers,*

L.L.C., Behrman Capital II, L.P., Strategic Entrepreneur Fund II, L.P. On June 21, 2004, the plaintiff filed an amended complaint alleging that the Merger is a freeze out of Common Stock by the Series F Preferred stockholders through unfair dealing by the defendants and that the defendants have breached and continue to breach their fiduciary duties of loyalty, care and good faith to the plaintiff and other members of the class. The amended complaint seeks for the Merger, if consummated, to be rescinded and set aside or for rescissory damages to be awarded to the class; for the defendants to be directed to account to the class for all profit received by the defendants and all damages sustained by the class; and for costs of the action including attorney s and experts fees to be awarded to the plaintiff. This case is in the initial stages and the amount of exposure, if any, is not determinable at this time.

Kurt Feierbend v. James Daleen, et al.

On May 12, 2004 a purported class action complaint was filed in the Court of Chancery of the State of Delaware in and for New Castle County by an individual holder of the Common Stock of the Company. The complaint is styled *Kurt Feierbend v. James Daleen, Gordon Quick, Daniel J. Foreman, Stephen J. Getsy, John S. McCarthy, Dennis G. Sisco, Ofer Nemirovsky, Daleen Technologies, Inc., Quadrangle Group LLC, Quadrangle Capital Partners LP, Behrman Capital and Behrman Brothers, L.L.C.* The complaint, which is purported to be brought on behalf of the public holders of the Common Stock, generally alleges that the Company and our directors breached their fiduciary duties; that the consideration offered by Quadrangle Capital Partners LP and Behrman Capital is inadequate and that the transaction was a result of unfair dealing; that Behrman Capital, as controlling stockholder, breached its fiduciary duty to our minority stockholders by acting to further its own interests at the expense of our minority stockholders; and that Behrman Brothers, Quadrangle Group and Quadrangle Capital Partners LP knowingly aided and abetted Behrman Capital s violations of fiduciary duty. The complaint seeks to enjoin the Merger and related transactions, or if the Merger and related transactions are consummated, to rescind them; to recover damages in an unstated amount and to recover costs including attorney s fees associated with the lawsuit. This case is in the initial stages and the amount of exposure, if any, is not determinable at this time.

Russell Winter v. James Daleen, et al.

On June 24, 2004, a purported class action complaint virtually identical to the complaint filed by Feierbend was filed in the Court of Chancery of the State of Delaware in and for New Castle County by another individual holder of the Common Stock of the Company. The complaint is styled *Russell Winter v. James Daleen, Gordon Quick, Daniel J. Foreman, Stephen J. Getsy, John S. McCarthy, Dennis G. Sisco, Ofer Nemirovsky, Daleen Technologies, Inc., Quadrangle Group LLC, Quadrangle Capital Partners LP, Behrman Capital and Behrman Brothers, L.L.C.* The complaint, which is purported to be brought on behalf of the public holders of the Common Stock, generally alleges that the Company and our directors breached their fiduciary duties; that the consideration offered by Quadrangle Capital Partners LP and Behrman Capital is inadequate and that the transaction was a result of unfair dealing; that Behrman Capital, as controlling stockholder, breached its fiduciary duty to our minority stockholders by acting to further its own interests at the expense of our minority stockholders; and that Behrman Brothers, Quadrangle Group and Quadrangle Capital Partners LP knowingly aided and abetted Behrman Capital s violations of fiduciary duty. The complaint seeks to enjoin the Merger and related transactions, or if the Merger and related transactions are consummated, to rescind them; to recover damages in an unstated amount and to recover costs including attorney s fees associated with the lawsuit. This case is in the initial stages and the amount of exposure, if any, is not determinable at this time.

Abiliti-Related Litigation

On August 1, 2003, a First Amended Petition, styled as *James E. Kientzy and David K. Wilson vs. Abiliti Solutions, Inc., a corporation, and Daleen Technologies, Inc., a corporation, and Daleen Solutions, Inc., a*

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corporation and wholly-owned subsidiary of Daleen, was filed in the Circuit Court of the County of St. Louis, State of Missouri. The First Amended Petition added Daleen Technologies and Daleen Solutions as defendants in the named action. The First Amended Petition contained certain allegations against Abiliti related to the non-payment of certain promissory notes in the aggregate principal amount of $1.2 million. In May, 2004, we reached a settlement with the plaintiffs and we made payments to the plaintiffs totaling $250,000. On June 28, 2004, the action was dismissed with prejudice.

On December 24, 2003, Daleen Solutions filed a collection action against Data Integration Systems, Inc. (DIS) seeking payment of license fees, services fees and equipment in the amount of $694,600 (which includes DIS obligation to make future payments under the contract). On January 30, 2004, DIS filed a cross-complaint against Daleen Solutions alleging damages of $1,500,000. This case is in the discovery stage of the proceeding. A loss and its effect on us, if any, cannot be determined with respect to this litigation.

General litigation

We are involved in other lawsuits and claims incidental to the ordinary course of our business. Management does not believe the outcome of any of these other activities would have a material adverse effect on our financial position or results of operations.

Item 5. Other Information.

Investment and Acquisition Transactions

On May 7, 2004 Quadrangle and Behrman signed definitive agreements to invest $25 million and $5 million, respectively, in cash into DHI, a newly formed subsidiary of the Company, that, subject to our shareholder approval, will simultaneously acquire us and Protek.

Quadrangle and Behrman will receive senior convertible redeemable preferred stock in DHI Preferred in consideration for their investment. The DHI Preferred will have a dividend of 6% per annum, payable in kind or in cash at DHI s election. The DHI Preferred will also carry the right to the issuance of additional shares of preferred equity should DHI not attain certain specified financial targets.

DHI will acquire Protek by purchase of stock from its shareholders and conversion of outstanding options, for aggregate consideration of up to $20 million, consisting of up to $13 million in cash, $5 million of DHI Common, and contingent earn-out consisting of up to $1 million in cash and $1 million of DHI Common. The purchase price will be subject to reduction in respect of closing date debt and working capital shortfalls.

In connection with the Investment and Acquisition Transactions, we will become a private company. All outstanding shares of our common stock will be purchased for $0.0384 per share in cash. The per share purchase price is based on an aggregate amount equal to approximately ten percent of the total value received by our stockholders. In addition, as a condition of closing the Investment and Acquisition Transactions, holders of our Series F preferred stock will be required to waive the $49.8 million redemption value of the Series F preferred stock. These stockholders will receive an aggregate of $15.4 million in cash and securities, with the cash component limited to a maximum of $2.8 million. Immediately prior to the consummation of the Investment and Acquisition Transactions, Behrman will be contractually obligated to exchange its shares of Series F preferred stock for $5 million in DHI Preferred plus the remaining value of its shares of Series F preferred stock in DHI Common. Other holders of Series F preferred stock will receive a combination of (a) an aggregate of $2.8 million in value of DHI Common and (b) the remaining value of their Series F preferred stock in DHI Common; however, holders of Series F preferred stock will be permitted to

convert all of their Series F preferred stock into DHI Common.

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Behrman extended to Daleen a $5.1 million Bridge Loan Facility. The Bridge Loan Facility will bear interest at a rate of 8% per annum. The aggregate amount of this Bridge Loan Facility will be credited against Behrman s commitment under the Investment and Acquisition Transactions pursuant to a note purchase agreement with DHI.

In order to assist Protek with ordinary course working capital needs during the period between the signing and closing of the transactions, we will provide Protek Network Management (U.K.) Limited (PNML) with a bridge facility of not more than $1.5 million (PNML Loan). We will fund the PNML Loan with proceeds of the Bridge Loan Facility. $500,000 of this amount will be treated as a deposit and creditable to the purchase price for Protek, as described above. The PNML Loan is secured by liens on all of PNML s and Protek s assets, subject solely to any first liens already existing in favor of PNML s creditors. The Company was also granted certain warrants for the stock of Protek exercisable in the event of certain defaults.

Resignation of Chief Financial Officer

Jeanne T. Prayther, Daleen s chief financial officer, resigned as an officer of Daleen effective on May 28, 2004. Ms. Prayther s resignation was for personal reasons.

Item 6. Exhibits And Reports On Form 8-K.

(a) Exhibit List

Exhibit Number	Description
10.1	Second Loan Modification Agreement, dated as of June 30, 2004, among the Company, Daleen IAC, LLP, DSI, Inc., Daleen Solutions, Inc. and Silicon Valley Bank filed herewith.
10.2	Security Agreement, dated July 2, 2004 among the Company, Daleen IAC, LLP, DSI, Inc., Daleen Solutions, Inc. and Behrman Capital II, L.P. filed herewith.
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended, filed herewith.
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended, filed herewith.
32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith.
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith.

(b) Reports on Form 8-K

Report on Form 8-K, item 12, furnished under item 9 on April 23, 2004 with respect to Daleen s first quarter 2004 financial operating results.

Report on Form 8-K item 5, filed on May 7, 2004 with respect to the announcement of the Investment and Acquisition Transactions.

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SIGNATURES

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

DALEEN TECHNOLOGIES, INC.

Date: August 16, 2004

/s/ GORDON QUICK
GORDON QUICK
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 16, 2004

/s/ GORDON QUICK
GORDON QUICK
President and Chief Executive Officer
(Principal Financial and Accounting Officer)