DALEEN TECHNOLOGIES INC
Form 10-Q
August 14, 2003

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2003

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, 2003, the Registrant had outstanding 45,828,912 shares of common stock.

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QUARTER ENDED JUNE 30, 2003

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

DALEEN TECHNOLOGIES, INC. AND SUBSIDIARIES

Condensed Unaudited Consolidated Balance Sheets

	December 31, 2002	June 30, 2003
	(In thousands, except share and per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,589	$ 4,682
Restricted cash	30	30
Accounts receivable, less allowance for doubtful accounts of $3,976 at December 31, 2002 and $1,918 at June 30, 2003	2,558	1,953
Cost in excess of billings		380
Unbilled revenue	203	329
Other current assets	1,022	407
Total current assets	10,402	7,781
Notes receivable	77	37
Property and equipment, net	1,824	1,381
Goodwill	5,086	5,086
Other assets	1,400	401
Total assets	$ 18,789	$ 14,686
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 368	$ 329
Accrued payroll and other accrued expenses	2,576	2,033
Current portion of capitalized lease	164	78
Billings in excess of costs	616	474
Deferred revenue	1,279	875
Other current liabilities	53	16
Total current liabilities	5,056	3,805
Long term portion of capitalized lease	26	2
Other noncurrent liabilities		5
Total liabilities	5,082	3,812
Stockholders equity:		
Series F Convertible Preferred Stock, $.01 par value; 588,312 shares authorized; 458,224 issued and outstanding at December 31, 2002 and June 30, 2003, respectively ($110.94 per share liquidation value)	27,656	27,656

Common stock, $.01 par value; 200,000,000 shares authorized; 46,848,876 shares issued and 45,847,865 and 45,828,912 outstanding at December 31, 2002 and June 30, 2003, respectively	469	469
Additional paid-in capital	196,649	196,649
Accumulated deficit	(210,918)	(213,749)
Treasury stock at cost; 1,001,011 and 1,019,964 shares at December 31, 2002 and June 30, 2003, respectively	(149)	(151)
Total stockholders equity	13,707	10,874
Total liabilities and stockholders equity	$ 18,789	$ 14,686

See accompanying notes to condensed unaudited consolidated financial statements.

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DALEEN TECHNOLOGIES, INC. AND SUBSIDIARIES

Condensed Unaudited Consolidated Statements of Operations

	Three months ended June 30,		Six months ended June 30,	
	2002	2003	2002	2003
	(in thousands, except per share data)			
Revenue:				
Professional services and other	$ 1,290	3,982	2,983	7,809
License fees	753	231	963	475
Total revenue	2,043	4,213	3,946	8,284
Cost of revenue:				
Professional services and other	608	1,109	1,614	2,165
License fees	63	165	98	468
Total cost of revenue	671	1,274	1,712	2,633
Gross margin	1,372	2,939	2,234	5,651
Operating expenses:				
Sales and marketing	1,083	831	2,233	1,732
Research and development	1,054	1,602	2,386	3,284
General and administrative	1,250	1,517	2,583	3,129
Impairment of long lived assets		500		500
Restructuring charges	745		745	
Total operating expenses	4,132	4,450	7,947	8,645
Operating loss	(2,760)	(1,511)	(5,713)	(2,994)
Other Income:				
Interest income and nonoperating income, net	118	99	268	163
Gain on sale of subsidiary	391		391	
Total other income, net	509	99	659	163
Net loss applicable to common stockholders	$ (2,251)	(1,412)	(5,054)	(2,831)
Net loss applicable to common stockholders per share -basic and diluted	$ (0.10)	(0.03)	(0.22)	(0.06)
Weighted average shares outstanding- basic and diluted	23,532	45,829	22,882	45,829

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

	Six Months Ended	
	June 30, 2002	June 30, 2003
	(In thousands)	
Cash flows from operating activities:		
Net loss	$ (5,054)	$ (2,831)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,307	2,311
Amortization of deferred stock compensation	68	
Loss on disposal of property and equipment	13	14
Bad debt expense	320	96
Impairment of long-lived assets		500
Interest income on stockholders notes receivable	(58)	(2)
Gain on sale of subsidiary	(391)	
Changes in assets and liabilities		
Accounts receivable	345	589
Costs in excess of billings	(51)	(380)
Unbilled revenue	443	(126)
Other current assets	(109)	(583)
Other assets	17	(4)
Accounts payable	(223)	60
Accrued payroll and other accrued expenses	(1,595)	(387)
Billings in excess of costs	(478)	(142)
Deferred revenue	(308)	(407)
Other current liabilities		(44)
Net cash used in operating activities	(5,754)	(1,336)
Cash flows used in financing activities:		
Payment of capital lease		(110)
Payment of deferred offering costs	(28)	
Net cash used in financing activities	(28)	(110)
Cash flows used in investing activities:		
Issuance of stockholder s notes receivable	1	
Proceeds from sale of fixed assets	1	
Net proceeds from sale of subsidiary	69	
Repayment of stockholder s notes receivable	12	30
Payments related to the acquisition of Abiliti		(262)
Capital expenditures	(151)	(205)
Net cash used in investing activities	(68)	(437)
Effect of exchange rates on cash and cash equivalents	(39)	(24)
Net decrease in cash and cash equivalents	(5,889)	(1,907)
Cash and cash equivalents-beginning of period	13,092	6,589
Cash and cash equivalents-end of period	$ 7,203	$ 4,682

See accompanying notes to condensed unaudited consolidated financial statements.

Daleen Technologies, Inc. and Subsidiaries
Notes to Condensed Unaudited Consolidated Financial Statements
June 30, 2003

(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, 2002 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, 2002, included in the Company s annual report on Form 10-K as of and for the year ended December 31, 2002, filed with the Securities and Exchange Commission (the SEC) on March 28, 2003.

The results of operations for the three or six months ended June 30, 2003 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

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.

On October 3, 2002 the Company formed a wholly-owned subsidiary DSI, Inc. and a wholly-owned subsidiary of DSI, Inc., Daleen Solutions, Inc. (Daleen Solutions). These entities were formed for the purpose of purchasing the assets and assuming certain liabilities of Abiliti Solutions, Inc. (Abiliti) on December 20, 2002 (the Abiliti Acquisition). The operations of Daleen Solutions are included for the three and six months ended June 30, 2003. See Note 9 for proforma results of operations for the three and six months ended June 30, 2002.

The accounts and operations of the Company for the three and six months ended June 30, 2002 included PartnerCommunity, Inc. (PartnerCommunity), a subsidiary of the Company. The Company sold this subsidiary on June 24, 2002.

On July 4, 2003 the Company formed a branch office in Bogotá, Colombia, Daleen Technologies Surcursal Colombia. This branch was formed for the purpose of doing business with a customer in Bogotá, Colombia.

(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 56,262,532 shares and 56,179,467 shares for the three and six months ended June 30, 2003, respectively. Common stock equivalents were 28,697,699 shares and 28,717,699 shares for the three and six months ended June 30, 2002, respectively.

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(4) Liquidity

The Company had an accumulated deficit of $213.7 million at June 30, 2003 and although the Company continued to experience operating losses during the six months ended June 30, 2003, the losses have improved from the same period in 2002 and have remained consistent with the first quarter of 2003. Cash used from operations was $1.3 million during the six months ended June 30, 2003 compared to cash used in operations of $5.8 million during the six months ended June 30, 2002. Cash and cash equivalents at June 30, 2003 were $4.7 million.

The Company believes the cash and cash equivalents at June 30, 2003 may be sufficient to fund operations for the foreseeable future due to the Company s 2003 anticipated revenue, including the revenue stream associated with the Abiliti Acquisition and due to the cash received from customers subsequent to June 30, 2003. However, the telecommunications and software industries are still faced with many challenges. In addition, there is a high business concentration risk with Allegiance Telecom, Inc. (Allegiance), the Company s largest outsourcing service customer. If this customer were to terminate its agreement or be unable to fulfill its contractual obligations it would severely impact the Company s operations. The Company provides outsourcing services to this customer pursuant to a contract expiring at the end of December 2003. Allegiance filed for relief under Chapter 11 of the U.S. Bankruptcy Code in May 2003. As a critical vendor, the Company was paid by Allegiance in June and July 2003 an agreed amount for all pre-petition amounts due. The Company continues to provide services pursuant to its contract with this customer and the customer is current on all post-petition amounts due. If this customer were to cease doing business with the Company for any reason, the Company may be required to reduce operations and/or seek additional public or private equity financing or financing from other sources or consider other strategic alternatives, including a possible merger, sale of assets, or other business combination or restructuring transactions. There can be no assurances that additional financing or strategic alternatives will be obtainable on terms acceptable to the Company or that any additional financing would not be substantially dilutive to existing stockholders. If this customer were to cease to do business with Daleen and the Company failed to obtain additional financing or failed to engage in one or more strategic alternatives it may have a material adverse affect on the Company s ability to continue to operate as a going concern. See business concentration risk in Note 10. The condensed unaudited consolidated financial statements have been prepared assuming the Company will continue as a going concern, and do not include any adjustments that might result from the outcome of this uncertainty.

(5) 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.

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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.

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.

(6) Restructuring Activities

During 2001, the Company performed various restructuring activities. For the year ended December 31, 2001, the Company recorded $11.8 million of restructuring charges related to restructuring activities that were announced on January 5, 2001 (the January 2001 Restructuring), April 10, 2001 (the April 2001 Restructuring), and October 17, 2001 (the October 2001 Restructuring). For the year ended December 31, 2002 the Company recorded a $745,000 restructuring charge related to restructuring activities announced on May 14, 2002 (the 2002 Restructuring). Management started to implement these actions immediately following the announcements. Such charges included the estimated costs related to workforce reductions, closing and downsizing of facilities, asset writedowns and other costs.

At December 31, 2002, an accrual remained on the condensed unaudited consolidated balance sheet related to the January 2001 Restructuring and 2002 Restructuring in the amount of $144,000.

Amounts charged against the restructuring accrual for the six months ended June 30, 2003 were as follows (in thousands):

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	January 2001 Restructuring	2002 Restructuring	Total
Employee termination benefits	$	$ 79	$79
Facility costs/rent on idle facilities	20		20
	$ 20	$ 79	$99

As of June 30, 2003, an accrual in the amount of $45,000 remains on the condensed unaudited consolidated balance sheets in accrued payroll and other accrued expenses related to the January 2001 Restructuring consisting of facility costs and rent on idle facilities in Atlanta, Georgia.

(7) Goodwill

At December 31, 2002 and June 30, 2003, goodwill represents the excess of costs over the fair value of assets related to the Abiliti Acquisition (See Note 9). 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.

(8) Impairment Charges

The Company recorded an impairment charge of $500,000 in the three and six months ended June 30, 2003 related to an investment in a third party technology company due to a decline in fair value which was other than temporary. As a result of an assessment performed by management, the Company determined that the asset was impaired, and this investment was written off, in full, during the three and six months ended June 30, 2003.

(9) Abiliti Acquisition and 2002 Private Placement

On December 20, 2002, pursuant to an Asset Purchase Agreement dated October 7, 2002, Daleen Solutions, a wholly-owned subsidiary of Daleen, consummated the Abiliti Acquisition. Abiliti was a provider of carrier-class telecommunications billing, rating and event management solutions. As consideration for the Abiliti Acquisition, Daleen issued to Abiliti 11,406,284 shares of common stock, 115,681 shares of Series F convertible preferred stock and warrants to purchase 5,666,069 additional shares of common stock at an exercise price of $0.9060 per share. The fair value of these warrants was calculated using the Black Scholes Model. The total consideration for the Abiliti Acquisition amounted to $6.1 million.

Concurrently with the consummation of the Abiliti Acquisition, on December 20, 2002, pursuant to an Investment Agreement dated October 7, 2002, Daleen completed its private placement of 10,992,136 shares of common stock, 115,681 shares of Series F preferred stock, warrants to purchase 5,666,069 additional shares of common stock at an exercise price of $0.9060 per share, and warrants to purchase 500,000 additional shares of common stock at an exercise price of $0.17 per share, for total proceeds of $5.015 million in cash (the 2002 Private Placement). The purchasers in the 2002 Private Placement were Behrman Capital II L.P. and Strategic Entrepreneur Fund II, L.P., which are related entities and stakeholders of Abiliti. The proceeds of the 2002 Private Placement are being used for working capital and general corporate purposes.

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The Abiliti Acquisition was accounted for as a purchase transaction and accordingly, the acquisition price was allocated to the acquired assets and assumed liabilities based on their estimated fair value as of the acquisition date. The excess of the consideration paid over the estimated fair value of net assets and purchase in-process research and development acquired was recorded as goodwill. The preliminary purchase price was allocated as follows (in thousands):

Purchase in-process research and development	$ 104
Net assets	$ 921
Goodwill	$5,086
	$6,111

The following unaudited proforma results of operations of the Company for the six months ended June 30, 2002 assumes the Abiliti Acquisition occurred as of January 1, 2002. The proforma results have been prepared for comparative purposes only and do not purport to indicate the results of operations that would have actually occurred had the combinations been in effect on the dates indicated, or which may occur in the future. The unaudited proforma results of operations are as follows (in thousands):

	Three Months Ended June 30, 2002	Six Months Ended June 30, 2002
Total Revenue	$ 5,116	$ 9,813
Net loss applicable to common stockholders	$ (2,299)	$ (5,353)
Net loss applicable to common stockholders per share basic and diluted	$ (0.05)	$ (0.12)
Weighted average outstanding shares	44,623	45,366

The proforma revenue amount for the three months ended June 30, 2002 includes a high business concentration risk due to three customers amounting to approximately 68.5 percent of proforma revenues for such period. The proforma amount for the six months ended June 30, 2002 includes a high business concentration risk due to two customers amounting to approximately 54.3 percent of proforma revenues for such period.

(10) Business and Credit Concentrations

During the three months ended June 30, 2003, 64.4 percent of the Company s total revenue was attributed 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, 2003. During the three months ended June 30, 2002, 36.1 percent of the Company s total revenue was attributed to one customer.

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 total revenue for the six months ended June 30, 2003. During the six months ended June 30, 2002, 33.2 percent of the Company s total revenue was attributed to two customers. Sales to these customers accounted for 18.7 percent and 14.5 percent of the revenue for the six months ended June 30, 2002.

See unaudited proforma business concentration risk in Note 9.

Three customers accounted for 74.2 percent and 68.4 percent of total accounts receivable at June 30, 2003 and December 31, 2002, respectively.

(11) 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, 2003 was $35,000 and $49,000, respectively. Revenues related to SAIC for the three and six months ended June 30, 2002 was $21,000 and $66,000, respectively. SAIC owns 44 percent of the voting stock of Danet, Inc. (Danet) and 100 percent of the voting stock of Telcordia Technologies, Inc. (Telcordia) and Intesacol. Danet is a customer and a subcontractor of the Company s product. There was no revenue recognized related to Danet for the three and six months ended June 30, 2003 and 2002. In the three and six months ended June 30, 2003, we paid Danet $75,000 and $178,000, respectively, related to professional services. There were no payments made to Danet for the three and six months ended June 30, 2002. The Company has a strategic alliance relationship and an Original Equipment Manufacturer Agreement with Telcordia. Revenue related to Telcordia for the three and six months ended June 30, 2003, was $0 and $4,000, respectively. Revenue related to Telcordia for the three and six months ended June 30, 2002 was $143,000 and $608,000, 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, 2003 the Company did not make any payments to Intesacol for professional services.

(12) 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 in 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.

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In June 2003, the Company approved the terms of a proposed settlement involving the plaintiffs, the insurance companies and numerous issuers, including the Company and the individual defendants, that includes a waiver by the insurance companies of any retention amounts under the policies. Court approval of the settlement will be required. Under the terms of the proposed settlement, there would be no liability to be recorded by the Company other than legal fees incurred in the initial defense of the action, which are immaterial. There is no assurance that a settlement with the plaintiffs 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 a loss cannot be determined because the lawsuit is in its initial stages.

General litigation

The Company is involved in a number of 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.

(13) Capital and Operating Leases

The Company has previously entered into agreements to lease office facilities and certain equipment in Boca Raton, Florida; Atlanta, Georgia; Chesterfield, Missouri; and Toronto, Ontario, Canada. These operating leases expire on various dates through August 2004. The facilities in Atlanta and Toronto are currently being sublet.

Property, plant and equipment includes certain computer hardware and furniture and equipment that are under capital leases which expire on various dates through August 2004. The gross amount of the leased equipment and related accumulated amortization recorded under capital leases are as follows (in thousands):

Furniture and Equipment	$ 1,515
Less accumulated amortization	(1,446)
	$ 69

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, 2003 are as follows (in thousands):

Year Ending December 31:	Capital Leases	Operating Leases
2003	$ 58	$ 836
2004	27	718
Total minimum lease payments	85	1,554
Less amount representing interest	5	
Present value of minimum capital lease payments	$ 80	
Less current installment of obligations under capital lease payments	78	
Obligation under capital leases, excluding current installment	$ 2	

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The Company subleases some office space in Toronto and in Atlanta. The amounts of minimum operating lease payments reflected in the above table are offset by future minimum rental receipts from sub lessee of $117,000 and $132,000 in years 2003 and 2004, respectively.

(14) 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,	
	2002	2003	2002	2003
Expected life	5 years	5 years	5 years	5 years
Risk-free interest rate	4.09%	2.46%	4.09%	2.46%
Volatility	131.48%	141.14%	131.48%	141.14%
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 let 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,	
	2002	2003	2002	2003
Net loss, as reported	$(2,251)	(1,412)	$(5,054)	$(2,831)
Deduct: Additional stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(674)	(822)	(1,871)	(1,618)
Pro forma net loss	$(2,925)	(2,234)	$(6,925)	$(4,449)
Loss per share:				
Basic and diluted as reported	$ (.10)	$ (.03)	$ (.22)	$ (.06)
Basic and diluted pro forma	$ (.12)	$ (.05)	$ (.30)	$ (.10)

(15) New Accounting Pronouncements

In June 2001, the FASB Issued Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations* (SFAS No. 143). SFAS No. 143 requires a company to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets. A company also records a corresponding asset that is depreciated over the life of the asset.

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Subsequent to the initial measurement of the asset retirement obligation, the obligation will be adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The Company was required to adopt SFAS No. 143 on January 1, 2003. The Company does not have asset retirement obligations and the adoption of SFAS No. 143 did not have an impact on the Company s financial statements.

On April 30, 2002, the FASB issued Statement of Financials Accounting Standards No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections* (SFAS No. 145). Through this rescission, SFAS No. 145 eliminates the requirement that gains and losses from the extinguishment of debt be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. In addition, SFAS No. 145 requires sale-leaseback accounting treatment for certain lease modifications that have economic effects that are similar to sales-leaseback transactions. SFAS No. 145 also makes several other technical corrections to existing pronouncements that may change accounting practice. SFAS No. 145 is effective for fiscal years beginning after May 15, 2002. The adoption of SFAS No. 145 did not have an impact on the Company s consolidated financial statements.

In July 2002, the FASB issued a Statement of Financial Accounting Standards No. 146, Accounting for Exit or Dismissal Activities (SFAS No. 146). SFAS No. 146 is effective for disposal activities initiated by the Company after December 31, 2002. The Company has not initiated any exit or dismissal activities in 2003 and therefore the adoption of SFAS No. 146 did not have an impact on the Company s consolidated financial statements.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others,* (FIN No. 45) an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34. This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. The Interpretation also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation are applicable to guarantees issued or modified after December 31, 2002. The Company does not have guarantees falling under the requirements of FIN No. 45 and as a result the adoption of this interpretation did not have an effect on the Company s consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock Based Compensation Transition and Disclosure, an amendment of SFAS No. 123.* This Statement amends SFAS No. 123, to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock based employee compensation. In addition, this Statement amends the disclosures in both annual and interim financial statements. The Company is currently using the provisions of APB No. 25 and has included the disclosure modifications in Note 14.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (SFAS No. 150). SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 applies specifically to a number of financial instruments that companies have historically presented within their financial statements either as equity or between the liabilities section and the equity section, rather than as liabilities. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have an impact on the Company s consolidated financial statements.

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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, 2002.

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 w 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 and 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, 2002 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

Daleen Technologies, Inc. (Daleen or the Company) is a global provider of advanced billing, customer care, event management, and revenue assurance outsourcing services and software for traditional and next generation communication service providers and other technology solutions providers. Our solutions leverage the latest open Internet technologies to enable providers to enhance their operational efficiency while driving maximum revenue from their products and services. Our RevChain® billing and customer management and Asuriti event management and revenue assurance products deliver proven interoperability with other legacy billing systems and other downstream operational support systems (OSS) applications, and have a high degree of flexibility and scalability, making the software highly adaptable and ready for the future. RevChain and Asuriti can be purchased as part of a turn-key solution through BillingCentral® or as licensed software applications.

The Company acquired the assets and assumed certain liabilities of Abiliti Solutions, Inc. (the Abiliti Acquisition) in December 2002. The BillingCentral operation was acquired in the Abiliti Acquisition. BillingCentral is a carrier-class operation staffed by billing and telecommunications experts with an intimate knowledge of our applications that has the capacity to provide multiple levels of comprehensive outsourcing services to customers of all sizes. The BillingCentral operation added a significant revenue stream in the six months ended June 30, 2003 and is expected to continue to be a significant part of our revenue in future periods. These outsourced billing, event management and revenue assurance services are billed and revenue is recognized on a monthly basis as services are rendered, which provides more stability and greater visibility into future performance. Together with our licensed software applications which derive revenues primarily from licensed software sales and complementary services, the revenue from our BillingCentral operation results in a more balanced business model that supports our goals of becoming cash flow positive and reaching sustainable profitability.

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. Actual results may differ from these estimates under different assumptions or conditions.

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.

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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 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. 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 of accounts receivable 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, 2002 and June 30, 2003 the goodwill balance was related to the Abiliti Acquisition.

At December 31, 2002 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, a decrease in demand for our products, a change in the competitive environment and other economic factors.

Results of Operations

The accounts and operations for the three and six months ended June 30, 2002 included PartnerCommunity, Inc. (PartnerCommunity). We sold this subsidiary on June 24, 2002 and therefore the results of operations for the three months and six months ended June 30, 2003 do not include any results from PartnerCommunity.

The Abiliti Acquisition has created an increased revenue stream and 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 which was significant to our operations for the three months and six months ended June 30, 2003.

As a result of the Abiliti Acquisition and the savings we have realized as a result of our cost reduction plans in 2001 and 2002, we have reduced our cost structure throughout the Company. We have reduced our costs and use of cash over the past six months and we continue to focus on achieving growth through sales to our existing customers as well as maintaining a direct sales force and alliance partners.

As a result of the Abiliti Acquisition, the Company formed a wholly owned subsidiary DSI, Inc., and a wholly owned subsidiary of DSI, Inc., Daleen Solutions, Inc. (Daleen Solutions). For the three months and six months ended June 30, 2003, the results of operations include the operating results of Daleen Solutions. The results of operations for the three and six months ended June 30, 2002 do not include any results of Daleen Solutions.

Three Months Ended June 30, 2003 Compared to Three Months Ended June 30, 2002

Total Revenue. Total revenue, which includes professional services and other revenue and license revenue, increased $2.2 million, or 106.3% to $4.2 million in the three months ended June 30, 2003, from $2.0 million for the same period in 2002. The primary reason for the increase in revenue is related to the outsourcing services revenue stream related to the Abiliti Acquisition.

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 increased $2.7 million, or 208.7%, to $4.0 million in the three months ended June 30, 2003 from $1.3 million for the same period in 2002. The increase was primarily related to revenue earned by our outsourcing services. Professional services and other revenue increased to 94.5% of total revenue in the three months ended June 30, 2003, compared to 63.2% in the same period in 2002. The increase in the percentage of total revenue is due to a reduction in license revenue in the three months ended June 30, 2003.

License Fees. Our license fees are derived from licensing our software products. License fees decreased $522,000, or 69.3%, in the three months ended June 30, 2003 to $231,000, from $753,000 for the same period in 2002. In the three months ended June 30, 2002, one customer exceeded contractually specified billed revenues resulting in additional license fees of $700,000. In the three months ended June 30, 2003 we recognized additional license fees from an existing customer related to the licensing of our Asuriti product and an additional license fee from an existing customer exceeding contractually billed revenue levels in the amount of $90,000. License fees constituted 5.5% of total revenue in the three months ended June 30, 2003, compared to 36.8% in the same period

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in 2002. The decrease in license fees as a percentage of total revenue is due to the increase in professional services and other revenue in the three months ended June 30, 2003.

Cost of Revenue. Cost of revenue increased $603,000, or 89.9%, to $1.3 million in the three months ended June 30, 2003 from $671,000 in the same period in 2002. 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 revenue, the increase in labor costs for the three months ended June 30, 2003 related to the Abiliti Acquisition and the recording of $145,000 related to a stamp tax that was incurred upon execution of a license and services agreement in Bogotá Columbia. The total cost of revenue as a percentage of total revenue decreased to 30.2% in the three months ended June 30, 2003 from 32.8% in the same period in 2002. The decrease as a percentage of total revenue is due to an increase in total revenue in the three months ended June 30, 2003.

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 $501,000, or 82.3%, to $1.1 million, in the three months ended June 30, 2003 from $608,000 in the same period in 2002 mainly due to the increase in labor costs in the three months ended June 30, 2003 related to the Abiliti Acquisition and due to the increase in professional services and other revenue. This increase was offset by the cost reduction measures taken in May 2002. Cost of professional services and other decreased to 27.8% of professional services and other revenue in the three months ended June 30, 2003, compared to 47.1% for the same period in 2002. The decrease as a percentage of professional services and other revenue is due to the increase in professional services and other revenue in the three months ended June 30, 2003.

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 third-party software license payments. Cost of license fees increased $102,000, or 164.0%, to $165,000 in the three months ended June 30, 2003 from $63,000 in the same period in 2002. The total costs increased primarily due to $145,000 of stamp tax that was due upon execution of a license and services agreement in Bogotá, Colombia. Cost of license fees as a percentage of license revenue increased to 71.5% in the three months ended June 30, 2003, compared to 8.3% in the same period in 2002. This increase was due to the stamp tax being recorded which was incurred upon execution of a license and services in Bogotá, Columbia.

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 $252,000, or 23.3%, to $831,000 in the three months ended June 30, 2003, compared to $1.1 million in the same period in 2002. These costs decreased as a result of our cost reduction measures taken in May 2002 and a corresponding decrease in our travel and entertainment and trade show costs. In addition, the decrease is a result of the reduction in sales and marketing activities due to the sale of PartnerCommunity in June 2002. As a percentage of total revenue, these expenses decreased to 19.7% in the three months ended June 30, 2003 compared to the 53.0%, for same period in 2002.

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 increased $548,000, or 52.1%, to $1.6 million for the three months ended June 30, 2003, from $1.1 million in the same period in 2002. The increase was primarily due to the increase in labor costs associated with the Abiliti

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Acquisition. As a percentage of revenue, these expenses decreased to 38.0% in the three months ended June 30, 2003 compared to 51.6% in the same period in 2002. The decrease as a percentage of total revenue is due to the increase in total revenue in the three months ended June 30, 2003.

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 $267,000, or 21.4%, to $1.5 million in the three months ended June 30, 2003, from $1.3 million in the same period in 2002. This increase was primarily due to the increase in labor costs associated with the Abiliti Acquisition and in 2003 we began to pay compensation to our board of directors which amounted to $48,000 for the three months ended June 30, 2003. These increases were offset by the decrease in labor costs and facility costs associated with the sale of PartnerCommunity and our cost reduction measures taken in May 2002. In addition, there was a decrease in our provision for bad debts from $201,000 in the three months ended June 30, 2002 compared to a net recovery of $16,200 in the three months ended June 30, 2003 due to receiving a payment for pre-petition claims which were fully reserved from a customer who declared bankruptcy in 2000. In addition, the provision for bad debt in the three months ended June 30, 2002 was due to the uncertainty of collections of some of our outstanding receivables from certain customers at June 30, 2002 which were reserved during that period. As a percentage of total revenue, these expenses decreased to 36.0% in the three months ended June 30, 2003 as compared to 61.2% in the same period in 2002. The decrease as a percentage of total revenue is due to the increase in total revenue in the three months ended June 30, 2003.

Impairment of Long Lived Assets. Impairment charges increased $500,000 or 100%, to $500,000 in the three months ended June 30, 2003 from $0 for the same period in 2002. 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.

Restructuring Charges. Restructuring charges decreased $745,000 or 100% to $0 in the three months ended June 30, 2003 from $745,000 for the same period in 2002. Restructuring charges in the three months ended June 30, 2002 was a result of the cost reduction measures taken in May 2002. There were no cost reductions taken in the three months ended June 30, 2003.

Other Income. Other income decreased $410,000, or 80.6%, to $99,000 in the three months ended June 30, 2003, from $509,000 for the same period in 2002. This was primarily attributable to the gain recorded of $391,000 related to the sale of PartnerCommunity on June 20, 2002. In addition, the decrease was a result of the decrease in our cash balance and a decrease in interest rates in 2003.

Six Months Ended June 30, 2003 Compared To Six Months Ended June 30, 2002

Total Revenue. Total revenue, which includes professional services and other revenue and license revenue, increased $4.3 million, or 110.0%, to $8.3 million in the six months ended June 30, 2003 from $3.9 million for the same period in 2002. The primary reason for the increase in revenue is related to the outsourcing services revenue stream acquired with the Abiliti Acquisition.

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 increased $4.8 million, or 161.8%, in the six months ended June 30, 2003 to $7.8 million, compared to $3.0 million in the same period in 2002. The increase was primarily related

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to revenue earned by our outsourcing services. Professional services and other revenue constituted 94.3% of total revenue in the six months ended June 30, 2003, compared to 75.6% for the same period in 2002. The increase as a percentage of total revenue is due to a reduction in license revenue in the six months ended June 30, 2003.

License Fees. Our license fees are derived from licensing our software products. License fees decreased $488,000, or 50.7%, in the six months ended June 30, 2003 to $475,000 from $963,000 for the same period in 2002. In the six months ended June 30, 2002 the decrease was primarily due to an existing customer exceeding contractually billed revenue levels resulting in $700,000 of additional license fees. License fees constituted 5.7% of total revenue in the six months ended June 30, 2003, compared to 24.4% in the same period in 2002.

Cost of Revenue. Cost of revenue increased $921,000, or 53.8%, to $2.6 million in the six months ended June 30, 2003, from $1.7 million in the same period in 2002. 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 prepaid third-party licenses and related corporate overhead costs to provide professional services to our customers. These costs increased due to (1) the increase in total revenue, (2) the increase in labor costs related to the Abiliti Acquisition (3) the write-off of $202,000 of prepaid third-party software license costs because the contract expired and these products were no longer available to be sublicensed to customers and (4) the recording of $145,000 related to a stamp tax that was incurred upon execution of a license and services agreement in Bogotá, Colombia. The total cost of revenue as a percentage of total revenue decreased to 31.8% in the six months ended June 30, 2003, compared to 43.4% in the same period in 2002. This decrease in the cost of revenue as a percentage of total revenue resulted from the increase in total revenue in the six months ended June 30, 2003.

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 $551,000, or 34.1%, to $2.2 million in the six months ended June 30, 2003, from $1.6 million in the same period in 2002. These costs increased mainly due to the increase in labor costs related to the Abiliti Acquisition. In addition, the revenue related to professional services and other has increased. Cost of professional services and other decreased to 27.7% of professional services and other revenue in the six months ended June 30, 2003, compared to 54.1% for the same period in 2002 due to the increase 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 increased $370,000 or 378.8% to $468,000, in the six months ended June 30, 2003, from $98,000 in the same period in 2002 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 a contract we signed in June 2003 discussed above in the Cost of Revenue. Cost of license fees increased to 98.5% of license revenue in the six months ended June 30, 2003, compared to 10.2% for the same period in 2002.

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 $501,000, or 22.5%, to $1.7 million in the six months ended June 30, 2003, from $2.2 million for the same period in 2002. The decrease was a result of our cost reduction measures taken in May 2002 with a corresponding decrease in travel and entertainment costs and tradeshow costs. In addition, the decrease is a result of the reduction in sales and marketing activities due to the sale of PartnerCommunity in June 2002. As a percentage of total revenue, these expenses decreased to 20.9% in the six months ended June 30, 2003 compared to 56.6% for the same period in 2002.

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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 increased $898,000, or 37.6%, to $3.3 million in the six months ended June 30, 2003, from $2.4 million for the same period in 2002. The increase was primarily due to the increase in labor costs associated with the Abiliti Acquisition. As a percentage of revenue, these expenses decreased to 39.6% in the six months ended June 30, 2003 compared to 60.5% for the same period in 2002 mainly due to the increase in total revenue.

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 increased $546,000, or 21.1%, to $3.1 million in the six months ended June 30, 2003, from $2.6 million in the same period in 2002. The increase was primarily due to the increase in labor costs associated with the Abiliti Acquisition in addition to the payment of $107,000 in compensation to our board of directors during the six months ended June 30, 2003. The increase was offset by a decrease in our provision for bad debt. In the six months ended June 30, 2003 there was a net recovery of $11,100 due to receiving a payment for pre-petition claims which were fully reserved from a customer who declared bankruptcy in 2000 compared to a charge of $320,000 in the six months ended June 30, 2002. The charge for the six months ended June 30, 2002 was due to certain customers significantly reducing or liquidating their operations in 2002. As a percentage of revenue, general and administrative expenses decreased to 37.8% in the six months ended June 30, 2003 from 65.5% in the same period in 2002 due to the increase in total revenue.

Impairment of Long-Lived Assets. Impairment charges increased $500,000, or 100%, to $500,000 in the six months ended June 30, 2003, from $0 for the same period in 2002. 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.

Restructuring Charges. Restructuring charges decreased $745,000, or 100%, to $0 in the six months ended June 30, 2003 from $745,000 for the same period in 2002. Restructuring charges in the six months ended June 30, 2002 was a result of the cost reduction measures taken in May 2002. There were no cost reduction measures taken in the six months ended June 30, 2003.

Other Income. Other income decreased $496,000 or 75.3%, to $163,000 in the six months ended June 30, 2003 from $659,000 for the same period in 2002. This was primarily attributable to recording a gain of $391,000 associated with the sale of PartnerCommunity. In addition, the decrease in investment earnings was due to the decrease in interest rates in 2003 compared to 2002.

Liquidity And Capital Resources

Net cash used in operating activities was $1.3 million for the six months ended June 30, 2003, compared to $5.8 million for the six months ended June 30, 2002. During the second quarter of 2003, cash used in operations was approximately $1.2 million compared to $0.1 million in the first quarter of 2003. The variation was principally due to the ordinary course fluctuation in the timing of our cash receipts and disbursements that we experience from quarter to quarter. The principal use of cash for all periods was to fund our losses from operations.

Net cash used in financing activities was $110,000 for the six months ended June 30, 2003 compared to net cash used in financing activities of $28,000 for the six months ended June 30, 2002. In 2003, cash was used in financing activities related to capital lease payments. In 2002, the cash used in financing activities was for transaction costs related to the sale of Series F convertible preferred stock (Series F preferred stock) in 2001.

Net cash used in investing activities was $437,000 for the six months ended June 30, 2003, compared to $68,000 for the six months ended June 30, 2002. The cash used in investing activities for the six months ended June 30, 2003 was primarily related to payments of expenses for transaction costs related to the Abiliti Acquisition and 2002 Private Placement and capital expenditures. The cash used in investing activities for the six months ended June 30, 2002 was mainly related to capital expenditures offset by cash received from the sale of PartnerCommunity.

We had an accumulated deficit of $213.7 million at June 30, 2003 and although we continued to experience operating losses during the six months ended June 30, 2003, the losses have improved from the same period in 2002 and have remained consistent with the first quarter of 2003. Cash and cash equivalents at June 30, 2003 were $4.7 million.

We believe the cash and cash equivalents at June 30, 2003, may be sufficient to fund operations for the foreseeable future due to our 2003 anticipated revenue, including the revenue stream associated with the Abiliti Acquisition. However, the telecommunications and software industries are still faced with many challenges. In addition, there is a high business concentration risk with Allegiance Telecom, Inc. (Allegiance), our largest outsourcing service customer. If this customer were to terminate its agreement or be unable to fulfill its contractual obligations it would severely impact our operations. We provide outsourcing services to this customer pursuant to a contract expiring at the end of December 2003. Allegiance filed for relief under Chapter 11 of the U.S. Bankruptcy Code in May 2003. As a critical vendor, we were paid by Allegiance in June and July 2003 an agreed amount for all pre-petition amounts due. We continue to provide services pursuant to our contract with this customer and the customer is current on all post-petition amounts due. If this customer were to cease doing business with us for any reason, we may be required to reduce operations and/or seek additional public or private equity financing or financing from other sources or consider other strategic alternatives, including a possible merger, sale of assets, or other business combination or restructuring transactions. There can be no assurances that additional financing or strategic alternatives will be obtainable on terms acceptable to us or that any additional financing would not be substantially dilutive to existing stockholders. If this customer were to cease to do business with us and we failed to obtain additional financing or failed to engage in one or more strategic alternatives it may have a material adverse affect on our ability to continue to operate as a going concern. The condensed unaudited consolidated 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. See Risks Associated with Our Business and Operating Results below.

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. 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 as well as the risk factors described in our annual report on Form 10-K for the year ended December 31, 2002.

Risks Associated with our Business and Operations

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 69.7% of our total revenue for the six months ended June 30, 2003. If an unfavorable development occurs with respect to any significant customer, such as described below, it would likely materially adversely impact our total revenues and financial results. We provide services to our largest outsourcing service customer, Allegiance, pursuant to a contract expiring at the end of December 2003. This customer filed for relief under Chapter 11 of the U.S. Bankruptcy Code in May 2003. There can be no assurance that we will achieve anticipated revenues from this customer for the remainder of 2003, that we will be able to extend or replace the contract that expires at the end of 2003, or that we will retain any business from this customer.

In addition, we entered into a contract with Empresa De Telecomunicaciones De Bogotá (ETB) in the second quarter of 2003 and we anticipate that ETB will become a significant customer in the third quarter of 2003. ETB may terminate its contract with us at anytime for any reason. If ETB terminates 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. The first significant payment is anticipated in the fourth quarter and will continue periodically throughout 2004. There can be no assurance that we will achieve anticipated revenues or payments from ETB for 2003 or 2004.

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

We incurred net losses of approximately $2.8 million for the six months ended June 30, 2003, and we had an accumulated deficit of approximately $213.7 million as of June 30, 2003. Our cash and cash equivalents at June 30, 2003 were $4.7 million. Cash used in operations for the six months ended June 30, 2003 was $1.3 million. As a result of our business concentration risk, our past recurring losses from operations and our accumulated deficit, the independent auditors report covering our December 31, 2002 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.

We believe the cash and cash equivalents at June 30, 2003 may be sufficient to fund operations in the foreseeable future due to our 2003 anticipated revenue, including the revenue stream associated with the Abiliti Acquisition and due to cash received from customers subsequent to June 30, 2003. However, the telecommunications and software industries are still faced with many challenges. In addition, there is a high business concentration risk with Allegiance, our largest outsourcing service customer. If this customer were to terminate their agreement or be unable to fulfill its contractual obligations, it would severely impact our operations. We provide outsourcing services to our largest customer pursuant to a contract expiring at the end of December 2003. Allegiance filed for relief under Chapter 11 of the U.S. Bankruptcy Code in May 2003. As a critical vendor, we were paid by Allegiance in June and July 2003 an agreed amount for all pre-petition amounts due. We continue to provide services pursuant to our contract with this customer and the customer is current on all post-petition amounts due. If this customer were to cease doing business with us for any reason, we may be required to reduce operations and/or seek additional public or private equity financing or financing from other sources or consider other strategic alternatives, including a possible merger, sale of assets, or other business

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combination or restructuring transactions. There can be no assurances that additional financing or strategic alternatives will be obtainable on terms acceptable to us or that any additional financing would not be substantially dilutive to existing stockholders. If this customer were to cease to do business with us and we failed to obtain additional financing or failed to engage in one or more strategic alternatives it may have a material adverse effect on our ability to continue to operate as a going concern. See 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 for a discussion of the terms of the Series F preferred stock applicable in the event of a business combination, liquidation event or issuance of equity securities.

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. Moreover, 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 for at least the next several quarters.

We incurred net losses of approximately $2.8 million for the six months ended June 30, 2003. As of June 30, 2003 we had an accumulated deficit of approximately $213.7 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.

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 weakening of the U.S. economy. 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 utilize 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.

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.

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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.

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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 delisting of our common stock from The Nasdaq SmallCap Market may make trading more difficult and result in further declines in the share price.

In December 2002, our common stock was delisted from The Nasdaq SmallCap Market and subsequent to this event, our common stock has been quoted on the Over the Counter Bulletin Board (OTCBB) service. The OTCBB is generally considered less desirable and liquid than the market for securities quoted on The Nasdaq SmallCap Market. This could make trading shares of our common stock more difficult for investors, leading to increased volatility and potentially further declines in the trading price of our common stock. It may also make it more difficult for us to raise additional capital, and we may incur additional costs under state blue sky securities laws if we choose to issue additional equity securities.

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.

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We are the target of a securities class action lawsuit 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 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. While we are not aware of any other complaints being filed against us, and we do not know of any facts and circumstances that could give rise to such an action, any securities litigation may result in substantial costs and divert management s attention and resources, which may seriously harm our business.

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.

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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 $50.8 million based on the number of shares of Series F preferred stock outstanding at July 31, 2003.

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 $50.8 million of the transaction value based on the Series F preferred stock outstanding July 31, 2003.

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 July 31, 2003, the voting power of the holders of the currently outstanding shares of Series F preferred stock constitutes approximately 50.0% 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 approximately 55.31% 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 82.8% of the vote on any proposal submitted to the holders of our common stock, or approximately 86.19% 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, the Behrman Funds, HarbourVest Partners V Direct Fund L.P. and HarbourVest VI Direct Fund L.P. (collectively HarbourVest) and SAIC Venture Capital Corporation control approximately 48.0%, 14.0% and 9.83%, respectively, or in the aggregate, approximately 71.83% 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 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.

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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 56.1 million shares of common stock assuming the conversion of all of the shares of Series F preferred stock outstanding as of July 31, 2003.

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.

(a) Evaluation of Disclosure Controls and Procedures.

Our management, under the supervision and with the participation of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), 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 and CFO concluded that our disclosure controls and procedures were effective as of the end of such period.

(b) Changes in Internal Control Over Financial Reporting

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

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 in 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 our IPO, the defendants failed to disclose excessive commissions purportedly solicited by and paid to the underwriter defendants in exchange for allocating shares of our 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 our 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 us to further inflate our 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 our prospectus included in our 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 2003, we 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. Court approval of the settlement will be required. Under the terms of the proposed settlement, there would be no liability to be recorded by us other than legal fees incurred in the initial defense of the action, which are immaterial. There is no assurance that a settlement with the plaintiffs 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 us. 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 a loss cannot be determined because the lawsuit is in its initial stages.

General Litigation

We are involved in a number of other lawsuits and claims incidental to our ordinary course of business. We do not believe the outcome of any of this litigation would have a material adverse impact on our financial position or our results of operations.

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

We held our 2003 Annual Meeting of Stockholders on June 10, 2003 (the Annual Meeting). At the Annual Meeting the stockholders of the Company voted on and approved the following proposal:

Proposal One: To approve the election of Dennis Sisco, John S. McCarthy and Ofer Nemirovsky as directors to serve for a term expiring at the 2006 Annual Meeting of Stockholders.

The following list indicates the number of votes received by each nominee for election to our Board of Directors:

	For	Withheld	Result
Dennis Sisco	83,522,060	93,338	Approved
John S. McCarthy	83,546,905	68,493	Approved
Ofer Nemirovsky	83,538,723	76,675	Approved

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

(a) Exhibit List

Exhibit Number	Description
10.1	Lease dated September 16, 1999 between Olympia Properties, L.L.C. and Intertech Management Group, Inc. (subsequently assigned to Daleen Solutions, Inc.) and Assignment of Lease filed herewith.
10.2	Amendment No. 1 to Registration Rights Agreement dated March 30, 2001, dated as of June 3, 2003, 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, items 7 and item 12 furnished under item 9, furnished April 29, 2003 with respect to Daleen s first quarter 2003 financial operating results.

Report on Form 8-K, items 5 and 7, filed May 21, 2003 with respect to the filing by Allegiance Telecom, Inc. and its affiliates for relief under Chapter 11 of the U.S. Bankruptcy Code.

Report on Form 8-K, items 5 and 7, filed June 4, 2003 with respect to an update of the status of a payment by Allegiance Telecom, Inc.

Report on Form 8-K, items 5 and 7, filed June 10, 2003 with respect to the Company s 2003 Annual Meeting of Stockholders.

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Report on Form 8-K, item 5, filed June 23, 2003 with respect to an update of the status of a payment by Allegiance Telecom, Inc.

Report on Form 8-K, items 5 and 7, filed June 23, 2003 with respect to entering into a contract with Empresa de Telecomunicaciones de Bogotá.

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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
	/s/ GORDON QUICK
Date: August 14, 2003	GORDON QUICK President and Chief Executive Officer (Principal Executive Officer)
Date: August 14, 2003	/s/ JEANNE PRAYTHER
	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)

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