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DALEEN TECHNOLOGIES INC  
Form 10-Q  
August 12, 2002

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SECURITIES AND EXCHANGE COMMISSION  
Washington, D.c. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2002

OR

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

For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 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  No

As of August 5, 2002, there were 23,532,081 shares of registrant's common stock, \$0.01 par value, outstanding.

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DALEEN TECHNOLOGIES, INC. AND SUBSIDIARIES  
FORM 10-Q

QUARTER ENDED JUNE 30, 2002

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PART I

FINANCIAL INFORMATION

- Item 1. Condensed Unaudited Consolidated Financial Statements.

DALEEN TECHNOLOGIES, INC. AND SUBSIDIARIES

Condensed Unaudited Consolidated Balance Sheets  
(In thousands, except share and per share data)

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December 31,  
2001  
-----

ASSETS

Current assets:

Cash and cash equivalents	\$ 13,093
Restricted cash	30
Accounts receivable, less allowance for doubtful accounts of \$3,789 at December 31, 2001 and \$3,388 at June 30, 2002	2,397
Unbilled revenue	488
Other current assets	436
	-----
Total current assets	16,444
Notes receivable, less reserve of \$1,188 at December 31, 2001 and \$1,519 at June 30, 2002	659
Property and equipment, net	2,704
Other assets	1,386
	-----
Total assets	\$ 21,193 =====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:

Accounts payable	\$ 678
Accrued payroll and other accrued expenses	3,733
Billings in excess of costs	1,323
Deferred revenue	1,013
	-----
Total current liabilities	6,747
Minority interest	184
Stockholders' equity:	
Series F Convertible Preferred Stock, \$.01 par value; 356,950 shares authorized; 247,882 and 234,362 issued and outstanding at December 31, 2001 and June 30, 2002 respectively, (\$110.94 per share liquidation value)	25,564
Common stock, \$.01 par value; 70,000,000 shares authorized; 21,876,554 shares issued and outstanding at December 31, 2001 and 23,532,081 shares issued and outstanding at June 30, 2002	219
Stockholders' notes receivable	(241)
Deferred stock compensation	(88)
Additional paid-in capital	190,065
Accumulated deficit	(201,257)
	-----
Total stockholders' equity	14,262
	-----
Total liabilities and stockholders' equity	\$ 21,193 =====

SEE ACCOMPANYING NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS.

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(In thousands, except per share data)

	Three months ended June 30,	
	2001	2002
Revenue:		
License fees	\$ 1,063	753
Professional services and other	2,351	1,290
	3,414	2,043
Total revenue		
Cost of revenue:		
License fees	321	63
Professional services and other	1,608	608
	1,929	671
Total cost of revenue		
Gross margin	1,485	1,372
Operating expenses:		
Sales and marketing	2,632	1,083
Research and development	3,179	1,054
General and administrative	5,639	1,250
Amortization of goodwill and other intangibles	3,642	--
Impairment of long lived assets	--	--
Restructuring charges	4,771	745
	19,863	4,132
Total operating expenses		
Operating loss	(18,378)	(2,760)
Other Income:		
Interest income and nonoperating income, net	373	118
Gain on sale of subsidiary	--	391
	373	509
Total other income, net		
Net loss	(18,005)	(2,251)
Less: preferred stock dividends arising from beneficial conversion feature	(26,065)	--
	\$ (44,070)	(2,251)
Net loss applicable to common stockholders		
Net loss applicable to common stockholders per share - basic and diluted	\$ (2.02)	(0.10)

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Weighted average shares outstanding- basic and diluted	21,812 =====	23,532 =====
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SEE ACCOMPANYING NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS.

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DALEEN TECHNOLOGIES, INC. AND SUBSIDIARIES  
Condensed Unaudited Consolidated Statements of Cash Flows  
(In thousands)

	Six M ----- June 30, 2001 -----
Cash flows from operating activities:	
Net loss	\$ (40,314)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	2,135
Amortization of deferred stock compensation	1,611
Amortization of goodwill and other intangibles	8,579
Loss on disposal of fixed assets	1,994
Impairment of long lived assets and other assets	4,307
Bad debt expense	1,350
Interest income on stockholders' notes receivable	(81)
Non-cash stock settlement expense	495
Gain on sale of subsidiary	--
Changes in assets and liabilities:	
Restricted cash	131
Accounts receivable	3,938
Costs in excess of billings	1,786
Unbilled revenue	715
Other current assets	201
Other assets	(156)
Accounts payable	(1,098)
Accrued payroll and other accrued expenses	(3,695)
Billings in excess of costs	(291)
Deferred revenue	(754)
Other current liabilities	(895)
	-----
Net cash used in operating activities	(20,042)
	-----
Cash flows provided by (used in) financing activities:	
Proceeds from sale of Series F preferred stock and warrants, net	25,700
Payment of capital lease	(300)
Proceeds from exercise of stock options and bridge warrants	11
Payment of deferred offering costs	--
	-----

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Net cash provided by (used in) financing activities	25,411 -----
Cash flows used in investing activities:	
Issuance of stockholder's notes receivable	(1,241)
Proceeds from sale of fixed assets	--
Net proceeds from sale of subsidiary	--
Repayment of stockholder's notes receivable	87
Capital expenditures	(696) -----
Net cash used in investing activities	(1,850) -----
Effect of exchange rates on cash and cash equivalents	(66)
Net increase (decrease) in cash and cash equivalents	3,453
Cash and cash equivalents-beginning of period	22,268 -----
Cash and cash equivalents-end of period	\$ 25,721 =====

SEE ACCOMPANYING NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS.

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Daleen Technologies, Inc. and Subsidiaries  
Notes to Condensed Unaudited Consolidated Financial Statements  
June 30, 2002

(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, 2001 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, 2001, included in the Company's annual report on Form 10-K as of and for the year ended December 31, 2001 filed with the Securities and Exchange Commission ("SEC") on April 1, 2002.

The results of operations for the three or six months ended June 30, 2002 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 of Daleen Technologies, Inc. and its subsidiaries, which include the accounts of

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PartnerCommunity, Inc. through June 24, 2002. On June 24, 2002, the Company sold this subsidiary (see note 14). All significant intercompany balances and transactions have been eliminated in consolidation.

### (3) BASIC AND DILUTED NET LOSS PER SHARE

Basic and diluted net loss per share was computed by dividing net loss applicable to common stockholders by the weighted average number of shares of common stock outstanding for each period presented. Common stock equivalents were not considered since their effect would be antidilutive. Common stock equivalents amount to 28,697,699 shares and 28,717,699 shares for the three months and six months ended June 30, 2002, respectively. Common stock equivalents amounted to 29,924,932 shares and 30,264,172 shares for the three months and six months ended June 30, 2001.

Net loss applicable to common stockholders differs from net loss in the three and six months ended June 30, 2001 due to the preferred stock dividends arising from the beneficial conversion features from the sale ("Private Placement") in June 2001 of the Series F convertible preferred stock ("Series F preferred stock") and warrants to purchase additional shares of Series F preferred stock ("Warrants").

### (4) LIQUIDITY

The Company continued to experience operating losses for the six months ended June 30, 2002 and has an accumulated deficit of \$206.3 million at June 30, 2002. Cash and cash equivalents at June 30, 2002 was \$7.2 million. Cash used in operations for the six months ended June 30, 2002 was \$5.8 million which was principally used to fund the operating losses.

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The Company continues to manage its use of cash and believes that the cash and cash equivalents at June 30, 2002, together with the reduction of costs related to the restructuring activities that took place in 2001 and 2002, may be sufficient to fund the Company's operations through December 31, 2002. The Company may be required to further reduce operations and/or seek additional public or private equity financing or financing from other sources. The Company is also considering other options, which may include, but are not limited to, forming strategic partnerships or alliances and/or considering other strategic alternatives, including a possible merger, sale of assets or other business combinations. There can be no assurance that additional financing will be available, or that, if available, the financing will be obtainable on terms acceptable to the Company or that any additional financing would not be substantially dilutive to the Company's existing stockholders. There can be no assurance that any other strategic alternatives will be available, or if available, will be on terms acceptable to the Company, or all of its stockholders. Failure to obtain additional financing or to engage in one or more strategic alternatives may have a material adverse effect on the Company's ability to operate as a going concern which may result in filing for bankruptcy protection, winding down operations and/or liquidation of assets. The condensed unaudited financial statements have been prepared assuming that the Company will continue as a going concern, and do not include any adjustments that might result from the outcome of this uncertainty.

### (5) REVENUE RECOGNITION

The Company recognizes revenue under Statement of Position 98-9, MODIFICATION OF SOP 97-2, SOFTWARE REVENUE RECOGNITION, WITH RESPECT TO CERTAIN

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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 arrangements with its customers:

- o Software license
- o Maintenance and support
- o Professional services
- o Third-party software licenses and maintenance
- o 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.

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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:

- o 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 that maintenance is renewed at each year and is dependent on the amount of the license fee as well as the type of maintenance the customer chooses.
- o 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. There are two types of service contracts that are entered into with customers: fixed fee and time and materials.



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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 consolidated balance sheets.

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

- o 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.
- o 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% 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 licensing fee is not due until after expiration of the license or due after the normal and customary terms to customers. 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 assess 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.

In December 1999, the SEC issued Staff Accounting Bulletin No. 101, "REVENUE RECOGNITION IN FINANCIAL STATEMENTS" ("SAB No. 101"). SAB No. 101 summarizes certain of the SEC's views in applying accounting principles generally accepted in the United States to revenue recognition in financial statements. The Company recognizes revenue in accordance with SAB No. 101.

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### (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 which were announced on January 5, 2001 (the "January Restructuring"), April 10, 2001 (the "April Restructuring"), and October 17, 2001 (the "October Restructuring"). Management started to implement these actions immediately following the announcements. The Company recorded a \$3.0 million restructuring charge for the six months ended June 30, 2001 related to the January Restructuring. The Company recorded a \$4.8 million restructuring charge for the three months and six months ended June 30, 2001 related to the April Restructuring. Such charges included the estimated costs related to workforce reductions, closing and downsizing of facilities, asset writedowns and other costs.

In May 2002, management initiated another business review continuing to identify additional areas for cost reduction. As a result, the Company's Board of Directors formally approved a plan to further reduce operating expenses on May 13, 2002 (the "2002 Restructuring"). On May 14, 2002 the Company announced and immediately began to implement the 2002 Restructuring. The Company recorded a \$745,000 restructuring charge for the three and six months ended June 30, 2002 related to the 2002 Restructuring in accrued restructuring. Such charge included the estimated costs related to workforce reductions, due to the termination of 35 employees from substantially all of the Company's employee groups.

The costs were from the following financial statement captions (in thousands):

Cost of sales - professional services	\$	140
Research and development		168
Sales and marketing		148
General and administrative		289
		-----
	\$	745
		=====

At December 31, 2001, an accrual remained on the condensed unaudited consolidated balance sheet related to the January Restructuring, April Restructuring and October Restructuring in the amount of \$652,000. During the six months ended June 30, 2002, the Company recorded \$745,000 against the accrual related to the 2002 Restructuring.

Amounts charged against the restructuring accrual for the six months ended June 30, 2002 were as follows (in thousands):

	January Restructuring -----	April Restructuring -----	October Restructuring -----
Employee termination benefits	\$ 19	\$ 45	\$210
Facility costs/rent on idle facilities	21	32	22
Asset writedowns	--	--	109
Other costs	--	--	2
	----	----	----
	\$ 40	\$ 77	\$343
	=====	=====	=====

As of June 30, 2002, an accrual remains on the condensed unaudited consolidated balance sheets in accrued payroll and other accrued expenses related to the January Restructuring, April Restructuring, October Restructuring and 2002 Restructuring consisting of the following components (in thousands):

	January Restructuring -----	April Restructuring -----	October Restructuring -----
Employee termination benefits	\$ 1	\$ 23	\$ 70
Facility costs/rent on idle facilities	82	--	--
Asset writedowns	--	--	--
Other costs	2	10	4
	----	----	----
	\$ 85	\$ 33	\$ 74
	====	====	====

(7) IMPAIRMENT CHARGES

The Company recorded an impairment charge of approximately \$3.3 million in the six months ended June 30, 2001 related to the following (in thousands):

Employee workforce - other intangible asset	\$ 1,565
Property and equipment	1,742
	-----
	\$ 3,307
	=====

Due to the various restructuring activities initiated by the Company, an evaluation of the recoverability of the employee workforce under Statement of Financial Accounting Standards ("SFAS") No. 121, "ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF" was performed. Management of the Company determined that the asset was impaired.

As of March 31, 2001, the Company determined that certain property, leasehold improvements and equipment, which mainly represented computer equipment and furniture from the Toronto and Atlanta facilities, which were closed, was impaired. The Company recorded an impairment charge during the six months ended June 30, 2001 for the difference between the fair value and the carrying value of the assets.

(8) GOODWILL

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In January 2002, the Company adopted Statement No. 141, "BUSINESS COMBINATIONS" and Statement No. 142, "GOODWILL AND OTHER INTANGIBLE ASSETS" ("SFAS No. 142"). SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 as well as all purchase method business combinations completed after June 30, 2001. SFAS No. 141 also specifies criteria for intangible assets acquired in a purchase method combination which must be met to be recognized and reported apart from goodwill, noting that any purchase price allocable to an assembled workforce may not be accounted for separately. SFAS No. 142 requires goodwill to no longer be amortized but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires the Company to

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evaluate goodwill whenever events and changes in circumstances suggest that the carrying amount may be recoverable from its estimated future cash flows.

Due to economic conditions and the Company's past revenue performance, the Company assessed the recoverability of goodwill and other intangibles in 2001 by determining whether the amortization of the goodwill and other intangibles over the remaining life could be recovered through undiscounted future operating cash flows over the remaining amortization period. The Company's carrying value of goodwill and other intangibles was reduced by the estimated short fall of cash flows, discounted at a rate commensurate with the associated risks. The carrying value was written off at December 31, 2001. As a result, as of the date of adoption of SFAS No. 141 and SFAS No. 142, there was no impact to the Company's financial statements.

### (9) BUSINESS AND CREDIT CONCENTRATIONS

During the three months ended June 30, 2002 and 2001, 36.1 percent and 19.1 percent, respectively, of the Company's total revenue was attributed to one customer.

For the six months ended June 30, 2002, 33.2 percent of the Company's total revenue was attributed to two customers. Sales to one of the two customers accounted for 18.7 percent and sales to the other accounted for 14.5 percent of total revenue for the six-month period. For the six months ended June 30, 2001, 29.7 percent of total revenue was attributed to two customers. Sales to one of these two customers accounted for 18.2 percent and sales to the other accounted for 11.5 percent of the Company's total revenue for the six-month period.

One customer accounted for 27.9% of total accounts receivable at June 30, 2002. One customer accounted for 38.0% of total gross accounts receivable at December 31, 2001.

### (10) RELATED PARTY TRANSACTIONS

A former member of the Company's board of directors, who resigned effective March 31, 2002, is a corporate executive vice president of Science Applications International Corporation ("SAIC"). 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, 2002 was \$20,600 and \$65,600, respectively. Revenue related to SAIC for the three and six months ended June 30, 2001 was \$27,523 and \$36,293 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"). Danet is a customer and a distributor of the Company's product. Revenue related to Danet for the six

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months ended June 30, 2001 and 2002 was \$7,129 and \$279, respectively. The Company has a strategic alliance relationship and an OEM Agreement and Services Agreement with Telcordia. Revenue related to Telcordia for the three and six months ended June 30, 2002 was \$142,519 and \$608,289, respectively. There were no sales to Telcordia for the three and six months ended June 30, 2001.

In January 2001, the Company loaned \$1,237,823 to its Chairman, President and Chief Executive Officer and his limited partnership (collectively "the Makers"). The loan bears interest at a rate of 8.75% per annum. The principal is payable in full January 31, 2006; interest is payable annually on January 31. The loan is secured by 901,941 shares of the Company's common stock, and is non-recourse to the Makers except to the extent of 901,941 shares of the Company's common stock held as the collateral. On January 31, 2002, an interest payment of \$119,871 was due and payable. That interest payment has not been made. As a result of non-payment of this interest, this note is in default. Pursuant to the terms of the loan, the Company may, at its option, give notice of default due to the nonpayment of interest. In that event, the principal and interest on the loan would become due and payable. As a result of the loan being non-recourse, the Company's remedy at that time would be to take possession of the Company's common stock held as collateral for the loan. At such time, the loan would be deemed satisfied.

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As a result of the loan being non-recourse, the Company recorded an allowance for the difference between the face value of the loan plus accrued interest and the fair market value of the underlying collateral. At June 30, 2002, the allowance was approximately \$1,242,000.

### (11) SERIES F PREFERRED STOCK

In March 2002, the holders of 13,520 shares of Series F preferred stock converted their shares into common stock resulting in the issuance of 1,655,528 shares of common stock and a reduction in the number of outstanding shares of Series F preferred stock to 234,362 shares.

### (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., BANCOSTON ROBERTSON STEPHENS INC., HAMBRECHT & QUIST LLC, SALOMON SMITH BARNEY INC., JAMES DALEEN, DAVID B. COREY AND RICHARD A. SCHELL, Index Number 01 CV 10944. The defendants include the Company, certain of the underwriters in the Company's initial public offering ("IPO") and certain current and former officers and directors of the Company. 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. In the past year, more than 300 similar class action lawsuits have been filed in the Southern District of New York. These actions have been consolidated for pretrial purposes before one judge under the caption "In re Initial Public Offering Securities Litigation" in federal district court for the Southern District of New York.

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Specifically, the plaintiffs allege in the complaint that, in connection with the Company's 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 Company's 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 Company's prospectus included in its registration statement on Form S-1 filed with the SEC in September 1999 materially false and misleading. Plaintiffs seek unspecified damages and other relief. The Company intends to defend vigorously against the plaintiffs' claims. Currently a loss cannot be determined because the lawsuit is in its initial stages. The Company believes that it is entitled to indemnification by the underwriters under the terms of the underwriting agreements although no assurances can be given that such indemnification will be available. The Company has notified the underwriters of the action, but the underwriters have not yet agreed to indemnify the Company. The Company is currently in mediation with the plaintiffs in an attempt to facilitate a resolution of this matter against the issuer defendants. A Motion to Dismiss was filed by the issuers and individual defendants on July 15, 2002. The plaintiffs have initiated discussions related to a possible stipulated dismissal of certain of the individual defendants.

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### GENERAL LITIGATION

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

### (13) NEW ACCOUNTING PRONOUNCEMENTS

In July 2001, Financial Accounting Standards Board ("FASB"), issued Statement of Financial Accounting Standards No. 143, "ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS" ("SFAS No. 143"). That statement requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity will capitalize a cost by increasing the carrying amount of the related long-lived asset. Over-time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. The standard is effective for the fiscal years beginning after June 15, 2002, with earlier adoption permitted. The Company believes the adoption of the SFAS No. 143 will not have a significant impact on the Company's financial position and results of operations.

In August 2001, FASB issued Statement of Financial Accounting Standards No. 144, "ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG LIVED ASSETS" ("SFAS No. 144"). This statement is effective for fiscal years beginning after December 15, 2001. This statement supercedes SFAS No. 121, while retaining many of the

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requirements of such statement. Under SFAS No. 144 assets held for sale will be included in discontinued operations if the operations and cash flows will be or have been eliminated from the ongoing operations of the entity and the entity will not have any significant continuing involvement in the operations of the Company. The Company adopted SFAS No. 144 as of January 1, 2002. The adoption had no impact to the Company's financial statements.

On April 30 2002, the FASB issued FASB Statement of Financial Accounting Standards No. 145 (" SFAS No. 145"), "RESCISSION OF FASB STATEMENTS NO. 4, 44, AND 64, AMENDMENT TO FASB STATEMENT NO. 13, AND TECHNICAL CORRECTIONS". Through this rescission, SFAS No. 145 eliminates the requirement (in both SFAS No. 4 and SFAS No. 64) 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 transactions and certain lease modifications that have economic effects that are similar to sale-leaseback treatment for certain modifications of a capital lease that result in the lease being classified as an operating lease. 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 early adoption had no impact on the Company's financial statements.

In July 2002, the FASB issued Statement of Financial Accounting Standards No. 146, "Accounting for Exit or Disposal Activities" ("SFAS No. 146"). SFAS No. 146 will be effective for disposal activities initiated after December 31, 2002. The Company is in the process of evaluating the effect that adopting SFAS No. 146 will have on its financial statements.

### (14) SALE OF SUBSIDIARY

On June 24, 2002, the Company sold all of its common and preferred stock in PartnerCommunity, Inc. ("PartnerCommunity"), a majority owned subsidiary, in exchange for net cash proceeds of approximately \$69,000; a promissory note for \$200,000 payable in 30 months which bears interest at a rate of 8% per year payable annually; and five year warrants to purchase 1,200,000 shares of PartnerCommunity preferred stock at a price of \$.10 per share. The estimated fair value of the warrants of \$165,700 was recorded as an other asset in the condensed unaudited balance sheet of the Company. The fair value of the warrants was calculated using the Black-Scholes model. The Company recorded a gain on sale of the subsidiary of approximately \$391,000 in the three and six months ended June 30, 2002.

The Company placed a 100% reserve against the note receivable due to the long term nature of the note and the uncertainty of collectibility. As cash is received, the Company will record an additional gain on the transaction.

## 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 with our Annual Report on Form 10-K for the year ended December 31, 2001.

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### 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 rather are based on current expectations, estimates and projections about our business and industry, our beliefs and assumptions. Words such as "anticipates", "expects", "intends", "plans", "believes", "seeks", "estimates" and variations of these words and similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and are subject to known and unknown 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 "Risks Associated with Daleen's Business and Future Operating Results", "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, 2001 filed with the Securities and Exchange Commission on April 1, 2002. 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 "Risks Associated with Daleen's Business and Future Operating Results," that could cause the actual results to differ materially from those suggested by the forward-looking statements.

### OVERVIEW

From our founding in 1989 and through 1996, we operated as a software consulting company, performing contract consulting and software development services in a contract placement and staffing business. We sold the contract placement and staffing business to a third-party in 1996. Since 1996, we have been a provider of software solutions and have evolved to be a global provider of Internet software solutions that manage the revenue chain for traditional and next generation communications service providers. Our RevChain(R) applications enable service providers to automate and manage their entire revenue chain. In addition to our RevChain(R) product family, we offer professional consulting services, training, maintenance, support and third-party software fulfillment, in each case related to the products we develop. We recognized the first material revenue from software license fees in 1998.

Historically, we operated our business with primarily a direct sales model and our products and services were sold through our direct sales force. We also utilized strategic alliance partners, including operational support system providers, software application companies, consulting firms and systems integration firms, to provide some level of sales and marketing support to deliver a complete solution and successful implementation to our customers. In order to address a broader market and to satisfy customers' requirements associated with the use of independent consulting and systems integration firms, beginning in the first quarter of 2001 we increased our focus on indirect sales through our strategic alliance partners to assist our strategic alliance partners in sales to their customers. We believe that an increased focus on these strategic alliances will enable us to more easily enter into new markets and reach potential



new customers for our products. In addition, we have continued to maintain a reduced direct sales force for those sales opportunities that do not include or require third-party strategic alliance partners. We are currently working with several of these partners under various agreements to generate new business opportunities through joint sales and marketing efforts. Our success will depend to a large extent on the willingness and ability of our alliance partners to devote sufficient resources and efforts to marketing our products versus the products of others. There are no guarantees that this strategy will be successful.

#### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The discussion and analysis of our financial condition and results of operations included herein are based upon our condensed unaudited consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q, 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 bad debts, investments, 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 condensed unaudited consolidated financial statements.

#### REVENUE RECOGNITION

Revenue from 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 generally 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 have also entered into arrangements with service bureau providers and application service providers that utilize our products to service their customers. We expect to continue 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 licensing fees 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

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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.

If the contract requires us to perform services not considered essential to the functionality of the software, the revenue related to the software services is recognized using the percentage of completion method, based on the ratio of total labor hours incurred to date to total estimated labor hours. 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

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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.

Revenue related to professional services under a time and material arrangement is recognized as services are performed.

Revenue related to customer maintenance agreements is deferred and recognized ratably on a straight-line basis over the maintenance period of the agreement. 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 deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

### NOTES RECEIVABLE

We maintain an allowance for employees' notes receivable that are non-recourse except against the collateral, for the difference between the face value of the note plus accrued interest and the fair market value of the underlying collateral which consists of our common stock. If the common stock price were to decrease, additional allowances may be needed. Likewise, if the common stock price were to increase, a decrease in the allowance may be needed. An increase in the allowance would decrease income in the period the common stock price decreased while a decrease in the allowance would increase income in the period the common stock price increased.

We also maintain an allowance for former employee notes receivable that are full recourse for estimated losses resulting from the inability of our prior employees to make payments. We continually monitor the notes receivable and the allowance is based on specific issues that we have identified. If the financial condition of the holder of the notes were to deteriorate, resulting in such holders inability to make required payments, additional allowances may be required.

### INVESTMENT IN THIRD PARTIES

We have an investment in a technology company having operations in areas

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within our strategic focus. We also have warrants to purchase preferred stock of a former subsidiary. We would record an investment impairment charge when we believe these investments have experienced a decline in value that is other than temporary. Future adverse changes in market conditions, or poor operating results of these investments, could result in losses or an inability to recover the carrying value of investments that may not be reflected in our investment's current carrying value, thereby possibly requiring an impairment charge in the future.

### 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. 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 our 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.

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### RESULTS OF OPERATIONS

On January 4, 2001, our Board of Directors approved, and on January 5, 2001, we announced a plan to implement specific cost reduction measures (the "January Restructuring") that included workforce reductions, downsizing of facilities and asset writedowns. We recorded a \$3.0 million restructuring charge in the three months ended March 31, 2001 related to the January Restructuring. We implemented the actions associated with the January Restructuring immediately following the January 5, 2001 announcement. The workforce reductions in the January Restructuring included the termination of approximately 140 employees throughout our Boca Raton, Florida; Atlanta, Georgia; and Toronto, Ontario, Canada facilities, and included employees from substantially all of our employee groups. The downsizing of facilities included the downsizing of the Atlanta and Toronto facilities to one floor per each location. The asset writedowns were primarily related to the disposition of duplicative furniture and equipment and computer equipment from terminated employees, which was not resaleable.

In late March 2001, we initiated a second comprehensive business review to identify additional areas for cost reductions. As a result, our Board of Directors approved, and we announced, another restructuring on April 10, 2001 (the "April Restructuring"). The April Restructuring included the consolidation of our North American workforce into our Boca Raton, Florida corporate offices and the closure of our Toronto, Canada and Atlanta, Georgia facilities. The April Restructuring included the consolidation of our North American research and development and professional services resources and further reduced our administrative support functions. The workforce reductions resulted in the termination of 193 employees from substantially all of our employee groups, closing of facilities, asset writedowns and other costs. Other costs included accounting and legal fees, penalties for cancellation of software maintenance contracts in Atlanta and Toronto and penalties for cancellation of a trade show. We implemented the actions associated with the April Restructuring immediately following the April 10, 2001 announcement.

On October 17, 2001, our Board of Directors approved and on October 19, 2001 we announced a plan to further reduce expenses (the "October Restructuring"). The October Restructuring included the estimated costs related to workforce reductions of 75 employees from substantially all of our employee groups,

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further downsizing of facilities including rental property lease termination charges of \$1.4 million, asset writedowns, and other costs. We started to implement these actions immediately following the October 19, 2001 announcement.

On May 13, 2002, our Board of Directors approved and on May 14, 2002 we announced, a plan to further reduce expenses (the "2002 Restructuring"). The 2002 Restructuring included the estimated costs related to workforce reductions of 35 employees from substantially all of our employee groups. We implemented the actions associated with the 2002 Restructuring immediately following the May 14, 2002 announcement.

Due to the termination of employees in the January Restructuring, the April Restructuring, the October Restructuring and the 2002 Restructuring and assuming we do not hire any additional employees, we expect to achieve an annualized savings related to the cost of salaries and benefits for these terminated employees of approximately \$33.2 million. The anticipated savings are from the following: approximately \$9.8 million in cost of professional services and other; approximately \$12.2 million in research and development; approximately \$7.0 million in sales and marketing; and approximately \$4.2 million in general and administrative.

In recent years we have invested heavily in sales and marketing, research and development, and general operating expenses in order to increase our market position, develop our products and build our infrastructure. With the recent implementations of our January Restructuring, April Restructuring, October Restructuring and 2002 Restructuring, we expect operating expenses to continue to decrease in 2002 in areas such as compensation and benefits, capitalized expenditures, facilities and travel costs.

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THREE MONTHS ENDED JUNE 30, 2002 COMPARED TO THREE MONTHS ENDED JUNE 30, 2001

**TOTAL REVENUE.** Total revenue, which includes license revenue and professional services and other revenue, decreased \$1.4 million, or 40.2%, to \$2.0 million in the three months ended June 30, 2002, from \$3.4 million for the same period in 2001. The primary reason for lower revenue during the recent quarter is related to the decrease in the number of contracts being signed in recent quarters, which has resulted in a decrease in our professional services and other revenue due to less ongoing product implementations related to licensing our software products and the need for third-party software fulfillment. In addition, there was a decrease in license revenue due to fewer license contracts being signed in the second quarter 2002 than the second quarter 2001.

**LICENSE FEES.** Our license fees are derived from licensing our software products. License fees decreased \$311,000, or 29.2%, in the three months ended June 30, 2002 to \$753,000, compared to \$1.1 million for the same period in 2001. This decrease was due to fewer license contracts being signed in the second quarter 2002 compared to the same period in 2001. The primary reasons for this reduction include an overall reduction in technology spending, market conditions in the industries in which our customers operate, competition, lengthening of the sales cycle and postponement of customer licensing decisions. License fees constituted 36.8% of total revenue in the three months ended June 30, 2002, compared to 31.1% in the same period in 2001.

**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

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products we develop and license. We offer consulting services both on a fixed fee basis and on a time and materials basis. We also offer third-party software fulfillment based on our acquisition cost plus a reasonable margin. Professional services and other revenue decreased \$1.1 million, or 45.1%, in the three months ended June 30, 2002 to \$1.3 million, compared to \$2.4 million in the same period in 2001. The decrease was due to less ongoing product implementations, fewer maintenance contracts primarily due to customer insolvency and less revenue associated with third-party software fulfillment. Professional services and other revenue constituted 63.2% of total revenue in the three months ended June 30, 2002, compared to 68.9% for the same period in 2001.

**TOTAL COST OF REVENUE.** Total cost of revenue decreased \$1.3 million, or 65.2%, to \$671,000 in the three months ended June 30, 2002 from \$1.9 million in the same period in 2001. Total cost of revenue includes both cost of license fees and cost of professional services and other. These components include the cost of direct labor, benefits, overhead and materials associated with the fulfillment and delivery of license products, amortization expense related to prepaid third-party licenses and related corporate overhead costs to provide professional services to our customers. These costs decreased due to a decrease in total revenue, decrease in amortization expense related to prepaid third-party licenses, as well as the result of our cost reduction measures taken in the October Restructuring and the 2002 Restructuring. The cost reductions included a decrease in professional services personnel and other overhead costs. Overall, total cost of revenue as a percentage of total revenue decreased to 32.8% in the three months ended June 30, 2002, compared to 56.5% in the same period in 2001. This decrease resulted from the decrease in total revenue, decrease in amortization expense related to prepaid third-party license and the cost reductions related to the October Restructuring and the 2002 Restructuring.

**COST OF LICENSE FEES.** Cost of license fees includes direct cost of labor, benefits and packaging material for fulfillment and shipment of our software products and amortization expense related to prepaid third-party licenses. Cost of license fees decreased \$258,000 or 80.5% to \$63,000, in the three months ended June 30, 2002, from \$321,000 in the same period in 2001, due to a decrease in amortization expense related to prepaid third-party licenses. The majority of license fees recognized in the three months ended June 30, 2002 related to "pay as you grow" revenue from existing customers. Therefore, it did not require any amortization of third-party licenses. However, in the three months ended June 30, 2001, we recorded amortization of prepaid third-party licenses due to the license revenue being derived from new customers. In addition, the amortization period on the prepaid licenses has been completed, therefore, no amortization related to prepaid licenses will be required in the future.

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Cost of license fees as a percentage of license revenue decreased to 8.3% in the three months ended June 30, 2002, compared to 30.2% for the same period in 2001, due to the decrease in amortization.

**COST OF PROFESSIONAL SERVICES AND OTHER.** Cost of professional services and other includes direct cost of 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 decreased \$1.0 million, or 62.2% to \$608,000, in the three months ended June 30, 2002, from \$1.6 million in the same period in 2001. These costs decreased due to a decrease in total revenue, as well as the result of our cost reduction measures taken in the October Restructuring and the 2002 Restructuring. Cost of professional services and other decreased to 47.1% of professional services and other revenue in the

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three months ended June 30, 2002, compared to 68.4% for the same period 2001 due to cost reduction measures related to October Restructuring and the 2002 Restructuring.

**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 \$1.5 million or 58.8%, to \$1.1 million in the three months ended June 30, 2002, from \$2.6 million for the same period in 2001. These costs decreased as a result of a decrease in our trade show presence, a decrease in sales commissions, as well as the cost reduction measures taken with the October Restructuring and 2002 Restructuring. As a percentage of revenue, sales and marketing expenses decreased to 53.0% in the three months ended June 30, 2002, from 77.1% in the same period in 2001 mainly due to the cost reduction measures related to the October Restructuring and 2002 Restructuring.

**RESEARCH AND DEVELOPMENT.** Research and development expenses consist primarily of salaries and benefits for software developers, product testing and benchmarking, management and quality assurance personnel, subcontractor costs and related corporate overhead costs. Our research and development expenses decreased \$2.1 million, or 66.8%, to \$1.1 million in the three months ended June 30, 2002, from \$3.2 million for the same period in 2001. The overall decrease was primarily due to the cost reductions associated with the October Restructuring and 2002 Restructuring. The cost reductions included a decrease in research and development personnel and other costs. As a percentage of revenue, research and development expenses decreased to 51.6% in the three months ended June 30, 2002 compared to 93.1% in the same period in 2001, mainly due to the cost reduction measures related to the October Restructuring and the 2002 Restructuring.

**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. It also consists of non-cash stock compensation expense and provision for bad debt. Our general and administrative expenses decreased \$4.4 million, or 77.8%, to \$1.3 million in the three months ended June 30, 2002, from \$5.6 million in the same period in 2001. The decrease was attributed to the decrease in administrative personnel and administrative costs associated with the October Restructuring and the 2002 Restructuring. In addition, in the three months ended June 30, 2001, there was approximately \$3.4 million of charges which did not occur in the three months ended June 30, 2002. These charges encompassed (i) an asset writedown of \$1.0 million related to an investment; (ii) the issuance of warrants in connection with a legal settlement resulting in a charge of approximately \$495,000; (iii) a charge of \$1.2 million related to the amortization of stock compensation expense due to options issued in 1999 and 2000 with exercise prices at below fair market value; and (iv) the charge to our provision for bad debt for the three months ended June 30, 2001 was approximately \$925,000. The provision for bad debts for the three months ended June 30, 2002 was \$201,000. As a percentage of revenue, general and administrative expenses decreased to 61.2% in the three months ended June 30, 2002 from 165.1% in the same period in 2001 due to cost reduction measures related to the October Restructuring and the 2002 Restructuring and the non-cash charges recorded in the three months ended June 30, 2001.

**AMORTIZATION OF GOODWILL AND OTHER INTANGIBLES.** Amortization expense decreased \$3.6 million, or 100%, to \$0 in the three months ended June 30, 2002,

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from \$3.6 million for the same period in 2001. Goodwill and other intangibles was considered impaired and written off during 2001. Therefore, no amortization of goodwill and other intangibles was recorded in the three months ended June 30, 2002.

RESTRUCTURING CHARGES. Restructuring charges decreased \$4.0 million, or 84.4%, to \$745,000 in the three months ended June 30, 2002 from \$4.8 million for the same period in 2001. Restructuring charges incurred by us in the three months ended June 30, 2002 related to the 2002 Restructuring. These charges were related to employee terminations benefits. The costs were from the following financial statements captions:

Cost of sales - professional services	\$ 140,000
Research and development	\$ 168,000
Sales and marketing	\$ 148,000
General and administrative	\$ 289,000
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	\$ 745,000
	=====

Restructuring charges incurred by us in the three months ended June 30, 2001, were related to the April Restructuring and were higher than the same period in 2002 due to more employees being terminated, costs related to the closing of the Toronto and Atlanta facilities, and asset writedowns.

OTHER INCOME. Other income increased \$137,000, or 36.7%, to \$509,000 in the three months ended June 30, 2002, from \$373,000 for the same period in 2001. This was primarily attributable to the gain on the sale of our majority owned subsidiary PartnerCommunity, Inc., of \$391,000 offset by a decrease in investment earnings due to the decrease in interest rates in 2002 compared to 2001.

### SIX MONTHS ENDED JUNE 30, 2002 COMPARED TO SIX MONTHS ENDED JUNE 30, 2001

TOTAL REVENUE. Total revenue, which includes license revenue and professional services and other revenue, decreased \$4.6 million, or 53.7%, to \$3.9 million in the six months ended June 30, 2002 from \$8.5 million for the same period in 2001. The primary reason for lower revenue is related to fewer license contracts being signed in the six months ended June 30, 2002 than in the same period in 2001. In addition, the number of contracts being signed in recent quarters has decreased our professional services and other revenue due to less ongoing product implementations related to licensing our software products and the need for third-party software fulfillment.

LICENSE FEES. Our license fees are derived from licensing our software products. License fees decreased \$1.8 million, or 65.3%, in the six months ended June 30, 2002 to \$963,000 compared to \$2.8 million for the same period in 2001. This decrease was due to fewer license contracts being signed in the six months ended June 30, 2002 compared to the same period in 2001. The primary reasons for this reduction include an overall reduction in technology spending, market conditions in the industries in which our customers operate, competition, lengthening of the sales cycle and postponement of customer licensing decisions. License fees constituted 24.4% of total revenue in the six months ended June 30, 2002, compared to 32.6% in the same period in 2001.

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 and license. We offer consulting services on a fixed fee basis and on a time and materials basis. We offer third-party software fulfillment based on our acquisition cost plus a reasonable margin. Professional services and other revenue decreased \$2.8 million, or 48.1%, in the six months

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ended June 30, 2002 to \$3.0 million, compared to \$5.8 million in the same period in 2001. The decrease was due to less ongoing product implementations, fewer maintenance contracts primarily due to customer insolvency, and less revenue

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associated with third-party software fulfillment. Professional services and other revenue constituted 75.6% of total revenue in the six months ended June 30, 2002, compared to 67.4% for the same period in 2001. The increase as a percentage of total revenue is due to a reduction in license revenue in the six months ended June 30, 2002.

**TOTAL COST OF REVENUE.** Total cost of revenue decreased \$3.7 million, or 68.4%, to \$1.7 million in the six months ended June 30, 2002, from \$5.4 million in the same period in 2001. Total cost of revenue includes both cost of license fees and cost of professional services and other. 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 decreased due to the decrease in total revenue, decrease in amortization of prepaid third-party license fees as well as the result of our cost reduction measures taken in the April Restructuring, October Restructuring and 2002 Restructuring. The cost reductions included a decrease in professional services personnel and other overhead costs. Overall, total cost of revenue as a percentage of total revenue decreased to 43.4% in the six months ended June 30, 2002, compared to 63.5% in the same period in 2001. This decrease resulted from the decrease in total revenue, decrease in amortization expense related to prepaid third-party licenses and the cost reductions related to the April Restructuring, October Restructuring and 2002 Restructuring.

**COST OF LICENSE FEES.** Cost of license fees includes direct cost of labor, benefits and packaging material for fulfillment and shipment of our software products and amortization expense related to prepaid third-party licenses. Cost of license fees decreased \$270,000 or 73.4% to \$98,000, in the six months ended June 30, 2002, from \$368,000 in the same period in 2001 due to a decrease in amortization expense related to prepaid third-party licenses. Cost of license fees decreased to 10.2% of license revenue in 2002, compared to 13.3% in 2001.

**COST OF PROFESSIONAL SERVICES AND OTHER.** Cost of professional services and other includes direct cost of 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 decreased \$3.4 million, or 68.0%, to \$1.6 million in the six months ended June 30, 2002, from \$5.0 million in the same period in 2001. These costs decreased as a result of our cost reduction measures taken with the April Restructuring, October Restructuring and the 2002 Restructuring. In addition, the revenue related to professional services and other has decreased. Cost of professional services and other decreased to 54.1% of professional services and other revenue in the six months ended June 30, 2002, compared to 87.7% for the same period in 2001 due to cost reductions resulting from the April Restructuring, October Restructuring and 2002 Restructuring.

**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 \$4.7 million, or 67.9%, to \$2.2 million in the six months ended June



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30, 2002, from \$7.0 million for the same period in 2001. The decrease was a result of a decrease in our trade show presence, decrease in sales commissions as well as the cost reduction measures taken with the April Restructuring, October Restructuring and the 2002 Restructuring. As a percentage of revenue, these expenses decreased from 81.6% in the six months ended June 30, 2001, to 56.6% for the same period in 2002 mainly due to the cost reduction measures related to the April Restructuring, October Restructuring and 2002 Restructuring.

RESEARCH AND DEVELOPMENT. Research and development expenses consist primarily of salaries and benefits for software developers, product testing and benchmarking, management and quality assurance personnel, subcontractor costs and related corporate overhead costs. Our research and development expenses decreased \$6.1 million, or 72.0%, to \$2.4 million in the six months ended June 30, 2002, from \$8.5 million for the same period in 2001. The decrease was a result of the cost reduction measures associated with the April Restructuring, October Restructuring and the 2002 Restructuring. The cost reductions included a decrease in research and development personnel and other costs. As a percentage of revenue, these expenses decreased from 99.8% in 2001 to 60.5% in

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2002 mainly due to the cost reduction measures related to the April Restructuring, October Restructuring and 2002 Restructuring.

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. It also consists of non-cash stock compensation expense and provision for bad debt. Our general and administrative expenses decreased \$6.4 million, or 71.1%, to \$2.6 million in the six months ended June 30, 2002, from \$8.9 million in the same period in 2001. The decrease was attributed to the aggregate amount of approximately \$4.1 million non-cash charges recorded in the six months ended June 30, 2001, which did not occur in the six months ended June 30, 2002, encompassing: (i) an asset write-down of \$1.0 million related to an investment; (ii) the issuance of warrants in connection with a legal settlement resulting in a charge of approximately \$495,000; (iii) a charge of \$1.5 million related to amortization of stock compensation expense due to options issued in 1999 and 2000 with exercise prices below fair market value; and (iv) a \$1.4 million charge to our provision for bad debt for the six months ended June 30, 2001 compared to a \$320,000 charge for the six months ended June 30, 2002. The provision in the six month period in 2001 was due to the market conditions in the telecommunications industry and certain customers significantly reducing or liquidating their operations in 2001. The decrease in general and administrative expenses also was a direct result of the cost reduction measures associated with the April Restructuring, October Restructuring and 2002 Restructuring. As a percentage of revenue, general and administrative expenses decreased to 65.5% in the six months ended June 30, 2002 from 104.8% in the same period in 2001 due to the reduction, of the non-cash charges as well as the cost reduction measures related to the April Restructuring, October Restructuring and 2002 Restructuring.

AMORTIZATION OF GOODWILL AND OTHER INTANGIBLES. Amortization expense decreased \$8.6 million, or 100%, to \$0 in the six months ended June 30, 2002, from \$8.6 million for the same period in 2001. Goodwill and other intangibles were considered impaired and written off during 2001. Therefore no amortization of goodwill and other intangibles was recorded in the six months ended June 30, 2002.

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IMPAIRMENT OF LONG-LIVED ASSETS. Impairment charges decreased \$3.3 million, or 100%, to \$0 in the six months ended June 30, 2002, from \$3.3 million for the same period in 2001. Impairment charges in the six months ended June 30, 2001 consisted of an impairment of the employee workforce of \$1.6 million and a charge of approximately \$1.7 million representing the difference between the fair value and the carrying value of certain property, leasehold improvements and equipment.

RESTRUCTURING CHARGES. Restructuring charges decreased \$7.0 million, or 90.4%, to approximately \$745,000 in the six months ended June 30, 2002, from \$7.8 million for the same period in 2001. Restructuring charges incurred by us in the six months ended June 30, 2002 related to the 2002 Restructuring. These charges were related to employee termination benefits. The costs were from the following financial statement captions:

Cost of sales - professional services	\$ 140,000
Research and development	\$ 168,000
Sales and marketing	\$ 148,000
General and administrative	\$ 289,000
	-----
	\$ 745,000
	=====

Restructuring charges incurred by us in the six months ended June 30, 2001 related to the January Restructuring and April Restructuring and were higher than the same period in 2002, were due to more employees being terminated, costs related to the closing of the Toronto and Atlanta facilities, and asset writedowns.

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OTHER INCOME. Other income increased \$40,000 or 6.5%, to \$659,000 in the six months ended June 30, 2002 from \$619,000 for the same period in 2001. This was primarily attributable to the decrease in investment earnings due to the decrease in interest rates in 2002 compared to 2001, offset by the gain on sale of subsidiary of \$391,000.

### LIQUIDITY AND CAPITAL RESOURCES

Net cash used in operating activities was \$5.8 million for the six months ended June 30, 2002, compared to \$20.0 million for the six months ended June 30, 2001. The principal use of cash for both periods was to fund our losses from operations.

Net cash used in financing activities was \$28,000 for the six months ended June 30, 2002 compared to the net cash provided by financing activities of \$25.4 million for the six months ended June 30, 2001. In 2002, cash was used for additional expenses related to the private placement. In 2001, the cash provided was primarily related to the net proceeds received from the private placement.

Net cash used in investing activities was \$68,000 for the six months ended June 30, 2002, compared to the \$1.9 million for the six months ended June 30, 2001. The cash used in the six months ended June 30, 2002 was primarily related to capital expenditures of approximately \$151,000 offset by net proceeds of \$69,000 from the sale of the PartnerCommunity, Inc.. The cash used in the six months ended June 30, 2001 was primarily related to a non-recourse note receivable issued to our Chairman, President and Chief Executive Officer for

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approximately \$1.2 million and capital expenditures of approximately \$696,000.

We continued to experience operating losses during the six months ended June 30, 2002 and had an accumulated deficit of \$206.3 million at June 30, 2002. Cash and cash equivalents at June 30, 2002 were \$7.2 million. The cash used during the six months ended June 30, 2002 was a significant improvement from prior periods. The January Restructuring, April Restructuring, October Restructuring and 2002 Restructuring resulted in a reduction in operating expense levels, and cash usage requirements in the six months ended June 30, 2002.

We intend to continue to manage our use of cash and we believe the cash and cash equivalents together with the reduction in costs due to the January Restructuring, April Restructuring, October Restructuring and 2002 Restructuring, may be sufficient to fund our operations through December 31, 2002. However, we may be required to further reduce our operations and/or seek additional public or private equity financing or financing from other sources. We also will need to consider other options, which may include, but are not limited to, forming strategic partnerships or alliances and/or considering other strategic alternatives, including a possible merger, sale of assets or other business combination. There can be no assurance that additional financing will be available, or that, if available, the financing will be obtainable on terms acceptable to us or that any additional financing would not be substantially dilutive to our existing stockholders. Further, there can be no assurance that any other strategic alternatives will be available, or if available will be on terms acceptable to us or all of our stockholders. Failure to obtain additional financing or to engage in one or more strategic alternatives may have a material adverse effect on our ability to meet our financial obligations and to continue to operate as a going concern which may result in filing for bankruptcy protection, winding down of operations and/or liquidation of our assets. Our condensed unaudited consolidated financial statements included elsewhere in this Form 10-Q 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 Daleen's Business and Operating Results."

### NEW ACCOUNTING PRONOUNCEMENTS

In July 2001, Financial Accounting Standards Board ("FASB"), issued Statement of Financial Accounting Standards No. 143, "ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS" ("SFAS No. 143"). That statement requires

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entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity will capitalize a cost by increasing the carrying amount of the related long-lived asset. Over-time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. The standard is effective for the fiscal years beginning after June 15, 2002, with earlier adoption permitted. We believe the adoption of the SFAS No. 143 will not have a significant impact on our financial position and operating results.

In August 2001, FASB issued Statement of Financial Accounting Standards No. 144, "ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG LIVED ASSETS" ("SFAS No. 144"). This statement is effective for fiscal years beginning after December 15,

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2001. This statement supercedes SFAS No. 121, while retaining many of the requirements of such statement. Under SFAS No. 144 assets held for sale will be included in discontinued operations if the operations and cash flows will be or have been eliminated from the ongoing operations of the entity and the entity will not have any significant continuing involvement in the operations of the Company. We adopted SFAS No. 144 as of January 1, 2002. The adoption had no impact to our financial statements.

On April 30 2002, the FASB issued FASB Statement of Financials Accounting Standards No. 145 (" SFAS No. 145"), "RESCISSION OF FASB STATEMENTS NO. 4, 44, AND 64, AMENDMENT OF FASB STATEMENT NO. 13, AND TECHNICAL CORRECTIONS". Through this rescission, SFAS No. 145 eliminates the requirement (in both SFAS No. 4 and SFAS No. 64) 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 to treatment for certain modifications of a capital lease that result in the lease being classified as an operating lease. 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 early adoption had no impact on our 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 will be effective for disposal activities initiated by us after December 31, 2002. We are in the process of evaluating the effect that adopting SFAS No.146 will have on our financial statements.

### RISKS ASSOCIATED WITH DALEEN'S BUSINESS AND FUTURE OPERATING RESULTS

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 general risk factors, risk factors resulting from our Series F preferred stock are set forth below under the caption "Risks Associated with our Series F preferred stock" beginning on page 33. 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 in this report.

### RISKS ASSOCIATED WITH OUR BUSINESS AND OPERATIONS

ADDITIONAL CAPITAL AND/OR OTHER STRATEGIC ALTERNATIVES MAY BE REQUIRED FOR US TO HAVE THE ABILITY TO CONTINUE AS A GOING CONCERN, 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 \$5.1 million for the six months ended June 30, 2002. Our cash and cash equivalents at June 30, 2002 was \$7.2 million. Cash used in operations for the six months ended June 30, 2002 was \$5.8 million. As a result of our financial condition, the independent auditors' report covering our

December 31, 2001 consolidated financial statements and financial statement schedule contains an explanatory paragraph that states that our recurring losses from operations and accumulated deficit raised substantial doubt about our

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ability to continue as a going concern. We initiated cost reduction measures in the January Restructuring, April Restructuring, October Restructuring and 2002 Restructuring in order to reduce our operating expenses, including workforce reductions, reduction of office space, asset writedowns and consolidation of our North American research and development and professional services resources.

We believe that our cash and cash equivalents as of June 30, 2002 together with the January Restructuring, April Restructuring, October Restructuring and 2002 Restructuring, may be sufficient to fund our operations through December 31, 2002. However, there is no assurance that we will be able to continue as a going concern if we do not raise additional capital and/or engage in one or more strategic alternatives, including a possible merger, sale of assets or other business combinations. Further, such belief is based on a number of assumptions, some of which are beyond our control. Although we intend to carefully manage our use of cash and attempt to increase revenues, we likely will be required to further reduce our operations and/or seek additional public or private equity financing or financing from other sources. We also will need to consider other options, which may include but are not limited to forming strategic partnerships or alliances and/or considering other strategic alternatives. We have not yet identified the source of any additional financing, nor can we predict whether additional financing can be obtained, or if obtained, the terms of such financing. We would expect that any additional financing would be substantially dilutive to our existing stockholders. Further, there can be no assurance that any other strategic alternatives will be available, or if available, will be on terms acceptable to us, or all of our stockholders. Failure to obtain additional financing or to engage in one or more strategic alternatives may have a material adverse effect on our ability to meet our financial obligations and to continue to operate as a going concern, which may result in filing for bankruptcy protection, winding down of our operations and/or liquidation of our assets. 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" below 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.

WE HAVE NOT ACHIEVED PROFITABILITY AND MAY CONTINUE TO INCUR NET LOSSES FOR AT LEAST THE NEXT SEVERAL QUARTERS.

We incurred net losses of approximately \$5.1 million for the six months ended June 30, 2002. As of June 30, 2002, we had an accumulated deficit of approximately \$206.3 million. We have not realized any profit to date and may not achieve profitability in the near future. To achieve this objective, we need to generate significant additional revenue from licensing of our products and related services and support revenues. We have reduced our fixed operating expenses through the cost reduction measures implemented in the January Restructuring, April Restructuring, October Restructuring and 2002 Restructuring, which included workforce reductions, reduction of office space, asset writedowns, and other miscellaneous cost reductions. We consolidated our North American workforce into our Boca Raton, Florida facility and we closed our Toronto, Ontario, Canada and Atlanta, Georgia offices.

We likely will be required to further reduce our operations, seek additional financing and/or pursue other strategic alternatives. In addition, even if we do achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis in the future.

OUR REVENUE IS DIFFICULT TO PREDICT AND QUARTERLY OPERATING RESULTS MAY FLUCTUATE IN FUTURE PERIODS, AS A RESULT OF WHICH WE MAY FAIL TO MEET EXPECTATIONS, WHICH MAY CAUSE OUR COMMON STOCK PRICE TO DECLINE.

Our revenue and operating results have varied and may continue to vary

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significantly from quarter to quarter due to a number of factors. This fluctuation may cause our operating results to be below the expectations of public

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market analysts and investors, and the price of our common stock may fall. Factors that could cause quarterly fluctuations include:

- o variations in demand for our products and services;
- o competitive pressures;
- o continued low levels of corporate information technology spending;
- o prospective customers delaying their decision to acquire licenses for our products;
- o prospective customers' concerns of over their own financial viability and use of cash;
- o general market and economic conditions;
- o our ability to develop and attain market acceptance of enhancements to the RevChain product applications and any new products and services;
- o the pace of product implementation and the timing of customer acceptance;
- o industry consolidation reducing the number of potential customers;
- o the willingness of potential customers to conduct business with us related to concerns over operating losses and our long term financial viability;
- o changes in our pricing policies or the pricing policies of our competitors; and
- o the mix of sales channels through which our products and services are sold.

The timing of revenue and revenue recognition is difficult to predict. Historically, in any given quarter, most of our revenue has been attributable to a limited number of relatively large contracts and we expect this to continue. Further, our customer contract bookings and revenue recognized tends to occur predominantly in the last two weeks of the quarter. As a result, our quarterly results of operations are difficult to predict and the deferral of even a small number of contract bookings or delays associated with delivery of products in a particular quarter could significantly reduce our revenue and increase our net loss which would hurt our quarterly financial performance. As a result of a reduced number of new contracts, our revenue for the three months ended June 30, 2002 and previous quarters was derived primarily from our existing customers that signed contracts in prior periods. In addition, a substantial portion of our costs are relatively fixed and based upon anticipated revenue. A failure to book an expected order in a given quarter would not be offset by a corresponding reduction in costs and could adversely affect our operating results.

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THE LOW PRICE OF OUR COMMON STOCK COULD RESULT IN THE DELISTING OF OUR COMMON STOCK FROM THE NASDAQ SMALLCAP MARKET, WHICH COULD CAUSE OUR COMMON STOCK PRICE TO DECLINE AND MAKE TRADING IN OUR COMMON STOCK MORE DIFFICULT TO INVESTORS.

Our common stock was transferred to The Nasdaq SmallCap Market effective July 12, 2002, as a result of its delisting from The Nasdaq National Market for failure to maintain a minimum bid price of \$1.00 as required by the applicable Nasdaq Marketplace Rule and, as well as our failure to maintain the required minimum value of publicly held shares. The Nasdaq SmallCap Market is viewed by most investors as a less desirable and less liquid marketplace than The Nasdaq National Market.

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We must satisfy The Nasdaq SmallCap Market's minimum listing maintenance requirements to maintain our listing on The Nasdaq SmallCap Market. The listing maintenance requirements set forth in Nasdaq's Marketplace Rules include a series of financial tests relating to stockholders' equity, market capitalization, net income, public float, market value of public float, number of market makers and stockholders, and maintaining a minimum closing bid price of \$1.00 per share for shares of our common stock. On or before August 13, 2002, we must demonstrate a closing bid price of at least \$1.00 per share and must maintain a price of at least \$1.00 for a period of ten days immediately thereafter to regain compliance. If we are unable to achieve a \$1.00 bid price at the expiration of this period, we may be eligible for an additional 180-day extension of the bid price exception, or until February 10, 2003, provided we demonstrate stockholders' equity of at least \$5,000,000, a market capitalization of at least \$50,000,000 or net income of at least \$750,000 for the year ended 2001 or in two of the last three fiscal years based upon the most recently filed financial information. We must also demonstrate compliance with all requirements for continued listing on The Nasdaq SmallCap Market. As of June 30, 2002, our stockholders' equity was \$9.4 million.

If our common stock is delisted from The Nasdaq SmallCap Market, the common stock would trade on either the OTC Bulletin Board or the "pink sheets", both of which are viewed by most investors as less desirable and less liquid marketplaces. Thus, delisting from The Nasdaq SmallCap Market could make trading our shares more difficult for investors, leading to further declines in share price. It would also make it more difficult for us to raise additional capital. In addition, we would incur additional costs under state blue sky laws to sell equity if our common stock is delisted from The Nasdaq SmallCap Market.

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 markets in which we compete are relatively new, intensely competitive, highly fragmented and rapidly changing. Our principal competitors include other internet enabled billing and customer care system providers, operation support system providers, systems integrators and service bureaus, and the internal information technology departments of larger communications companies which may elect to develop functionalities similar to those provided by our product in-house rather than buying them from us. Several of our competitors have recently gone through business combinations with other competitors that may result in an advantage for them due to combinations in technology, experience, financial resources and other economic synergies. Many of our current and future competitors may have advantages over us, including:

- o longer operating histories;

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- o larger customer bases;
- o substantially greater financial, technical, research and development and sales and marketing resources;
- o a lead in expanding their business internationally;
- o greater name recognition; and
- o ability to more easily provide a comprehensive hardware and software solution.

Our current and potential competitors have established, and may continue to establish in the future, cooperative relationships among themselves or with third parties, including telecom hardware vendors, and system implementers, that would increase their ability to compete with us. In addition, competitors may be able to

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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. If we fail to adapt to market demands and to compete successfully with existing and new competitors, our business and financial performance would suffer.

WE DEPEND ON STRATEGIC BUSINESS ALLIANCES WITH THIRD PARTIES, INCLUDING SOFTWARE FIRMS, CONSULTING FIRMS AND SYSTEMS INTEGRATION FIRMS, TO SELL AND IMPLEMENT OUR PRODUCTS, AND ANY FAILURE TO DEVELOP OR MAINTAIN THESE ALLIANCES COULD HURT OUR FUTURE GROWTH IN REVENUE AND OUR GOALS FOR ACHIEVING PROFITABILITY.

Third parties such as operation support system providers, other software firms, consulting firms and systems integration firms help us with marketing, sales, implementation and support of our products. In order to address a broader market and to satisfy customers' requirements associated with the use of independent consulting and systems integration firms, we have increased our focus on indirect sales through our strategic alliance partners, including operational support system providers, other software application companies, consulting firms and systems integration firms. To be successful, we must maintain our relationships with these firms, develop additional similar relationships and generate new business opportunities through joint marketing and sales efforts. We may encounter difficulties in forging and maintaining long-term relationships with these firms for a variety of reasons. These firms may discontinue their relationships with us, they may fail to devote sufficient resources to adequately market our products, their business may, they may refocus their efforts to other market, they may fail to implement and support our products, they may develop relationships with our competitors, or they may fail to honor the terms of our agreements or make payments when due. Many of these firms also work with competing software companies, and our success will depend on their willingness and ability to devote sufficient resources and efforts to marketing our products versus the products of others. In addition, these firms may delay the product implementation or negatively affect our customer relationships. Our agreements with these firms typically are in the form of a non-exclusive referral fee or license and package discount arrangement that may be terminated by either party without cause or penalty and with limited notice.

MANY OF OUR CUSTOMERS AND POTENTIAL CUSTOMERS LACK FINANCIAL RESOURCES, AND IF



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THEY CANNOT SECURE ADEQUATE FINANCING, WE MAY NOT MAINTAIN THEIR BUSINESS, WHICH WOULD NEGATIVELY IMPACT OUR REVENUE AND RESULTS OF OPERATIONS.

Many of our customers and potential customers lack significant financial resources. These companies rely to a large degree, on access to the capital markets for growth that have cut back over the past year. Their failure to raise capital has hurt their financial viability and their ability to purchase our products. The lack of funding has caused potential customers to reduce information technology spending. If our potential customers cannot obtain the resources to purchase our products, they may turn to other options such as service bureaus, which is a solution we do not currently offer and which would hurt our business. Also, because we do at times provide financing arrangements to customers, their ability to make payments to us may impact when we can recognize revenue.

The revenue growth and profitability of our business depends significantly on the overall demand for software products and services that manage the revenue chain as it has been defined, particularly in the product and service segments in which we compete. Softening demand for these products and services caused by worsening economic conditions may result in decreased revenues or earning levels or growth rates. Recently, the U.S. and European economies have weakened. This has resulted in companies delaying or reducing expenditures, including expenditures for information technology. Highly publicized bankruptcies such as those at Global Crossing, Kmart, Enron and WorldCom have caused further tightening of the credit and equity markets overall. Telecommunication providers are among the most affected by these changes. The credit and equity situation has caused many of the telecommunication providers to significantly cut back capital spending on information technology. This reduction in capital spending has had and may continue to have an adverse impact on us.

In addition, our current customers' ability to generate revenues or otherwise obtain capital could adversely impact on their ability to purchase additional products or renew maintenance and support agreements with us. If

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they go out of business there will be no future licenses or services to support revenue. The lack of funding available in our customers' markets, the recent economic downturn in the technology market and customers shutting down operations, combining or declaring bankruptcy may cause our accounts receivable to continue to increase. There is no assurance we will be able to collect all of our outstanding receivables.

OUR LENGTHY SALES CYCLE MAKES IT DIFFICULT TO PREDICT THE TIMING OF SALES AND THE RESULTING REVENUE, AND REVENUE MAY VARY FROM PERIOD TO PERIOD, WHICH MAY ADVERSELY AFFECT OUR COMMON STOCK PRICE.

The sales cycle associated with the purchase of our products is lengthy, and the time between the initial proposal to a prospective customer and the signing of a license agreement can be as long as one year. Our products involve a commitment of capital which may be significant to the customer, with attendant delays frequently associated with large capital expenditures and implementation procedures within an organization. These delays may reduce our revenue in a particular period without a corresponding reduction in our costs, which could hurt our results of operations for that period.

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.

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The trading price of our common stock has fluctuated in the past and will fluctuate in the future. This future fluctuation could be a result of a number of factors, many of which are outside our control. Some of these factors include:

- o quarter-to-quarter variations in our operating results;
- o failure to meet the expectations of industry analysts;
- o announcements and technological innovations or new products by us or our competitors;
- o increased price competition; and
- o general conditions in the Internet, technology and the telecommunications industries.

The stock market has experienced extreme price and volume fluctuations which have particularly affected the market prices of many Internet and computer software companies, including ours.

WE ARE THE TARGET OF SECURITIES CLASS ACTION LITIGATION AND THE VOLATILITY OF OUR STOCK PRICE MAY LEAD TO ADDITIONAL LEGAL PROCEEDINGS BEING BROUGHT AGAINST THE COMPANY WHICH COULD RESULT IN SUBSTANTIAL COSTS AND DIVERT MANAGEMENT ATTENTION AND RESOURCES.

In December 2001 a class action complaint was filed in the United States District Court for the Southern District of New York against us, certain of the underwriters of our initial public offering and certain of our current and former officers and directors. The complaint alleges that the defendants failed to disclose "excessive commissions" paid to the underwriters in exchange for allocating shares to preferred customers, 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. Plaintiff seeks unspecified damages and other relief. We intend to defend vigorously against the plaintiff's claims. Such defense may result in substantial costs and divert management attention and resources, which may seriously harm our business. We believe 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

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indemnify us and no assurances can be given that such indemnification will be available. A motion to dismiss was filed by the issuers and individual defendants on July 15, 2002. The plaintiffs have initiated discussions related to a possible stipulated dismissal of certain of the individual defendants.

In addition, in the past, other types of securities class action litigation has often been brought against a company 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 a valid course of action, any securities litigation may result in substantial costs and divert management's attention and resources, which may seriously harm our business.

OUR STRATEGY TO EXPAND INTO INTERNATIONAL MARKETS THROUGH DIRECT SALES EFFORTS

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AND THROUGH STRATEGIC RELATIONSHIPS MAY NOT SUCCEED AS A RESULT OF LEGAL, BUSINESS AND ECONOMIC RISKS SPECIFIC TO INTERNATIONAL OPERATIONS.

Our strategy includes expansion into international markets through a combination of direct sales efforts and strategic relationships. In addition to risks generally associated with international operations, our future international operations might not succeed for a number of reasons, including:

- o dependence on sales efforts of third-party distributors and systems integrators;
- o difficulties in staffing and managing foreign operations;
- o difficulties in localizing products and supporting customers in foreign countries;
- o reduced protection for intellectual property rights in some countries;
- o greater difficulty in collecting accounts receivable; and
- o uncertainties inherent in transnational operations such as export and import regulations, 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 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 OFFERING TO MEET THE CHANGING NEEDS OF SERVICE PROVIDERS, 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 offering and packaged industry suites and to introduce new products and features to meet the requirements of our customers in a rapidly developing and evolving market. We devote significant resources to refining and expanding our software products, developing our pre-configured industry suites and investigating complimentary products and technologies. The requirements of our customers may change and our present or future products or packaged industry suites may not satisfy the evolving needs of our targeted markets. Due to our cost reduction measures, we have significantly reduced the amount of cash we will utilize for research and development. This reduction may make it more difficult to enhance future product offerings. If we are unable to anticipate or respond adequately to customer needs, we will lose business and our financial performance will suffer.

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IF WE CANNOT CONTINUE TO OBTAIN OR IMPLEMENT THE THIRD-PARTY SOFTWARE THAT WE INCORPORATE INTO OUR PRODUCT OFFERING, WE MAY HAVE TO DELAY OUR PRODUCT DEVELOPMENT OR REDESIGN EFFORTS, WHICH COULD HAVE AN ADVERSE EFFECT ON OUR REVENUE AND RESULTS OF OPERATIONS.

Our product offering involves 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 product offering, or fail to be supported by their vendors, it would be necessary for us to redesign our product offering. We might encounter difficulties in accomplishing any

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necessary redesign in a cost-effective or timely manner. We also could experience difficulties integrating our product offering 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 product offering which could cause our business and financial performance to suffer.

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.

Any misappropriation of our technology or the development of competitive technology could seriously harm our business. 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. These steps may not be adequate, and we do not know if they will prevent misappropriation of our intellectual property, particularly in foreign countries where the laws may not protect proprietary rights as fully as do the laws of the United States. Other companies could independently develop similar or superior technology without violating our proprietary rights. If we have to resort to legal proceedings to enforce our intellectual property rights, the proceedings could be burdensome and expensive and could involve a high degree of risk.

CLAIMS BY OTHERS THAT WE INFRINGE THEIR PROPRIETARY TECHNOLOGY COULD BE COSTLY AND HARM OUR BUSINESS.

Third parties could claim that our current or future products or technology infringe 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 product offering. If we faced a claim relating to proprietary technology or information, we might seek to license technology or information, or modify our own, but we might not be able to do so. Our failure to obtain the necessary licenses or other rights or to develop non-infringing technology could prevent us from selling our products and could seriously harm our business.

LOSS OF OUR SENIOR MANAGEMENT PERSONNEL WOULD LIKELY HURT 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 likely hurt our business. We have employment and non-compete agreements with some of our executive officers. However, these agreements do not obligate them to continue working for us.

PRODUCT 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 cause delays in product introductions or damage customer satisfaction, either of which could seriously harm our business. Our software products are highly

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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 hurt our business.

IN THE EVENT WE ACQUIRE THIRD PARTIES OR THIRD-PARTY TECHNOLOGIES, SUCH ACQUISITIONS COULD RESULT IN DISRUPTIONS TO OUR BUSINESS AND DIVERSION OF MANAGEMENT, AND COULD REQUIRE THAT WE ENGAGE IN FINANCING TRANSACTIONS THAT COULD HURT OUR FINANCIAL PERFORMANCE.

We may in the future make acquisitions of companies, products or technologies, or enter into strategic relationship agreements that require substantial up-front investments. We will be required to assimilate the acquired businesses and may be unable to maintain uniform standards, controls, procedures and policies if we fail to do so effectively. We may have to incur debt or issue equity securities to pay for any future acquisitions. The issuance of equity securities for any acquisition could be substantially dilutive to our stockholders. In addition, our profitability may suffer because of acquisition-related costs or amortization costs for acquired intangible assets and the time and focus required of Management to complete such an acquisition.

OUR SUCCESS DEPENDS IN PART ON OUR ABILITY TO MOTIVATE AND RETAIN HIGHLY SKILLED EMPLOYEES, WHICH IS DIFFICULT IN TODAY'S STRUGGLING TECHNOLOGY MARKET.

Our success depends in large part on our ability to motivate and retain highly skilled information technology professionals, software programmers and sales and marketing professionals. Our restructurings and general cost reductions may create uncertainties that could affect motivation and our ability to retain our employees. While qualified personnel in these fields may be readily employable, turnover of such personnel could create a lack of continuity that could prevent us from managing and competing for existing and future projects or to compete for new customer contracts.

DELAWARE LAW, OUR CERTIFICATE OF INCORPORATION AND OUR BYLAWS CONTAIN ANTI-TAKEOVER PROVISIONS THAT MAY DELAY, DEFER 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 in 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 by allowing only stockholders holding, in the aggregate, not less than 10% of the capital stock entitled to cast votes at these meetings to call a meeting, 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 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, unless an applicable exemption from the rule is available. These provisions do not apply to the purchasers of our Series F preferred stock.

RISKS ASSOCIATED WITH OUR SERIES F PREFERRED STOCK

THE HOLDERS OF OUR SERIES F PREFERRED STOCK HAVE RIGHTS THAT ARE SENIOR TO THOSE OF THE HOLDERS OF OUR COMMON STOCK IN THE EVENT OF THE SALE OF OUR COMPANY OR IN THE EVENT OF OUR LIQUIDATION, DISSOLUTION OR WINDING UP.

The holders of the Series F preferred stock will have a claim against our assets senior to the claim of the holders of our common stock in the event of our liquidation, dissolution or winding up. The aggregate amount of that senior claim will be at least \$110.94 per share of Series F preferred stock (the "Preferential Amount"), or approximately \$26.8 million based on the numbers of shares of Series F preferred stock outstanding at August 5, 2002.

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: (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 (except for a merger or consolidation after the consummation of which our stockholders immediately prior to such merger or consolidation own in excess of 50% of the voting securities of the surviving corporation or its parent corporation); or (ii) the sale or other disposition by us of substantially all of our assets (other than a sale or transfer of assets to one or more of our wholly owned subsidiaries). As a result, in the event of a Sale of the Company, the holders of the Series F preferred stock would be entitled to the first approximately \$26.8 million of the transaction value based on the number of shares of Series F preferred stock outstanding on August 5, 2002.

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, subject to adjustment for any stock split, stock dividend, reverse stock split, reclassification or consolidation of or on our common stock. As of August 5, 2002, the voting rights of the holders of Series F preferred stock, excluding shares of common stock currently owned by the holders of the Series F preferred stock, would constitute a majority of the entire voting class of common stock, or more than 60%, if the warrant holders exercise the warrants that were issued to purchase Series F preferred stock (the "Warrants").

As discussed below, the holders of the Series F preferred stock have the right 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. As a result, the holders of the outstanding shares of Series F preferred stock control a majority of the outstanding vote. Additionally, certain of the holders of 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 Series F preferred stock control more than 58% of the vote on any proposal submitted to the holders of our outstanding common stock, or more than 67% of the vote if the holders of the Series F preferred stock exercise their Warrants and warrants to purchase common stock. 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 down 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

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transaction or action, whether or not the holders of our common stock support or oppose the proposal. See "-- The holders of our Series F preferred stock have significant voting rights that are senior to those of the holders of our common stock" and "The Private Placement investors acquired voting power of our capital stock sufficient to enable the investors to control or significantly influence all major corporate decisions" below.

On August 5, 2002, we had 23,532,081 shares of common stock issued and outstanding and 234,362 shares of Series F preferred stock issued and outstanding. Additionally, we had outstanding Warrants for the purchase of an aggregate of 109,068 shares of Series F preferred stock.

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Following the conversion of the Series F preferred stock, the holders will be entitled to vote the number of shares of common stock issued upon conversion. As a result, the holders of Series F preferred stock have a significant ability to determine the outcome of matters submitted to our stockholders for a vote, including a vote with respect to a Sale of the Company and/or liquidation, dissolution or winding down of the Company. Additionally, the holders of the Series F preferred stock are entitled to vote as a separate class on certain matters, including:

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

As a result of these preferences and senior rights, the holders of the Series F preferred stock have rights that are senior to the common stock in numerous respects.

The holders of the Series F preferred stock have other rights and preferences, including the right to convert the Series F preferred stock into an increased number of shares of common stock as a result anti-dilution adjustments.

THE PRIVATE PLACEMENT PROVIDED THE INVESTORS IN THE SERIES F PREFERRED STOCK WITH SUBSTANTIAL EQUITY OWNERSHIP IN DALEEN AND HAD A SIGNIFICANT DILUTIVE EFFECT ON EXISTING STOCKHOLDERS.

The Series F preferred stock is convertible at any time into a substantial percentage of the outstanding shares of our common stock. The issuance of the Series F preferred stock has resulted in substantial dilution to the interests of the holders of our common stock. The exercise of the Warrants will result in further dilution. The number of shares of our common stock issuable upon

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conversion of the Series F preferred stock, and the extent of dilution to existing stockholders, depends on a number of factors, including events that cause an adjustment to the conversion price.

Due to the reset provision of the Series F preferred stock, the conversion price of the Series F preferred stock is \$0.9060. Based on the number of shares of Series F preferred stock that were outstanding as of August 5, 2002, if all of the holders of the Series F preferred stock and Warrants exercise the Warrants in full and convert all of the remaining shares of Series F preferred stock and Warrants into shares of common stock, we would issue an aggregate of approximately 42,053,109 additional shares of 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

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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 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 Warrant holder and will not be convertible or callable at the election of us. As a result of these provisions, the Series F preferred stock may remain outstanding indefinitely.

THE PRIVATE PLACEMENT INVESTORS ACQUIRED VOTING POWER OF OUR CAPITAL STOCK SUFFICIENT TO ENABLE THE INVESTORS TO CONTROL OR SIGNIFICANTLY INFLUENCE ALL MAJOR CORPORATE DECISIONS.

The holders of the Series F preferred stock and Warrants hold a percentage of the voting power of our capital stock that will enable such holders to elect directors and to control to a significant extent major corporate decisions involving Daleen and our assets that are subject to a vote of our stockholders. The voting rights of the holders of the Series F preferred stock, when combined with the common stock owned by their affiliates, currently represents more than a majority of the voting power of Daleen.

Following is information on HarbourVest Partners VI-Direct Fund L.P., one of the purchasers in the Private Placement as of August 5, 2002:



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- o HarbourVest Partners VI-Direct Fund L.P. is managed by HarbourVest, which also manages HarbourVest Partners V-Direct Fund L.P.
- o HarbourVest, through funds it manages, beneficially owns approximately 35.44% of our common stock, based on a Series F preferred stock conversion price of \$0.9060 and assuming conversion of all of the outstanding shares of Series F preferred stock and exercise of all HarbourVest funds' Warrants and outstanding warrants to purchase our common stock.
- o Prior to the conversion of the Series F preferred stock, but assuming exercise of the HarbourVest funds' Warrants and their other warrants, HarbourVest would control approximately 34.13% of the voting power of Daleen, or 27.32% prior to exercising the HarbourVest funds' Warrants and other warrants, based on the voting rights of the Series F preferred stock.

Following is information on SAIC Venture Capital Corporation, one of the purchasers in the private placement, as of August 5, 2002:

- o SAIC Venture Capital Corporation beneficially owns approximately 24.91% of our outstanding common stock, based on a Series F preferred stock conversion price of \$0.9060 and assuming conversion of all of the outstanding shares of Series F preferred stock and exercise of SAIC Venture Capital Corporation's Warrants.
- o Prior to the conversion of the Series F preferred stock, but assuming exercise of its Warrants, SAIC Venture Capital Corporation would control approximately 23.58% of the voting power of

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Daleen, or 19.18% prior to the exercise of its Warrants, based on the voting rights of the Series F preferred stock.

SALES OF A SUBSTANTIAL NUMBER OF SHARES OF COMMON STOCK IN THE PUBLIC MARKET, COULD LOWER OUR STOCK PRICE AND IMPAIR OUR ABILITY TO RAISE FUNDS IN NEW STOCK OFFERINGS.

Pursuant to the terms of the Purchase Agreements, the Company has filed with the Securities and Exchange Commission a Registration Statement on Form S-3 for the purpose of registering the shares of common stock issuable upon conversion of the Series F preferred stock. The Securities and Exchange Commission declared the Registration statement effective on September 25, 2001. Pursuant to other agreements with third parties, the Company has included in the Registration Statement shares of common stock held or that may be acquired by certain other stockholders of the Company. As a result, the Registration Statement covers an aggregate of 56,192,841 shares of common stock. The holders of the shares of common stock included in the Registration Statement are not obligated to sell any or all of the shares to be registered. However, it permits the holders of the registered shares, including the shares of common stock issuable upon conversion of the Series F preferred stock, to sell their shares of our common stock in the public market or in private transactions from time to time until all of the shares are sold or the shares otherwise may be transferred without restriction under the securities laws.

Future sales of a substantial number of shares of our common stock in the public market, or the perception that such sales could occur, including any

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perceptions that may be created upon the actual conversion of Series F preferred stock, could adversely affect the prevailing market price of our common stock. Additionally, a decrease in the market price of our common stock could make it more difficult for us to raise additional capital through the sale of equity securities.

### 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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## 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 our 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., BANCOSTON ROBERTSON STEPHENS INC., HAMBRECHT & QUIST LLC, SALOMON SMITH BARNEY INC., JAMES DALEEN, DAVID B. COREY AND RICHARD A. SCHELL, Index Number 01 CV 10944. The defendants include us, certain of the underwriters in our initial public offering and certain current and former officers and directors. 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. In the past year, more than 300 similar class action lawsuits have been filed in the Southern District of New York. These actions have been consolidated for pretrial purposes before one judge under the caption "In re Initial Public Offering Securities Litigation" in Federal district court for the Southern District of New York.

Specifically, the plaintiffs allege in the complaint that, in connection with our initial public offering, 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 initial public offering 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 initial public offering 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 our share price following our initial public offering. Plaintiffs claim that we and certain of our officers and directors knew or should have known of the underwriters actions and the failure to disclose these alleged arrangements rendered our prospectus included in our registration statement on Form S-1 filed with the Securities and Exchange Commission in September 1999 materially false and misleading. Plaintiffs seek unspecified damages and other relief. We intend to defend vigorously against the plaintiffs claims. We believe we are entitled

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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. We are currently in mediation with the plaintiffs in an attempt to facilitate a resolution of this matter against the defendants. A Motion to dismiss was filed by the issuers and individual defendants on July 15, 2002. The plaintiffs have initiated discussions related to a possible stipulated dismissal of certain of the individual defendants.

We are involved in a number of other lawsuits and claims incidental in our ordinary course of business. We do not believe the outcome of any of these activities 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

The Company held its 2002 Annual Meeting of Stockholders on June 11, 2002 (the "Annual Meeting"). At the Annual Meeting, the stockholders of the Company voted on and approved each of the following proposals:

Proposal One: To approve the election of James Daleen and Ofer Nemirovsky as directors to serve for a term expiring at the 2005 annual meeting of stockholders and to approve the election of Stephen J. Getsy as a director to serve for a term expiring at the 2004 annual meeting of stockholders.

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Proposal Two: To approve and adopt the Daleen Technologies, Inc. 2001 Broad-Based Stock Incentive Plan.

The total number of shares of our common stock issued, outstanding and entitled to vote at the Annual Meeting was 23,532,081 shares, of which 18,873,890 shares of common stock were present at the meeting in person or by proxy. The total number of shares of our Series F Convertible Preferred Stock outstanding and entitled to vote all matters as a class with the common stock (on the basis of 100 votes per share of Series F Preferred Stock) was 234,362 shares, of which 175,771 shares of Series F Preferred Stock were present at the meeting in person or by proxy.

The following list indicates the number of votes received by each of the nominees for election to the Company's Board of Directors in Proposal One:

	For -----	Withheld -----	Result -----
James Daleen	36,354,380	96,610	Approved
Ofer Nemirovsky	36,330,230	120,760	Approved
Stephen J. Getsy	36,360,580	90,410	Approved

Proposal Two was approved by the holders of 59.9% of the outstanding shares of common stock and Series F Preferred Stock (voting on a 100-1 basis as a single class with the holders of common stock) entitled to vote at the annual meeting. Specifically 28,118,939 shares were voted in favor of this proposal, 345,038 shares were voted against this proposal, 9,643 shares abstained from voting on this proposal and there were 7,977,370 broker non-votes.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibit List

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Exhibit Number -----	Description -----
99.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Chief Executive Officer
99.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Chief Financial Officer

(b) Reports on Form 8-K

Report on Form 8-K filed May 22, 2002 with respect to The Nasdaq National Market delisting notice and the Company requesting a hearing before a listing qualifications panel to appeal the delisting.

Report on Form 8-K filed June 27, 2002 with respect to the sale of PartnerCommunity, Inc.

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SIGNATURES

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

DALEEN TECHNOLOGIES, INC.

Date: August 12, 2002

/s/ JAMES DALEEN

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JAMES DALEEN  
Chairman of the Board of Directors,  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: August 12, 2002

/s/ JEANNE T. PRAYTHER

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JEANNE T. PRAYTHER  
Chief Financial Officer (Principal  
Financial Officer and Principal  
Accounting Officer)

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