DALEEN TECHNOLOGIES INC
Form 10-Q
May 17, 2004

**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended March 31, 2004**

**OR**

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

**For the transition period from ____________ to ____________**

**Commission File Number: 0-27491**

**DALEEN TECHNOLOGIES, INC.**

(Exact name of registrant as specified in Its charter)

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

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

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

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

As of May 1, 2004, the Registrant had outstanding 46,929,372 shares of common stock.

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**DALEEN TECHNOLOGIES, INC. AND SUBSIDIARIES**
**FORM 10-Q**

**QUARTER ENDED MARCH 31, 2004**

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## PART I

## FINANCIAL INFORMATION

### Item 1. Financial Statements.

**DALEEN TECHNOLOGIES, INC. AND SUBSIDIARIES**

**Condensed Unaudited Consolidated Balance Sheets**

| | December 31, 2003 | March 31, 2004 |
|---|---|---|
| | (in thousands, except share and per share data) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 2,497 | $ 2,195 |
| Restricted cash | 561 | 506 |
| Accounts receivable, less allowance for doubtful accounts of $887 and $862 at December 31, 2003 and March 31, 2004 respectively | 610 | 1,151 |
| Costs in excess of billings | 2,032 | 2,975 |
| Unbilled revenue | 392 | 806 |
| Other current assets | 487 | 568 |
| Total current assets | 6,579 | 8,201 |
| Property and equipment, net | 931 | 786 |
| Goodwill | 5,086 | 5,086 |
| Other assets | 430 | 481 |
| Total assets | $ 13,026 | $ 14,554 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 148 | $ 86 |
| Accrued payroll and other accrued expenses | 2,267 | 2,825 |
| Current portion of capitalized lease | 26 | 9 |
| Operating loan | | 2,000 |
| Billings in excess of costs | 97 | 320 |
| Deferred revenue | 372 | 508 |
| Other current liabilities | 16 | 3 |

| | | |
|---|---|---|
| Total current liabilities | 2,926 | 5,751 |
| Other long term liabilities | 5 | 11 |
| Total liabilities | 2,931 | 5,762 |
| Stockholders equity: | | |
| Series F convertible Preferred Stock $.01 par value; 588,312 shares authorized ; 453,322 and 449,237 issued and outstanding at December 31, 2003 and March 31, 2004, respectively ($110.94 per share liquidation value) | 27,112 | 26,659 |
| Common stock-$.01 par value; 200,000,000 shares authorized; 47,449,127 shares issued and 46,429,163 outstanding at December 31, 2003 and 47,949,336 shares issued and 46,929,372 outstanding at March 31, 2004 | 475 | 479 |
| Additional paid-in capital | 197,187 | 197,636 |
| Accumulated deficit | (214,528) | (215,831) |
| Treasury stock at cost; 1,019,964 shares at December 31, 2003 and March 31, 2004 respectively | (151) | (151) |
| Total stockholders equity | 10,095 | 8,792 |
| Total liabilities and stockholders equity | $ 13,026 | $ 14,554 |

See accompanying notes to condensed unaudited consolidated financial statements.

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**DALEEN TECHNOLOGIES, INC. AND SUBSIDIARIES**

**Condensed Unaudited Consolidated Statements of Operations**

| | Three months ended March 31, | |
|---|---|---|
| | **2003** | **2004** |
| | (In thousands, except per share data) | |
| Revenue: | | |
| Professional services and other | $ 3,824 | $ 3,667 |
| License fees | 245 | 587 |
| Total revenue | 4,069 | 4,254 |
| Cost of revenue: | | |
| Professional services and other | 1,370 | 1,584 |
| License fees | | |
| Total cost of revenue | 1,370 | 1,584 |
| Gross margin | 2,699 | 2,670 |
| Operating expenses: | | |
| Sales and marketing | 900 | 734 |
| Research and development | 1,681 | 1,652 |
| General and administrative | 1,614 | 1,623 |
| Total operating expenses | 4,195 | 4,009 |

| | | |
|---|---|---|
| Operating loss | (1,496) | (1,339) |
| Total interest income and nonoperating income, net | 78 | 36 |
| Net loss applicable to common stockholders | $ (1,418) | $ (1,303) |
| Net loss applicable to common stockholders per share -basic and diluted | $ (0.03) | $ (0.03) |
| Weighted average shares outstanding- basic and diluted | 45,829 | 46,858 |

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**

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2003** | **March 31, 2004** |
| | **(In thousands)** | |
| Cash flows from operating activities: | | |
| Net loss | $(1,418) | $(1,303) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 1,410 | 649 |
| Bad debt expense | 5 | 11 |
| Interest income on stockholders notes receivable | (1) | |
| Changes in assets and liabilities | | |
| Restricted cash | | 55 |
| Accounts receivable | 699 | (519) |
| Costs in excess of billings | (7) | (943) |
| Unbilled revenue | 5 | (414) |
| Other current assets | (308) | (557) |
| Other assets | (5) | (44) |
| Accounts payable | | (61) |
| Accrued payroll and other accrued expenses | 73 | 558 |
| Billings in excess of costs | 89 | 223 |
| Deferred revenue | (616) | 135 |
| Other current liabilities | 8 | (6) |
| Net cash used in operating activities | (66) | (2,216) |
| Cash flows (used in) provided by financing activities: | | |
| Payment of capital lease | (72) | (17) |
| Proceeds from operating loan | | 2,000 |
| Net cash (used in) provided by financing activities | (72) | 1,983 |
| Cash flows used in investing activities: | | |
| Repayment of stockholder s notes receivable | 12 | |
| Payments related to the Abiliti acquisition | (262) | |
| Capital expenditures | (104) | (68) |

| | | |
|---|---|---|
| Net cash used in investing activities | (354) | (68) |
| Effect of exchange rates on cash and cash equivalents | (13) | (1) |
| Net decrease in cash and cash equivalents | (492) | (301) |
| Cash and cash equivalents-beginning of period | 6,585 | 2,497 |
| Cash and cash equivalents-end of period | $ 6,080 | $ 2,195 |

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**
**March 31, 2004**

**(1) Basis of Presentation**

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

The results of operations for the three months ended March 31, 2004 are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year.

**(2) Principles of Consolidation and Reclassifications**

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

Certain reclassifications have been made to the 2003 condensed unaudited consolidated financial statements to conform to the 2004 presentation.

**(3) Basic and Diluted Net Loss Per Share**

Basic and diluted net loss per share was computed by dividing net loss applicable to common stockholders by the weighted average number of shares of common stock outstanding for each period presented. Common stock equivalents were not considered since their effect would be antidilutive. Common stock equivalents amounted to 55,523,212 shares and 56,109,665 shares for the three months ended March 31, 2004 and 2003, respectively.

**(4) Liquidity**

The Company incurred net losses of approximately $1.3 million for the three months ended March 31, 2004 and had an accumulated deficit of $215.8 million at March 31, 2004. Cash and cash equivalents and restricted cash at March 31, 2004 were $2.7 million. Cash used in operations for the three months ended March 31, 2004 was $2.2 million. The Company continued to provide outsourcing services to Allegiance Telecom Company Worldwide ( Allegiance ) pursuant to an agreement expiring on December 31, 2004. Allegiance accounted for 24.8% of total revenue for the three months ended March 31, 2004. There are no minimum revenues from Allegiance under this agreement. Allegiance has informed the Company that they are migrating data to another software system and intend to discontinue use of the Company s services gradually so that all data will be migrated by June 2004.

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

In February 2004, the Company closed a revolving loan facility (the Operating Loan ) with Silicon Valley Bank ( SVB ) and guaranteed by EXIM Bank. (See Note 5 for a description of terms and financial covenant requirements). Total funding under the Operating Loan is $2,700,000. The Company can borrow against the Operating Loan based on estimated funding dates and may have outstanding borrowings at any given time of up to $2,000,000. The balance on the Operating Loan as of March 31, 2004 was $2,000,000. Approximately $1.3 million of the Operating Loan was repaid in May 2004.

On May 7, 2004 definitive agreements were signed by affiliates of Quadrangle Capital Partners L.P. ( Quadrangle ) and Behrman Capital ( Behrman ) for investments of $25 million and $5 million, respectively, into Daleen Holdings, Inc. ( DHI ) a newly formed holding company that will simultaneously acquire Daleen and Protek Telecommunications Solutions Limited ( Protek ), (the Investment and Acquisition Transactions ). As part of the Investment and Acquisition Transactions, Daleen will become a private company. The Investment and Acquisition Transactions are subject to the satisfaction of customary closing conditions including the approval of Daleen stockholders. Upon signing the definitive agreements, Behrman entered into a $5.1 million bridge loan facility.(the Bridge Loan Facility ). The aggregate principal amount outstanding under the Bridge Loan Facility will be credited against Behrman s commitment under the Investment and Acquisition Transactions. (See note 15 for a description and the terms of the Investment and Acquisition Transactions and Bridge Loan Facility).

The Company believes the cash and cash equivalents at March 31, 2004, together with the Operating Loan proceeds, Bridge Loan Facility and the additional funding resulting from the Investment and Acquisition Transactions, may be sufficient to fund operations for the foreseeable future. The Investment and Acquisition Transactions are subject to a number of closing conditions, including the approval of the Company s stockholders, and there can be no assurance that the transactions will be consummated. If the transactions are not consummated the Company believes the cash and cash equivalents at March 31, 2004 may not be sufficient to fund the operations and the Company will be required to further reduce operations and/or seek additional financing. Although the Company is precluded from considering other strategic alternatives pending completion or termination of the Investment and Acquisition Transactions, if the transactions are not completed, the Company will consider other strategic alternatives.

There can be no assurance that additional financing will be available, or that, if available the financing will be obtainable on terms acceptable to the Company or that additional financing would not be substantially dilutive to the Company s existing stockholders. 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 consummate the Investment and Acquisition Transactions will have a material adverse affect on the Company s ability to operate as a going concern, which may result in filing for bankruptcy protection, winding down operations and/or liquidation of assets. The condensed unaudited consolidated financial statements have been prepared assuming that the Company will continue as a going concern, and do not include any adjustments that might result from the outcome of this uncertainty.

**(5) Operating Loan**

In February 2004, the Company closed the Operating Loan with SVB and guaranteed by EXIM Bank. The term of the Operating Loan is fifteen months. Total funding under the Operating Loan is $2.7 million. The Company can borrow against the Operating Loan based on estimated funding dates and may have outstanding borrowings at any given time of up to $2,000,000. The proceeds of the Operating Loan will be used for operating costs associated with its contract with Empresa de Telecomunicaciones de Bogotá ( ETB ), (the ETB Contract ). The Company intends to repay the Operating Loan solely from revenues received from the ETB Contract. Interest accrues at the rate of prime plus 2% (minimum 4%) per annum. SVB has a first priority security

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interest and EXIM Bank has a second priority security interest in substantially all of the Company s assets until the Operating Loan is paid in full. The Operating Loan contains customary representations and warranties and covenants including maintaining a tangible net worth requirement of $4.0 million. In May 2004, the Operating Loan was amended effective March 31, 2004 to change the tangible net worth requirement to $3.0 million. The Company is currently in compliance with all covenants under the Operating Loan. The balance on the Operating Loan as of March 31, 2004 was $2,000,000.. Approximately $1.3 million of the Operating Loan was repaid in May 2004 as a result of payments received from ETB..

**(6) Revenue Recognition**

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

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

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

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

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

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

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

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

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

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

Professional service fees are recognized separately from the license fee since the services are not considered significant to the functionality of the software and the software does not require significant modification, production or customization. In instances when the services performed in conjunction with certain contracts are significant to the functionality of the software and the software requires significant modification and customization at the customer s site, the Company recognizes the total license and services amount together.

There are two types of service contracts that are entered into with customers: fixed fee and time and materials. The Company recognizes revenue from fixed fee contracts using the percentage of completion method, based on the ratio of total hours incurred to date to total estimated labor hours. Changes in job performance, job conditions, estimated profitability and final contract settlement may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor and supplies. These costs are readily determinable since the Company uses the costs that would have been charged if the contract was a time and materials contract. Provisions for estimated losses on uncompleted contracts are recorded in the period in which losses are determined. Amounts billed in excess of revenue recognized to date are classified as Billings in excess of costs , whereas revenue recognized in excess of amounts billed are classified as Costs in excess of billings in the accompanying condensed unaudited consolidated balance sheets.

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

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

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

The Company typically receives 25 percent of the license fee as a down payment and the balance is typically due between three and nine months from contract execution. In limited situations, the Company enters into extended payment terms with certain customers if the Company believes it is a good business opportunity. When it enters into these arrangements, the Company evaluates each arrangement individually to determine whether collectibility is probable and the fees are fixed and determinable. An arrangement fee is not presumed to be fixed and determinable if payment of a significant portion of the license fee is due after the normal and customary terms usually offered to customers by the Company. Revenue related to arrangements containing extended payment terms where the fees are not considered fixed and determinable is deferred until payments are due.

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

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

**(7) Stock-Based Compensation**

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

| | **Three Months Ended March 31,** | |
|---|---|---|
| | **2003** | **2004** |
| Expected life | 5 years | 5 years |
| Risk-free interest rate | 1.19% - 3.83% | 1.20% - 3.86% |
| Volatility | 173.6% | 145.03% |
| Dividends | None | None |

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

| | **For the Three Months Ended March 31,** | |
|---|---|---|
| | **2003** | **2004** |
| Net loss, as reported | $(1,418) | (1,303) |
| Deduct: Additional stock-based employee compensation expense determined under the fair value based method for all awards | (713) | (326) |
| Pro forma net loss | $(2,131) | (1,629) |

| | | | |
|---|---|---|---|
| Loss per share: | | | |
| Basic and diluted | - as reported | $ (.03) | (.03) |
| Basic and diluted | - pro forma | $ (.05) | (.04) |

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**(8) Abiliti Acquisition and 2002 Private Placement**

On December 20, 2002, pursuant to an Asset Purchase Agreement dated October 7, 2002 (the Asset Purchase Agreement ), Daleen Solutions, an indirect wholly-owned subsidiary of Daleen, consummated its purchase of substantially all of the assets and assumption of certain liabilities of Abiliti (the Abiliti Acquisition ). As consideration for the Abiliti Acquisition, Daleen issued to Abiliti 11,406,284 shares of common stock, 115,681 shares of Series F preferred stock and warrants to purchase 5,666,069 additional shares of common stock at an exercise price of $0.9060 per share (the Asset Purchase Warrants ). The total consideration for the Abiliti Acquisition was $6.1 million.

Concurrently with the consummation of the Abiliti Acquisition, on December 20, 2002, pursuant to an Investment Agreement dated October 7, 2002 (the Investment Agreement ), Daleen completed its private placement of 10,992,136 shares of common stock, 115,681 shares of Series F preferred stock, warrants to purchase 5,666,069 additional shares of common stock at an exercise price of $0.906 (the Investment Warrants ) per share, and warrants to purchase 500,000 additional shares of common stock at an exercise price of $0.17 per share (the Additional Warrants ), for total proceeds of $5.015 million in cash (the 2002 Private Placement ). A portion of the securities were held in escrow , including 1,140,629 shares of common stock, 11,568 shares of Series F preferred stock, and warrants to purchase 566,607 additional shares of the Company s common stock at an exercise price of $.9060 per share (collectively the Escrowed Shares ). The Escrowed Shares and claims related thereto were released by the Company in partial consideration of the Bridge Loan Facility.

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

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

**(9) Goodwill**

At December 31, 2003 and March 31, 2004, goodwill represents the excess of costs over the fair value of assets related to the Abiliti Acquisition (See Note 8). The Company follows the provisions of Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* ( SFAS No. 142 ). Goodwill and other intangible assets acquired in a purchase business combination and determined to have an infinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets* . There has been no impairment to date related to the goodwill recorded in connection with the Abiliti Acquisition.

**(10) Business and Credit Concentrations**

During the three months ended March 31, 2004, 65.4 percent of the Company s total revenue was attributed to three customers. Sales to these three customers accounted for 30.1 percent, 24.8 percent, and 10.6 percent of the total revenue for the three month period. During the three months ended March 31, 2003, 75.2 percent of the Company s total revenue was attributable to three customers. Sales to these three customers accounted for 47.7 percent, 15.1 percent and 12.4 percent of the total revenue for the three month period.

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Three customers accounted for 64.3 percent and 45.7 percent of total accounts receivable at March 31, 2004 and December 31, 2003, respectively.

**(11) Related Party Transactions**

Science Applications International Corporation ( SAIC ) through its subsidiary SAIC Venture Capital Corporation is a significant stockholder of the Company. Revenue related to SAIC for the three months ended March 31, 2004 and March 31, 2003 was $7,500 and $13,800, respectively. SAIC owns 49 percent of the voting stock of Danet, Inc. ( Danet ), 100 percent of the voting stock of Telcordia Technologies, Inc. ( Telcordia ) and 60 percent of the voting stock of Intesacol. Danet is a customer and a subcontractor of the Company s product. There was no revenue recognized related to Danet for the three months ended March 31, 2004 and 2003. In the three months ended March 31, 2004 and March 31, 2003, we paid Danet $35,000 and $103,442, respectively, related to professional services. The Company has a strategic alliance relationship and an Original Equipment Manufacturer Agreement with Telcordia. Revenue related to Telcordia for the three months ended March 31, 2004 and March 31, 2003 was $0 and $36,000, respectively. In 2003, Intesacol became a subcontractor of the Company to perform services under the ETB Contract. In the three months ended March 31, 2004 and March 31, 2003, the Company paid $0 to Intesacol for professional services.

On May 7, 2004, the Company entered into the Bridge Loan Facility and the Investment and Acquisition Transactions with Behrman who is a significant stockholder of the Company. See note 15 for terms and conditions.

**(12) Legal Proceedings**

*Fazari v. Daleen Technologies, Inc.*

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

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

Plaintiffs seek unspecified damages and other relief.

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In June 2003, the Company approved the terms of a proposed settlement involving the plaintiffs, the insurance companies and numerous issuers, including the Company and the individual defendants, that includes a waiver by the insurance companies of any retention amounts under the policies. Court approval of the settlement is required. Under the terms of the proposed settlement, there would be no liability to be recorded by the Company other than legal fees incurred in the initial defense of the action, which are immaterial. There is no assurance that a settlement with the plaintiffs will be finalized. In the event that the settlement is not finalized and approved by the court, the Company intends to defend vigorously against the plaintiffs claims. The Company believes that it is entitled to indemnification by the underwriters under the terms of the underwriting agreements. The Company has notified the underwriters of the action, but the underwriters have not yet agreed to indemnify the Company. The lead underwriter, BancBoston Robertson Stephens Inc., has ceased doing business and there is no assurance it will have the financial resources to provide indemnification. Currently the amount of a loss, if any, cannot be determined and, accordingly no amounts have been recorded by the Company in the accompanying unaudited condensed consolidated financial statements with respect to this litigation.

*Kops v. Daleen Technologies, Inc., et al.*

On or about April 7, 2004, a class action complaint was filed in the Court of Chancery of the State of Delaware in and for New Castle County. The complaint is styled *Kops Investment Advisors LLC v. Daleen Technologies, Inc., James Daleen, Gordon Quick, Ofer Nemirovsky, Daniel J. Foreman, Dennis G. Sisco, Stephen J. Getsy, and John S. McCarthy.* The plaintiff is seeking a temporary and permanent injunction enjoining defendants from proceeding with the reverse stock split contemplated by the preliminary proxy filed in January, 2004, as well as costs and unspecified damages related to the reverse split. On May 7, 2004, the Company announced that it will not pursue a stockholder vote on or the completion of the reverse stock split proposed by the preliminary proxy statement and the transaction which is the subject of this litigation has been abandoned. Accordingly, no amounts have been recorded by the Company in the accompanying unaudited condensed consolidated financial statements with respect to this litigation.

*Abiliti-Related Litigation*

On August 1, 2003, a First Amended Petition, styled as *James E. Kientzy and David K. Wilson vs. Abiliti Solutions, Inc., a corporation, and Daleen Technologies, Inc., a corporation, and Daleen Solutions, Inc., a corporation and wholly-owned subsidiary of Daleen*, was filed in the Circuit Court of the County of St. Louis, State of Missouri. The First Amended Petition added Daleen Technologies and Daleen Solutions as defendants in the named action. The First Amended Petition contains certain allegations against Abiliti related to the non-payment of certain promissory notes in the aggregate principal amount of $1.2 million. The promissory notes that are the subject of the First Amended Petition are liabilities that were retained by Abiliti pursuant to the terms of the Abiliti Acquisition. The plaintiffs allege that the purchase of substantially all of the assets and certain liabilities of Abiliti constituted a de facto merger and, as a result, Daleen Technologies and its indirect wholly owned subsidiary, Daleen Solutions, are responsible for payment of the promissory notes and indemnification of the plaintiffs in connection with Abiliti s counterclaim against the plaintiffs. The First Amended Petition also seeks to set aside the transfer of Abiliti assets as a fraudulent transfer. In December 2003, the court granted summary judgment to the plaintiffs against Abiliti n/k/a Albacore Holdings, Inc. ( Albacore ) on the promissory notes awarding a judgment in the amount of $1,796,938.14. However, the judgment provides that it is not subject to execution until such time as the senior debt (certain promissory notes and series B preferred stock) is paid in full. Albacore currently has insufficient assets and no operating income with which to pay the senior debt. The trial on the remaining claims in this matter has been set forJuly 2004. The Company has provided notice to Albacore of the action and Albacore temporarily assumed the defense of the First Amended Petition on the Company s behalf. However, Albacore has notified the Company that it does not have the financial resources to defend and/or settle the claims, pay any judgment ultimately obtained by plaintiffs, or continue to provide indemnification in connection with this matter. The Escrowed Shares securing Albacore s indemnification

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obligations were released in partial consideration of the Behrman s entry into the Bridge Loan Facility. It appears probable that a settlement has been reached for $250,000 in this matter. An accrual has been placed in the condensed unaudited consolidated financial statements as of March 31, 2004.

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

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

*General litigation*

On August 5, 2003, the Company reached a settlement in satisfaction of an outstanding obligation with a customer under a software license agreement. Under the terms of the settlement, this customer satisfied their obligations by agreeing to make payments in cash of $365,000 plus interest. The Company received $250,000 on August 20, 2003, and $57,500 plus interest on November 5, 2003 and received $57,500 plus interest in February 2004. In accordance with SOP 97-2, the revenue related to the contractual agreement with this customer is recognized on a cash basis. Therefore, the Company recorded $57,500 as license revenue in the three months ended March 31, 2004.

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

**(13) Capital and Operating Leases**

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

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

| | |
|---|---|
| Furniture and Equipment | $ 141 |
| Less accumulated amortization | (134) |

| | |
|---|---|
| $ | 7 |

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Future minimum lease payments under non cancelable operating leases (with initial or remaining lease terms in excess of one year) and future minimum capital lease payments as of March 31, 2004 are as follows (in thousands):

| Year Ending December 31: | Capital Leases | Operating Leases |
|---|---|---|
| 2004 | $ 9 | $ 632 |
| 2005 | | 697 |
| 2006 | | 720 |
| 2007 | | 644 |
| 2008 and thereafter | | 857 |
| Total minimum lease payments | 9 | 3,550 |
| Less amount representing interest | | |
| Present value of minimum capital lease payments | 9 | |
| Less current installment of obligations under capital lease payments | 9 | |
| Obligation under capital leases, excluding current installment | $ | |

The Company subleases office space in Atlanta and in St. Louis. The amounts of minimum operating lease payments reflected in the above table are offset by future minimum rental receipts from sublessees of $94,808 in 2004.

**(14) New Accounting Pronouncements**

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

In December 2003, the FASB issued Interpretation No. 46 ( FIN 46R ) (revised December 2003), Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51 ( ARB 51 ), which addresses how a business enterprise should evaluate whether it has a controlling interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces FASB Interpretation No. 46 (FIN 46), which was issued in January 2003. Before concluding that it is appropriate to apply ARB 51 voting interest consolidation model to an entity, an enterprise must first determine that the entity is not a variable interest entity (VIE). As of the effective date of FIN 46R, an enterpri