

# SECURITIES AND EXCHANGE COMMISSION

## FORM S-1/A

General form of registration statement for all companies including face-amount certificate companies [amend]

Filing Date: **1999-09-10**  
SEC Accession No. **0000930661-99-002135**

([HTML Version](#) on [secdatabase.com](#))

### FILER

#### DATA RETURN CORP

CIK: **1088330** | IRS No.: **752725998** | State of Incorporation: **TX** | Fiscal Year End: **0331**  
Type: **S-1/A** | Act: **33** | File No.: **333-84011** | Film No.: **99709728**  
SIC: **7389** Business services, nec

#### Mailing Address

801 STADIUM DRIVE SUITE  
117  
ARLINGTON TX 76011

#### Business Address

801 STADIUM DRIVE SUITE  
117  
ARLINGTON TX 76011  
8174617715

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

AMENDMENT NO. 2  
TO  
FORM S-1  
REGISTRATION STATEMENT  
UNDER  
THE SECURITIES ACT OF 1933

DATA RETURN CORPORATION  
(Exact name of registrant as specified in its charter)

<TABLE>	<C>	<C>
<S>	Texas	7379
	(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)

</TABLE>

222 West Las Colinas Boulevard, Suite 450  
Irving, Texas 75039  
(972) 869-0770  
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Sunny C. Vanderbeck  
Chairman and Chief Executive Officer  
Data Return Corporation  
222 West Las Colinas Boulevard, Suite 450  
Irving, Texas 75039  
(972) 869-0770  
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

<TABLE>	<C>
<S>	Stephen B. Norris
	Mark C. Gunnin
	William D. Howell
	Thompson & Knight L.L.P.
	801 Cherry Street, Suite 1600
	Fort Worth, Texas 76102
	(817) 347-1700
	Jorge del Calvo
	Stanton D. Wong
	Gabriella A. Lombardi
	Christine F. Nakagawa
	Pillsbury Madison & Sutro LLP
	2550 Hanover Street
	Palo Alto, California 94304
	(650) 233-4500

</TABLE>

Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box.

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this form is a post effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. [ ]

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The registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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+++++  
+The information in this preliminary prospectus is not complete and may be +  
+changed. We may not sell these securities until the registration statement +  
+filed with the Securities and Exchange Commission becomes effective. This +  
+preliminary prospectus is not an offer to sell these securities nor a +  
+solicitation of an offer to buy these securities in any jurisdiction where +  
+the offer or sale is not permitted. +  
+++++

SUBJECT TO COMPLETION, DATED , 1999

PRELIMINARY PROSPECTUS Shares

[LOGO OF DATA RETURN APPEARS HERE]

Common Stock

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This is an initial public offering of 6,250,000 shares of common stock of Data Return Corporation. We are selling all of the shares of common stock under this prospectus. The underwriters may, under some circumstances, purchase up to an additional 937,500 shares of common stock from us at the initial public offering price less the underwriting discount.

It is currently estimated that the initial public offering price will be between \$11.00 and \$13.00 per share. We have applied to have our common stock approved for listing on the Nasdaq National Market under the symbol "DRTN."

Microsoft Corporation has agreed to purchase directly from us \$5.0 million of our common stock, in a private placement that will occur the day after the pricing of this offering. The price per share which Microsoft will pay us will be the lesser of the midpoint of the lowest filing range and the price to public.

See "Risk Factors" beginning on page 6 about the risks you should consider before buying shares of our common stock.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

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<TABLE>  
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Per  
Share Total  
-----

<S>	<C>	<C>
Public offering price.....	\$	\$
Underwriting discounts and commissions.....	\$	\$
Proceeds, before expenses, to us.....	\$	\$

</TABLE>

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The underwriters expect to deliver the shares against payment in New York, New York on , 1999.

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Joint Lead Managers

Bear, Stearns & Co. Inc.  
Book Running Manager

CIBC World Markets

-----

Wit Capital Corporation

The date of this prospectus is , 1999.

Outside of gate fold

An image of half a globe with images of some of our customers' web pages surrounding the globe above its surface is centered along the right side of the page.

To the left of the globe is the text "A WORLD OF OPPORTUNITY" above the Data Return logo and the slogan "Hosting The Back Office for E-Business."

Left page of inside of gate fold

The inside front cover of the prospectus has a caption centered at the top of the page in large text that reads "Hosting the Back Office for E-Business."

An image of the other half of the globe with images of some other customers' web pages surrounding the globe above its surface is centered along the left side of the page.

Centered on the right hand side of the page, there is an image of a hand plugging a phone line into a phone jack.

In the bottom right corner of the page, there are three sets of images: the first is a screen for Microsoft Exchange with the text "Microsoft Exchange"; the second set is a series of folders with icons representing applications with the text "Application Hosting"; and the third set is a sample web page with the text "Advanced Web Hosting."

Right page of inside of gate fold

The top half of the page is an image of four rows of server cabinets with servers in them.

Beneath this image are three circular frames with images inside. The left one contains an image of clustered hosting diagram. The text "Multi-Server Clustered Solutions" appears below the frame. The middle frame contains an image of a portion of the world, including the United States, with a network diagram drawn on it. The text "State-of-the-Art Infrastructure" appears below the frame. The right frame contains an image of a man looking at file folders. The text "Extensive Microsoft Expertise" appears below this frame.

The bottom one-third of the page contains the caption "Data Return currently hosts over 1,600 web sites. Here are a few of our more widely-known customers" over a list of widely-known customers.

Prospective investors may rely only on the information contained in this prospectus. Neither Data Return Corporation nor any underwriter has authorized anyone to provide prospective investors with different or additional information. This prospectus is not an offer to sell nor is it seeking an offer to buy these securities in any jurisdiction where the offer or sale is not permitted. The information contained in this prospectus is correct only as of the date of this prospectus, regardless of the time of delivery of this prospectus or any sale of these securities.

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Until , 1999 (25 days after the date of this prospectus), all dealers that buy, sell or trade these shares of common stock, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers' obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

PROSPECTUS SUMMARY

This summary highlights the key information contained in this prospectus. Because it is a summary, it does not contain all the information you should consider before making an investment decision. You should read the entire prospectus carefully, including the section titled "Risk Factors" and the financial statements and the notes relating to those statements.

Data Return

## Our Company

Data Return is a leading provider of advanced Internet hosting services based on technologies developed by Microsoft Corporation. We focus primarily on customers that are deploying sophisticated high-end web-based applications, including electronic commerce, through which they can conduct transactions and manage information worldwide over the Internet. We believe that hosting on the Microsoft platform offers a greater opportunity than hosting on other platforms. According to International Data Corp., Microsoft Windows NT will be the key engine for growth within the worldwide server market.

We provide high quality, high performance advanced hosting services, which are comprised of:

- . advanced managed services, whereby we configure, install, operate and maintain the hardware, software and network technologies necessary to implement and support our customers' complex, business-critical web sites and web-based applications.
- . a scalable deployment architecture, which allows us to quickly and cost-effectively expand and enhance our customers' web sites; and
- . high performance content delivery, which improves overall performance through increased speed and reliability.

As of August 31, 1999, we hosted over 1,600 web sites for more than 800 customers. Our customers range in size from large Fortune 500 companies to smaller businesses, both conventional and web-based. Some of our largest and most recognizable customers are Ericsson, Executive Software, First USA, Honeywell, Microsoft and Trane. We provide our services to companies across many industries located primarily in North America and Europe. We also have a small but growing customer base in South America, Asia, Africa and Australia.

Level 3 Communications, Inc. and Compaq Computer Corporation are shareholders of our company, and Microsoft has agreed to invest in our company. In addition to their investments in our common stock, we have entered into strategic agreements with each of these companies. We are currently Level 3's only preferred provider of Microsoft-based advanced hosting solutions. Pursuant to our agreement, we will train and team with Level 3's sales force to generate new business opportunities. Further, we will be able to locate our servers and related equipment in any of Level 3's existing or future U.S. facilities, or gateways. In doing so, we expect to avoid the significant cost of constructing additional data centers of our own. In addition, we will be able to utilize Level 3's personnel to install our equipment at these gateways. Under our agreement with Microsoft, we will license proprietary installation tools for third-party hosted applications to Microsoft and train Microsoft's employees and customers in the use of those tools. In exchange, Microsoft will provide us technical consulting and marketing services. We also have a server purchase agreement with Compaq which we believe strengthens our relationship with this key vendor. We believe these relationships enhance our credibility with potential customers and provide us with early access to new products, superior technical services, training and new business development opportunities.

We were incorporated in Texas in August 1997 by three former Microsoft product support engineers and

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have achieved an average quarterly revenue growth rate of 50% since October 1, 1997. However, we experienced net losses of approximately \$1.3 million for the year ended March 31, 1999, and we anticipate continuing and increasing losses. We believe the following are among the key factors that have distinguished our company and our offerings and that will continue to drive our growth:

- . a full range of hosting services pre-packaged with defined pricing and feature sets;
- . our exclusive focus and technical expertise on the Microsoft platform;

- . high availability, high performance web hosting solutions which we believe will increasingly involve the clustering of multiple web, database and applications servers in order to securely and efficiently distribute web site content and related data across multiple and sometimes geographically distributed servers;
- . an advanced and highly secure network architecture that, based on network improvements implemented during the week of August 16, 1999, since that period has delivered network performance faster on average in the United States compared to the single fastest backbone provider as measured by an independent third party (Keynote Systems) through its 65 United States measurement agents dispersed across various cities;
- . an integrated information system which automates our work flows and our service deployment processes;
- . our exclusive focus on hosting, which allows us to avoid direct competition with software developers and systems integrators; and
- . our commitment to building and maintaining strong relationships with members of the Microsoft developer community, many of whom have proven to be valuable sources of customers referrals.

#### Our Market Opportunity

According to Forrester Research, the hosting market will grow from \$0.9 billion in 1998 to \$14.6 billion in 2003, a 76% compound annual growth rate. In addition to the general expansion of the Internet, we believe that growth in e-commerce will drive demand for outsourced advanced hosting services such as ours because sites with e-commerce capabilities tend to be more complex. Forrester Research projects that e-commerce will generate over \$3.2 trillion in revenue by 2003. In addition, we believe that the trend toward outsourcing the hosting of web sites will continue as businesses increase the complexity of their web sites and require greater reliability and interactivity for end users. We also believe that these sites will increasingly be based on Microsoft Internet technologies. According to IDC, Windows NT's market share will grow at a compound annual growth rate of 25% from 1998 to 2003.

#### Our Strategy

Our goal is to take advantage of the growth in Internet usage, e-commerce and the outsourcing of hosting services to become the leading provider of advanced hosting services. Our strategy to achieve this goal contains the following key elements:

- . maintain focus on advanced hosting on the Microsoft platform;
- . offer a full range of highly scalable advanced hosting services;
- . maintain non-capital intensive business model;
- . enhance our marketing and sales programs;
- . capitalize on key relationships;
- . provide superior customer service;
- . expand our data center presence; and
- . expand into new hosting markets.

#### Our Address and Telephone Number

The address of our principal executive offices is 222 West Las Colinas Boulevard, Suite 450, Irving, Texas 75039, and our telephone number is (972)

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Data Return is our service mark. This prospectus also contains trademarks and tradenames of other companies.

#### THE OFFERING

<TABLE>

<C>	<S>
Common stock offered by Data Return.....	6,250,000 shares
Common stock to be outstanding after the offering.....	34,422,625 shares
Use of proceeds.....	We intend to use the net proceeds from this offering to fund our operations, fund our capital expenditures, expand our marketing and sales activities and for working capital and other general corporate purposes. See "Use of Proceeds" on page 17 for a more detailed description of our use of proceeds.
Proposed Nasdaq National Market symbol.....	DRTN

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Includes 416,667 shares of common stock to be issued to Microsoft before the closing of the offering.

Excludes 937,500 shares to be sold by Data Return if the underwriters' over-allotment option is exercised in full, as described in "Underwriting."

The number of shares outstanding excludes:

- . 6,559,296 shares of common stock issuable upon exercise of options outstanding at a weighted average exercise price of \$0.29 per share;
- . 3,313,004 shares of common stock reserved for issuance under our stock option plans; and
- . a warrant to purchase an assumed 312,500 shares at the lesser of the midpoint of the lowest filing range and the price to public.

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#### Conventions That Apply to This Prospectus

All information in this prospectus reflects a 269 for one stock split effected on September 10, 1999.

Except as otherwise indicated, the information in this prospectus assumes that the underwriters' over-allotment option is not exercised.

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#### SUMMARY FINANCIAL INFORMATION

In the following table, we provide you with summary historical financial data of Data Return. We have prepared this information using the financial statements of Data Return for the period from September 22, 1997 (inception) to March 31, 1998, the year ended March 31, 1999 and the three month periods ended June 30, 1998 and 1999. The financial statements for the period from September 22, 1997 (inception) to March 31, 1998 and the year ended March 31, 1999 have been audited by Ernst & Young LLP, independent auditors. The financial statements for the three month periods ended June 30, 1998 and 1999 have not been audited. The unaudited financial statements include all adjustments, consisting of normal recurring accruals, which Data Return considers necessary



for a fair presentation of its financial position and the results of its operations for these periods.

When you read this summary historical financial data, it is important that you read it in conjunction with the historical financial statements and related notes contained later in this prospectus, as well as "Management's Discussion and Analysis of Financial Condition and Results of Operations," also contained later in this prospectus.

<TABLE>

<CAPTION>

	Period from September 22, 1997 (inception) to March 31, 1998		Year Ended March 31, 1999		Three months ended June 30, ----- 1998                      1999 -----			
	<C>	<C>	<C>	<C>	<C>	<C>		
(In thousands, except per share data)								
<S>	<C>	<C>	<C>	<C>	<C>	<C>		
Statements of Operations Data:								
Revenues.....	\$	336	\$	1,889	\$	281	\$	1,228
Costs and expenses:								
Cost of revenue.....		198		1,105		205		489
General and administrative.....		231		1,063		213		866
Marketing and sales ..		39		663		105		384
Stock based compensation.....		61		349		85		140
		-----		-----		-----		-----
Total costs and expenses.....		529		3,180		608		1,879
		-----		-----		-----		-----
Loss from operations....		(193)		(1,291)		(327)		(651)
Other income (expense) ..		2		7		5		16
		-----		-----		-----		-----
Net loss.....	\$	(191)	\$	(1,284)	\$	(322)	\$	(635)
		=====		=====		=====		=====
Net loss per common share.....	\$	(0.01)	\$	(0.07)	\$	(0.02)	\$	(0.03)
		=====		=====		=====		=====
Shares used in per share computation.....		15,882,326		18,371,300		17,592,600		22,272,804
		=====		=====		=====		=====
Other Financial Data:								
EBITDA(1).....	\$	(118)	\$	(813)	\$	(222)	\$	(400)
Net cash provided by (used in) operating activities.....		1		(644)		(243)		(282)
Net cash used in investing activities...		(55)		(939)		(79)		(696)
Net cash provided by financing activities...		528		1,952		502		3,251
Purchases of property and equipment.....		55		814		79		696

</TABLE>

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	June 30, 1999		
	Actual	Pro Forma(2)	As Adjusted(3)
----- Pro Forma Actual    Pro Forma(2)    As Adjusted(3) -----			
(In thousands)			
<S>	<C>	<C>	<C>
Balance Sheet Data:			
Working capital.....	\$2,291	\$8,291	\$81,901
Total assets.....	6,011	17,011	90,569
Notes payable and capital lease obligations--long-term.....	140	140	--
Total shareholders' equity.....	4,024	15,024	88,774

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- (1) EBITDA consists of loss from operations plus depreciation and amortization, including amortization of unearned stock based compensation. EBITDA does not represent funds available for management's discretionary use and is not intended to represent cash flow from operations as measured under generally accepted accounting principles. EBITDA should not be considered as an alternative to net loss or net cash used in operating activities, but may be useful to investors as an indication of operating performance. Our calculations of EBITDA may not be consistent with calculations of EBITDA used by other companies.
  - (2) On a pro forma basis to reflect private sales of 4,296,468 shares of our common stock between June 30, 1999 and the date of this prospectus.
  - (3) On a pro forma as adjusted basis to give effect to the sale of an assumed 416,667 shares of our common stock at an assumed price of \$12.00 per share to Microsoft and the sale of 6,250,000 shares of common stock we are offering under this prospectus, at an assumed initial public offering price of \$12.00 per share (based upon the midpoint of the filing range), after deducting the estimated underwriting discounts and commissions and estimated offering expenses that we will pay and the application of the estimated net proceeds from this offering as described under "Use of Proceeds," including repayment of the long term portion of notes payable.

#### RISK FACTORS

Investing in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below before you purchase any of our common stock. While we have described all risks and uncertainties that we believe are material to our business, other risks and uncertainties that affect our business operations may arise or become material in the future.

If we cannot address the following risks and uncertainties effectively, our business, financial condition or results of operations could be materially and adversely affected. In this event, the trading price of our common stock could decline and you could lose all or a part of your investment.

This prospectus also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of several factors, including the risks and uncertainties described below and elsewhere in this prospectus.

Our business and prospects are difficult to evaluate because we have a limited operating history and our business model is still evolving.

We were incorporated in August 1997 and commenced operations in September of that year with a focus on advanced hosting services. As a result, we have a limited operating history and our business model is evolving. We may not be able to successfully implement our business plan or adapt it to changes in the market. If we are not able to do so, our business, results of operations and financial condition will be adversely affected.

We have a history of substantial losses, and we anticipate continuing and increasing losses.

We have experienced operating losses and negative cash flows from operations in each quarterly and annual period since incorporating in 1997. We experienced net losses of approximately \$ 635,000, or 52% of revenues, for the three month period ended June 30, 1999, and \$1.3 million, or 68% of revenues, for the year ended March 31, 1999. As of June 30, 1999, we had an accumulated deficit of

approximately \$2.1 million. We expect our operating losses to increase in the future due primarily to an increase in operating expenses to expand our marketing and sales operations, develop our distribution channel, fund greater levels of research and development, support and improve our operational and financial systems and broaden customer service and support. We cannot assure you that we will ever be profitable on a quarterly or annual basis, or that if we achieve profitability, it will be sustainable.

Our quarterly and annual results may fluctuate, resulting in fluctuations in the price of our common stock.

Our operating results may fluctuate significantly in the future on a quarterly and annual basis. Because of these fluctuations, comparisons of our operating results from period to period are not necessarily meaningful and should not be relied upon as an indicator of future performance. We expect to continue to experience significant fluctuations as a result of a variety of factors, many of which are outside of our control. The following factors could affect our operating results:

- . size and timing of customer installations and related payments;
- . fluctuations in data and voice communications costs;
- . timing and magnitude of capital expenditures;
- . costs relating to the expansion of operations;
- . customer discounts and credits;

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- . changes in our pricing policies or those of our competitors; and
- . economic conditions specific to the hosting industry, as well as general economic conditions.

We plan to increase our operating expenses to develop our business. If our revenues do not increase as quickly as our expenses, our operating results will suffer.

For these and other reasons, in future periods our operating results may fall below the expectations of securities analysts or investors, which could result in widely varying stock prices and negatively affect the market price of our common stock.

We rely on our strategic relationship with Level 3, and if this relationship is terminated or deteriorates our business will suffer.

We recently entered into a strategic relationship with Level 3. Level 3 is a communications and information services company that is building an advanced facilities-based communications network through which it provides co-location, Internet connectivity and other services. We are currently Level 3's only preferred provider of Microsoft-based advanced hosting solutions. Our ability to increase demand for our services depends in part upon Level 3's referrals of new customers to us. This relationship is non-exclusive, and our marketing agreement can be terminated by Level 3 if we default on our obligations under this agreement or are acquired by a competitor of Level 3. If Level 3 fails to refer new customers to us or refers potential customers to our competitors or if our relationship with Level 3 deteriorates or is terminated for any reason, we may not be able to increase our customer base and, therefore, our revenues as rapidly as we anticipate and our business would suffer. If we fail to train Level 3's sales personnel, or fail to train them adequately, we will not realize some of the benefits that we believe we will receive under this arrangement, including customer referrals. As part of our relationship, we have committed to purchase a fixed amount of services from Level 3, including, among other things, bandwidth, co-location space, installation and maintenance services, over the next five years. We will incur these expenses even if anticipated increases in sales do not materialize or, in some circumstances, if the agreement is terminated. We have also agreed to purchase most of our

bandwidth and co-location requirements to the extent they meet our then-current performance and capacity requirements. We are required to purchase these services from Level 3 even if these services are available at lower prices from alternative vendors.

Our relationship with Level 3 also entitles us to offer our services from all existing and future U.S. Level 3 data centers. We currently rely on Level 3 to provide most of the data center capacity that we need to provide our hosting services, and in the future we will be required to purchase most of our data center capacity from Level 3. Further, Level 3 will provide personnel at these data centers to install equipment and assist with support as necessary for us to deliver service in these facilities. If Level 3 fails to perform these services in a timely or effective manner, or at all, we would be required to make alternate arrangements, possibly including hiring additional implementation engineers. In addition, if our relationship with Level 3 is terminated or if Level 3 does not provide the data center capacity that we need, we would be required to seek arrangements with other data center providers or construct our own data centers. We cannot be certain that alternate data center capacity will be available on commercially reasonable terms or at all. We currently rely, and for the foreseeable future will continue to rely, on Level 3 to provide bandwidth and other networking services. If we are unable to obtain these services from Level 3, we would be required to seek arrangements with other providers of these services, and we cannot be certain that alternate services will be available on commercially reasonable terms or at all.

Our success depends on Microsoft's continued success, and the loss or deterioration of our relationship with Microsoft could harm our business and have an adverse impact on our revenues.

We focus on advanced hosting services for Microsoft-based Internet technologies. If these technologies are not widely used building blocks for advanced Internet sites in the future, the demand for our services would decrease and our business would be adversely affected.

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Our relationship with Microsoft is informal. We believe this relationship provides us with access to developments in Microsoft products before they are generally available, which allows us to maintain and enhance our technical expertise. If our relationship with Microsoft deteriorates or if we lose some of the status or privileges we currently enjoy, our technical expertise could be adversely affected. Our ability to market our services as a provider of advanced hosting services for Microsoft-based Internet technologies would also be adversely affected if Microsoft does not continue to confer certifications and designations on us, or changes our current certifications or designations. We do not have a written agreement with Microsoft relating to these certifications or designations. Some of our competitors also have received these certifications and designations. For example, we are aware of seven other businesses that have been designated as Microsoft Advanced Hosting Partners. These certifications and the number of businesses holding them are described on page 40 under the heading "Microsoft." Microsoft confers these certifications unilaterally and in its sole discretion and could change them at any time. Thus, we cannot be certain that we will continue to enjoy them.

If we are unable to expand our network infrastructure to meet increasing demand, we could lose customers and our operating results could suffer.

We must continue to expand and adapt our network infrastructure to accommodate the increasing number of customers, the amount of information they wish to transmit and their changing requirements. We face risks related to our network's ability to be scaled to meet increasing customer levels while maintaining acceptable performance levels. The expansion and adaptation of our networking and hosting facility infrastructure will require substantial financial, operational and management resources as we negotiate bandwidth capacity with existing and other network infrastructure suppliers. If we are required to expand our network significantly and rapidly due to increased usage, additional stress will be placed upon our network hardware, traffic

management systems and hosting facilities as well as our financial, operational and management resources. Due to the limited deployment of our services to date, the ability of our network to support a substantially larger number of customers at high transmission speeds is unknown.

If the network providers upon which we rely fail to provide reliability, capacity and performance for our network, we could lose customers and our operating results could suffer.

Our success partly depends upon the capacity, reliability and security of our network infrastructure, including the capacity leased from our network suppliers. Our network currently delivers service through Level 3, MCI WorldCom, Inc., including UUNET Technologies, Inc., e.spire Communications, Inc., Sprint Corporation, Digex, Incorporated, Cable & Wireless plc and SAVVIS Communications Enterprises, LLC. Some of these suppliers are also our competitors. In the future, we will be required to purchase most of our network capacity from Level 3 to the extent they meet our then-current performance and capacity requirements. We depend on these companies to provide uninterrupted and error-free service through their telecommunications networks. As our customers' usage of telecommunications capacity increases, we will need to make additional investments in our infrastructure to maintain adequate data transmission speeds, the availability of which may be limited or the cost of which may be significant. Our average utilization of our network capacity was 17.7% during the last year. We monitor all network links to prevent their being utilized in excess of their recommended capacity. If capacity is not available to us as our customers' usage increases, our network may not be able to achieve or maintain sufficiently high data transmission capacity, reliability or performance. In addition, our business would suffer if our network suppliers increased the prices for their services and we were unable to pass along any increased costs to our customers. Any failure on our part or the part of our third-party suppliers to achieve or maintain high data transmission capacity, reliability or performance could significantly reduce customer demand for our services and damage our business.

We may not be able to deliver our services and our business may suffer if our third-party suppliers do not provide us with key components of our network infrastructure.

We depend on other companies to supply key components of our network infrastructure. Any failure to obtain needed products or services in a timely fashion or at an acceptable cost could adversely affect our

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business. We buy servers, routers and switches on an as-needed basis and therefore do not carry significant inventories of them. We also have no guaranteed supply arrangements with our vendors. We currently only use servers from Compaq and rely on Compaq to provide us with access to Compaq technical personnel. We recently entered into an agreement with Compaq under which we have agreed for the next three years to purchase from Compaq the lesser of 2,000 servers or the number of servers reasonably necessary to adequately operate our business consistent with our business plan. Our requirement to purchase these servers is contingent upon Compaq providing financing for the servers on competitive terms, upon the price, performance and quality of the Compaq servers being reasonably satisfactory to us and upon Compaq's commitment to deliver these servers on the schedule we request. In addition, we rely on Cisco Systems, Inc. and Alteon to supply equipment critical to our network, but we do not have a supply agreement with either of them. If this equipment were to become unavailable on terms acceptable to us, we would be forced to find alternative equipment. The inability to obtain equipment or technical services from Compaq, Cisco or Alteon on terms acceptable to us would force us to spend time and money selecting and obtaining new equipment, training our personnel to use different equipment and deploying alternative components needed to integrate the new equipment, and as a result our business could be adversely affected.

Because we operate in a new and evolving market with uncertain prospects for growth, we may be unable to sustain growth in our customer base and our operating results may suffer.

Our market is new and rapidly evolving. Growth in demand for and acceptance of advanced hosting services are highly uncertain. Businesses may not be aware of the potential benefits of outsourcing or may find it cheaper, more secure or otherwise preferable to host their web sites internally. Internet technologies, such as e-commerce applications, which require advanced hosting, may not grow as rapidly as we expect. If the market for advanced hosting services fails to grow or grows more slowly than we anticipate, our business, operating results and financial condition will be adversely affected. Growth in the demand for our products and services may be inhibited, and we may be unable to sustain growth in our customer base, for a number of reasons, including:

- . our inability to market our products and services in a cost-effective manner to new customers;
- . the inability of customers to differentiate the products and services we offer from those of our competitors;
- . the termination of our customer contracts, which can generally be canceled on 30 days' notice;
- . our inability to strengthen awareness of our brand; and
- . reliability, quality or compatibility problems with our services.

We may not be able to adapt to evolving technologies and customer demands, which could cause our business to suffer.

Our market is characterized by rapidly changing technology, evolving industry standards and frequent new product announcements. These characteristics are magnified by the recent growth of the Internet and the intense competition in our industry. We are also subject to risks from technological changes in the way hosting solutions are marketed and delivered. To be successful, we must adapt to our rapidly changing market by continually improving the performance, features and reliability of our services and modifying our business strategies accordingly. We could also incur substantial costs if we need to modify our services or infrastructure in order to adapt to these changes. Our business would suffer if we fail to respond to these changes in a timely and cost-effective manner or at all.

Our business will suffer if Internet usage does not continue to increase or if the Internet fails to perform reliably.

Use of the Internet for retrieving, sharing and transferring information among businesses, consumers, suppliers and partners has recently begun to increase rapidly. Our success depends in large part on continued

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growth in the use of the Internet, and we would be adversely affected if Internet usage does not continue to grow. Internet usage and growth may be inhibited for a number of reasons, such as:

- . inadequate network infrastructure;
- . security concerns;
- . uncertainty of legal and regulatory issues concerning the use of the Internet;
- . inconsistent quality of service;
- . lack of availability of cost-effective, reliable, high-speed service; and
- . failure of Internet use to expand internationally.

If Internet usage grows, the Internet infrastructure may not be able to support the demands placed on it by this growth, or its performance and

reliability may decline. For example, web sites have experienced interruptions in service as a result of outages and other delays occurring throughout the Internet network infrastructure. If these outages or delays occur frequently, use of the Internet as a commercial or business medium could in the future grow more slowly or decline, which would adversely affect our business.

Failure of our operating and financial systems to keep pace with the anticipated growth in our business could result in customer dissatisfaction, operating inefficiencies and lost revenue opportunities.

The rapid growth of our business and our service offerings has placed, and is likely to continue to place, a significant strain on our operating and financial resources. Our future performance will partly depend on our ability to manage our growth effectively, which will require that we further develop our operating and financial system capabilities and controls. We are in the process of implementing new billing and other management information systems. If our information systems, including the systems that we are currently implementing, and other infrastructure are unable to support the demands placed on them by the rapid growth in our business, we may be forced to implement new systems. If we fail to improve our operational systems or to expand our customer service capabilities to keep pace with the growth of our business, we could experience customer dissatisfaction, cost inefficiencies and lost revenue opportunities, which could harm our operating results. We may not be able to successfully implement these systems when needed or they may not perform reliably.

We may not be able to successfully sustain our growth if we are unable to attract and retain additional highly skilled personnel.

We are currently experiencing rapid growth and intend to continue expanding. Since incorporating in August 1997, we had grown from five to 79 employees as of August 31, 1999. We believe that we will need to hire over 150 additional personnel in all areas of our business over the next 12 months. If we do not succeed in attracting and retaining new, qualified personnel and/or retaining our current personnel, our business could suffer.

We must expand our direct and indirect sales operations to increase market awareness of our products and generate increased revenues. We cannot be certain that we will be successful in these efforts. We plan to increase our sales force significantly in the second half of 1999. Newly-hired employees will require training and it will take time for them to achieve full productivity. Also, through our relationship with Level 3, we intend to begin training their sales force to sell our products and services in October 1999. We cannot be certain that we will be able to hire enough qualified individuals in the future, that newly-hired employees will achieve necessary levels of productivity or that our Level 3 relationship will result in increased sales.

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We may need additional capital to fund our operations and finance our growth, and we may not be able to obtain it on terms acceptable to us or at all.

We believe that our existing capital resources, including the anticipated proceeds of this offering, will enable us to maintain our current and planned operations for at least the next 12 months. However, we may require additional funds during or after that 12-month period. Any required financing may not be available or may be available only on terms that are not favorable to us. Further, if additional funds are raised through the issuance of additional equity securities, the percentage ownership of our shareholders would be diluted. Any new equity securities may have rights, preferences or privileges senior to those of our common stock.

We could experience system failures which could harm our business and reputation.

To succeed, we must be able to operate our network management infrastructure around the clock without interruption. Our operations depend upon our ability to protect our network infrastructure, equipment and customer files against damage from human error, fire, earthquakes, hurricanes, floods, power loss,

telecommunications failures, sabotage, intentional acts of vandalism and similar events. Our servers and network infrastructure are located in the Dallas and Fort Worth, Texas metropolitan area. Even though we have attempted to minimize risk through redundant systems, we do not have a comprehensive disaster recovery plan and the occurrence of a natural disaster or other unanticipated problems at any of our data centers could result in interruptions in the services we provide to our customers.

Although we have attempted to build redundancy into our network and hosting infrastructure, we have experienced interruptions in service in the past. We have experienced partial system failures due to routing problems, hard drive failures, database corruption and other computer failures. Our network is subject to various points of failure, and a problem with our routers, switches or other equipment could cause an interruption in the services we provide to some of our customers. Any future interruptions could:

- . cause customers or end users to seek damages for losses incurred;
- . require us to replace existing equipment or add redundant facilities;
- . damage our reputation for reliable service;
- . cause existing customers to cancel their contracts; or
- . make it more difficult for us to attract new customers.

Any of these results could damage our business.

Disruption of our services caused by unknown software defects could harm our business and reputation.

Our service offerings depend on complex software, including software licensed from third parties and our proprietary software tools. Complex software often contains defects, particularly when first introduced or when new versions are released. We may not discover software defects that affect our new or current services or enhancements until after they are deployed. Although we have not experienced any material software defects to date, it is possible that defects may occur in the software. These defects could cause service interruptions, which could damage our reputation or increase our service costs, cause us to lose revenue, delay market acceptance or divert our development resources.

Our business and reputation will suffer if we do not prevent security breaches.

Despite our design and implementation of a variety of network security measures, unauthorized access, computer viruses, accidents, misconduct resulting in disruptions and other disruptions could occur. In addition, we may incur significant costs to prevent breaches in security or to alleviate problems caused by breaches. We rely on third-party suppliers such as Level 3 to protect our equipment and hardware against breaches in

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security. We cannot be certain that they will provide adequate security. While we have experienced no material security breaches in the past, any breaches that may occur could result in liability to us, loss of existing customers or the deterrence of future customers.

Our limited ability or failure to protect our intellectual property may adversely affect our ability to compete.

Third parties may infringe or misappropriate our technology or proprietary rights, which could have an adverse effect on our business, results of operations or financial condition. In addition, our competitors or potential competitors may independently develop technologies that are equivalent or superior to our technology. We rely on a combination of copyright, trademark, service mark and trade secret laws to protect our intellectual property. We are in the process of filing federal registrations for the trademark "Data Return," as well as other service and trademarks which incorporate the Data Return name. We also have internally developed software and other tools that are important



to our business for which we rely on copyright protection. We have entered into some contractual arrangements with our employees and contractors as well as suppliers, distributors and some of our key customers in order to limit access to, and any disclosure of, our proprietary information. The steps we have taken to protect our intellectual property may be insufficient. We may need to take legal action to protect our intellectual property rights, which could be costly and divert the attention of our technical and management personnel.

We may be accused of infringing the proprietary rights of others, which could subject us to costly and time consuming litigation.

In addition to the technologies we develop or have developed, we license certain technologies from third parties and may license additional technologies in the future. Although we have not been accused of infringing the proprietary rights of others in the past, we could become subject to infringement actions based upon our internally developed technologies or technologies licensed from third parties. Any of these claims, with or without merit, could subject us to costly litigation and divert the attention of our technical and management personnel. In addition, third parties may change the terms of their license agreements in ways that would prevent us from using technologies licensed from them on commercially reasonable terms or that would prevent us from using them at all. We may not be able to replace those technologies with technologies that have the same features or functionality on commercially reasonable terms or at all.

If we do not adequately address Year 2000 issues, we may incur significant costs and our business could suffer.

Currently, many computer and software products are coded to accept only two-digit entries in the date code field. These date code fields will need to accept four-digit entries to distinguish 21st century dates from 20th century dates. As a result, many companies' software and computer systems may need to be upgraded or replaced in order to comply with Year 2000 requirements. We cannot predict whether our Year 2000 compliance issues will require us to upgrade or replace our systems and equipment. Should we be required to upgrade or replace our systems and equipment, it could represent a significant cost to us. If we are not successful in identifying and planning for Year 2000 issues, our business operations could be materially and adversely affected. Additionally, we cannot evaluate our customers' Year 2000 readiness. Some of our customers' sites may fail due to Year 2000 issues and any failures may affect other customers' sites or our network. Also, to the extent that a customer's site is not functioning correctly and it is not possible to determine that the malfunction is caused by the customer's software, the customer may request service credits or we might otherwise have a difficult time realizing the expected revenues from that customer. Level 3 has indicated that they are Year 2000 compliant. However, we have not undertaken any independent assessment of Level 3's Year 2000 compliance and any failure of Level 3's network due to Year 2000 issues could cause a disruption in our services, which could cause us to lose customers.

The worst-case scenario related to the Year 2000 issue would be an overall failure of the Internet, the telecommunications infrastructure and the electrical grid. If this happened, we would be unable to service our

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customers for an uncertain period of time. Any widespread disruption to these systems would have unpredictable and potentially severe impacts on our business and financial condition. We currently have no contingency plan to deal with this worst-case scenario.

See "Management's Discussion and Analysis of Financial Condition and Results of Operations--The Year 2000."

Regulatory and legal uncertainties could result in significant costs or otherwise harm our business.

The success of our business depends on the growth of the Internet. Laws and regulations directly applicable to commerce or communications over the Internet

are becoming increasingly prevalent. However, the law of the Internet remains largely unsettled. The adoption or modification of laws or regulations relating to the Internet could adversely affect our business if they impose a direct cost on us or if they curtail the growth of the Internet. If liability for materials carried on or disseminated through their systems is imposed on service providers, we would make efforts to implement measures to reduce our exposure to such liability. Such measures could require us to expend substantial resources or discontinue certain product or service offerings. In addition, increased attention to liability issues, as a result of lawsuits, legislation and legislative proposals, could divert management attention, result in unanticipated expenses and harm our business. If legislation that makes transacting business over the Internet, such as e-commerce, less favorable or otherwise curtails the growth of the Internet is adopted in the U.S. or internationally, our business would suffer. See "Business--Government Regulation."

The loss of key personnel including our Chairman and Chief Executive Officer or our President and Chief Operating Officer could harm our business.

We depend on the continued service of our key technical, sales and senior management personnel, including Sunny C. Vanderbeck, our Chairman and Chief Executive Officer, and Michelle R. Chambers, our President and Chief Operating Officer. We have entered into three-year employment agreements with Mr. Vanderbeck and Ms. Chambers, but any of our officers or employees can quit at any time. Losing one or more of our key employees could harm our business.

We operate in an extremely competitive market, and our business would suffer if we are unable to compete effectively.

The market for hosting and Internet services is highly competitive. There are few substantial barriers to entry to keep new competitors from entering this market. We expect that we will face additional competition from existing competitors and new market entrants in the future. Many of our competitors have substantially greater financial, technical and marketing resources, larger customer bases, longer operating histories, greater name recognition and more established relationships in the industry than we do. As a result, some of these competitors may be able to:

- . develop and expand their network infrastructures and service offerings more rapidly;
- . adapt to new or emerging technologies and changes in customer requirements more quickly;
- . take advantage of acquisition and other opportunities more readily;
- . devote greater resources to the marketing and sales of their services; and
- . adopt more aggressive pricing policies.

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In addition, some of our competitors have entered and will likely continue to enter into joint ventures or other arrangements to provide additional services competitive with those provided by us. We believe that the market in which we compete is likely to experience consolidation in the near future, which could result in increased competition on price and other factors that could adversely affect our business.

In an effort to gain market share, some of our competitors have offered hosting services similar to ours at prices lower than ours or with incentives not matched by us. In addition, some of our competitors may be able to provide customers with additional benefits that could reduce the overall costs of their services relative to ours. We may not be able to reduce the pricing of our services or offer incentives in response to the actions of our competitors without an adverse impact on our business.

See "Business--Competition."

Because we have customers internationally, our business may be adversely affected by foreign political and economic conditions.

In fiscal 1999, approximately 8% of our revenues were derived from our customers located in Europe and Asia. In addition, we expect to begin operating from Level 3's data center in London, England during the second half of 1999. Our success depends in part on expanding our customer base internationally and our ability to successfully operate from data centers in foreign markets. Because our international sales are denominated in U.S. dollars, currency fluctuations may deter foreign customers from purchasing our services. In addition, we face risks in operating and servicing customers in foreign markets, such as:

- . different Internet access fees;
- . different technology standards;
- . different privacy, censorship and service provider liability standards and regulations; and
- . less protective intellectual property laws.

Any of these risks could adversely affect our ability to operate or expand internationally, which would limit the growth of our business.

We have broad discretion as to the use of proceeds from this offering, and our use of proceeds may not yield a favorable return.

We intend generally to use the net proceeds from this offering to fund our operations, fund our capital expenditures, expand our marketing and sales activities and for working capital and other general corporate purposes. We may also acquire or make investments in other businesses, products, services or technologies, and, if we do, we may not be able to make those acquisitions or investments on commercially acceptable terms or we could have difficulty assimilating and integrating any acquired businesses, technologies, services or products. We have not yet determined the actual expected expenditures and thus cannot estimate the amounts to be used for each specified purpose. The actual amounts and timing of these expenditures will vary significantly depending on a number of factors, including, but not limited to, the amount of cash generated by our operations and the market response to the introduction of any new service offerings. Depending on future developments and circumstances, we may use some of the proceeds for uses other than those described above. Our management will have significant flexibility in applying the net proceeds of this offering. We cannot be certain that our use of the proceeds will yield a favorable return. See "Use of Proceeds."

Our principal shareholders, directors and executive officers will own approximately 76% of our common stock, which may allow them to exert influence over us or to prevent a change of control.

After this offering our shareholders who currently own over 5% of our common stock, our directors and our executive officers will beneficially own approximately 76% of our outstanding common stock. These shareholders will be able to exercise significant influence over all matters requiring shareholder approval, including the election of directors and approval of significant corporate transactions. This concentration of ownership may also delay or prevent a change in control of us even if beneficial to our shareholders.

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Some provisions of our articles, bylaws and rights plan and of Texas law could delay or prevent a change of control which could adversely affect our stock price.

Our articles of incorporation and bylaws contain provisions that could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our shareholders. These provisions could limit the price that investors might be willing to pay in the future for shares of our common stock.

Some of these provisions:

- . authorize the issuance of preferred stock which can be created and issued by our board of directors without prior shareholder approval, commonly referred to as "blank check" preferred stock, with rights senior to those of common stock;
- . prohibit certain shareholder actions by written consent;
- . establish advance notice requirements for submitting nominations for election to our board of directors and for proposing matters that can be acted upon by shareholders at a meeting; and
- . provide for a classified board of directors with staggered three-year terms.

We are also subject to certain provisions of Texas law which could delay, deter or prevent a change in control of us.

We intend to adopt a shareholder rights plan before this offering is consummated. This plan will entitle our shareholders to rights to acquire additional shares of our common stock when a third party acquires 15% of our common stock or commences or announces its intent to commence a tender offer for at least 15% of our common stock. This plan could delay, deter or prevent a change in control of us.

You will suffer immediate and substantial dilution.

The initial public offering price of our common stock is expected to be substantially higher than the net tangible book value of our common stock. Therefore, if you purchase our common stock in this offering, you will incur immediate dilution of approximately \$9.42 in the net tangible book value per share of common stock from the price per share that you pay for such common stock (based upon an assumed initial public offering price of \$12.00 per share). You will also experience additional dilution upon the exercise of outstanding stock options at prices below the initial public offering price.

Future sales of our common stock could cause our stock price to decline.

After this offering is completed, 34,422,625 shares of our common stock will be issued and outstanding, assuming no exercise of the underwriters' over-allotment option. All of the shares of our common stock sold in this offering will be freely tradable unless purchased by our "affiliates." In connection with this offering, our officers, directors and shareholders not purchasing in the offering who together own approximately 28,172,625 shares of our common stock agreed to refrain from selling any shares of our common stock for a period of 180 days after the date of this prospectus. We cannot be sure what effect, if any, future sales of our common stock or the availability of shares for future sale will have on the market price of our common stock. The market price of our common stock could drop due to sales of a large number of shares of our common stock in the market after this offering or the perception that these sales could occur. These factors could also make it more difficult to raise funds through future offerings of our common stock. There will be 34,422,625 shares outstanding upon the completion of this offering, of which 20,551,600 shares will become available for sale to the public 180 days from the date of this prospectus, subject in some cases to volume limitations.

#### FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISKS

Some of the information in this prospectus contains forward-looking statements. These statements include, among others, statements relating to expenditure levels, the adequacy of capital resources and plans for expansion of our marketing and sales efforts, risk factors, use of proceeds, liquidity, strategy, sales and technology and network operations. These statements may be found under Prospectus Summary, Risk Factors, Management's Discussion and Analysis of Financial Condition and Results of Operations and Business. Forward-looking statements are typically identified by the use of terms such as

"may," "will," "expect," "intend," "anticipate," "estimate" and similar words, although some forward-looking statements are expressed differently. You should be aware that our actual results could differ materially from those contained in the forward-looking statements due to a number of factors, including without limitation, changes in external competitive market factors, changes in our business strategy or an inability to execute our strategy, unanticipated changes in the hosting industry, the economy in general and changes in the use of the Internet. We cannot guarantee future results, levels of activity, performance or achievements. You should also consider carefully the statements under "Risk Factors" and other sections of this prospectus, which address additional factors that could cause our actual results to differ from those set forth in the forward-looking statements.

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#### USE OF PROCEEDS

We estimate that the net proceeds from the sale of 6,250,000 shares of common stock we are offering will be approximately \$68.8 million at an assumed initial public offering price of \$12.00 per share and after deducting the estimated underwriting discounts and commissions and estimated offering expenses. If the underwriters' over-allotment option is exercised in full, we estimate that the net proceeds will be approximately \$79.2 million.

We currently intend to use approximately \$25.0 million of the net proceeds to fund capital expenditures, consisting of the purchase of servers and other hardware. We also intend to use \$192,000 to pay off and cancel our notes payable to Bank One of Texas, N.A. that we entered into in July 1998 in connection with the purchase of equipment. We intend to use the balance of the net proceeds for working capital and other general corporate purposes, including funding our anticipated operating losses, expanding our marketing and sales activities and hiring additional personnel. In addition, we may use some of the proceeds for strategic investments and acquisitions. However, we have no current plans, agreements or commitments with respect to any acquisition or investments of this type. Our management may spend the proceeds from this offering in ways which the shareholders may not deem desirable.

The timing and amount of our actual expenditures will be based on many factors, including cash flows from operations and the growth of our business.

Until we use the net proceeds of this offering for the above purposes, we intend to invest the funds in short-term, investment grade, interest-bearing securities. We cannot predict whether the proceeds invested will yield a favorable return.

#### DIVIDEND POLICY

We have never paid any cash dividends on our capital stock. We anticipate that we will retain earnings to support operations and to finance the growth and development of our business. Therefore, we do not expect to pay cash dividends in the foreseeable future.

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#### CAPITALIZATION

The following table sets forth our capitalization on June 30, 1999:

- . on an actual basis;
- . on a pro forma basis to reflect the net proceeds from private sales of 4,296,468 shares of our common stock to Level 3, Compaq and ZeroDotNet, Inc. between June 30, 1999 and the date of this prospectus; see "Certain Transactions" on page 56 for a description of these transactions; and
- . on a pro forma as adjusted basis to give effect to the sale of an assumed 416,667 shares of our common stock to Microsoft at an assumed price of \$12.00 per share and the sale of the shares of common stock we

are offering, at an assumed initial public offering price of \$12.00 per share (based upon the midpoint of the filing range), after deducting the estimated underwriting discounts and commissions and estimated offering expenses that we will pay and the application of the estimated net proceeds as described under "Use of Proceeds," including repayment of the long term portion of notes payable.

This table should be read in conjunction with the audited financial statements and the notes relating to those statements included elsewhere in this prospectus.

<TABLE>  
<CAPTION>

	June 30, 1999		
	Actual	Pro Forma	Pro Forma As Adjusted
(In thousands, except share and per share data)			
<S>	<C>	<C>	<C>
Cash.....	\$ 3,116	\$ 9,116	\$ 82,674
Notes payable and capital lease obligations--long term.....	\$ 140	\$ 140	\$ --
Shareholders' equity:			
Preferred stock; \$.001 par value, 20,000,000 shares authorized; none issued or outstanding, actual, pro forma and pro forma as adjusted...	--	--	--
Common stock; \$.001 par value; 100,000,000 shares authorized, 23,459,490 shares issued and outstanding, actual; 27,755,958 shares issued and outstanding, pro forma; 34,422,625 shares issued and outstanding, pro forma as adjusted.....	24	28	34
Additional paid-in capital.....	8,039	19,035	92,779
Deferred stock compensation.....	(1,930)	(1,930)	(1,930)
Accumulated deficit.....	(2,109)	(2,109)	(2,109)
Total shareholders' equity.....	4,024	15,024	88,774
Total capitalization.....	\$ 4,164	\$15,164	\$ 88,774

</TABLE>

The number of shares of common stock outstanding does not include:

- . 5,924,725 shares of common stock issuable at June 30, 1999 upon exercise of options outstanding at a weighted average exercise price of \$0.14 per share;
- . 3,313,004 shares of common stock reserved for future issuance under our stock option plans; and
- . a warrant to purchase an assumed 312,500 shares at the lesser of the midpoint of the lowest filing range and the price to public.

#### DILUTION

Our net tangible book value on June 30, 1999, was approximately \$4,024,300 or \$0.17 per share. "Net tangible book value" is total assets minus the sum of liabilities and intangible assets. "Net tangible book value per share" is net tangible book value divided by the total number of shares outstanding.

After giving effect to adjustments relating to the offering described below, our pro forma net tangible book value on June 30, 1999, would have been \$88,774,300 or \$2.58 per share. The adjustments made to determine pro forma net

tangible book value per share are the following:

- . an increase in total assets to reflect the net proceeds from private sales of 4,296,468 shares of our common stock;
- . an increase in total assets to reflect the estimated net proceeds from the sale of 416,667 shares to Microsoft and the sale of 6,250,000 shares in the offering as described under "Use of Proceeds" (assuming an initial public offering price of \$12.00 per share (based upon the midpoint of the filing range)); and
- . the addition of the number of shares offered by this prospectus and by private sales of shares to the number of shares outstanding.

The following table illustrates the pro forma increase in net tangible book value of \$2.04 per share and the dilution (the difference between the offering price per share and net tangible book value per share) to new investors. Dilution per share in the table below does not include dilution from the exercise of options outstanding at June 30, 1999, to purchase 5,924,725 shares of common stock at a weighted average exercise price of \$0.14 per share. If these options are exercised, new investors will experience additional dilution.

<TABLE>			
<S>			
Assumed initial public offering price per share.....		<C>	<C>
Pro forma net tangible book value per share at June 30, 1999....	\$0.54		
Increase in net tangible book value per share attributable to new investors.....		\$2.04	
		-----	
Pro forma net tangible book value per share after offering.....		\$ 2.58	
		-----	
Dilution per share to new investors.....		\$ 9.42	
		=====	
</TABLE>			

The following table summarizes the differences between the number of shares of common stock purchased from Data Return, the aggregate cash consideration paid and the average price per share paid by existing shareholders and new investors purchasing shares of common stock in this offering:

<TABLE>					
<CAPTION>					
	Shares Purchased		Total Consideration		Average Price
	Number	Percent	Amount	Percent	Per Share
	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>
Existing shareholders.....	27,755,958	80.6%	\$19,121,000	19.3%	\$ 0.69
New investors.....	6,666,667	19.4	80,000,000	80.7	12.00
	-----	-----	-----	-----	-----
Total.....	34,422,625	100.0%	99,000,000	100.0%	
	=====	=====	=====	=====	
</TABLE>					

SELECTED FINANCIAL DATA

The following selected financial data should be read in conjunction with the financial statements, related notes and other financial information contained later in this prospectus. You should also read "Management's Discussion and Analysis of Financial Condition and Results of Operations," contained later in this prospectus. The Statements of Operations data for the period from September 22, 1997 (inception) to March 31, 1998 and the year ended March 31, 1999 and the balance sheet data as of March 31, 1998 and 1999 are derived from the financial statements of Data Return that have been audited by Ernst & Young LLP, independent auditors. The financial data for the three month periods ended June 30, 1998 and 1999 are derived from unaudited financial statements. The unaudited financial statements include all adjustments, consisting of normal

recurring accruals, which Data Return considers necessary for a fair presentation of its financial position and the results of its operations for these periods. The results of operations for the three month period ended June 30, 1999 are not necessarily indicative of the results of operations to be expected for the full year.

<TABLE>  
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	Period from September 22, 1997 (inception) to March 31, 1998		Year Ended March 31, 1999		Three Months Ended June 30, 1998		1999	
	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
(In thousands, except per share data)								
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Statements of Operations Data:								
Revenues.....	\$	336	\$	1,889	\$	281	\$	1,228
Costs and expenses:								
Cost of revenue.....		198		1,105		205		489
General and administrative.....		231		1,063		213		866
Marketing and sales...		39		663		105		384
Stock based compensation.....		61		349		85		140
Total costs and expenses.....		529		3,180		608		1,879
Loss from operations....		(193)		(1,291)		(327)		(651)
Other income (expense)...		2		7		5		16
Net loss.....	\$	(191)	\$	(1,284)	\$	(322)	\$	(635)
Net loss per common share.....	\$	(0.01)	\$	(0.07)	\$	(0.02)	\$	(0.03)
Shares used in per share computation.....		15,882,326		18,371,300		17,592,600		22,272,804
Other Financial Data:								
EBITDA (1).....	\$	(118)	\$	(813)	\$	(222)	\$	(400)
Net cash provided by (used in) operating activities.....		1		(644)		(243)		(282)
Net cash used in investing activities...		(55)		(939)		(79)		(696)
Net cash provided by financing activities...		528		1,952		502		3,251
Purchases of property and equipment.....		55		814		79		696

<TABLE>  
<CAPTION>

	March 31,		June 30, 1999				
	1998	1999	Actual	Pro Forma (2)	Pro Forma as adjusted (3)		
(In thousands)							
<S>	<C>	<C>	<C>	<C>	<C>		
Balance Sheet Data:							
Working capital.....	\$	321	\$	561	\$2,291	\$8,291	\$81,901
Total assets.....		734		2,214	6,011	17,011	90,569
Notes payable and capital lease obligations--long-term.....		36		166	140	140	--
Total shareholders' equity.....		430		1,245	4,024	15,024	88,774



- (1) EBITDA consists of loss from operations plus depreciation and amortization, including amortization of unearned stock based compensation. EBITDA does not represent funds available for management's discretionary use and is not intended to represent cash flow from operations as measured under generally accepted accounting principles. EBITDA should not be considered as an alternative to net loss or net cash used in operating activities, but may be useful to investors as an indication of operating performance. Our calculations of EBITDA may not be consistent with calculations of EBITDA used by other companies.
- (2) On a pro forma basis to reflect the private sales of 4,296,468 shares of our common stock between June 30, 1999 and the date of this prospectus.
- (3) On a pro forma as adjusted basis to give effect to the sale of an assumed 416,667 shares of our common stock at an assumed price of \$12.00 per share to Microsoft and the sale of 6,250,000 shares of common stock we are offering under this prospectus, at an assumed initial public offering price of \$12.00 per share (based upon the midpoint of the filing range), after deducting the estimated underwriting discounts and commissions and estimated offering expenses that we will pay and the application of the estimated net proceeds from this offering as described under "Use of Proceeds," including repayment of the long term portion of notes payable.

MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion together with the financial statements and other financial information included in this prospectus. This prospectus contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those projected in the forward-looking statements. Please see "Forward-Looking Statements and Associated Risks" elsewhere in this prospectus. Our fiscal year ends on March 31.

Overview

Data Return provides advanced Internet hosting services based on Microsoft technologies. We provide these services to businesses seeking to outsource the deployment, maintenance and support of their complex web sites. Our services include providing, configuring, operating and maintaining the hardware, software and network technologies necessary to implement and support these web sites.

The nature of our business is rapidly evolving and we have a limited operating history. As a result, we believe that period-to-period comparisons of our revenue and operating results, including our cost of revenue and other operating expenses as a percentage of total revenue, are not meaningful and should not be relied upon as indicators of future performance. We do not believe that our historical growth rates are indicative of future results. See "Risk Factors beginning on page 6 for a discussion of risks related to buying shares of our common stock.

Currently, we derive substantially all of our revenues from advanced hosting services. We also derive a nominal amount of revenue from technical reviews and the resale of software and other products. Currently, most of our advanced hosting revenues are generated from recurring monthly fees. The remainder are derived from one-time set-up fees for installation. Revenues are billed on a monthly basis and are recognized as the service is performed. Most of our customer agreements may be canceled on 30 days' notice.

Our expenses are comprised of:

- . cost of revenue, which consists primarily of compensation and related expenses for technical operations, bandwidth expenses, space in data centers and depreciation of equipment;
- . general and administrative, which consists primarily of compensation and related expenses and occupancy costs;
- . marketing and sales, which consists primarily of advertising and compensation and related expenses; and
- . stock based compensation, which relates to employee options granted at prices less than fair market value.

We have incurred significant losses since our inception and, as of June 30, 1999, had an accumulated deficit of approximately \$2.1 million. We intend to invest heavily in marketing and sales and the continued development of our network infrastructure and technology. We expect to expand our operations and workforce, including our network operations, technical support, sales, marketing and administrative resources. In particular, we intend to expand our existing inside sales force and create an outside sales force to develop new sales channels and relationships. We expect to continue to incur substantial losses for the foreseeable future. We may not be able to successfully execute our expansion plans.

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## Results of Operations

The following table sets forth selected financial data for the period from September 22, 1997 (inception) to March 31, 1998, the year ended March 31, 1999 and the three month periods ended June 30, 1998 and 1999.

<TABLE>  
<CAPTION>

	% of Revenue			
	Period from September 22, 1997 (inception) to March 31, 1998	Year Ended March 31, 1999	Three Months Ended June 30,	
			1998	1999
<S>	<C>	<C>	<C>	<C>
Revenues.....	100.0%	100.0%	100.0%	100.0%
Costs and expenses:				
Cost of revenue.....	58.9	58.5	73.0	39.9
General and administrative.....	68.5	56.3	75.9	70.5
Marketing and sales.....	11.6	35.1	37.4	31.3
Stock based compensation..	18.2	18.5	30.1	11.4
Loss from operations.....	(57.2)	(68.4)	(116.4)	(53.1)
Other income (expense):				
Interest income.....	0.7	1.1	2.2	1.9
Interest expense.....	(0.1)	(0.7)	(0.4)	(0.5)
Net loss.....	(56.6)%	(68.0)%	(114.6)%	(51.7)%
	=====	=====	=====	=====

</TABLE>

## Comparison of three month periods ended June 30, 1998 and 1999

### Revenues

Our revenues increased \$946,700 to \$1,227,500 for the three month period ended June 30, 1999 from \$280,800 for the three month period ended June 30, 1998. The increase was due to an increase in both the number of customers and the average monthly revenue per customer. We increased our marketing and sales personnel from two at June 30, 1998 to 12 at June 30, 1999.

## Cost of revenue

Our cost of revenue increased \$284,600 to \$489,500, or 39.9% of revenue, during the three month period ended June 30, 1999 from \$204,900, or 73% of revenue, during the three month period ended June 30, 1998. The increase in cost of revenue over the two periods was due primarily to increases in personnel and related costs, depreciation and bandwidth. Personnel and related expenses increased approximately \$128,500 to \$225,200, or 46% of cost of revenue, for the three month period ended June 30, 1999 from \$96,700 for the three month period ended June 30, 1998, as we increased our systems and customer support personnel from 11 at June 30, 1998 to 25 at June 30, 1999. Depreciation expense increased approximately \$70,600 to \$75,300 for the three month period ended June 30, 1999 as we added approximately \$1.4 million in computer and related equipment since June 30, 1998. Our bandwidth expenses increased \$65,100 to approximately \$145,200 for the three month period ended June 30, 1999 from \$80,100 for the three month period ended June 30, 1998, to support our increased business activities. We expect our cost of revenue to continue to increase in conjunction with the growth of our overall business.

## General and administrative

General and administrative expense increased \$652,400 to \$865,600, or 70.5% of revenue, during the three month period ended June 30, 1999 from \$213,200, or 75.9% of revenue, for the three month period ended June 30, 1998. The increase is primarily due to increases in personnel and related expenses and employee recruiting fees. Personnel and related expenses increased \$355,500 to \$450,700, or 52.1% of general and administrative expenses, for the three month period ended June 30, 1999 from \$95,200 for the three month period ended June 30, 1998. We increased our number of employees in general and administrative functions

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from five employees at June 30, 1998 to 13 employees at June 30, 1999. Recruiting fees increased approximately \$64,500 to \$65,500 for the three month period ended June 30, 1999 from \$1,000 in the comparable period in 1998.

## Marketing and sales

Marketing and sales expense increased \$279,500 to \$384,500, or 31.3% of revenues, during the three month period ended June 30, 1999 from \$105,000, or 37.4% of revenues, during the three month period ended June 30, 1998. The increase was due primarily to an increase in marketing and sales personnel and related expenses and increased advertising costs. Personnel and related expenses increased \$191,500 to \$244,700, or 63.6% of marketing and sales expense, from \$53,200 for the three month period ended June 30, 1998. Advertising costs increased \$88,000 to \$139,800 for the three month period ended June 30, 1999 from \$51,800 for the three month period ended June 30, 1998. We increased our marketing and sales personnel from two at June 30, 1998 to 12 at June 30, 1999. We intend to significantly increase our marketing and sales expenditures during the remainder of fiscal 2000.

## Stock based compensation

Deferred stock compensation was recorded in connection with the grant of employee stock options below fair value. Amortization of stock based compensation totaled \$84,600 for the three month period ended June 30, 1998 and \$139,500 for the three month period ended June 30, 1999. The amortization of stock based compensation is based on the vesting schedule of stock options held by the Company's employees. We recorded deferred stock compensation of \$874,100 during the three month period ended June 30, 1999.

## Other income (expense)

Other income (expense) consists primarily of interest income on our cash balances and interest expense on our outstanding notes payable and capital lease obligations. Interest earned on our cash and cash equivalents increased \$16,700 to \$22,900 for the three month period ended June 30, 1999 from \$6,200

for the three month period ended June 30, 1998. This increase was due primarily to the closing of private placements of equity securities in May 1998 and February 1999, which resulted in larger cash balances available for investment. During the three month period ended June 30, 1998 and 1999, we incurred interest expense in the amount of \$1,100 and \$6,100, respectively.

#### Income taxes

No provision for federal income taxes has been recorded as we have incurred net operating losses since our inception. We have recorded a valuation reserve against all of our net deferred tax asset, which is primarily attributable to net opening loss carryforwards, due to uncertainty that we will generate sufficient taxable income during the carryforward period to realize the benefit of our net deferred tax asset.

#### Net losses

Our net loss increased \$313,000 to \$634,800 for the three month period ended June 30, 1999 from \$321,800 for the three month period ended June 30, 1998. This increase was due primarily to the growth of our business and the increase in the number of personnel in all areas.

Comparison of the period from September 22, 1997 (inception) to March 31, 1998 and fiscal 1999

#### Revenues

Our revenues increased \$1,552,900 to \$1,889,000 during fiscal 1999 from \$336,100 for the period from September 22, 1997 (inception) to March 31, 1998. This increase was primarily due to our generating revenues

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for a full year during fiscal 1999 and the growth of our business activities. Approximately 41% of our fiscal 1999 revenue was recognized in the fourth quarter, due in part to the addition of two sales people in the third quarter.

#### Cost of revenue

Our cost of revenue increased \$907,300 to \$1,105,300, or 58.5% of revenue, during fiscal 1999 from \$198,000, or 58.9% of revenue, during the period from September 22, 1997 (inception) to March 31, 1998. This increase was due primarily to a full year of operations in fiscal 1999 and the growth of our business and related expenses, including increasing our systems and customer support personnel from six at March 31, 1998 to 20 at March 31, 1999. We expect our cost of revenue to continue to increase in conjunction with the growth of our overall business.

#### General and administrative

General and administrative expense increased \$832,800 to \$1,063,000, or 56.3% of revenue, during fiscal 1999 from \$230,200, or 68.5% of revenue, for the period from September 22, 1997 (inception) to March 31, 1998. This increase was due primarily to a full year of operations in fiscal 1999 and an increase in the number of general and administrative personnel. We increased our number of employees in this area from four employees at March 31, 1998 to eight employees at March 31, 1999. We expect to significantly increase our general and administrative expenditures. The decrease as a percentage of revenues was due to revenues increasing at a more rapid rate than general and administrative expenses.

#### Marketing and sales

Marketing and sales expense increased \$623,800 to \$662,800, or 35.1% of revenues, during fiscal 1999 from \$39,000, or 11.6% of revenues, during the period from September 22, 1997 (inception) to March 31, 1998. This increase was due primarily to a full year of operations in fiscal 1999 and an increase in the number of marketing and sales personnel. We increased our marketing and sales personnel from one to six in fiscal 1999. We intend to significantly

increase our marketing and sales expenditures during fiscal 2000.

#### Stock based compensation

Deferred stock compensation was recorded in connection with the grant of employee stock options below fair value. Amortization of stock based compensation totaled \$61,300 for the period from September 22, 1997 (inception) through March 31, 1998 and \$348,800 for the year ended March 31, 1999. The amortization of stock based compensation is based on the scheduled vesting of stock options held by several employees. We recorded deferred stock compensation of \$1,277,000 in the period from September 22, 1997 (inception) to March 31, 1998 and \$328,000 during fiscal 1999.

#### Other income (expense)

Other income (expense) consists primarily of interest income on our cash balances and interest expense on our outstanding notes payable and capital lease obligations. Interest earned on our cash and cash equivalents increased \$17,700 to \$19,900 during fiscal 1999 from \$2,200 during the period from September 22, 1997 (inception) to March 31, 1998. This increase was due primarily to the closing of private placements of equity securities in May 1998 and February 1999, which resulted in cash balances available for investment. During fiscal 1999, we incurred interest expense in the amount of \$12,700.

#### Income taxes

No provision for federal income taxes has been recorded as we have incurred net operating losses from inception through March 31, 1999. As of March 31, 1999, we had approximately \$980,000 of federal net

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operating loss carryforwards available to offset future taxable income which expire in varying amounts beginning in 2013. We have recorded a valuation reserve for all of our net deferred tax benefit for the period ended March 31, 1999 due to uncertainty that we will generate sufficient taxable income during the carryforward period to realize the benefit of our net deferred tax asset. In addition, after this offering, we may experience a change in control under Section 382 of the Internal Revenue Code, which would limit our use of these net operating loss carryforwards.

#### Net losses

Our net loss increased \$1,093,000 to \$1,284,000 during fiscal 1999 from \$191,000 for the period from September 22, 1997 (inception) to March 31, 1998. This increase was due primarily to the growth of our business and the increases in general and administrative and marketing and sales expenses.

#### Selected Quarterly Operating Results

The following table sets forth certain unaudited statement of operations data for each of the five quarters in the period ended June 30, 1999, as well as the percentage of our revenue represented by each item. This data has been derived from unaudited interim financial statements prepared on the same basis as the audited financial statements contained in this prospectus. The interim financial statements include all adjustments, consisting of normal recurring adjustments, that we consider necessary for a fair presentation of such information when read in conjunction with our financial statements and notes thereto appearing elsewhere in this prospectus. The operating results for any quarter should not be considered indicative of the results for any future period.

<TABLE>  
<CAPTION>

Quarter Ended				
June 30, 1998	September 30, 1998	December 31, 1998	March 31, 1999	June 30, 1999

	(Dollars in thousands)									
	\$	% of Revenue	\$	% of Revenue	\$	% of Revenue	\$	% of Revenue	\$	% of Revenues
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Revenues.....	\$ 281	100.0%	\$ 366	100.0%	\$ 467	100.0%	\$ 775	100.0%	\$1,228	100.0%
Costs and expenses:										
Cost of revenue.....	205	73.0	243	66.4	280	60.0	377	48.6	490	39.9
General and administrative.....	213	75.8	211	57.7	243	52.0	396	51.1	866	70.5
Marketing and sales....	105	37.4	165	45.1	163	34.9	230	29.7	384	31.3
Stock based compensation.....	85	30.2	86	23.5	86	18.4	92	11.9	140	11.4
Total costs and expenses.....	608	216.4	705	192.7	772	165.3	1,095	141.3	1,880	153.1
Loss from operations....	(327)	(116.4)	(339)	(92.7)	(305)	(65.3)	(320)	(41.3)	(652)	(53.1)
Other income (expense):										
Interest income.....	6	2.1	5	1.4	3	0.6	6	0.8	23	1.9
Interest expense.....	(1)	(0.3)	(3)	(0.8)	(4)	(0.8)	(5)	(0.7)	(6)	(0.5)
Net loss.....	\$(322)	(114.6)%	\$(337)	(92.1)%	\$(306)	(65.5)%	\$(319)	(41.2)%	\$( 635)	(51.7)%

</TABLE>

Revenues increased 30.2% during the quarter ended September 30, 1998, 27.6% during the quarter ended December 31, 1998, 66.0% during the quarter ended March 31, 1999 and 58.5% for the quarter ended June 30, 1999, as the size and number of new customer orders rose significantly during each quarter. Cost of revenue increased in each quarter, but decreased as a percentage of revenue. General and administrative expense and marketing and sales expense generally increased quarter over quarter primarily due to the addition of personnel as our business increased.

#### Liquidity and Capital Resources

We have historically financed our operations primarily through private placements of equity. Our cash increased by approximately \$2,272,900 during the three months ended June 30, 1999 to \$3,115,700. This net change is partially a result of our raising approximately \$3,275,000 from the sale of equity securities offset by approximately \$282,100 used to fund operating activities. In addition, our investment in property and

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equipment increased approximately \$696,300 during the three month period ended June 30, 1999. Installation of network infrastructure equipment and purchases of furniture and equipment for new employees accounted for this increase.

Total borrowings under our notes payable as of June 30, 1999 were approximately \$205,000. We intend to repay the amounts outstanding under these agreements with a portion of the proceeds of this offering. Our credit agreements and capital lease obligations contain no provisions that would limit our future borrowing ability.

Since June 30, 1999, we completed additional rounds of common stock financing through the issuance of approximately 8,712 shares for gross cash proceeds of \$6.0 million. In addition, in July 1999, Level 3 purchased 7,260 shares of common stock in exchange for a \$5.0 million credit to be used against future purchases of bandwidth in excess of our quarterly purchase commitment. In addition, Microsoft has agreed to purchase \$5.0 million of our common stock for a per share price equal to the lesser of the midpoint of the lowest filing range and the price to public.

We believe that our current cash balances, proceeds from the private equity financings closed since June 30, 1999 and the proceeds of this offering will be sufficient to meet our working capital and capital expenditure requirements for at least the next 12 months. If the offering is not consummated, we believe

that we could support operating and capital outlays for at least the next 12 months. Under our agreement with Level 3, we are required to purchase at least \$10.0 million of bandwidth and co-location services over the next five years. Our quarterly commitment is \$200,000 in the first year, \$300,000 in the second year, \$400,000 in the third year, \$600,000 in the fourth year and \$1.0 million in the fifth year of the agreement. We anticipate that further expansion of our operations will cause us to incur negative cash flows on a short-term basis, and therefore require us to use our cash and other liquid resources to support our growth. Our operating and investing activities on a long-term basis may require us to obtain additional equity or debt financing. We have no present understandings, commitments or agreements with respect to any acquisition of other businesses, products, services or technologies. However, we may evaluate potential acquisitions of other businesses, products and technologies from time to time. In order to consummate potential acquisitions, we may need additional equity or debt financings in the future.

#### Recent Accounting Pronouncements

On March 4, 1998, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants (AICPA) issued Statement of Position No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" (SOP 98-1). SOP 98-1 requires computer software costs related to internal software that are incurred in the preliminary project stage to be expensed as incurred. Once the capitalization criteria of SOP 98-1 have been met, external direct costs of materials and services consumed in developing or obtaining internal-use computer software; payroll and payroll-related costs for employees who are directly associated with and who devote time to the internal-use computer software project (to the extent of the time spent directly on the project); and interest costs incurred when developing computer software for internal use should be capitalized. SOP 98-1 is effective for financial statements for fiscal years beginning after December 15, 1998. Accordingly, we will adopt SOP 98-1 in our financial statements for the year ending March 31, 2000. We do not expect SOP 98-1 to have a material impact on our financial statements.

In April of 1998, the AICPA issued Statement of Position No. 98-5, "Reporting on the Costs of Start-up Activities", which requires that costs related to such activities be expensed as incurred. SOP 98-5 is effective for financial statements for fiscal years beginning after December 15, 1998. Accordingly, we will adopt SOP 98-5 in our financial statements for the year ending March 31, 2000. We do not expect SOP 98-5 to have a material impact on our financial statements.

#### The Year 2000

##### Impact of the Year 2000

Currently, many computer and software products are coded to accept two-digit entries in the date code field. These date code fields will need to accept four-digit entries to distinguish 21st century dates from 20th century dates. As a result, many companies' software and computer systems will need to be upgraded or replaced to comply with Year 2000 requirements. Failure to make such upgrades or replacements could result in system failure or erroneous calculations, causing disruptions of operations, such as an inability to process transactions, send invoices and engage in other normal business activities. We recognize the need to ensure that our operations are not adversely impacted by Year 2000 software and computer system failures. We are not currently aware of any Year 2000 compliance problems relating to our computer systems that would have a significant negative effect on our business, operating results or financial condition.

##### Project Plan and State of Readiness

We have made a preliminary assessment of the Year 2000 readiness of our computer systems and software, including the hardware and software that enable us to provide and deliver our solutions. We plan to continue our Year 2000

readiness efforts by:

- . testing our internal systems for Year 2000 compliance;
- . contacting third-party suppliers, vendors and licensors of material hardware, software and systems that are both directly and indirectly related to the delivery of our solutions to our customers;
- . assessing repair and replacement requirements;
- . implementing repair and replacement requirements; and
- . creating contingency plans for potential Year 2000 failures.

We have initiated a four-phase plan for addressing Year 2000 issues with the following estimated dates of completion:

<TABLE>  
<CAPTION>

Phase -----	Estimated Date of Completion -----
<C> <S>	<C>
I. Preparation and Information Gathering....	April 30, 1999
II. Develop Project Plan.....	August 31, 1999
III. Execution of Project Plan.....	September 30, 1999
IV. Full Compliance.....	October 31, 1999

</TABLE>

Some elements of the project plan are not dependent upon completion of other elements. Therefore, we may execute elements of the project plan while there may be outstanding tasks associated with other elements of the plan.

Phase I - Preparation and Information Gathering. In this phase we determined our Year 2000 risk. We inventoried our hardware and software and determined what replacements and modifications were required for our systems and networks to function properly after December 31, 1999. Upon review of hardware and software data gathered during the inventory, we gathered Year 2000 compliance information from our vendors via web site visits, phone calls or correspondence. Although we have received information from the majority of our key hardware and software component vendors that the products they supply to us are currently Year 2000 compliant, we cannot be certain that any representation made to us by any vendor is complete or accurate. In addition, we cannot be sure that we have not overlooked critical systems. As we acquire new hardware and software, we intend to use the same procedures to determine Year 2000 compliance.

We primarily rely on four key hardware and software vendors: Microsoft, Compaq, Cisco and Alteon. We have tested the Year 2000 compliance of the products supplied by these vendors. For Microsoft products, the software is considered Year 2000 compliant if it will function through the end of year 2035. We have identified remedial action that we need to perform on some of our vendors' products. These upgrades are available, and we intend to install them by September 30, 1999.

Our internal systems are based upon the same key vendor hardware and software product families described above. We have been advised by the vendor that our customer relationship management package is Year 2000 compliant. In 1998, we upgraded our internal accounting software with a package that, according to the vendor, would make the system Year 2000 compliant. We are currently installing a new phone system, and the vendor has informed us that it is Year 2000 compliant. We have contacted all of our significant vendors and third-party providers to obtain assurance as to their Year 2000 compliance. All of these vendors and providers have responded to our inquiries by directing us to their Year 2000 compliance statements on their web sites. The web sites of our significant vendors indicate that all software products are Year 2000 compliant and all hardware is currently Year 2000 compliant or is being updated to become Year 2000 compliant. We have not independently investigated these vendors' Year



2000 compliance.

Phase II - Develop Project Plan. We have a project plan that identifies the hardware and software replacements and/or modifications discovered during Phase I. We have assigned departments and resources for completing the project plan during this phase. While significant achievements were made in identifying critical Year 2000 issues regarding information technology and non-information technology related functions, we cannot assure you that critical equipment has not been overlooked. Some Microsoft products may require additional service packs and/or patches to make them Year 2000 compliant. In addition, some Compaq servers have required revisions. We expect that hardware and software revisions, such as applying updates, service packs and patches, will be minimal.

Phase III - Execution of Project Plan. We intend to accomplish the hardware and software replacements and/or modifications identified in Phase I and execute the project plan created in Phase II. During this phase we are continuing to test and monitor Year 2000 compliance and the effect of any non-compliance of our internal systems, vendors, service providers, clients and their respective systems and monitor the effect of any non-compliance on our business. We intend to re-evaluate the Year 2000 compliance of our hardware and software components that have been replaced or modified. We intend to give priority to those applications or processes posing the greatest threat of failure and greatest potential impact on our business.

While we believe that we have substantially completed our plan for achieving Year 2000 compliance, the discovery of additional systems requiring remediation could have a negative effect on the current plan and the resources required to implement the plan.

Phase IV - Full Compliance. We intend to be Year 2000 compliant by October 31, 1999 on all components critical to our business. However, we rely upon hardware and software vendors and do not control the accuracy, timeliness or completeness of their Year 2000 efforts. In addition, because our ability to provide services depends on the networks and systems of other carriers, to the extent that these networks and systems are adversely impacted by Year 2000 problems our ability to provide services to our customers may be adversely impacted.

#### Costs

To date we have not incurred any material expenditures in connection with identifying or evaluating Year 2000 compliance issues. We continue to collect information and make the necessary revisions to our systems in an ongoing effort to maintain Year 2000 compliance. We are not aware of any critical third-party software application which requires replacement. In the event we are required to make such a replacement, we do not anticipate that such expenses will be substantial. However, such expenses, if higher than anticipated, could harm our business and operating results.

#### Risks and Contingencies

Although we are not currently aware of any Year 2000 compliance problems relating to our computer systems that would have a material negative impact on our business, operating results or financial condition, we cannot assure you that we will not discover Year 2000 compliance problems in our software and systems that will require substantial revisions or expenditures or replacement. In addition, we cannot be certain that we will not need to modify or replace third-party software or hardware incorporated into our computer systems, which could be time consuming and expensive. If an oversight were to occur by us or one of our vendors and we or a

vendor failed to correct a material Year 2000 problem, we could experience an interruption in or a failure of normal business activities or operations, such as interruptions in our ability to provide services to our customers, an inability to market our services to potential new customers and the loss of customers. Any of these results could have a negative effect on our business.

Moreover, if we fail to adequately address Year 2000 compliance issues, it could result in claims of mismanagement, misrepresentation or breach of contract and related litigation, and any of these claims would likely be costly and time-consuming to defend. In addition, we cannot assure you that government agencies, utility companies, telecommunications companies, Internet service providers, third-party service providers, hardware or software manufacturers and others outside of our control will be Year 2000 compliant. The failure by such entities to be Year 2000 compliant could result in systemic failures beyond our control. Prolonged Internet, telecommunications, electrical or other failures could decrease the demand for our services and the use of the Internet or prevent users from accessing the web sites of our customers. This would materially harm our business.

Year 2000 issues may also impact the interaction of our systems with the software, hardware or systems of our suppliers. Furthermore, our ability to provide services to our customers depends on the networks and systems of other carriers. Any failures or problems experienced by the networks and systems of those carriers may adversely impact our ability to provide services to our customers. In addition, because we rely on our web site as a marketing and sales tool, any failures or problems affecting the Internet or our web site could hinder our marketing and sales efforts. We are not evaluating the Year 2000 compliance of our customers' web sites.

Each of the following events must be included in a consideration of the worst case scenario, which is an overall failure of the Internet, the telecommunications infrastructure and the electrical grid: widespread failure of communications carriers, public utilities, unavailability of transit for staff, suppliers and clients; disruption of our ability to gain access to, and continue operating in, office buildings and other facilities; the failure of significant portions of our critical computer systems and their respective components, including both internal business systems and systems controlling operational facilities such as electrical generation, transmission and distribution systems; and the failure of outside entities' systems, including systems related to banking and finance.

We provide our hosting services through a combination of skilled labor, hardware and software products and services from major vendors within the computer and telecommunications industries. Because our ability to provide our services depends on the performance of each of these components, the Year 2000 problem has introduced many risks and uncertainties, and the Year 2000 compliance of many of these components, such as the supply chain, utility companies and our customers' systems, is beyond our control and in some case beyond our ability to test. Because of these uncertainties, we are unable to determine whether the consequences of Year 2000 failures will have a material impact on our business.

If we cannot operate effectively after December 31, 1999, we could, among other things, face substantial claims by customers, including for lost profits, or loss of revenue due to service interruptions, inability to fulfill contractual obligations or bill customers accurately and on a timely basis, and increased expenses associated with litigation, stabilization of operations following critical system failures and the execution of contingency plans. We could also experience an inability by customers and others to pay us on a timely basis or at all. Under these circumstances, the adverse effects, although not quantifiable at this time, would be material.

We are continuing to gather information and evaluate the possible impact of the Year 2000 on our business and to develop contingency plans to implement if any of our systems are not Year 2000 compliant.

#### Quantitative and Qualitative Disclosures About Market Risk

All our customer contracts are currently denominated in United States dollars, and we do not currently invest in derivative financial instruments. However, we invest our excess cash balances in cash equivalents and are therefore subject to market risk related to changes in interest rates. We believe, but cannot be certain, that the effect on our financial position, results of operation and cash flows of any reasonably likely changes in interest rates would not be material.

## BUSINESS

## Our Company

Data Return provides advanced Microsoft-based Internet hosting services to businesses, web site developers and other organizations. Our advanced Microsoft hosting services enable our customers to establish and maintain sophisticated e-commerce and other applications through which they can conduct transactions and manage information on a worldwide basis over the Internet. Our hosting services, which are based on the Microsoft platform, provide support for software such as Windows NT, Internet Information Server, Active Server Pages, SQL Server and Site Server Commerce Edition. According to IDC, Microsoft Windows NT will be the key engine for growth within the worldwide server market and Windows NT's market share will grow at a compound annual growth rate of 25% from 1998 to 2003.

We provide our services to companies across many industries located primarily in North America and Europe. We also have a small but growing customer base in South America, Asia, Africa and Australia. As of August 31, 1999, we hosted over 1,600 web sites for more than 800 customers.

Our advanced hosting services are designed for customers deploying sophisticated, high-end Internet applications that require a professionally-managed environment incorporating high performance network access, advanced system monitoring and technical support in highly secure, fault-tolerant facilities. We believe that we are well positioned to take advantage of the rapidly growing demand for advanced hosting which is being driven by the growth in user access to the Internet, e-commerce and the outsourcing of web services.

We were incorporated in August 1997 by three former Microsoft product support engineers. We believe that our exclusive focus on the Microsoft platform and our approach to offering pre-packaged hosting services have been the major contributors to our growth. We believe the following are among the key factors that have distinguished our company and our offerings and that will continue to drive our growth:

- . a full range of pre-packaged hosting services supported by advanced managed services for fixed monthly prices;
- . high availability and high performance clustering solutions for web servers and database servers;
- . an advanced and secure network architecture that has delivered faster network performance compared to the single fastest backbone provider;
- . automated work flows and service deployment processes;
- . avoiding competition with software developers and systems integrators; and
- . a commitment to serving members of the Microsoft developer community, who are valuable sources of customer referrals.

Level 3 and Compaq have invested in our company, and Microsoft has agreed to purchase shares of our common stock. We believe our relationships with these companies enhance our credibility with potential customers and provide us with early access to new products, superior technical services, training and new business development opportunities. In July 1999, we entered into a five-year agreement with Level 3 under which:

- . Level 3 has designated us as a preferred provider of advanced Microsoft hosting services;
- . we will train Level 3's sales personnel to identify and refer potential customers to us on a commission basis;

- . we are entitled to offer our services from the 17 existing and all future Level 3 gateways in the U.S. enabling us, we believe, to avoid the significant costs of building our own data centers;
- . Level 3 will provide assistance as needed in the installation and support of our equipment located in their gateways; and
- . Level 3 has acquired shares of our common stock in exchange for \$5.0 million in credit for future bandwidth purchases in excess of our purchase commitment.

Also in July 1999, we entered into a three-year agreement with Compaq. Under that agreement, Compaq has agreed to include Data Return in any program under which it approves for recommendation to its customers a specified group of application service providers. Although Compaq is not required to develop such a program, it will include us in any such program that it does establish at the highest level for which we qualify. In addition, Compaq has purchased shares of our common stock for a purchase price of \$3.0 million.

In September 1999, we entered into an agreement with Microsoft under which we will license proprietary installation tools for third-party hosted applications to Microsoft and train Microsoft's employees and customers in the use of those tools. Under that agreement, Microsoft will provide technical consulting and writing services, and we will co-market the tools with Microsoft. Microsoft has also agreed to invest \$5.0 million in our common stock.

#### Industry Background

##### Growth of the Internet and Electronic Commerce

The market for advanced hosting services has been driven by the growth of the Internet. The Internet has emerged as a new medium for communicating, exchanging information and transacting business. IDC projects that the number of Internet users will grow from approximately 159 million at the end of 1998 to over 410 million at the end of 2002. Forrester Research projects that during the next five years U.S. online business-to-business trade will exceed \$1.0 trillion. Forrester Research also projects that e-commerce will generate over \$3.2 trillion in worldwide revenue by 2003. We believe businesses and other organizations will attempt to take advantage of this growth by establishing new web sites or upgrading existing web sites. We further believe that many of these sites, particularly those used for electronic commerce, will be increasingly complex and have high traffic volume requirements.

##### Outsourcing of Web Hosting

As businesses attempt to take advantage of the revenue potential presented by the growth of the Internet and e-commerce by establishing web sites that interact with customers, vendors and employees, we believe that they will increasingly outsource the hosting of their web sites. To support e-commerce applications, these sites must be capable of reliably and securely completing financial transactions. The process of establishing a web site includes:

- . specification of site requirements, including the associated business work flows and processes;
- . development and testing of software consistent with the specifications;
- . acquisition and installation of hardware, software and network access in a controlled environment; and
- . physical implementation of the web site onto the Internet.

Once a web site is implemented, it requires monitoring, maintenance and management provided by knowledgeable personnel. While some businesses currently choose to operate and maintain their web sites in-house, we believe that many businesses, even those with relatively large and sophisticated information

technology departments, will find outsourcing the hosting of their web sites attractive due to the following factors:

- . rapid changes in the various complex technologies involved;
- . difficulty of deploying highly sophisticated web applications;

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- . challenge of hiring and retaining experienced and qualified personnel;
- . lack of the infrastructure needed to deploy, expand, upgrade and maintain essential applications on the Internet around the clock; and
- . potential cost savings associated with personnel and system infrastructure requirements.

We believe that the trend toward outsourcing the hosting of web sites will continue as businesses increase the complexity of their web sites and require greater interactivity for end users. We believe that these web sites will increasingly be based on Microsoft Internet technologies. IDC projects that Windows NT will be the key engine for growth within the worldwide server market and Windows NT's market share will grow at a compound annual growth rate of 25% from 1998 to 2003.

#### The Outsourcing of Packaged Application Hosting

For many of the above reasons, companies are seeking to outsource the management of important software applications that can be accessed over the Internet. We believe that many of these applications will also be based on Microsoft Internet technologies. These applications govern business processes such as e-mail, sales force automation, human resource management, decision support, supply chain management, core financials and overall enterprise resource management. We believe that the potential benefits of outsourcing these applications include significant improvements in application availability and reduced ongoing management costs. According to IDC, information systems outsourcing, which includes data center, client/server and help desk applications, is the fastest growing segment of the market, and spending in this area will increase at a 12.2% compound annual growth rate through 2003. Further, IDC projects that spending on worldwide outsourcing services will increase from \$99.0 billion in 1998 to more than \$151.0 billion by 2003.

#### Our Market Opportunity

##### The Advanced Hosting Opportunity

Advanced hosting is distinguished from basic hosting by requirements for:

- . more bandwidth;
- . more complex system architectures, including support for extranets and intranets;
- . more complex software technologies;
- . a higher level of technical expertise to support these complex systems; and
- . higher system performance and reliability.

Advanced hosting is used to support highly interactive web sites on which real-time transactions and full-featured e-commerce applications are implemented. These sites provide users with the ability to interact with databases and require a high level of expertise for implementation and maintenance support. For higher volumes of user traffic and transactions, multiple servers may be required.

As e-commerce becomes increasingly important to businesses worldwide, we believe that many businesses will outsource the hosting and maintenance of

their high-volume, transactional web sites. Further, beyond e-commerce, we believe that the hosting market will be driven by a demand for the outsourcing of other enterprise-wide, business unit and information technology department functions. According to Forrester Research, the hosting market will grow from \$0.9 billion in 1998 to \$14.6 billion in 2003, a 76% compound annual growth rate.

#### Hosting on the Microsoft Platform

We believe that the market for advanced hosting on the Microsoft platform offers a greater opportunity than the market for hosting on other platforms, such as Unix. Microsoft is the dominant provider of operating systems for personal computers. We believe that many developers are writing web applications for the Microsoft platform because of previous experience gained in the Microsoft architecture, including experience with Basic, Visual Basic and Active Server Pages. According to Microsoft, more than two million developers participate in Microsoft's Developer Network and Site Builder Network programs. We believe that, as businesses demand applications that are capable of operating on the Internet, developers are increasingly responding by producing Microsoft-based solutions that require hosting on Microsoft platforms. For example, IDC reports that Microsoft 32-bit Windows offerings have the leading position in terms of operating environment license revenues and license shipments for client operating environments. Additionally, we believe the momentum toward the Microsoft platform is driven by market demand for shortened development cycles, lower development costs and lower operating costs.

#### Our Solution

Data Return is an advanced hosting provider dedicated to delivering scalable, reliable and high performance hosting services on the Microsoft platform. By combining our expertise in managing Microsoft-based Internet technologies, a scalable deployment architecture and high performance content delivery, we have developed a family of services that addresses a wide range of customer needs.

#### Advanced Managed Services

Managing the deployment of business-critical web applications requires an in-depth understanding of all underlying software, hardware and network technologies. We use our expertise in Microsoft technologies to provide management services for our customers' hosting needs which include:

- . consultation and recommendations on standardized system architecture;
- . installation, configuration and stress testing of hardware and software;
- . ongoing maintenance of hardware and software including content back-ups and system upgrades;
- . a broad array of system and network monitoring and reporting services provided 24 hours a day; and
- . advanced technical support designed to respond to both simple and complex system issues.

#### Scalable Deployment Architecture

Our customers require system architecture that is flexible and can be expanded over time to meet increasing demand. Data Return has developed a scalable deployment architecture for the Microsoft platform that enables customers to begin with cost effective shared solutions and then migrate to dedicated services and high-end multi-server clustered solutions as their site traffic grows. The flexibility of this architecture allows us to offer a wide range of hosting solutions to our customers.

#### High Performance Content Delivery

Overall application performance is an essential component to deploying an Internet-based application successfully. There are many factors that contribute to overall performance including the configuration and architecture for hardware, software and Internet access. Our private networking architecture bypasses the congested public exchange points, such as the Metropolitan Area Exchanges and Network Access Points, increasing speed and reliability. By taking a comprehensive approach to optimizing application performance, we delivered network performance faster on average, during the period from August 16, 1999 through the date of this prospectus in the United States compared to the single fastest backbone provider as measured by Keynote Systems.

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#### Pre-Packaged Solutions for Advanced Hosting

We have standardized our services into packages with defined pricing and feature sets. We believe these pre-packaged solutions simplify the sales process and customer support compared to co-location. Co-location arrangements typically involve a vendor supplying space for the server and Internet connections and the customer being responsible for defining and implementing the deployment architecture. Our pre-packaged solutions enable our customers to outsource these responsibilities to us for their Internet, extranet or intranet applications.

#### Our Strategy

Our goal is to take advantage of the growth in Internet usage, e-commerce and the outsourcing of hosting services to become the leading provider of advanced hosting services. Our strategy for accomplishing this goal contains the following key elements:

**Maintain Focus on Advanced Hosting on the Microsoft Platform.** We intend to maintain our exclusive focus on Microsoft-based advanced hosting, which enables us to concentrate our expertise. We believe that we are better able to attract customers because we have targeted the Microsoft platform, which we believe is significantly underserved. By focusing on one platform, we are not required to duplicate systems and operations costs which would be necessary to support multiple platforms. In addition, by focusing exclusively on advanced hosting and not engaging in web site development or systems integration services ourselves, we are able to maintain close relationships with developers and systems integrators, who serve as a valuable source of referrals.

**Offer a Full Range of Highly Scalable Advanced Hosting Services.** We attract customers by offering a full range of Microsoft-based hosting services from shared and dedicated services to complex, clustered solutions. We intend to continue working with Microsoft and other technology partners to remain at the forefront of packaging new technologies into advanced hosting services. We believe that our advanced hosting customers view their web applications as an important part of their business strategy and are seeking a growing number of services. We target larger customers with substantial and complex requirements. However, our broad range of service offerings also attracts customers with lower volume requirements who can migrate to more powerful service offerings as their needs evolve. We believe that our broad range of service offerings attracts customers who are likely to be long-term customers.

**Maintain Non-Capital Intensive Business Model.** We deploy our hosting services within third-party data centers to avoid the high capital expenditures associated with building our own data centers. Rather than investing in data centers and other capital intensive assets, we invest in internally developed and third-party software and other tools. We believe this allows us to increase customer satisfaction by providing better service and increases our financial flexibility by reducing fixed costs. Specifically, we are able to add value and generate a competitive advantage by continuing to develop best practices, standardized service offerings and automated processes that improve operational efficiency.

**Enhance Our Marketing and Sales Programs.** Through the packaging of our offerings, we believe we have substantially reduced the complexity of purchasing advanced hosting services. We intend to substantially increase our

advertising efforts to further promote awareness of the Data Return brand and our advanced Microsoft-based hosting offerings. To date, our sales have been made through our inside sales force, which has focused on responding to leads and other inquiries generated from advertising and referrals. In parallel with the expansion of our inside sales force, we intend to establish an outside sales force to proactively seek larger

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opportunities. Additionally, we intend to train Level 3's sales force, as contemplated by our agreement with Level 3, and to further formalize our partner programs with developers and systems integrators to identify and refer their leads for advanced Microsoft-based hosting services to Data Return.

**Capitalize on Key Relationships.** We have relationships with Level 3, Compaq, Microsoft and Alteon that we believe provide us with early access to new products, superior technical services, training and new business development opportunities. In some cases, these partners have provided us with direct and indirect funding. We believe that our association with industry leaders enhances our credibility with potential customers. We intend to strengthen our existing relationships and to seek additional strategic arrangements when appropriate.

**Provide Superior Customer Service.** We intend to continue to provide high-quality customer service by maintaining a high level of technological expertise in our customer support and sales organizations and by proactively monitoring the performance of our customers' web sites. We believe that our standardization of hardware and software solutions, which results in efficient training, documentation and overall logistics and operations, allows us to deliver high-quality customer service. We intend to continue leveraging our relationships with Compaq, Microsoft and Alteon to receive the technical training and support necessary to provide high levels of customer support during both installation and ongoing maintenance.

**Expand Our Data Center Presence.** The servers we use in offering our hosting services are located in data centers, which are secure facilities with multiple Internet connections, multiple power sources and other features designed to minimize the possibility of service interruptions. We currently operate from data centers in Fort Worth and Dallas, and our agreement with Level 3 allows us to establish data centers in the 17 current and all future Level 3 gateways located in the U.S. We intend to offer services from Level 3's data centers in San Francisco and London in the second half of 1999. We also intend to provide services through Level 3's network, which is currently planned to be composed of local networks in approximately 50 cities, over the next five years. Additionally, our relationship with Level 3 will provide us with access to bandwidth and personnel to assist in the installation and implementation of our equipment in their gateways. These capabilities position us to offer nationwide points of presence for shared, dedicated, clustered and geographically dispersed clustered hosting services.

**Expand into New Hosting Markets.** We believe that the execution of the above elements of our strategy will enable us to address new hosting markets as they develop. In particular, we believe that we are positioned to expand into the emerging application service provider market without significant changes to our operations or business model. We believe that our Microsoft-based hosting services will be a desirable platform for electronic distribution in the emerging software rental market. Additionally, we believe that software companies whose products either draw upon Microsoft technologies or whose products typically interface to the large installed base of Microsoft systems will find our hosting services attractive. We have recently begun offering hosting services for Microsoft Exchange, which is an advanced messaging service.

#### Our Services

We have made an extensive effort to package our hosting services into standardized, definable product offerings. Our services are designed to be comprehensive in terms of feature sets and to address customers' outsourcing needs for a wide variety of requirements, including:



- . customers accessing public web sites on the Internet;
- . employees accessing private web sites through intranets; and
- . partners and other designated user groups accessing private or public web sites through extranets.

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## Offerings

Our advanced Microsoft hosting platform allows us to support the Internet, intranets and extranets for both commercially developed applications and custom developed applications. To address this wide variety of customer requirements, Data Return has developed three distinct categories within our service family. During the three month period ended June 30, 1999, excluding set-up fees, 50.6% of our revenues was derived from our shared services, 38.2% was derived from dedicated services and 11.2% was from clustered hosting services.

**Shared Hosting Services.** Shared hosting services are entry level service plans designed for customers with complex requirements but relatively low volumes of traffic. We have designed our shared hosting packages to minimize the cost for customers by providing these services on a server shared by multiple customers. Our service plans include many standard features and options for database support, commerce support, media services and extensive e-mail support.

**Dedicated Hosting Services.** Dedicated hosting services are designed for customers with more complex requirements, high traffic volumes and who are seeking greater control over management of their servers. Our dedicated service plans provide each customer with its own server. These service plans offer a number of advantages to our customers in addition to those received in our shared hosting packages, including:

- . improved service reliability and content delivery by limiting each server to a single developer environment;
- . greater flexibility in configuration of the specific server environment; and
- . complete server control by providing customers with console-level server access.

We offer several dedicated service options that range from entry-level web servers to high performance, multi-processor database servers.

**Clustered Hosting Services.** For customers that deploy e-commerce enabled or other business-critical applications or expect very high user traffic volumes, we have developed a family of clustered hosting services, including geographically dispersed clusters. Our clustered service plans distribute content and functionality across multiple servers, which allows our customers' applications to scale beyond a single server. Additionally, our clustering services are designed to allow our customers' business-critical applications to continue operating in the event a server fails. These services are designed to provide significantly enhanced system performance and system reliability for application and database services. These services require specialized hardware and software which we include in our pre-packaged solutions. We believe that customers will increasingly require the type of services supported by clustered solutions and therefore our sales volumes in this category will increase.

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## Pricing

We bill for our services on a monthly basis and for a one-time initial setup fee at the time the server is configured. In addition to our pre-packaged

product offerings, we also work with customers to develop custom configurations that are based on our standard hosting architecture. Our product offerings and prices for new installations as of August 31, 1999 are generally described in the table below.

<TABLE>

<CAPTION>

Service Type -----	Service Level -----	Set-up Fee -----	Monthly Fee -----
<S>	<C>	<C>	<C>
Shared Hosting Services	Shared Level 1.....	\$ 100	\$ 100
	Shared Level 2.....	150	200
	Shared Level 3.....	200	400
Dedicated Hosting Services	Enterprise Dedicated I.....	2,000	1,500
	Enterprise Dedicated II.....	2,500	2,000
	Enterprise Dedicated III....	5,000	3,500
Clustered Hosting Services	Level I--Configuration 1....	6,000	5,100
	Configuration 2.....	6,500	6,100
	Configuration 3.....	10,000	8,100
	Level II--Configuration 1...	14,000	8,800
	Configuration 2.....	20,000	12,800
	Configuration 3.....	22,500	17,000

</TABLE>

To further simplify the purchasing process for our customers, all service plans, including features and pricing, are described on our web site. This enables our customers to evaluate the various service offerings before contacting one of our sales representatives, which in turn can shorten our selling cycle, reduce our customer acquisition costs and ultimately enhance customer satisfaction by making readily available the necessary technical and business information for choosing the appropriate service level. We intend to continually upgrade our web site to provide more product information and enhanced purchasing capabilities for our existing and prospective customers.

#### Customers

We provide hosting services to end user businesses, web site development firms and other organizations. Our customers are located primarily in North America and Europe. We also have a small but growing customer base in South America, Asia, Africa and Australia. As of August 31, 1999, we hosted over 1,600 web sites for more than 650 customers ranging from small- and medium-sized businesses to Fortune 500 companies. Some of our more widely known customers at that time were:

www.activeserverpages.com	Microtouch Systems, Inc.
Berlitz Languages, Inc.	Motorola, Inc.
The Better Business Bureau	www.ntbugtraq.com
The Boeing Company	www.oceanfutures.com
www.cartoonbank.com	Olin Corporation
www.clubwin.com	Palo-Alto Software
Compaq Computer Corporation	Planetoutdoors.com
www.dash.com	Proxima Corporation
Data Junction Corporation	Razorfish
Ericsson	Ryder System, Inc.
Executive Software	Sensormatic Electronics
First USA	Siemens A.G.
HNC Software	www.siteserver101.com
Honeywell, Inc.	Solomon Software
International Data Corp (IDC), India	Successories
Isbister Software	www.telezoo.com
IXL, Inc.	Trane Company
Kaetron Software	Travel Zoo
KPMG	Tudor Publishing
www.merchandizer.com	Wilson's the Leather Experts
Microsoft Corporation	Winchester

#### Key Relationships

We entered into a five-year relationship with Level 3 in July 1999 and are currently Level 3's only preferred provider of advanced hosting services for the Microsoft platform. Our strategic relationship with Level 3 allows us to leverage our advanced hosting and managed application services with their sales force and U.S. data center infrastructure. Level 3 provides us with segregated rack space capacity and environment controls for up to 6,000 servers in its Dallas gateway and access to the 17 existing and all future U.S. Level 3 gateways. In addition, Level 3 will provide personnel at these data centers to install equipment and assist with support as necessary for us to deliver service in these facilities. This reduces the number of implementation engineers we require to deploy and support solutions for our customers in these locations. We believe that these benefits, coupled with geographic and network proximity to our customers, will become a marketing and technological advantage in the immediate future. Under our agreement with Level 3 we have agreed to purchase most of our bandwidth and co-location requirements from Level 3 to the extent they meet our then-current performance and capacity requirements. We have also made a purchase commitment to Level 3 increasing from \$800,000 in the first year to a total of \$4.0 million in the fifth year for a total minimum commitment for the term of the contract of \$10.0 million. Level 3 can terminate this agreement for a default by us which is not cured within 30 days of notice or a change of control that results in Data Return being owned by a competitor of Level 3.

We will train Level 3's sales personnel to identify potential customers for our advanced hosting services and refer them to us. Level 3's sales personnel will be paid a commission based on a percentage of the first month's monthly recurring revenue on all leads that become our customers. As we train Level 3's sales force at a particular data center, we intend to deploy our own outside sales force in that region to work with Level 3 to

develop and close joint sales leads. To date, our growth has been driven primarily by our inside sales force. We believe that the lead generation of Level 3's sales force, combined with our future outside sales force, positions us to substantially increase our rate of growth. Level 3 has acquired shares of our common stock in exchange for \$5.0 million in credit for future bandwidth purchases in excess of our quarterly purchase commitment.

#### Compaq

We use Compaq servers exclusively to provide the hardware platform for our advanced hosting services. Our relationship provides direct contact with product development engineers and marketing management at multiple levels within the Compaq organization. We recently entered into a three-year agreement with Compaq under which we will purchase from Compaq the lesser of 2,000 servers or the number of servers reasonably necessary to adequately operate our business consistent with our business plan. We are required to purchase these servers only if Compaq provides financing for the servers on competitive terms, if the price, performance and quality of the Compaq servers is reasonably satisfactory to us and if Compaq commits to deliver these servers on the schedule we request. Also as part of our strategic relationship with Compaq, Compaq has agreed to include Data Return in any program under which it approves for recommendation to its customers a specified group of application service providers. Although Compaq is not required to develop such a program, it will include us in any such program that it does establish at the highest level for which we qualify. Compaq has also purchased \$5.0 million of our common stock.

We work collaboratively with the Compaq engineering and product marketing teams on the Distributed Internet Server Array (DISA) architecture to develop enhanced offerings for multiple server configurations (clustered web and SQL server solutions). We are also currently working on a Compaq co-funded print campaign featuring our use of Compaq servers in a clustered environment. We are also a Compaq Solutions Alliance SELECT Partner. The SELECT Partner designation is the highest attainable level in this program and provides us with a wide variety of information, tools, services and networking opportunities.

## Microsoft

We recently entered into a licensing agreement with Microsoft. Under this agreement we will license proprietary installation tools for third-party hosted applications to Microsoft. We will also train Microsoft's employees and customers in the use of those tools. Microsoft will, in return, provide us with technical consulting and writing services during the development of the tools. Microsoft has also agreed to co-market the tools with us in a manner that is mutually acceptable to both parties. Microsoft has also agreed to purchase \$5.0 million of our common stock.

We are recognized by Microsoft as one of the leading providers of advanced hosting services on the Microsoft platform. We have received the Microsoft Advanced Hosting Partner and Application Service Provider Partner designations and have achieved a high level of integration at all levels within Microsoft. We believe that one of our key competitive advantages is the level of customer service and support that we can provide as a result of this enhanced relationship. However, we do not have an agreement with Microsoft to provide this level of support and integration or to continue to confer these certifications and designations. Microsoft could discontinue its relationship with us at any time. Our expertise in deploying and managing the Microsoft Internet platform is also an important factor in our business relationship with Microsoft. Our status with Microsoft provides us with the following:

- . access to a local, field-based Microsoft representative;
  - . a corporate-based business development manager;
  - . designated points of contact in the customer units and product groups;
  - . escalated technical support;
  - . advance product notification;
  - . advance product releases;
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- . participation in beta programs;
  - . joint marketing programs; and
  - . leads and new business development opportunities generated by Microsoft.

Following are some of the Microsoft designations, certifications and related agreements that Data Return currently has:

- . We are one of eight Microsoft Advanced Hosting Partners. This status signifies our ability to provide database integration, full back-end transaction processing and advanced content management.
- . We are one of ten designated Microsoft Application Service Providers, defined by Microsoft as being able to provide superior infrastructure, service and performance for hosted applications on the Microsoft platform.
- . We are one of 11 Microsoft Commerce Hosting Services providers. This signifies our ability to provide customers with an advanced e-commerce hosting infrastructure.
- . We are a Microsoft Windows Media Service Provider. This status signifies our ability to deploy and maintain audio and video streaming media solutions.
- . We participate in rapid deployment programs for various Microsoft products. As such, we are responsible for providing feedback on Microsoft products in the advanced hosting and managed application markets prior to release, and by doing so we are able to provide

services and gain expertise on these products before the general market.

- . We are a Microsoft Certified Solution Provider at the Partner level. The Partner designation is the highest attainable level in this program. We believe this designation provides us with preferred access to a broad range of Microsoft resources and is a distinguishing factor for development firms and systems integrators looking to identify sources for advanced hosting.
- . We have acquired Microsoft Premier Support, which provides the most direct, fastest and highest formal escalation path for resolution of product-related problems within Microsoft, including a technical account manager at Microsoft who is responsible for ensuring that Microsoft product support provides timely and accurate resolutions to problems we or our customers may encounter.

#### Alteon

Alteon manufactures state-of-the-art switching products capable of supporting millions of concurrent connections with load balancing and fail-over for clustered server configurations. We believe we were the first commercial installation of the Alteon server switching platform for the Microsoft Internet platform. Our Chairman and Chief Executive Officer, Sunny Vanderbeck, is an advisory board member of Alteon. The advisory board assists management in product, marketing and distribution planning. Additionally, we are using the Alteon WebOS application programming interface to enhance clustered solutions. These enhanced clustered solutions deliver real-time performance data to the hardware platforms, providing increased functionality, reliability and scalability in high-volume and complex deployments.

#### Marketing and Sales

Our marketing strategy has initially been focused on our product packaging. We have made an extensive effort to package our hosting services in standardized, definable product offerings that are competitive in terms of features, functions and prices. We have made our services easy to purchase by presenting these packages in detail on our web site, including all set-up and monthly charges. We believe that this packaging and standardization shortens our selling cycle and enhances customer satisfaction by making available to decision makers the technical and business information necessary to choose a service level.

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We intend to substantially increase our marketing expenditures to help build awareness of our brand and to further generate sales. We have a customer tracking system that provides us with timely reports as to which marketing activities are producing the greatest return, which enables us to better allocate our marketing resources. We currently have a diversified marketing effort for demand generation. Primarily we market through advertising in magazines targeted at developers and information service professionals. We also advertise online, through direct mail and at trade shows and conferences. Additionally, many web sites of our customers and partners have direct links to our web site. We intend to increase our spending in all of these areas, and in particular focus on direct mail because we believe it will significantly help our outside sales force in their business generation efforts.

Our sales have predominantly been generated by developer and customer referrals. We believe that a distinguishing characteristic of our company is that we do not provide application development services and, therefore, do not compete with any of our development focused customers. We believe that as more development companies make the decision to outsource the hosting of their clients' applications, Data Return will be an attractive alternative to hosting providers that also offer development services.

Our inside sales force responds to inquiries, which typically have been generated by advertising and referrals from customers, strategic partners and developers. We intend to significantly increase our inside sales force during the second half of 1999 to respond to the inquiries that we believe will be

generated by our increased marketing efforts. Concurrently, we are developing an outside sales force to proactively seek potential customers. Each outside salesperson's territory will include one or more Level 3 U.S. gateways. The outside sales force will work in conjunction with Level 3's sales force to provide training and ongoing sales support. Both our inside and outside sales force will be responsible for following up on leads generated by Level 3's sales force. We intend to continue to add outside salespeople as Level 3 builds out its U.S. gateways.

We have recently implemented a sales incentive program that we believe has increased sales productivity and enhanced pre-sales customer service. Our sales force is paid a commission for each sale that they complete based upon the customer's first month of recurring revenue. To encourage our sales force to pursue long-term revenue generating business, we adjust the commission paid to the sales person if the customer does not use our service for a minimum period of time. In addition to paying commissions to our inside and outside sales personnel, we will pay commissions to Level 3's sales force for all sales based on leads they refer to us. We believe this commission structure will create a high level of cooperation in the field between Data Return's and Level 3's sales forces.

#### Customer Support

We believe a critical element of our customer service is providing a high level of technical expertise within both our customer support and systems organizations. Our technical support engineers are expected to be proficient in at least:

- . one major network operating system;
- . two applications from our supported product list; and
- . either one programming language or one database application.

Further, we require all of our support and systems technicians to become Microsoft Certified Systems Engineers or Microsoft Certified Professionals.

All systems are monitored and maintained on a 24 hours a day, seven days a week, or 24x7, basis. We provide standard customer support from 9AM-8PM Central time Monday through Friday and 12PM-5PM Saturday via both telephone and electronic request forms. We provide business-critical customer support on a 24x7 basis. We strive to respond within 15 minutes or less for business-critical problems. Response times for all severity levels are published on our support web site and are prioritized according to our customers' assessment of severity levels.

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Our customer care system provides support personnel with timely online information regarding the status of all set-up and support incidents. Additionally, support personnel have access to information regarding the sales history and current sales activities for each customer account. This integration of support and sales systems enables us to allocate resources with a full knowledge of both new business opportunities and any customer support issues. We believe that this system will support substantially greater economies of scale and quality of service.

#### Infrastructure

We use a platform which is comprised mostly of Internet-related software products running on Microsoft's Windows NT operating system and Compaq servers. We use Alteon clustering switches along with Cisco switches and routers to connect our servers to the Internet. Using our standard platform, we have gained efficiency and effectiveness in terms of training, documentation, spare parts, overall support and system performance. We also maintain some legacy hosting services running on the Unix platform. In addition, our customers benefit from our ability to support application level services such as SQL Server, Active Server Pages and Site Server Commerce Edition. Specifically, our infrastructure consists of the following key elements:

- . highly secure, carrier-class data centers;
- . a scalable server platform;
- . automated deployment processes;
- . comprehensive and centralized monitoring and systems management;
- . fault-tolerant clustered servers; and
- . an advanced, high performance network.

#### Highly Secure, Carrier-Class Data Centers

Our first data center is located in a facility in downtown Fort Worth. The facility is a Bellcore standard Class A facility, which is an industry term indicating that the facility has redundant systems to prevent down-time caused by system failures at the facility. Security for the data center is provided with a 24x7 armed guard and entry restriction via card key access. Power to the building is provided by redundant connections from separate transformers. The data center is also equipped with FM200 gas fire suppressant systems, environmental control systems and redundant networking hardware.

In January 1999, we established our second data center within Level 3's Dallas gateway. The Level 3 facility, which is also a Bellcore standard Class A facility, provides us with environmental resources similar to the Fort Worth data center, but on a much larger scale. In addition to providing greater capacity for server racks and associated environmental support, the Level 3 facility provides us with access to Level 3's worldwide IP network. The Level 3 relationship provides us with access to the 17 current and all future gateways in the U.S. This provides us with the ability to expand not only bandwidth resources, but also the ability to open new data centers in major cities across the U.S. on relatively short notice and with relatively little investment by us. All of Level 3's highly secure, carrier-class facilities are designed for scalability and include advanced security features that may include biometric palm readers, video monitoring and card key access, and fault-tolerant power systems, such as multiple power grids, facilities-based AC/DC battery back-up and diesel generators. We intend to offer services from Level 3's London, England and San Francisco data centers in the second half of 1999.

#### A Scalable Server Platform

Our standard platform for service delivery uses Compaq servers. These servers generally run the Windows NT or Windows 2000 operating system, along with various application software such as Microsoft SQL Server

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or Microsoft Internet Information server. Compaq's Distributed Internet Server Array (DISA) architecture leverages the clustering and load balancing features of Windows NT Server, Enterprise Edition with Internet Information Server. This architecture enables us to support scalable, highly-available Internet-enabled applications. In addition, our standard hardware configuration allows us to maintain standby hardware for use in the event of hardware failure. While these servers use a standard hardware and software platform, we apply our expertise in their configuration and tuning.

#### Automated Deployment Processes

We configure and test our hardware and software through the use of both commercially available and internally built tools. The software installation process consists of a series of unattended scripts and batch files providing a fast, consistent and repeatable configuration. As the server is provisioned with user accounts, web sites and file transfer protocol sites, the automated script also tests each step to verify that the server is functioning correctly. We also manually test the installation process to further evaluate the quality and integrity of the installation.

We combine commercial tools and internally built applications to provide comprehensive and centralized monitoring, analysis and reporting of application, service and hardware performance on a 24x7 basis. Proactive hardware and application monitoring maximizes service performance levels and reliability. Systems administration and management is remotely performed using an interface which encrypts all client-server communication with a 64-bit encryption algorithm for added security. Additionally, we offer a customer control panel, which provides a standard user interface that allows them to perform the most commonly performed web site administrative tasks. The customer control panel also allows the customer to electronically submit support requests to our service and support group for the more advanced administrative tasks and support issues. This approach to monitoring and systems management allows us to use the same methodologies and processes across all of our data centers regardless of geographic location.

#### Fault-Tolerant Clusters

We currently offer two levels of clustered solutions: level one clustered application services and level two clustered application and database services. Level one clustered solutions utilize products from Alteon to provide high availability and traffic load balancing for application resources, such as web servers and application servers. In the event of an application server failure, all traffic is redirected from the failed server to the remaining available application servers to protect against service outage. Level two clustered solutions provide enhanced application availability by adding clustered database services, which are well suited for the clustering of transactional data resources including Microsoft SQL Server. These solutions are based on Fibre Channel storage systems from Compaq and the Microsoft Cluster Service. We also offer geographically dispersed solutions which allows us to load balance and fail-over applications between data centers.

#### Advanced High Performance Network

We have based our network hardware on Cisco and Alteon technologies. Our highly secure network consists of multiple, diverse connections to the Internet which currently provide us with local access to seven leading backbone providers. These multiple connections allow us to increase both performance and reliability by routing traffic over private connections, bypassing congested public exchange points such as the Metropolitan Area Exchanges and Network Access Points. By taking a comprehensive approach to optimizing application performance, we have delivered network performance faster in the United States on average compared to the single fastest backbone provider as measured by Keynote Systems over the period from August 16, 1999 through the date of this prospectus. In addition to increased performance, our network

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architecture reduces our dependency on any one network provider, increasing network availability for our customers. Further, we have our own IP addresses, which reduces our dependence on specific network providers or other third parties. Our network security solutions include firewalls, encryption techniques, virtual private networks and other security technologies and techniques. To date in 1999, we are one of the top three issuers of Verisign certificates, which enable secure e-commerce.

#### Competition

The markets in which we operate are highly competitive, and competition is increasing because few apparent substantial barriers to entry exist in the Internet hosting market. We expect that we will face competition from existing competitors as well as new market entrants in the future. The primary competitive factors in our market are:

- .technical expertise in developing advanced web hosting solutions;
- .quality of service, including network capability, scalability, reliability and functionality;



- .customer service and support;
- .variety of services and products offered;
- .price;
- .brand name recognition;
- .Internet system engineering and technical expertise;
- .timing of introductions of value-added services and products;
- .network security;
- .financial resources; and
- .conformity with industry standards.

Our current and potential competitors vary by size, product offering and by geographic region and may elect to partner with each other or with focused companies like us to deliver service on the Microsoft platform. They include:

- . Microsoft advanced hosting providers, such as Digex, MCI WorldCom (including UUNET), GTE Internetworking and USWeb/CKS Group;
- . web and application hosting service providers, such as Interliant, Navisite and USinternetworking;
- . application-specific hosting service providers, such as Critical Path;
- . co-location providers, such as AboveNet, Exodus, Digital Island and Frontier GlobalCenter;
- . local, regional and international Internet service providers, such as AppliedTheory, Concentric, Globix, MindSpring, Verio and PSINet;
- . local, regional and international telecommunications companies, such as AT&T, British Telecommunications, Cable & Wireless, Telecom Italia, Nippon Telegraph and Telephone, Qwest and the regional Bell operating companies such as Bell Atlantic and U S WEST;
- . systems integrators and large information technology outsourcing companies, such as IBM, EDS, Oracle, Andersen Consulting, PricewaterhouseCoopers and others;
- .multimedia hosting companies, such as broadcast.com; and
- .other hardware, software and technology companies.

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We believe that our expertise and exclusive focus on the advanced hosting segment of the Internet services market enables us to differentiate ourselves from our competitors. We also believe that our expertise and focus on Microsoft-based Internet technologies, our customer support and our ability to maintain a service delivery infrastructure that is designed to parallel or surpass the performance provided by Internet backbone providers and other telecommunications carriers will further differentiate us from our competitors. Additionally, our marketing and sales methodologies are focused on enabling customers to easily select and deploy solutions based on packaged service offerings, which can shorten our selling cycle, reduce our customer acquisition costs and ultimately enhance customer satisfaction.

#### Intellectual Property Rights

We rely on a combination of copyright, trademark, service mark and trade secret laws and contractual restrictions to establish and protect certain proprietary rights in our data, applications and services. We are in the

process of filing Federal registrations for the trademark "Data Return," as well as other service and trademarks which incorporate the Data Return name.

#### Government Regulation

We are not currently subject to direct federal, state or local government regulation, other than regulations applicable to businesses generally. There is currently only a small body of laws and regulations directly applicable to access to e-commerce on the Internet.

Congress recently enacted the "Digital Millennium Copyright Act," which became effective in October 1998. The Digital Millennium Copyright Act provides a limitation on liability of online service providers for copyright infringement for transmitting, routing or providing connections, transient storage, caching or storage at the direction of a user, if the service provider had no knowledge or awareness that the transmitted or stored material was infringing and meets certain other conditions. Since this law is new and does not apply outside of the United States, we are unsure of how it will be applied to limit any liability we may face in the future for any possible copyright infringement or copyright-related issues. This new law also requires service providers to follow "notice and take-down" procedures and to meet other conditions in order to be able to take advantage of the limitation on liability. We have not yet implemented such procedures, met such conditions or evaluated the cost of complying with them. However, our customers are subject to an acceptable use policy which prohibits them from transmitting, storing or distributing material on or through any of our services which, in our sole judgment is (1) in violation of any United States local, state or federal law or regulation, (2) fraudulent online marketing or sales practices or (3) fraudulent customer information, including identification and payment information. Although this policy is designed to promote the security, reliability and privacy of our systems and network, we cannot be certain that our policy will accomplish this goal or effectively limit our liability.

Despite enactment of the Digital Millennium Copyright Act, the law relating to the liability of online services companies and Internet access providers for information carried on or disseminated through their networks remains largely unsettled. It is possible claims could be made against online services companies and Internet access providers under both United States and foreign law for defamation, obscenity, negligence, copyright or trademark infringement, or other theories based on the nature and content of the materials disseminated through their networks. Several private lawsuits seeking to impose such liability upon online services companies and Internet access providers are currently pending.

Although sections of the Communications Decency Act of 1996 that proposed to impose criminal penalties on anyone distributing indecent material to minors over the Internet were held to be unconstitutional by the U.S. Supreme Court, similar laws may be proposed, adopted and upheld. The nature of future legislation and the manner in which it may be interpreted and enforced cannot be fully determined and, therefore, legislation similar to the Communications Decency Act could subject us and/or our customers to potential liability, which

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in turn could harm our business. The adoption of any of these types of laws or regulations might decrease the growth of the Internet, which in turn could decrease the demand for our services or increase our cost of doing business or in some other manner harm our business.

Due to the increasing popularity and use of the Internet, it is likely that a number of additional laws and regulations may be adopted at the federal, state and local levels with respect to the Internet, covering issues, such as user privacy, freedom of expression, pricing, characteristics and quality of products and services, taxation, advertising, intellectual property rights, information security, access fees and the convergence of traditional telecommunications services with Internet communications. The adoption of any of these laws or regulations might decrease the growth of the Internet, which in turn could decrease the demand for our services or increase the cost of doing business or in some other manner harm our business, results of operations

or financial condition. In addition, applicability to the Internet of existing laws governing issues such as property ownership, copyrights and other intellectual property issues, taxation, libel, obscenity and personal privacy is uncertain. The vast majority of such laws were adopted prior to the advent of the Internet and related technologies and, as a result, do not contemplate or address the unique issues of the Internet and related technologies.

Employees

As of August 31, 1999, we had 79 employees. None of our employees are covered by collective bargaining agreements. We believe that our relations with our employees are good.

Facilities

Our corporate headquarters are currently located in Irving, Texas and consist of approximately 23,000 square feet of office space that is leased until October 31, 2001. We also have an office in Arlington, Texas, consisting of 5,000 square feet of office space that is leased until March 31, 2000.

Legal Proceedings

We do not believe that we are subject to any pending or threatened legal proceedings.

MANAGEMENT

Executive Officers and Directors

The following sets forth, as of August 31, 1999, the name, age and position of our executive officers and directors and nominees to our board:

<TABLE>  
<CAPTION>

Name	Age	Position
----	---	-----
<C>	<C>	<S>
Sunny C. Vanderbeck.....	26	Chairman of the Board and Chief Executive Officer
Michelle R. Chambers.....	31	President, Chief Operating Officer and Director
Michael S. Shiff.....	45	Senior Vice President - Marketing, Sales and Business Development
Mark A. Bowles.....	38	Vice President - Advanced Technology Deployment
Scott W. Brewer.....	35	Vice President - Technical Services
Kenneth S. Garber.....	46	Vice President - Sales
Jason A. Lochhead.....	26	Vice President - Research and Product Development and Director
J. Todd Steitle.....	34	Vice President - Marketing
Stuart A. Walker.....	34	Vice President - Chief Financial Officer, Treasurer and Secretary
Nathan Landow.....	67	Director
T. Geir Ramleth.....	40	Nominee for Director

</TABLE>

Sunny C. Vanderbeck, a co-founder of our company, has served as Chairman and

Chief Executive Officer since our incorporation in August 1997. Before founding Data Return, from July 1996 to January 1997, Mr. Vanderbeck was a technical product manager and Lead Internet/Intranet Consultant for Software Spectrum, a reseller of Microsoft products. From May 1995 to June 1996, while employed by Software Spectrum, Mr. Vanderbeck served as an independent consultant to Microsoft where he served as a team leader for Microsoft Messaging products and as a product support engineer. From July 1994 to May 1995, Mr. Vanderbeck was an independent consultant. From 1990 to 1994, Mr. Vanderbeck served as a Section Leader in the 2nd Ranger Battalion, a U.S. Army Special Operations unit. Mr. Vanderbeck is a regional finalist for the Ernst & Young Entrepreneur of the Year award and is a Microsoft Certified Systems Engineer.

Michelle R. Chambers, a co-founder of our company, has served as President and a director since our inception and was appointed Chief Operating Officer in April 1998. Before founding Data Return, from October 1996 to March 1997, Ms. Chambers was a Consultant at Microsoft, where she was a member of the Microsoft Consulting team responsible for the design and development of the migration plan for Audionet's (now broadcast.com) platform conversion from Unix to Windows NT. Prior thereto, Ms. Chambers served as a product support engineer at Microsoft from February 1995 to October 1996, and was the Corporate E-mail Coordinator for Arco Exploration and Production Technology from August 1993 to February 1995. Ms. Chambers is a Microsoft Certified Systems Engineer. Ms. Chambers graduated magna cum laude from the University of North Texas with a Bachelor in Business Administration in Business Computer Information Systems.

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Michael S. Shiff has served as Senior Vice President - Marketing, Sales and Business Development since June 1999 and previously served as Vice President - Marketing, Sales and Business Development since March 1998. Mr. Shiff served as President of MicroVision Medical Systems, a manufacturer of medical imaging systems, from April 1996 to December 1996. From April 1993 to November 1995, Mr. Shiff was Vice President of Sales for Kodak Health Imaging Systems, a manufacturer of medical imaging systems. He also served as Vice President of Marketing and Sales for Vortech Data, a manufacturer of medical imaging systems, from March 1989 until Vortech's acquisition by Eastman Kodak in March 1993. Prior thereto, Mr. Shiff was Director of Strategic Sales Development for Hughes Network Systems, a manufacturer of telecommunications systems, and was Domestic Marketing Manager for the Satellite Communications Group of M/A-COM Telecommunications, a manufacturer of telecommunications systems, which was acquired by Hughes Aircraft. Mr. Shiff graduated with distinction from the University of Wisconsin with a Bachelor of Science in Education.

Mark A. Bowles has served as Vice President - Advanced Technology Deployment since June 1999. For the period from March 1998 to May 1999, Mr. Bowles served as our Director of Service and Support and Executive Director of Technical Services. Prior to joining Data Return, from February 1997 to March 1998, Mr. Bowles was a manager of the Advanced Technologies Group at Arthur Andersen LLP, a public accounting firm. Mr. Bowles also served as a Project Manager at Interface Teknologies, a systems integration firm, from April 1995 through February 1997. Mr. Bowles graduated from the University of Texas at Arlington with a Bachelor of Business Administration.

Scott W. Brewer has served as Vice President - Technical Services since June 1999. Before joining Data Return, Mr. Brewer was with CompuCom Systems, a technology services company, where he served as Director, Professional Services from October 1998 to April 1999, General Manager of Houston Sales from May 1998 through October 1998, and Manager, Technical Services, Dallas Sales from October 1997 through May 1998. Mr. Brewer also served as Manager, Systems Engineering, Dallas Sales from April 1996 to October 1997 and Consulting Systems Engineer, Dallas Sales from January 1991 to April 1996 at CompuCom Systems.

Kenneth S. Garber has served as Vice President - Sales since June 1999. From March 1996 to May 1999, Mr. Garber was Vice President of Sales and Business Development for Chroma Vision Medical Systems, Inc., a manufacturer of medical imaging systems. Prior to that, Mr. Garber served as Vice President and General Manager of the Imagelink Business Unit for Kodak Health Imaging Systems from 1994 to March 1996. Previously, Mr. Garber held various marketing and sales

positions with Vortech Data, Hughes Network Systems, Satellite Business Systems and Federal Data Corporation. Mr. Garber graduated from George Washington University with a Bachelor of Science in Environmental Science.

Jason A. Lochhead, a co-founder of our company, has served as Vice President - Research and Product Development and as a director since our inception. From September 1996 until August 1997, Mr. Lochhead was an independent consultant. Previously, from September 1995 to September 1996, while employed by Software Spectrum, Mr. Lochhead served as an independent consultant to Microsoft where he served as a product support engineer for Microsoft Mail and Microsoft Exchange. While at Software Spectrum, Mr. Lochhead also served as the Microsoft Mail Gateway team lead for the period from March 1996 to September 1996. From July 1993 to September 1995, Mr. Lochhead was a System Administrator at Hughes Training, a division of Hughes Aircraft. Mr. Lochhead is a Microsoft Certified Systems Engineer.

J. Todd Steitle has served as Vice President - Marketing since June 1999. Previously, he served as our Director of Marketing from May 1998 to June 1999. Before joining Data Return, Mr. Steitle was a sales representative for the Tools Division of Sybase Corporation, formerly Powersoft Corporation, a software company, from May 1996 to May 1998. From September 1994 to May 1996, Mr. Steitle served as Manager of Business Development for Kodak Health Imaging Systems. Previously, Mr. Steitle held various marketing and sales positions for Apple Computer Corporation. Mr. Steitle graduated from the University of Texas in Austin with a Bachelor of Business Administration in Marketing.

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Stuart A. Walker has served as our Chief Financial Officer since March 1999 and as Vice President - Chief Financial Officer, Treasurer and Secretary since June 1999. Prior to joining Data Return, Mr. Walker was a consultant with Eubank, Wofford and Nichols, LLP, a public accounting firm, from June 1998. Mr. Walker served as Vice President and Chief Financial Officer of Aviation Group, Inc., an aviation services company, from September 1997 to April 1998. He served as Corporate Controller of Precept Business Products, Inc., a business products distribution company, from August 1996 to August 1997. He was Vice President Finance and Controller of DirectNet Corporation, an educational technology company, from March 1995 to August 1996. Mr. Walker served in various capacities at Price Waterhouse LLP in the audit, bankruptcy, consulting and litigation support areas from September 1988 to March 1995. Mr. Walker is a Certified Public Accountant and graduate from California Polytechnic State University, San Luis Obispo with a Bachelor of Science in Business Administration.

Nathan Landow has served as one of our directors since April 1998. Mr. Landow has been President of Landow Company, a real estate development company, since 1959.

T. Geir Ramleth has agreed to serve as a director of our company upon completion of this offering. Mr. Ramleth is currently a private investor. Mr. Ramleth served as the Chief Executive Officer and a director of ZeroDotNet, Inc., a private equity firm, from April 1999 to August 1999. Mr. Ramleth was the President and Chief Executive Officer of Genuity, Inc., an Internet service provider, from December 1995 to November 1998. Prior to that, Mr. Ramleth was the Manager of Commercial Systems at Bechtel Group, Inc., an engineering firm, from February 1995 to December 1995, where he was responsible for consolidating all commercial systems activities. From February 1993 to February 1995, Mr. Ramleth was the Practice Director at Oracle Corporation, a software company. Since January 1998, Mr. Ramleth has served as director at UWI.com.

#### Director Compensation

Our directors receive no remuneration for serving on our board of directors.

#### Board Composition

We currently have five authorized directors. In accordance with the terms of our restated articles of incorporation, the terms of office of the directors are divided into three classes:

- . Class I, whose term will expire at the annual meeting of shareholders to be held in 2000;
- . Class II, whose term will expire at the annual meeting of shareholders to be held in 2001; and
- . Class III, whose term will expire at the annual meeting of shareholders to be held in 2002.

Currently, the Class I directors are Jason A. Lochhead and Nathan Landow, the Class II director is Michelle R. Chambers and the Class III director is Sunny C. Vanderbeck. T. Geir Ramleth will serve as a Class II director upon completion of this offering. As part of an agreement with Level 3, they are entitled to nominate one of their employees to serve on our board of directors. Mr. Vanderbeck, Ms. Chambers and Mr. Lochhead have agreed to vote for Level 3's nominee. This agreement terminates upon a public offering of our common stock. Level 3 has not exercised its right to nominate a person to serve on our board of directors. At each annual meeting of shareholders after the initial classification or special meeting in lieu thereof, the successors to directors whose terms will then expire will be elected to serve from the time of election and qualification until the third annual meeting following election or special meeting held in lieu thereof. The authorized number of directors may be changed only by resolution of the board of directors or a super-majority vote of the shareholders. Any additional directorships resulting from an increase in the number of directors will be distributed among the three classes so that, as nearly as possible, each class will consist of one third of the directors. This classification of the board of directors may have the effect of delaying or preventing changes in control or management of Data Return.

Board Committees

Within 90 days of the closing of this offering, the board will create an audit committee that will consist of two independent directors and Ms. Chambers. The audit committee will review, act on and report to the board of directors on various auditing and accounting matters, including the recommendation of our independent auditors, the scope of the annual audits, fees to be paid to the independent auditors, the performance of our independent auditors and our accounting practices.

Within 90 days of the closing of this offering, the board will create a compensation committee that will consist of two independent directors and Ms. Chambers. The compensation committee will determine the salaries and benefits for our employees, consultants, directors and other individuals compensated by our company. The compensation committee will also administer our stock option plans, including determining the stock option grants for our employees, consultants, directors and other individuals.

Summary Compensation Table

The following table sets forth the total compensation of our Chief Executive Officer and each other executive officer whose total salary and bonus for fiscal 1999 exceeded \$100,000 (each a named executive officer, and collectively, the named executive officers).

<TABLE>  
<CAPTION>

Name and Principal Position	Fiscal Year	Annual Compensation			Long-Term Compensation Awards
		Salary	Bonus	Other Annual Compensation	Shares Underlying Options
<S>	<C>	<C>	<C>	<C>	<C>
Sunny C. Vanderbeck.....	1999	\$95,000	\$5,000	--	--

Chairman and Chief Executive  
Officer

Michelle R. Chambers.....	1999	95,000	5,000	--	--
President and Chief Operating Officer					
Michael S. Shiff.....	1999	150,000	8,610	\$40,000 (1)	3,308,700
Senior Vice President - Marketing, Sales and Business Development					

</TABLE>  
-----

(1) Other annual compensation for Mr. Shiff consists of deferred salary.

Fiscal 1999 Exercises and Year-End Option Values

The following table sets forth information concerning the value realized upon exercise of options during fiscal 1999 and the number and value of unexercised options held by each of the named executive officers at March 31, 1999. The values set forth in the table have been calculated assuming an initial public offering price of \$12.00 per share, less the per share exercise price, multiplied by the number of shares underlying the option.

<TABLE>  
<CAPTION>

Name	Shares		Number of		Value of Unexercised	
	Acquired	Value	Unexercised Options	at March 31, 1999	In-the-Money	Options at
	on	Realized	Exercisable	Unexercisable	Exercisable	Unexercisable
	Exercise	Realized	Exercisable	Unexercisable	Exercisable	Unexercisable
	-----	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Sunny C. Vanderbeck.....	--	--	--	--	--	--
Michelle R. Chambers....	--	--	--	--	--	--
Michael S. Shiff.....	--	--	--	--	\$9,908,000	\$29,725,000

</TABLE>

Stock Option Plans

1998 Stock Option Plan. Our 1998 Stock Option Plan authorizes the issuance of up to 3,308,700 shares of our common stock. As of September 1, 1999, we had granted options to purchase an aggregate of 3,223,696 shares of our common stock to employees and directors under this plan with a weighted average exercise price of \$0.56 per share. After the completion of this offering, no further options will be granted under this plan.

The board of directors, or a board committee, has the power to determine the terms of the options, including the exercise price of the options, the number of shares subject to each option, the exercisability thereof, and the form of consideration payable on such exercise, provided that the exercise price must be at least 100% of fair market value. Incentive stock options granted to any holder of 10% or more of the combined voting power of all classes of stock must have an exercise price of not less than 110% of fair market value and be exercisable for a term of no more than five years.

1999 Long-Term Incentive Plan. Our 1999 Long-Term Incentive Plan was adopted by our board of directors and shareholders and became effective in July 1999 as a successor plan to our 1998 Plan. Up to 3,228,000 shares of common stock may be issued under the 1999 Plan.

The 1999 Plan provides for the discretionary grant of incentive stock options, within the meaning of Section 422 of the Internal Revenue Code of 1986, to employees and for the grant of nonstatutory stock options, stock appreciation rights, performance awards, dividend equivalents, stock payments and restricted stock to employees and consultants. The 1999 Plan provides that

we cannot issue incentive stock options after June 2009.

The 1999 Plan may be administered by the board or a board committee. The administrator has the power to determine the terms of the options or other awards granted, including the exercise price of the options or other awards, the number of shares subject to each option or other award (up to 269,000 shares per year per participant), the exercisability thereof and the form of consideration payable upon exercise. In addition, the administrator has the authority to amend, suspend or terminate the 1999 Plan, provided that no such action may affect any share of common stock previously issued and sold or any option previously granted under the 1999 Plan without the consent of the holder.

The exercise price of all incentive stock options granted under the 1999 Plan must be at least equal to the fair market value of the common stock on the date of grant. The exercise price of nonstatutory stock options and other awards granted under the 1999 Plan is determined by the administrator, but the exercise price of nonstatutory stock options must be at least 50% of the fair market value of the common stock on the date of grant. With respect to any participant who owns stock possessing more than 10% of the voting power of all classes of our outstanding capital stock, the exercise price of any incentive stock option granted must be at least equal to 110% of the fair market value on the grant date and the term of such incentive stock option must not exceed five years. The term of all other options granted under the 1999 Plan may not exceed ten years.

Options and other awards granted under the 1999 Plan are generally not transferable by the optionee. Options granted under the 1999 Plan must generally be exercised within three months after the end of the optionee's status as an employee, director or consultant, or within one year after such optionee's termination by disability or death, respectively, but in no event later than the expiration of the option's term.

The 1999 Plan provides that in the event of a change of control of Data Return all options and other awards shall be assumed or a substitute option or award issued by the acquiring company unless the board determines in its sole discretion to accelerate vesting or remove any restrictions.

#### Compensation Committee Interlocks and Insider Participation

We currently have no separate compensation or stock option committee or other board committee performing equivalent functions to determine compensation for executive officers. These functions are

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performed by our board of directors, which includes Mr. Vanderbeck and Ms. Chambers. Within 90 days after we complete this offering, we intend to establish a compensation committee that will be composed of Ms. Chambers and two independent directors. No interlocking relationship exists between any member of our board or our compensation committee and any member of the board of directors or compensation committee of any other company, and no such interlocking relationship has existed in the past.

#### Employment Agreements

Mr. Vanderbeck, Ms. Chambers, Mr. Bowles, Mr. Brewer, Mr. Lochhead and Mr. Walker have employment agreements expiring on June 30, 2002. These agreements provide for:

- . set base salaries; and
- . incentive bonuses determined by the compensation committee or board of directors.

Each of these executives has agreed not to compete with us during the term of the agreement and for two years after resignation or termination for cause or for one year after a termination without cause or any resignation or termination following a change of control. The employment agreements define



"cause" as an employee committing an immoral crime, materially breaching the employment agreement or failing to obey written directions of a senior corporate executive. A "change of control" will be deemed to occur if a substantial portion of our ownership changes or the constitution of the board changes during any 15-month period without the approval of our board of directors or shareholders. If there has not been a change in control, the agreements provide for the payment of salary for 12 months after any termination by Data Return other than for cause. Further, if the termination follows a change of control and is not voluntary, it will be made in a lump sum equal to the following items, or in the case of Mr. Vanderbeck and Mr. Chambers three times the following items:

- . the highest annualized base salary earned during the employee's employment with us;
- . two times the employee's largest bonus during the last two years;
- . any unpaid expense, reimbursement or accrued but unpaid salary or benefit; and
- . the estimated cost of insurance coverage for the next 12 months.

If the termination is following a change of control and is voluntary, the base salary component of these severance payments will, in the case of Mr. Vanderbeck, Ms. Chambers and Mr. Walker, equal 75% and, in the case of Mr. Bowles, Mr. Brewer and Mr. Lochhead equal 25%, of the highest annualized base salary earned during the employee's employment with us.

In addition, upon a change of control, all outstanding options of Mr. Vanderbeck, Ms. Chambers and Mr. Walker will vest. That number of the outstanding options of Mr. Bowles, Mr. Brewer and Mr. Lochhead that would have vested upon their next annual vesting date will immediately vest upon a change of control, and, if they are terminated within 24 months of a change of control, all of their options will immediately vest.

We also have employment agreements with Mr. Shiff, Mr. Garber and Mr. Steitle. Mr. Shiff's agreement expires on December 31, 2002. His agreement provides for a set base salary plus deferred salary and a fixed performance bonus. Mr. Shiff's agreement provides for the payment of all accrued salary and bonus upon his termination by Data Return. Upon a change of control or an initial public offering, all of Mr. Shiff's outstanding options will vest immediately. Mr. Shiff has agreed not to compete with us during the term of his agreement and for one year after his termination.

Mr. Garber's agreement expires on March 31, 2004. His agreement provides for a set base salary plus commissions. Upon a termination of his employment by Data Return without cause, Mr. Garber is entitled to the payment of salary for 12 months and the right to participate in benefit plans and exercise his outstanding

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options for 12 months. Upon a public offering or change of control, 50% of Mr. Garber's outstanding options vest immediately and the remaining 50% vest one year later. If Mr. Garber is terminated following a change of control, he is entitled to 12 months of salary and all of his outstanding options immediately vest. Mr. Garber has agreed not to compete with us during the term of the agreement and for one year after resignation or termination for cause.

Mr. Steitle's agreement expired on May 3, 1999 and was automatically renewed for a one year period. His agreement will continue to be renewed automatically for one year periods unless terminated by either party upon notice at least 15 days prior to a renewal date. Mr. Steitle is entitled to a set base salary. Upon termination other than for cause, Mr. Steitle is entitled to his accrued salary. Upon a change of control, or upon an initial public offering or if Mr. Vanderbeck and Ms. Chambers cease to be executive officers, all of Mr. Steitle's options immediately vest. Mr. Steitle has agreed not to compete with us during the term of his agreement and for one year after his agreement.

## PRINCIPAL SHAREHOLDERS

The following table sets forth information regarding the beneficial ownership of our common stock as of September 1, 1999, based on 27,755,958 shares outstanding on that date, and as adjusted to reflect the issuance of additional shares of common stock in this offering, by the following individuals or groups:

- . each person or entity who is known by us to own beneficially more than 5% of our common stock;
- . each director;
- . each named executive officer; and
- . all of our executive officers and directors as a group.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission. In general, a person who has voting power and/or investment power with respect to securities is treated as a beneficial owner of those securities. Shares subject to options, warrants or rights currently exercisable or exercisable within 60 days of the date of this prospectus are considered beneficially owned by the person holding such options, warrants or rights. Unless indicated otherwise, we believe that the persons named in the table below have sole voting and investment power with respect to the shares shown.

Unless otherwise indicated, the address for each 5% shareholder listed in the table is c/o Data Return Corporation, 222 West Las Colinas Boulevard, Suite 450, Irving, Texas 75039. Except as otherwise indicated, and subject to applicable community property laws, the persons named in the table have sole voting and investment power with respect to all shares of common stock held by them.

To the extent that any shares are issued upon exercise of options or other rights to acquire capital stock that are presently outstanding or granted in the future or reserved for future issuance under stock plans, there will be further dilution to new public investors.

<TABLE>  
<CAPTION>

Beneficial Owner -----	Number of Shares Beneficially Owned -----	Percentage of Ownership -----	
		Before Offering	After Offering
<S>	<C>	<C>	<C>
Sunny C. Vanderbeck (1).....	8,106,315	29.2%	23.5%
Michelle R. Chambers (2).....	6,562,255	23.6	19.1
Nathan Landow (3).....	5,135,210	18.5	14.9
Michael S. Shiff (4).....	827,175	2.9	9.0
Jason A. Lochhead.....	772,030	2.8	2.2
T. Geir Ramleth.....	96,571	*	*
Level 3 Communications, Inc. (5).....	1,952,940	7.0	5.7
ZeroDotNet, Inc. (6).....	2,374,732	8.6	6.9
DCR Technology Fund I, Ltd (1).....	8,106,315	29.2	23.5
OHG Technology, Ltd (2).....	6,562,255	23.6	19.1
Nathan Landow Family Limited Partnership (3)...	4,788,200	17.2	13.9
All directors and executive officers as a group (10 persons) (7).....	19,088,778	66.6	59.8

</TABLE>

\* Less than 1%.

(1) Consists of 8,106,315 shares of our common stock owned by DCR Technology

Fund I, Ltd., which is controlled by Mr. Vanderbeck.

- (2) Consists of 6,562,255 shares of our common stock owned by OHG Technology, Ltd., which is controlled by Ms. Chambers.
- (3) Includes 4,788,200 shares of our common stock owned by the Nathan Landow Family Limited Partnership, which is controlled by Mr. Landow and 347,010 shares of our common stock owned by Mr. Landow. The address for the Nathan Landow Family Limited Partnership is 4710 Bethesda Avenue, Bethesda, Maryland 20814.
- (4) Consists of 827,175 shares of our common stock issuable pursuant to options that are exercisable within 60 days of \_\_\_\_\_, 1999. Mr. Shiff also has options to purchase 2,481,525 shares of our common stock which will be exercisable upon the completion of this offering.
- (5) The address of Level 3 Communications, Inc. is 3555 Farnam Street, Omaha, Nebraska 68131.
- (6) The address of ZeroDotNet, Inc. is 650 Mission Street, San Francisco, California 94105.
- (7) Includes 887,700 shares of common stock issuable pursuant to options that are exercisable within 60 days of September 1, 1999.

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#### CERTAIN TRANSACTIONS

On February 20, 1998, we issued 2,152,000 shares of our common stock to the Nathan Landow Family Limited Partnership in exchange for \$500,000 cash and a \$500,000 promissory note that has been repaid. On December 24, 1998, we issued 2,690,000 shares of our common stock to the Nathan Landow Family Limited Partnership for \$1,000,000. On April 23, 1999, we issued 3,499,152 shares of our common stock to the Nathan Landow Family Limited Partnership for \$250,000. Mr. Landow, one of our directors, controls the Nathan Landow Family Limited Partnership.

On May 14, 1999, we issued 96,571 shares of our common stock to Mr. Ramleth, one of our nominees for director, for \$125,000.

On May 18, 1999, we issued 1,202,968 shares of our common stock to ZeroDotNet for \$2,000,000. Also, on July 26, 1999 we sold 1,171,764 shares of common stock to ZeroDotNet, Inc. for a purchase price of \$3.0 million.

On July 1, 1999, we entered into a Strategic Marketing and Sales Agreement with Level 3 that contemplates our committing to purchase \$10.0 million of services over the next five years. As part of this agreement, we have agreed to train Level 3 sales personnel to identify and refer potential customers to us and to pay those sales personnel a commission on sales resulting from their referrals. On July 26 1999, Level 3 acquired 1,952,940 shares of our common stock in exchange for a \$5.0 million credit to be applied to the purchase of future bandwidth services. Pursuant to our Service Credit Agreement dated July 23, 1999 with Level 3, the credit can be applied to bandwidth services in excess of the minimum purchase under the Strategic Marketing and Sales Agreement beginning in 2001. We have a right to repurchase the stock in the event that Level 3 fails to fulfill its obligations under the Service Credit Agreement or Level 3 does not honor orders submitted by us under the Strategic Marketing and Sales Agreement. The number of shares subject to this repurchase right will be reduced pro rata in each quarter of calendar year 2001 by the greater of the credit applied or 25% of the total shares. In the event that Level 3 defaults under the Service Credit Agreement and fails to cure within 30 days, Level 3 is required to pay us \$750,000 ratably reduced based on the amount of bandwidth credit used. Level 3 is entitled to one demand and unlimited "piggyback" registration rights.

Also on July 23, 1999, Data Return, Sunny C. Vanderbeck, Michelle R. Chambers and Jason A. Lochhead entered into a Voting Agreement with Level 3. Under that agreement, Level 3 is entitled to nominate one of its employees to serve on our board of directors. Mr. Vanderbeck, Ms. Chambers and Mr. Lochhead have agreed to vote for Level 3's nominee. The Voting Agreement terminates upon the

completion of a public offering of our common stock.

On July 29, 1999, we sold 1,171,764 shares of our common stock to Compaq for an aggregate purchase price of \$3.0 million. Compaq is entitled to one demand and unlimited "piggyback" registration rights. Compaq also has a right of first refusal that does not include this offering and that terminates upon completion of this offering. Also on July 23, 1999, we entered into an ASP and Server Agreement with Compaq. Under that agreement, we have agreed for a three-year period to purchase from Compaq the lesser of 2,000 servers or the number of servers reasonably necessary to adequately operate our business plan. Our requirement to purchase these servers is contingent upon Compaq providing financing for the servers on competitive terms, upon the price, performance and quality of the Compaq servers being reasonably satisfactory to us and upon Compaq's commitment to deliver these servers on the schedule we request. Under the ASP and Server Agreement, Compaq has agreed to include Data Return in any program under which it approves for recommendation to its customers a specified group of application service providers. Although Compaq is not required to develop such a program, it will include us in any such program that it does establish at the highest level for which we qualify.

On September 3, 1999, we agreed to sell \$5.0 million of our common stock for a per share purchase price equal to the lesser of the midpoint of the lowest filing range and the price to public. Microsoft will also acquire a warrant to purchase \$3.75 million of our common stock at the same per share purchase price. Based on the

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current filing range, Microsoft would acquire 416,667 shares under the stock purchase agreement and the warrant would entitle Microsoft to acquire an additional 312,500 shares at an exercise price of \$12.00 per share. Microsoft is entitled to one demand and unlimited "piggyback" registration rights. Microsoft also has a right of first refusal that does not include this offering and that terminates upon completion of this offering. This transaction will close the earlier of the day after the pricing of this offering and December 12, 1999. In addition, on September 3, 1999, we entered into a five-year Development, License and Co-Marketing Agreement with Microsoft to grant a non-exclusive perpetual license to proprietary installation tools for third-party hosted applications to Microsoft. We will also train Microsoft's employees and customers in the use of those tools. Microsoft has the sole right to terminate the agreement if we fail to deliver the tools on a timely basis or if we fail to correct any errors in the tools on a timely basis. Also as part of the agreement, Microsoft will provide up to one hundred hours of technical consulting and writing services during the development of the tools.

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#### DESCRIPTION OF CAPITAL STOCK

The following summaries highlight the material provisions of our articles of incorporation and bylaws, as amended. Copies of our articles and bylaws are available from us upon request. See "Where You Can Find More Information."

##### Authorized Capital Stock

Our authorized capital stock consists of 100,000,000 shares of common stock, par value \$.001 per share, and 20,000,000 shares of preferred stock, par value \$.001 per share. As of September 1, 1999, there were 27,755,958 shares of common stock issued and outstanding, and no shares of preferred stock issued and outstanding. No holder of any shares of our stock has any preemptive or preferential right to acquire or subscribe for any unissued shares of any class of stock or any authorized securities convertible into or carrying any right, option or warrant to subscribe for or acquire shares of any class of stock.

##### Common Stock

Each share of common stock has identical rights and privileges in every respect. The holders of our common stock are entitled to vote upon all matters submitted to a vote of our shareholders and are entitled to one vote for each share of common stock held.

Subject to the prior rights and preferences, if any, applicable to shares of preferred stock, the holders of common stock are entitled to receive such dividends, payable in cash, stock or otherwise, as may be declared by our board out of any funds legally available for the payment of dividends.

If we voluntarily or involuntarily liquidate, dissolve or wind-up, the holders of common stock will be entitled to receive after distribution in full of the preferential amounts, if any, to be distributed to the holders of preferred stock, all of the remaining assets available for distribution ratably in proportion to the number of shares of common stock held by them. Holders of common stock have no preferences or any preemptive, conversion or exchange rights.

#### Preferred Stock

Our board is authorized to provide for the issuance of shares of preferred stock in one or more series, and to fix for each series voting rights, if any, designations, preferences and relative, participating, optional or other special rights and such qualifications, limitations or restrictions as provided in a resolution or resolutions adopted by the board. The board may authorize the issuance of shares of preferred stock with terms and conditions which could discourage a takeover or other transaction that holders of some or a majority of shares of common stock might believe to be in their best interests or in which holders of common stock might receive a premium for their shares over the then market price.

#### Warrants

Upon the earlier of the day after the pricing of this offering and December 11, we will have outstanding a warrant to purchase \$3.75 million of our common stock at a per share exercise price equal to the lesser of the midpoint of the lowest filing range and the price to public. This warrant will expire five years after the date of its issuance. Based on the current filing range, this warrant would entitle Microsoft to acquire 312,500 shares at an exercise price of \$12.00 per share.

#### Preferred Stock Purchase Rights

We intend to adopt a shareholder rights plan and declare a dividend of preferred stock purchase rights before this offering is consummated. These rights will entitle our shareholders to rights to acquire additional

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shares of our common stock when a third party acquires 15% of our common stock or commences or announces its intent to commence a tender offer for at least 15% of our common stock. The final terms of these rights will be contained in a rights agreement between us and the rights agent we appoint.

#### Transfer Agent and Registrar

The transfer agent and registrar for our common stock is ChaseMellon Shareholder Services, LLC.

#### Anti-Takeover Effects of Provisions of our Articles of Incorporation and Texas Law

#### Restated Articles of Incorporation and Bylaws

Pursuant to our articles, the board may issue additional shares of common stock or establish one or more series of preferred stock having the number of shares, designations, relative voting rights, dividend rates, liquidation and other rights, preferences and limitations that the board may decide without shareholder approval. Any additional issuance of common stock or designation of

rights, preferences, privileges and limitations with respect to preferred stock could have the effect of impeding or discouraging the acquisition of control of Data Return by means of a merger, tender offer, proxy contest or otherwise (including a transaction in which the shareholders would receive a premium over the market price for their shares) and thereby protects the continuity of our management. Specifically, if in the due exercise of its fiduciary obligations, the board were to determine that a takeover proposal was not in our best interest, shares could be issued by the board without shareholder approval in one or more transactions that might prevent or render more difficult or costly the completion of the takeover by:

- . diluting the voting or other rights of the proposed acquiror or insurgent shareholder group;
- . putting a substantial voting block in institutional or other hands that might undertake to support the incumbent board; or
- . effecting an acquisition that might complicate or preclude the takeover.

Our bylaws provide that the board is divided into three classes of one or two directors each, with each class elected for three-year terms expiring in successive years. Our articles also allow the board to set the number of directors in the bylaws with no minimum or maximum number of directors required. The articles specifically deny cumulative voting in the election of directors. This could delay or prevent a tender offer or takeover attempt that a shareholder might consider to be in his or her best interest, including attempts that might result in a premium over the market price for the shares held by the shareholders.

Our articles and bylaws provide that special meetings of shareholders generally can be called only by the president or the board or by holders of at least 50% of our voting stock and provide for an advance notice procedure for the nomination, other than by or at the direction of the board or a committee of the board, of candidates for election as directors as well as for other shareholder proposals to be considered at annual meetings of shareholders. In general, we must receive notice of intent to nominate a director or make a proposal at such meetings no less than 90 days before the meeting. The notice must contain certain information concerning the person to be nominated or the matters to be brought before the meeting and concerning the shareholder submitting the proposal. These provisions of the bylaws:

- . may preclude a nomination for the election of directors or preclude the conduct of business at a particular meeting if the proper procedures are not followed; and
- . may discourage or deter a third party from conducting a solicitation of proxies to elect its own directors or otherwise attempting to obtain control of Data Return, even if the conduct of such solicitation or attempt might be beneficial to us and our shareholders.

#### Texas Takeover Statute

Subsequent to this offering, we will be subject to Part Thirteen of the Texas Business Corporation Act. Subject to certain exceptions, Part Thirteen prohibits a Texas corporation which is an issuing public corporation from engaging in any business combination with any affiliated shareholder for a period of three years following the date that such shareholder became an affiliated shareholder, unless:

- . prior to such date, the board of directors of the corporation approved either the business combination or the transaction that resulted in the shareholder becoming an affiliated shareholder; or
- . the business combination is approved by at least two-thirds of the outstanding voting shares that are not beneficially owned by the affiliated shareholder or an affiliate or associate of the affiliated

shareholder at a meeting of shareholders called not less than six months after the affiliated shareholder's share acquisition date.

In general, Part Thirteen defines an affiliated shareholder as any entity or person beneficially owning 20% or more of the outstanding voting stock of the issuing public corporation and any entity or person affiliated with or controlling or controlled by such entity or person. Part Thirteen defines a business combination to include, among other similar types of transactions, any merger, share exchange or conversion of an issuing public corporation involving an affiliated shareholder.

Part Thirteen may have the effect of inhibiting a non-negotiated merger or other business combination involving Data Return.

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#### SHARES ELIGIBLE FOR FUTURE SALE

Prior to this offering, there has been no public market for our common stock. We cannot predict what effect, if any, market sales of shares or the availability of shares for sale will have on the market price of our common stock prevailing from time to time. Nevertheless, sales of substantial amounts of common stock in the public market, or the perception that such sales could occur, could adversely affect the market price of the common stock and could impair our future ability to raise capital through the sale of our equity securities. Upon the closing of this offering, we will have a total of 34,422,625 shares of common stock outstanding, assuming no exercise of the underwriters' over-allotment option and no exercise of any other stock options. Of the outstanding 34,422,625 shares, the 6,250,000 shares being sold in this offering will be freely tradable, except that any shares held by our "affiliates" may only be sold in compliance with the limitations described below. The remaining 28,172,625 shares of common stock will be "restricted securities" that may be sold in the public market only if they are registered under the Securities Act or if they qualify for an exemption from registration under Rules 144, 144(k) or 701 promulgated under the Securities Act. Subject to the lock-up agreements described below and the provisions of Rules 144, 144(k) and 701, additional shares will become available for sale in the public market as follows:

<TABLE>	<S>	Number of Shares	<C>	Date
		-----		----
		--	Upon the date of this prospectus. These shares are eligible for resale under Rule 144(k) and are not subject to lock-up agreements.	
		--	After 90 days from the date of this prospectus. These additional shares are eligible for resale under Rules 144 and 701 and are not subject to lock-up agreements.	
		20,551,600	After 180 days from the date of this prospectus. These additional shares are eligible for resale under Rules 144 and 701 upon release of lock-up agreements.	

</TABLE>

#### Rule 144

In general, under Rule 144, a person, or persons whose shares are required to be aggregated, including an affiliate, who has beneficially owned shares for at least one year is entitled to sell, within any three-month period commencing 90 days after the date of this prospectus, a number of shares that does not exceed the greater of (i) 1% of the then-outstanding shares of common stock, which will be approximately 344,227 shares immediately after this offering, or (ii) the average weekly trading volume of the common stock during the four calendar weeks preceding the date on which notice of that sale is filed.

Rule 144(k)

Under Rule 144(k), a person who is not considered an affiliate at any time during the 90 days preceding a sale and who has beneficially owned the shares proposed to be sold for at least two years is entitled to sell such shares under Rule 144(k) without regard to the volume limitations described above.

Stock Options

Following the closing of this offering, we intend to file a registration statement to register for resale the shares of common stock available for issuance under our stock option plans. Accordingly, shares issued under those plans will become eligible for resale in the public market from time to time, subject to the lock-up agreements described below and, in the case of affiliates, the volume limitations of Rule 144 described above.

As of the date of this prospectus, options to purchase a total of 6,532,396 shares of common stock are outstanding under our stock option plans.

Lock-Up Agreements

Directors, officers and shareholders holding an aggregate of 28,172,625 shares of common stock have agreed that they will not sell, directly or indirectly, or otherwise dispose of any shares of common stock without the prior written consent of Bear, Stearns & Co. Inc. for a period of 180 days after the date of this prospectus. Please refer to our discussion in "Underwriting" for further discussion of these agreements. We have agreed not to sell, directly or indirectly, or otherwise dispose of any shares of common stock during the 180-day period following the date of this prospectus, other than the grant of options under our stock option plans and the issuance of common stock pursuant thereto, provided the holders of such shares or options agree to the 180-day lock-up agreement.

UNDERWRITING

Subject to the terms and conditions of the underwriting agreement between us and the underwriters named below, who are represented by Bear, Stearns & Co. Inc., CIBC World Markets Corp. and Wit Capital Corporation, the underwriters have severally agreed to purchase from us the following respective numbers of shares of common stock at the public offering price less the underwriting discounts and commissions set forth on the cover of this prospectus.

<TABLE>  
<CAPTION>

Underwriter: -----	Number of Shares -----
<S>	<C>
Bear, Stearns & Co. Inc. ....	
CIBC World Markets Corp.....	
Wit Capital Corporation.....	
	-----
Total.....	6,250,000 =====

</TABLE>

The underwriting agreement provides that the obligations of the underwriters to purchase and accept delivery of the shares included in this offering are subject to approval of legal matters by their counsel and to customary conditions, including the effectiveness of the registration statement, the continuing correctness of our representations to them, the receipt of a "comfort letter" from our accountants, the listing of the common stock on the Nasdaq National Market and no occurrence of an event that would have a material



adverse effect on our business. The underwriters are obligated to purchase and accept delivery of all the shares, other than those covered by the over-allotment option described below, if they purchase any of the shares.

We have granted to the underwriters an option, exercisable for 30 days from the date of the underwriting agreement, to purchase up to 937,500 additional shares at the public offering price less the underwriting fees. The underwriters may exercise the over-allotment option solely to cover over-allotments, if any, made in connection with this offering. To the extent that the underwriters exercise the over-allotment option, each underwriter will become obligated, subject to conditions, to purchase a number of additional shares approximately proportionate to that underwriter's initial purchase commitment.

The underwriters propose to initially offer some of the shares directly to the public at the public offering price set forth on the cover page of this prospectus and some of the shares to dealers at the public offering price less a concession not in excess of \$ per share. The underwriters may allow, and the dealers may re-allow, a concession not in excess of \$ per share on sales to other dealers. After the initial offering of the shares to the public, the representatives of the underwriters may change the public offering price and the amount of the concessions.

The following table shows the underwriting fees to be paid to the underwriters by us in connection with this offering. The underwriting fee is equal to the public offering price per share of common stock, less the amount paid by the underwriters to us per share of common stock. The underwriting fee will be approximately percent of the public offering price. The underwriting fee amounts are shown assuming both no exercise and full exercise of the underwriters' option to purchase additional shares of the common stock.

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<TABLE>  
<CAPTION>

Underwriting Fees -----	No	
	Exercise	Full Exercise
	-----	-----
<S>	<C>	<C>
Per share.....	\$	\$
Total.....	\$	\$

</TABLE>

We estimate that the total expenses of this offering, excluding underwriting fees, will be approximately \$1.0 million.

In order to facilitate the offering of the common stock, the underwriters may engage in transactions that stabilize, maintain or otherwise affect the market price of the common stock. Specifically, the underwriters may over-allot shares of the common stock in connection with this offering, thereby creating a short position in the common stock for their own account. Additionally, to cover these over-allotments or to stabilize the market price of the common stock, the underwriters may bid for, and purchase, shares of the common stock in the open market. Finally, the representatives, on behalf of the underwriters, also may reclaim selling concessions allowed to an underwriter or dealer if the underwriting syndicate repurchases shares distributed by that underwriter or dealer. Any of these activities may maintain the market price of our common stock at a level above that which might otherwise prevail in the open market. The underwriters are not required to engage in these activities and, if commenced, may end any of these activities at any time.

At our request, the underwriters have reserved for sale at the initial public offering price up to of the shares, or percent, of our common stock to be sold in this offering for sale to employees and directors of Data Return and other persons designated by Data Return. The number of shares available for sale to the general public will be reduced to the extent that any reserved shares are purchased. Any reserved shares not purchased will be offered by the underwriters on the same basis as the other shares offered hereby.

Internet Prospectus. A prospectus in electronic format is being made available on a web site maintained by Wit Capital Corporation. In addition, pursuant to an e-Dealer Agreement, all dealers purchasing shares from Wit Capital in the offering, the e-Dealers, similarly have agreed to make a prospectus in electronic format available on the web sites that they maintain. Other than the prospectus in electronic format, any information on those web sites that is not part of this prospectus or the registration statement of which this prospectus forms a part, has not been approved or endorsed by Data Return or any underwriter and should not be relied on by prospective investors.

Internet Distribution. The underwriters, at our request, have reserved for sale at the initial public offering price up to \_\_\_\_\_ shares of common stock to members and visitors to Wit Capital's services or web site who express an interest in purchasing these shares. The sale of these shares will be made by Wit Capital. Purchases of the reserved shares will be made through an account at Wit Capital in accordance with Wit Capital's procedures for opening an account and transacting in securities. Any of these reserved shares not purchased by visitors to and users of Wit Capital's services or web site will be offered by the underwriters to the public on the same terms as the other shares.

Wit Capital, a member of the National Association of Securities Dealers, Inc., will participate in the offering as one of the underwriters. The National Association of Securities Dealers, Inc. approved the membership of Wit Capital on September 4, 1997. Since that time, Wit Capital has acted as an underwriter, e-manager or selected dealer in over 100 public offerings. Except for its participation as a manager in this offering, Wit Capital has no relationship with Data Return or any of its founders or significant shareholders.

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We have agreed to indemnify the underwriters against liabilities specified in the underwriting agreement, including civil liabilities under the Securities Act and liabilities arising from breaches of representations and warranties contained in the underwriting agreement.

The representatives of the underwriters have advised us that the underwriters do not intend to confirm sales to any account over which they exercise discretionary authority.

We have applied to list our common stock on the Nasdaq National Market under the symbol "DRTN."

Data Return and our directors, officers and substantially all of our current shareholders have agreed that we, and they, respectively, will not sell, directly or indirectly, or otherwise dispose of any shares of common stock without the prior written consent of Bear, Stearns & Co. Inc. for a period of 180 days from the date of this prospectus. However, Bear, Stearns & Co. Inc. may, in its sole discretion and at any time or from time to time, without notice to our shareholders or Nasdaq, release all or any portion of the shares subject to lock-up agreements. We have agreed that for a period of 180 days after the date of this prospectus we will not, without the prior written consent of Bear, Stearns & Co. Inc., sell or otherwise dispose of any shares of common stock.

Prior to this offering, there has been no public market for our common stock. Consequently, the initial public offering price for our common stock will be determined by negotiation among Data Return and the representatives of the underwriters. The material factors to be considered in determining the public offering price will be:

- . prevailing market conditions;
- . our results of operations in recent periods;
- . the present stage of our development;
- . the market capitalizations and stages of development of generally

comparably companies; and

. estimates of our business potential.

CIBC World Markets Corp. acted as the placement agent for the sale of shares of Data Return's common stock in May and July 1999. In compensation for its services, CIBC World Markets Corp. received a fee. In addition, individuals affiliated with CIBC World Markets Corp. purchased shares of common stock on terms substantially similar to the terms under which other investors purchased shares of common stock at approximately the same time.

#### LEGAL MATTERS

The validity of the shares of common stock offered hereby will be passed upon for Data Return by Thompson & Knight L.L.P., Fort Worth, Texas. Pillsbury Madison & Sutro LLP, Palo Alto, California, is acting as counsel for the underwriters in connection with various legal matters relating to the shares of common stock offered by this prospectus.

#### EXPERTS

Ernst & Young LLP, independent auditors, have audited our financial statements at March 31, 1998 and 1999 and for the period from September 22, 1997 (inception) through March 31, 1998 and for fiscal 1999 as set forth in their report. We have included our financial statements in this prospectus in reliance on Ernst & Young LLP's report given on their authority as experts in auditing and accounting.

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#### WHERE YOU CAN FIND MORE INFORMATION

We have filed with the SEC a registration statement on Form S-1, including exhibits, schedules and amendments, under the Securities Act with respect to the shares of common stock to be sold in this offering. This prospectus does not contain all the information set forth in the registration statement. For further information with respect to us and the shares of common stock to be sold in this offering, reference is made to the registration statement. Statements contained in this prospectus as to the contents of any contract, agreement or other document referred to are not necessarily complete. In each instance reference is made to the copy of that contract, agreement or other document filed as an exhibit to the registration statement.

You may read and copy all or any portion of the registration statement or any other information Data Return files at the SEC's public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549. You can request copies of these documents, upon payment of a duplicating fee, by writing to the SEC. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference rooms. Our SEC filings, including the registration statement, are also available to you on the SEC's web site, which may be found at <http://www.sec.gov>.

As a result of this offering, we will become subject to the information and reporting requirements of the Securities Exchange Act, and, in accordance with those requirements, will file periodic reports, proxy statements and other information with the SEC.

This prospectus is part of the registration statement and does not contain all of the information included in the registration statement. Whenever a reference is made in this prospectus to any contract or other document of ours, the reference may not be complete, and you should refer to the exhibits that are a part of the registration statement for a copy of the contract or document.

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#### DATA RETURN CORPORATION

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REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareholders  
Data Return Corporation

We have audited the accompanying balance sheets of Data Return Corporation as of March 31, 1998 and 1999, and the related statements of operations, changes in shareholders' equity and cash flows for the period from September 22, 1997 (inception) to March 31, 1998 and the year ended March 31, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Data Return Corporation at March 31, 1998 and 1999, and the results of its operations and its cash flows from September 22, 1997 (inception) to March 31, 1998 and the year ended March 31, 1999 in conformity with generally accepted accounting principles.

/s/ Ernst & Young LLP

Dallas, Texas  
May 18, 1999, except for Note 9,

as to which the date is September 10, 1999

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## DATA RETURN CORPORATION

## BALANCE SHEETS

<TABLE>  
<CAPTION>

	March 31,		June 30,
	1998	1999	1999
			(unaudited)
<S>	<C>	<C>	<C>
Assets			
Current assets:			
Cash.....	\$ 473,800	\$ 842,800	\$ 3,115,700
Restricted cash.....	--	125,000	125,000
Accounts receivable, net of allowance for doubtful accounts of \$6,800 and \$20,100 at March 31, 1998 and 1999, respectively and \$69,600 at June 30, 1999.....	91,100	368,400	796,500
Prepaid and other.....	24,800	28,200	101,100
Total current assets.....	589,700	1,364,400	4,138,300
Property and equipment, net.....	141,400	826,000	1,433,100
Other assets.....	3,100	23,300	440,000
Total assets.....	\$ 734,200	\$ 2,213,700	\$ 6,011,400
Liabilities and shareholders' equity			
Current liabilities:			
Accounts payable.....	\$ 108,600	\$ 288,900	\$ 672,100
Accrued expenses.....	60,500	132,900	561,200
Deferred revenue.....	76,900	286,100	516,400
Notes payable and capital lease obligations--current.....	22,500	95,200	97,400
Total current liabilities.....	268,500	803,100	1,847,100
Notes payable and capital lease obligations--long-term.....	36,200	166,000	140,000
Commitments and contingencies.....	--	--	--
Shareholders' equity:			
Preferred stock, \$.001 par value; 20,000,000 shares authorized, none issued or outstanding.....	--	--	--
Common stock, \$.001 par value; 100,000,000 shares authorized; 17,592,600, 20,551,600 and 23,459,490 issued and outstanding at March 31, 1998, 1999 and June 30, 1999 respectively.....	17,600	20,600	23,500
Additional paid-in capital.....	2,318,100	3,893,100	8,039,300
Receivable for shares issued.....	(500,000)	--	--
Deferred stock compensation.....	(1,215,700)	(1,194,900)	(1,929,500)
Accumulated deficit.....	(190,500)	(1,474,200)	(2,109,000)
Total shareholders' equity.....	429,500	1,244,600	4,024,300
Total liabilities and shareholders' equity.....	\$ 734,200	\$ 2,213,700	\$ 6,011,400

</TABLE>

The accompanying notes to financial statements are an integral part of these statements.

DATA RETURN CORPORATION

STATEMENTS OF OPERATIONS

<TABLE>  
<CAPTION>

	Period from September 22, 1997 (inception) to March 31, 1998		Three Months Ended June 30, ----- 1998		1999 -----	
	<C>	<C>	<C>	<C>	<C>	<C>
<S>						
Revenues.....	\$ 336,100	\$ 1,889,000	\$ 280,800	\$ 1,227,500		
Costs and expenses:						
Cost of revenue.....	198,000	1,105,300	204,900	489,500		
General and administrative.....	230,200	1,063,000	213,200	865,600		
Marketing and sales...	39,000	662,800	105,000	384,500		
Stock based compensation.....	61,300	348,800	84,600	139,500		
	-----	-----	-----	-----		
Total costs and expenses.....	528,500	3,179,900	607,700	1,879,100		
	-----	-----	-----	-----		
Loss from operations....	(192,400)	(1,290,900)	(326,900)	(651,600)		
Other income (expense):						
Interest income.....	2,200	19,900	6,200	22,900		
Interest expense.....	(300)	(12,700)	(1,100)	(6,100)		
	-----	-----	-----	-----		
Net loss.....	\$ (190,500)	\$ (1,283,700)	\$ (321,800)	\$ (634,800)		
	=====	=====	=====	=====		
Net loss per common share:						
Basic and diluted....	\$ (0.01)	\$ (0.07)	\$ (0.02)	\$ (0.03)		
	=====	=====	=====	=====		
Shares used in computing basic and diluted net loss per share.....	15,882,326	18,371,300	17,592,600	22,272,804		

</TABLE>

The accompanying notes to financial statements are an integral part of these statements.

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DATA RETURN CORPORATION

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

<TABLE>  
<CAPTION>

	Common Stock		Additional Paid-In Capital	Receivable for Shares Issued	Deferred Stock Compensation	Accumulated (Deficit)	Shareholders' Equity
	Shares	Amount					
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Balance--September 22, 1997 (inception)							
Initial issuance of common stock.....	15,440,600	\$15,400	\$ 43,300	\$ --	\$ --	\$ --	\$ 58,700
Issuance of common stock.....	2,152,000	2,200	997,800	(500,000)	--	--	500,000
Deferred compensation related to stock options.....	--	--	1,277,000	--	(1,277,000)	--	--
Amortization of deferred							

stock compensation.....	--	--	--	--	61,300	--	61,300
Net loss.....	--	--	--	--	--	(190,500)	(190,500)
-----							
Balance--March 31, 1998.....	17,592,600	17,600	2,318,100	(500,000)	(1,215,700)	(190,500)	429,500
Issuance of common stock.....	2,959,000	3,000	1,247,000	500,000	--	--	1,750,000
Deferred compensation related to stock options.....	--	--	328,000	--	(328,000)	--	--
Amortization of deferred stock compensation.....	--	--	--	--	348,800	--	348,800
Net loss.....	--	--	--	--	--	(1,283,700)	(1,283,700)
-----							
Balance--March 31, 1999.....	20,551,600	20,600	3,893,100	--	(1,194,900)	(1,474,200)	1,244,600
Issuance of common stock (unaudited).....	2,907,890	2,900	3,272,100	--	--	--	3,275,000
Deferred compensation related to stock options (unaudited)....	--	--	874,100	--	(874,100)	--	--
Amortization of deferred stock compensation (unaudited).....	--	--	--	--	139,500	--	139,500
Net loss (unaudited)....	--	--	--	--	--	(634,800)	(634,800)
-----							
Balance--June 30, 1999 (unaudited).....	23,459,490	\$23,500	\$8,039,300	\$ --	\$ (1,929,500)	\$ (2,109,000)	\$ 4,024,300
=====							

</TABLE>

The accompanying notes to financial statements are an integral part of these statements.

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DATA RETURN CORPORATION  
STATEMENTS OF CASH FLOWS

<TABLE>  
<CAPTION>

	Period from September 22, 1997 (inception) to March 31, 1998	Year Ended March 31, 1999	Three Months Ended June 30,	
			1998	1999
			(unaudited)	(unaudited)
<S>	<C>	<C>	<C>	<C>
Operating activities				
Net loss.....	\$ (190,500)	\$ (1,283,700)	\$ (321,800)	\$ (634,800)
Adjustments to reconcile net loss to net cash flows used in operating activities:				
Depreciation and amortization.....	12,900	129,500	14,100	89,300
Stock based compensation expense.....	61,300	348,800	84,600	139,500
Provision for doubtful accounts.....	6,800	40,400	4,100	59,900
Changes in operating assets and liabilities:				
Accounts receivable..	(71,900)	(317,700)	(37,300)	(488,000)
Prepaid and other....	(16,500)	(3,200)	7,100	(73,000)

Other assets.....	(3,100)	(20,200)	(4,400)	(416,700)
Accounts payable and accrued expenses....	125,500	252,700	(8,800)	811,400
Deferred revenue.....	76,900	209,200	19,400	230,300
	-----	-----	-----	-----
Net cash provided by (used in) operating activities.....	1,400	(644,200)	(243,000)	(282,100)
Investing activities				
Purchases of property and equipment.....	(55,400)	(814,200)	(79,300)	(696,300)
Purchase of certificate of deposit restricted as to use.....	--	(125,000)	--	--
	-----	-----	-----	-----
Net cash used in investing activities...	(55,400)	(939,200)	(79,300)	(696,300)
Financing activities				
Proceeds from notes payable.....	11,700	250,000	3,500	--
Payments on notes payable and capital leases.....	(200)	(47,600)	(1,200)	(23,700)
Net proceeds from issuance of common stock.....	516,300	1,750,000	500,000	3,275,000
	-----	-----	-----	-----
Net cash provided by financing activities...	527,800	1,952,400	502,300	3,251,300
	-----	-----	-----	-----
Net increase in cash....	473,800	369,000	180,000	2,272,900
Cash at beginning of the period.....	--	473,800	473,800	842,800
	-----	-----	-----	-----
Cash at end of period...	\$ 473,800	\$ 842,800	\$ 653,800	\$3,115,700
	=====	=====	=====	=====

Supplemental disclosure of cash flows information

Noncash investing and financing activities:

Deferred compensation.....	\$1,277,000	\$ 328,000	\$ 52,100	\$ 874,100
Equipment acquired under capital leases.....	38,900	--	--	--
Shares issued for note receivable.....	500,000	--	--	--
Net assets contributed for common stock....	42,400	--	--	--
Cash paid for interest.....	--	11,400	1,100	7,400

</TABLE>

The accompanying notes to financial statements are an integral part of these statements.

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DATA RETURN CORPORATION

NOTES TO FINANCIAL STATEMENTS

March 31, 1999

(Information as of June 30, 1999 and for the three month



## 1.Organization, Basis of Presentation and Significant Accounting Policies

### Organization

Data Return Corporation (the "Company") was incorporated in August 1997 under the laws of the State of Texas and commenced operations on September 22, 1997 (inception). The Company primarily provides advanced Microsoft Internet hosting services to businesses, web site developers and other organizations. The Company's advanced Microsoft hosting services enable its customers to establish and maintain e-commerce and other applications through which they can conduct transactions and manage information on a worldwide basis over the Internet.

The Company's computer equipment, principally servers, is primarily located in separate facilities owned by two of its vendors. The vendors provide data center facilities and bandwidth connectivity to the Company on a contractual basis.

### Basis of Presentation

The accompanying financial statements of the Company reflect the operations and financial position of the Company for the period from its inception on September 22, 1997 to March 31, 1998 and for fiscal 1999. The Company was formed when its founders contributed net assets, principally computer equipment, with an approximate fair market value of \$42,000 and cash of approximately \$17,000 as consideration for 15,440,600 shares of the Company's common stock.

The Company does not expect to generate positive cash flow from its operations for several years. As a result, the Company has obtained and intends to continue to seek funding from external sources. In addition, the Company intends to file a registration statement for the initial public offering of the Company's common stock. The Company contemplates using the proceeds from the proposed public offering to fund its operations, fund its capital expenditures, expand its marketing and sales activities, repay its credit facility and for working capital and other general corporate purposes, including potential acquisitions and investments and expenses associated with its anticipated move to a new headquarters facility. Management of the Company believes that the proceeds from the private issuance of common stock described in Note 9 as well as the proceeds received, if any, of the proposed public offering will be sufficient to meet the Company's projected cash needs for at least the next 12 months.

### Significant Accounting Policies

#### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

#### Revenue Recognition

Revenues are primarily derived from monthly recurring hosting service fees and from set-up fees. Basic services, defined as accounts expected to generate less than \$400 monthly, do not require a contract. More

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DATA RETURN CORPORATION

NOTES TO FINANCIAL STATEMENTS--(Continued)

(Information as of June 30, 1999 and for the three month periods ended June 30, 1998 and 1999 is unaudited)

## 1.Organization, Basis of Presentation and Significant Accounting Policies--

complex services require a contract that is generally six months in length. These contracts generally are cancelable by either party without penalty upon 30 days' notice. Revenues from these contracts are recognized ratably over the contractual period as service is delivered. Payments received for billings in advance of providing services are deferred until the period such services are provided. Set-up fees are separately priced from hosting services and are recognized at the time a new customer account is created. Therefore, the customer has no expectation of any future value from set-up fees after the account is set up and the service is activated. Set-up costs consist primarily of labor by technical support personnel to activate the new service and are incurred at the time of set-up. No future set-up costs are incurred. There is no obligation of the Company to perform any future set-up services, and the set-up fees are non-refundable. Following expiration of the initial contract period and upon renewal of the contract by the customer, there are no additional set-up charges and the renewal prices for hosting services are generally unchanged from the original contract period.

The Company's accounts receivable are financial instruments that expose the Company to credit risk, as defined by Statement of Financial Accounting Standards No. 105, Disclosure of Information About Financial Instruments with Off-Balance Sheet Risk and Financial Instruments with Concentrations of Credit Risk. Accounts receivable are due from commercial entities to whom credit is extended based on evaluation of the customer's financial condition, and generally collateral is not required. Anticipated credit losses are provided for in the financial statements and have been within management's expectations for all periods presented.

#### Property and Equipment

Property and equipment is stated at cost. Depreciation is computed using the straight-line method over estimated useful lives of the property and equipment, generally three years for computer equipment and up to seven years for furniture and fixtures. Equipment acquired under capital leases is amortized using the straight-line method over the lesser of the lease term or the estimated useful life of the asset, generally three years. The cost of license agreements with software vendors are amortized over the term of the agreements.

#### Restricted Cash

Restricted cash consists of a certificate of deposit which is pledged as collateral for the Company's notes payable.

#### Impairment of Long-Lived Assets

In accordance with Statement on Accounting Standards No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of, the Company reviews its long-lived assets for impairment when events or changes in circumstances indicate the carrying value of such assets may not be recoverable. This review consists of a comparison of the carrying value of the asset with the asset's expected future undiscounted cash flows without interest costs. Estimates of expected future cash flows represent management's best estimate based on reasonable and supportable assumptions and projections. If the expected future cash flow exceeds the carrying value of the asset, no impairment indicator is considered present. If the carrying value exceeds the future cash flow, an impairment indicator is considered present. Such impairment would be measured and recognized using a discounted cash flow method.

#### Financial Instruments

The carrying amounts reported in the balance sheets for accounts receivable and accounts payable approximate their fair values.

(Information as of June 30, 1999 and for the three month periods ended June 30, 1998 and 1999 is unaudited)

1.Organization, Basis of Presentation and Significant Accounting Policies--  
(Continued)

Purchase Commitments

The Company has an obligation to acquire certain minimum amounts of co-location space, technical assistance, broadband service and private line service. In the event the Company expects to incur a loss in fulfilling its future obligations, the estimated loss will be accrued at the date the Company first believes a loss is likely to be incurred.

Advertising Costs

The Company expenses advertising costs as incurred. Advertising expense amounted to \$25,200 and \$296,400 for the period from September 22, 1997 (inception) to March 31, 1998, and the year ended March 31, 1999, respectively.

Stock Based Compensation

The Company accounts for employee stock based compensation in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations, because the alternative fair value accounting model provided under Statement of Financial Accounting Standards No. 123, Accounting for Stock Based Compensation (SFAS 123) is not required. Accordingly, in cases where exercise prices equal or exceed fair market value of the underlying common stock, the Company recognizes no compensation expense. In cases where exercise prices are less than the fair value, compensation is recognized over the lesser of the period of performance or vesting period.

Income Taxes

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Comprehensive Income

In June 1997, the FASB issued Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income (SFAS 130). SFAS 130 requires that total comprehensive income (loss) be disclosed with equal prominence as net income (loss). The Company's comprehensive loss is equal to its net losses for all periods presented.

Segment Reporting

The Company operated during all periods in a single segment when applying the management approach defined in Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information.

Recent Accounting Pronouncements

On March 4, 1998, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants (AICPA) issued Statement of Position No. 98-1, "Accounting for the Costs of Computer

1.Organization, Basis of Presentation and Significant Accounting Policies--  
(Continued)

Software Developed or Obtained for Internal Use" (SOP 98-1). SOP 98-1 requires computer software costs related to internal software that are incurred in the preliminary project stage to be expensed as incurred. Once the capitalization criteria of SOP 98-1 have been met, external direct costs of materials and services consumed in developing or obtaining internal-use computer software; payroll and payroll-related costs for employees who are directly associated with and who devote time to the internal-use computer software project (to the extent of the time spent directly on the project); and interest costs incurred when developing computer software for internal use should be capitalized. SOP 98-1 is effective for financial statements for fiscal years beginning after December 15, 1998. Accordingly, the Company has adopted SOP 98-1 in its financial statements for the year ending March 31, 2000.

In April of 1998, the Accounting Standards Executive Committee of the AICPA issued Statement of Position No. 98-5, Reporting on the Costs of Start-up Activities, which requires that costs related to such activities be expensed as incurred. SOP 98-5 is effective for financial statements for fiscal years beginning after December 15, 1998. Accordingly, the Company has adopted SOP 98-5 in the financial statements for the year ending March 31, 2000. The adoption of SOP 98-5 had no material impact on our financial statements.

Net Loss Per Share

Net loss per share is computed using the weighted average number of shares of common stock outstanding during each period for basic and diluted earnings per share. No common stock equivalents are considered in the calculation of diluted earnings per share as the Company has incurred a loss for all periods presented and the effect of common stock equivalents would be anti-dilutive.

Unaudited Interim Financial Statements

The unaudited interim consolidated financial statements as of June 30, 1999, and for the three month periods ended June 30, 1998 and 1999, have been prepared in accordance with generally accepted accounting principles for interim financial information and with Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. They do reflect all adjustments (consisting only of normal recurring entries) which, in the opinion of the Company's management, are necessary for a fair presentation of the results for the interim periods presented.

The results of operations for the three month period ended June 30, 1999, are not necessarily indicative of the results that may be expected for any other interim period or for the full year.

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DATA RETURN CORPORATION

NOTES TO FINANCIAL STATEMENTS--(Continued)

(Information as of June 30, 1999 and for the three month periods ended June 30, 1998 and 1999 is unaudited)

2.Property and Equipment

Property and equipment consists of the following:

<TABLE>  
<CAPTION>

March 31,		June 30,
-----		1999
1998	1999	

	<C>	<C>	<C>
			(unaudited)
<S>			
Electronics and computer equipment.....	\$ 94,400	\$ 852,600	\$1,518,600
Computer software.....	--	39,400	63,200
Furniture and office equipment.....	7,700	14,800	21,300
Leasehold improvements.....	5,000	10,600	10,600
Capital leases--equipment.....	47,200	51,100	51,100
	-----	-----	-----
	154,300	968,500	1,664,800
Less accumulated depreciation and amortization.....	(12,900)	(142,500)	(231,700)
	-----	-----	-----
	\$141,400	\$ 826,000	\$1,433,100
	=====	=====	=====

</TABLE>

### 3. Accrued Expenses

Accrued expenses consist of the following:

	March 31,		June 30,
	1998	1999	1999
			(unaudited)
<S>	<C>	<C>	<C>
Professional fees.....	\$ --	\$ --	\$289,700
Bonuses.....	--	42,800	125,000
Deferred compensation.....	40,000	40,000	40,000
Commissions.....	--	20,800	47,400
Other.....	20,500	29,300	59,100
	-----	-----	-----
	\$60,500	\$132,900	\$561,200
	=====	=====	=====

</TABLE>

### 4. Notes Payable

The Company entered into two separate note agreements for \$125,000 each with a commercial bank. The notes are cross collateralized by a \$125,000 certificate of deposit at the bank and all computer equipment acquired with the loan proceeds. The notes bear interest at 9.25 percent and 6.9 percent. The notes are due in equal monthly installments of principal and interest of \$3,990 and \$3,871, respectively. Future principal payments at March 31, 1999 are as follows:

	<C>
<S>	
2000.....	\$ 78,900
2001.....	85,500
2002.....	60,400
	-----
	\$224,800
	=====

</TABLE>

## 5.Shareholders' Equity

### Common Stock

Pursuant to a Stock Sales Agreement (the Agreement) dated February 20, 1998, between the Company and a private investor, the Company sold 2,152,000 shares of its common stock for \$0.46 per share. The Agreement provided for the issuance of the shares in return for \$500,000 cash and a promissory note in the amount of \$500,000 that has been repaid. The Agreement provided the investor the right to acquire an additional 2,690,000 shares of the Company's common stock during a specified period in 2001 for \$0.37 per share and provided the Company the right to require the investor to purchase the shares for a period beginning in February 1999 through August 2001. In February of 1999, the Company exercised its rights under the Agreement and sold 2,690,000 shares of its common stock to the investor for \$0.37 per share.

The Agreement also provides the investor additional rights including: a right of first refusal to participate in any future equity offerings up to the total amount of such offerings and on the same terms as those offered to other investors, a right to designate two members of the Company's five member Board of Directors and a requirement for unanimous approval by the Board of Directors for certain transactions.

The investor's rights terminate upon the earlier to occur of: the mutual agreement of the Company and the investor, events the result of which are such that the investor owns less than 5 percent of the issued and outstanding common stock of the Company, consummation of a public offering of the Company's capital stock or a breach by the investor of his obligations.

### Stock Based Compensation Arrangements

The Company's 1998 Stock Option Plan (the Plan) provides for the issuance to employees of options to acquire 3,308,700 shares of common stock. The options are to be issued at fair market value, as defined, and vest as approved by the Board of Directors. Options generally expire 10 years from the date of grant and automatically expire at termination of employment. The vesting period for options to acquire 901,150 shares of common stock accelerates to the effective date of any registration statement filed by the Company or in the event of a merger or acquisition of the Company.

Subsequent to March 31, 1999, the Company adopted the 1999 Long-Term Incentive Plan. See Note 9.

The following table summarizes the stock option activity related to the Company:

<TABLE>  
<CAPTION>

	Number of Shares	Per Share Exercise Price	Weighted Average Exercise Price
<S>	<C>	<C>	<C>
Outstanding options--September 22, 1997.....	--	\$ --	\$ --
Granted.....	3,577,700	0.02	0.02
Outstanding options--March 31, 1998...	3,577,700	0.02	0.02
Granted.....	1,069,275	0.08- 0.17	0.15
Outstanding options--March 31, 1999...	4,646,975	0.02- 0.17	0.05
Granted.....	1,304,650	0.23- 1.66	0.44
Expired.....	(26,900)	0.23	0.23
Outstanding options--June 30, 1999....	5,924,725	\$0.02-\$1.66	\$0.14
Options exercisable--March 31, 1999...	916,752	\$ 0.02	\$0.02

</TABLE>

## DATA RETURN CORPORATION

## NOTES TO FINANCIAL STATEMENTS--(Continued)

(Information as of June 30, 1999 and for the three month periods ended June 30, 1998 and 1999 is unaudited)

## 5.Shareholders' Equity--(Continued)

Outstanding options as of March 31, 1999, had a weighted average remaining contractual life of approximately nine years and a weighted average fair value at issuance of \$0.36 based on the minimum value method.

Certain employees of the Company have been granted options under the Plan to purchase shares of the Company's common stock at less than fair market value. Prior to the adoption of the Plan, an employee was granted 3,308,700 options at a price below fair market value which vest over 4 years. The vesting period for the 3,308,700 options accelerates to the effective date of any registration statement filed by the Company. The Company recorded deferred stock compensation of \$1,277,000, \$328,000 and \$874,100 for the period from September 22, 1997 (inception) through March 31, 1998, the year ended March 31, 1999 and the three month period ended June 30, 1999, respectively, for the difference between the exercise price and the deemed fair value of the Company's common stock underlying certain options granted. These amounts are being amortized over the vesting period of the individual options, generally four years. The stock compensation expense charged to income amounted to \$61,300 and \$348,800 for the period from September 22, 1997 (inception) to March 31, 1998 and the year ended March 31, 1999, respectively. The stock compensation expense charged to income amounted to \$84,600 and \$139,500 for the three month periods ended June 30, 1998 and 1999, respectively.

As discussed in Note 1, the Company accounts for its stock based awards to employees using the intrinsic value method in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related interpretations.

SFAS No. 123 requires the disclosure of pro forma net income (loss) and net income (loss) per share as if the Company had adopted the fair value method since September 22, 1997 (inception). Under SFAS No. 123, the fair value of stock based awards to employees is calculated through the use of option pricing models, even though such models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock option awards. These models also require subjective assumptions, including future price volatility and expected time to exercise, which greatly affect the calculated values.

The Company's calculations for employee grants were made using the minimum value method using the following weighted average assumption: expected life, four years; risk free interest rate of 6 percent; no dividends during the expected term; and a volatility of zero as the Company is private and has no trading history. If the computed values of the Company's stock based awards were amortized to expense over the vesting period of the awards as specified under SFAS No. 123, net loss would have been \$191,320 (\$0.01 per basic and diluted share) and \$1,289,160 (\$0.07 per basic and diluted share) for the period from September 22, 1997 (inception) to March 31, 1998 and the year ended March 31, 1999, respectively.

## DATA RETURN CORPORATION

## NOTES TO FINANCIAL STATEMENTS--(Continued)

(Information as of June 30, 1999 and for the three month periods ended June 30, 1998 and 1999 is unaudited)

6.Income Tax Information

At March 31, 1998 and 1999, the Company had temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws. Significant components of the Company's deferred tax assets and liabilities were as follows:

<TABLE>  
<CAPTION>

	March 31,	
	1998	1999
<S>	<C>	<C>
Deferred tax assets:		
Net operating loss carryforwards.....	\$ 26,000	\$ 333,000
Stock based compensation.....	21,000	139,000
Accrued expenses.....	16,000	22,000
Allowance for bad debts.....	2,000	7,000
Total deferred tax assets.....	65,000	501,000
Less: valuation allowance.....	(65,000)	(501,000)
Net deferred tax asset.....	\$ --	\$ --

</TABLE>

At March 31, 1999, the Company's net operating loss carryforward for federal income tax purposes is approximately \$980,000, expiring in 2013 and 2014. The Company has recorded a valuation reserve for its net deferred tax benefit for the period ended March 31, 1998 and the year ended March 31, 1999 due to uncertainty that the Company will generate sufficient taxable income during the carryforward period to realize the benefit of its deferred tax asset. In addition, in connection with the equity transactions that have taken place since its inception and the proposed initial public offering, the Company may experience a change in control pursuant to Internal Revenue Code Section 382. As such, the net operating loss carryforward may be limited as to its possible use in future periods.

7.Commitments

Leases

The Company leases office space and office equipment under operating leases. Future noncancelable lease payments under the Company's lease commitments at March 31, 1999 are as follows:

<TABLE>  
<CAPTION>

	Capital Leases	Operating Leases
	<C>	<C>
<S>		
Year Ended March 31:		
2000.....	\$20,500	\$102,100
2001.....	20,200	56,500
2002.....	3,300	11,100
	44,000	\$169,700
Less amount representing interest.....	(7,600)	
Present value of lease payments.....	36,400	
Current portion of capital leases.....	15,200	
Noncurrent portion of capital leases.....	\$21,200	

</TABLE>



The Company recorded rent expense of \$13,300 for the period from September 22, 1997 (inception) to March 31, 1998, and \$60,500 for the year ended March 31, 1999.

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DATA RETURN CORPORATION

NOTES TO FINANCIAL STATEMENTS--(Continued)

(Information as of June 30, 1999 and for the three month periods ended June 30, 1998 and 1999 is unaudited)

7.Commitments--(Continued)

Bandwidth and Co-Location Agreements

The Company has entered into agreements for bandwidth, co-location space and dedicated Internet access with multiple vendors. The agreements are generally three year commitments and require penalties for early termination. The agreements are generally subject to a master contract which allows for service order upgrades at the Company's request. Following are the Company's minimum commitments at March 31, 1999.

<TABLE>

<S>	<C>
Year Ended March 31:	
2000.....	\$ 525,000
2001.....	475,000
2002.....	175,000
	-----
	\$1,175,000
	=====

</TABLE>

Subsequent to year end, the Company entered into an agreement with a vendor which requires the Company to acquire an additional \$10.0 million of services over the next five years (See Note 9).

8.International Operations

International revenues were approximately \$43,500 and \$189,000 for the period from September 22, 1997 (inception) to March 31, 1998 and fiscal 1999, respectively. The Company's international revenues were primarily generated from customers located in Europe and Asia. In fiscal 1999, revenues from customers located in Europe and Asia accounted for approximately 6% and 2% of total revenues, respectively. Total assets from international operations, comprised of accounts receivable, were \$16,700 and \$32,700 of total assets as of March 31, 1998 and 1999, respectively.

9.Subsequent Events

Proposed Public Offering of Common Stock (Unaudited)

The Board of Directors of the Company has authorized management of the Company to file a registration statement with the Securities and Exchange Commission for the initial public offering of the Company's common stock. The Company contemplates using the proceeds from the proposed public offering to fund its operations, fund its capital expenditures, expand its marketing and sales activities, repay its credit facility and for working capital and other general corporate purposes, including potential acquisitions and investments and expenses associated with its anticipated move to a new headquarters facility.

Adoption of the 1999 Long-Term Incentive Plan

In July 1999, the Company adopted the 1999 Long-Term Incentive Plan. The Plan provides for the issuance of up to 3,228,000 options to acquire its common stock.

Issuance of Common Stock

Subsequent to year end, the Company issued 5,251,418 shares of common stock to private investors for total cash consideration of \$9.375 million through July 29, 1999.

DATA RETURN CORPORATION

NOTES TO FINANCIAL STATEMENTS--(Continued)

(Information as of June 30, 1999 and for the three month periods ended June 30, 1998 and 1999 is unaudited)

9.Subsequent Events--(Continued)

In addition, on July 26, 1999, Level 3 Communications, Inc. (Level 3) acquired 1,952,940 shares of the Company's common stock in exchange for a \$5.0 million credit to be applied to the purchase of future bandwidth services. Use of the credit is as allowed by the Service Credit Agreement. The credit can be applied as payment for services in excess of the minimum purchases required under the Strategic Marketing and Sales Agreement (see below) beginning on January 1, 2001. The Company has a limited right to reacquire the stock in the event that Level 3 fails to fulfill its obligations under the Service Credit Agreement or fails to deliver the bandwidth pursuant to the terms of the Service Credit Agreement. The number of shares subject to the Company's right to reacquire the stock will be reduced pro rata in each quarter of calendar year 2001 by the greater of the credit applied to future purchases of bandwidth or 25% of the total shares. The stock can be reacquired by the Company at the original purchase price by the Company's forgiveness of the remaining balance of the credit. In the event the Company's right to reacquire the stock is exercised, Level 3 is required to pay the Company \$750,000, reduced ratably, based on the amount of bandwidth credit used by the Company.

Strategic Marketing and Sales Agreement

The Company entered into a Strategic Marketing and Sales Agreement with Level 3 on July 1, 1999. The Strategic Marketing and Sales Agreement provides that the Company will acquire most of its requirements for co-location space, technical assistance, broadband service and private line service (collectively the "Services") over a five year period commencing with the date of the agreement, which are substantially similar or perform substantially the same function as the Services from Level 3. The Agreement also provides for joint sales and marketing efforts between the Company and Level 3, including cross training of personnel, and provides that Level 3 will designate the Company as a preferred provider for Advanced Microsoft Hosting Service. The Company will pay commission to Level 3 personnel for new customers generated by their leads.

The Company's annual commitment for the Services is as follows for its year ended March 31:

<TABLE>	
<S>	<C>
2000.....	\$ 400,000
2001.....	1,000,000
2002.....	1,400,000
2003.....	2,000,000
2004.....	3,200,000
2005.....	2,000,000
	-----
	\$10,000,000
	=====

</TABLE>

Payments for the minimum annual purchase commitments will be required regardless of whether the Company uses the Services. The Company can apply the \$5.0 million credit described above beginning on January 1, 2001 to purchases

in excess of the minimum annual commitments required by the Strategic Marketing and Sales Agreement. Pricing of the Services will be based on Level 3's established market prices at the time the service is provided.

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DATA RETURN CORPORATION

NOTES TO FINANCIAL STATEMENTS--(Continued)

(Information as of June 30, 1999 and for the three month periods ended June 30, 1998 and 1999 is unaudited)

9.Subsequent Events--(Continued)

ASP and Server Agreement

The Company entered into an agreement with Compaq to purchase the lesser of 2,000 servers or the number of servers reasonably necessary to operate the Company's business. The requirement to purchase the servers is contingent upon Compaq providing financing for the servers on competitive terms, upon the price, performance and quality of the servers being reasonably satisfactory to the Company and upon Compaq's commitment to deliver these servers on the schedule we request.

Microsoft Agreements (unaudited)

On September 3, 1999, the Company agreed to sell \$5.0 million of its common stock for a per share purchase price equal to the lesser of the midpoint of the lowest filing range and the price to public. Microsoft will also acquire a warrant to purchase \$3.75 million of the Company's common stock at the same per share purchase price. Microsoft is entitled to one demand and unlimited "piggyback" registration rights. Microsoft also has a right of first refusal that does not include this offering and that terminates upon completion of the initial public offering. This transaction will close the earlier of the day after the pricing of this offering and December 12, 1999.

In addition, on September 3, 1999, the Company entered into a five-year Development, License and Co-Marketing Agreement with Microsoft to grant a non-exclusive perpetual license to proprietary installation tools for third-party hosted applications to Microsoft. The Company will also train Microsoft's employees and customers in the use of those tools. Microsoft has the sole right to terminate the agreement if the Company fails to deliver the tools on a timely basis or if the Company fails to correct any errors in the tools on a timely basis. Also as part of the agreement, Microsoft will provide up to one hundred hours of technical consulting and writing services during the development of the tools.

Stock Split

On September 10, 1999, the Board of Directors approved a 269 for 1 split of the Company's common stock. All share and per share amounts have been retroactively restated to reflect the effect of the stock split.

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Inside back cover

The inside back cover of the prospectus has a caption centered at the top of the page in large text that reads "Hosting the Back Office for E-Business."

An image a globe with images of customers' web pages surrounding the globe above its surface is centered in the middle of the page.

Centered at the bottom of the page is the Data Return logo and the slogan

Centered on the page is the Data Return logo and the slogan "Hosting The Back Office for E-Business."

Part II

INFORMATION NOT REQUIRED IN PROSPECTUS

ITEM 13. Other Expenses of Issuance and Distribution

The following is an itemized statement of the amounts of all expenses payable by the Registrant in connection with the registration of the common stock offered hereby (estimated except for the Registration Fee, NASD Filing Fee and Nasdaq National Market listing fee), other than underwriting discounts and commissions:

<S>	<C>
Registration Fee-Securities and Exchange Commission.....	\$ 23,977.50
NASD Filing Fee.....	9,125.00
Nasdaq National Market listing fee.....	
Blue Sky fees and expenses.....	10,000.00
Accountants' fees and expenses.....	200,000.00
Legal fees and expenses.....	200,000.00
Printing and engraving expenses.....	300,000.00
Transfer agent and registrar fees.....	30,000.00
Miscellaneous.....	226,897.50
	-----
Total.....	\$1,000,000.00
	=====

</TABLE>

ITEM 14. Indemnification of Directors and Officers

We have authority under Article 2.02A.(16) and 2.02-1 of the Texas Business Corporation Act (the "TBCA") to indemnify our directors and officers to the extent provided for in the TBCA. Our Restated Articles of Incorporation permit indemnification of directors and officers to the fullest extent permitted by law.

The TBCA provides in part that a corporation may indemnify a director or officer or other person who was, is, or is threatened to be made a named defendant or respondent in a proceeding because the person is or was a director, officer, employee or agent of the corporation, if it is determined that such person (i) conducted himself in good faith; (ii) reasonably believed, in the case of conduct in his official capacity as a director or officer of the corporation, that his conduct was in the corporation's best interests, and, in all other cases, that his conduct was at least not opposed to the corporation's best interests; and (iii) in the case of any criminal proceeding, had no reasonable cause to believe that this conduct was unlawful.

A corporation may indemnify a person under the TBCA against judgments, penalties, (including excise and similar taxes), fines, settlement, and reasonable expenses actually incurred by the person in connection with the proceeding. If the person is found liable to the corporation or is found liable on the basis that personal benefit was improperly received by the person, the indemnification is limited to reasonable expenses actually incurred by the person in connection with the proceeding, and shall not be made in respect of any proceeding in which the person shall have been found liable for willful or intentional misconduct in the performance of his duty to the corporation.

A corporation may also pay or reimburse expenses incurred by a person in

connection with his appearance as a witness or other participation in a proceeding at a time when he is not a named defendant or respondent in the proceeding.

Article Eight of our Restated Articles of Incorporation provides that, to the fullest extent permitted by the TBCA as it exists or as it may be amended, no director shall be personally liable to Data Return or our shareholders for monetary damages for breach of fiduciary duty as a director.

Prior to consummation of this offering, we intend to obtain directors and officers liability insurance.

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Reference is made to Section \_\_\_\_\_ of the underwriting agreement filed as Exhibit 1.1 hereto, indemnifying the officers and directors of the registrant against certain liabilities.

### ITEM 15. Recent Sales of Unregistered Securities

Set forth in chronological order is information regarding all securities sold and employee stock options granted by the Registrant since August 17, 1997 (the date of incorporation).

(1) Since August 17, 1997, the Registrant has granted to employees options to purchase an aggregate of 6,532,396 shares of Common Stock at a weighted average exercise price of \$0.29.

(2) On August 17, 1997, the Registrant issued 8,106,315 shares to Sunny Vanderbeck, 6,562,255 shares to Michelle Chambers and 772,030 to Jason Lochhead, the founders of the Registrant, in exchange for assets, principally computer equipment, with a value of \$42,000 and cash of \$17,000 contributed to the Registrant.

(3) On February 20, 1998, the Registrant issued 2,152,000 shares of Common Stock to Nathan Landow Family Limited Partnership for a purchase price of \$1,000,000.

(4) On December 22, 1998, the Registrant issued 215,200 shares of Common Stock to Dexter Stewart RIRA for a purchase price of \$100,000.

(5) On December 24, 1998, the Registrant issued 2,690,000 shares of Common Stock to Nathan Landow Family Limited Partnership for a purchase price of \$1,000,000.

(6) On February 1, 1999, the Registrant issued 53,800 shares of Common Stock to Nathan Landow Family Limited Partnership for a purchase price of \$25,000.

(7) On April 23, 1999, the Registrant issued 351,852 shares of Common Stock to Nathan Landow for an aggregate purchase price of \$250,000.

(8) On April 26, 1999, the Registrant issued 2,450 shares of Common Stock to two investors for an aggregate purchase price of \$500,000. The distribution of such shares was as follows: 329,525 shares to David Slagel for a purchase price of \$250,000; 329,525 shares to Steve Loftus for a purchase price of \$250,000.

(9) On May 5, 1999, the Registrant issued 1,862 shares of Common Stock to four investors for an aggregate purchase price of \$500,000. The distribution of such shares was as follows: 290,789 shares to Tom O'Shea for a purchase price of \$290,000; 110,021 shares to Bob Nolan for a purchase price of \$110,000; 75,051 shares to Bruce Eatroff for a purchase price of \$75,000; 25,017 shares to Tim Brown for a purchase price of \$25,000.

(10) On May 14, 1999, the Registrant issued 718 shares of Common Stock to two investors for an aggregate purchase price of \$250,000. The distribution

of such shares was as follows: 96,571 shares to Andrew Evans for a purchase price of \$125,000; 96,571 shares to T. Geir Ramleth for a purchase price of \$125,000.

(11) On May 18, 1999, the Registrant issued 1,202,968 shares of Common Stock to ZeroDotNet, Inc. for a purchase price of \$2,000,000.

(12) On July 26, 1999, the Registrant issued 1,952,940 shares of Common Stock to Level 3 Communications, Inc. for \$5,000,000 in credit for future bandwidth purchases.

(13) On July 26, 1999, the Registrant issued 1,171,764 shares of Common Stock to ZeroDotNet, Inc. for a purchase price of \$3,000,000.

(14) On July 29, 1999, the Registrant issued 1,171,764 shares of Common Stock to Compaq Computer Corporation for a purchase price of \$3,000,000.

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The sales described in (2) through (15) were deemed to be exempt from registration under the Securities Act in reliance on section 4(2) of the Securities Act as transactions by an issuer not involving a public offering. The grants of options described in (1) were deemed to be exempt from registration under the Securities Act in reliance on Rule 701 promulgated under Section 3(b) of the Securities Act as transactions pursuant to compensatory benefit plans and contracts relating to compensation as provided under such Rule 701. All such transactions were completed on the dates given.

ITEM 16. Exhibits and Financial Statement Schedules

(a) Exhibits

<TABLE>

<CAPTION>

Exhibit

Number Description

-----

<C> <S>

- 1.1\*\* Form of Underwriting Agreement
- 3.1\* Form of Amended and Restated Articles of Incorporation of the Registrant to be filed just prior to effectiveness of this Registration Statement.
- 3.2\* Amended and Restated Bylaws of the Registrant
- 4.1\*\* Form of Common Stock Certificate
- 4.2 Form of Common Stock Warrant dated September 3, 1999, between Data Return Corporation and Microsoft Corporation.
- 5.1\* Opinion of Thompson & Knight L.L.P.
- 10.1\*+ Strategic Marketing and Sales Agreement dated July 1, 1999, by and between Data Return Corporation and Level 3 Communications, LLC.
- 10.2\* Restricted Stock Purchase Agreement dated July 23, 1999, by and between Data Return Corporation and Level 3 Communications, LLC.
- 10.3\* Service Credit Agreement dated July 23, 1999, by and between Data Return Corporation and Level 3 Communications, LLC.
- 10.4\*+ Customer Order dated April 28, 1999, executed by Data Return Corporation and Level 3 Communications, LLC
- 10.5\*+ Managed Services Proposal for Data Return dated March 6, 1997, by and between Data Return Corporation and American Communications Services, Inc.
- 10.6\* Basic Internet Services Agreement dated December 12, 1997, between Data Return Corporation and Savvis Communications Enterprises, L.L.C.
- 10.7\* Commercial Lease Agreement dated April 1, 1998, between Data Return Corporation and DSW Property Management, for approximately 5,088 square feet situated at 801 Stadium Drive, Suite 120, Arlington, Texas 76011.
- 10.8\* Commercial Lease Agreement dated July 14, 1997, between Data Return Corporation and DSW Property Management, for approximately 2,713 square feet situated at 801 Stadium Drive, Suite 117, Arlington, Texas 76011.
- 10.9\* 1999 Long-Term Incentive Plan

- 10.10\* 1998 Stock Option Plan
- 10.11\* Employment Agreement effective as of May 3, 1998, between Data Return Corporation and Todd Steitle.
- 10.12\* Employment Agreement dated March 18, 1999, between Data Return Corporation and Kenneth S. Garber.
- 10.13\* Employment Agreement effective as of January 15, 1998, between Data Return Corporation and Michael S. Shiff.
- 10.14\* Form of Employment Agreement dated July 1, 1999 between Data Return Corporation and each of Sunny C. Vanderbeck, Michelle R. Chambers, Jason A. Lochhead, Stuart A. Walker, Mark A. Bowles and Scott W. Brewer.
- 10.15\* Sublease dated June 28, 1999, between Data Return Corporation and Eastman Kodak Company, for approximately 22,663 square feet situated at 222 Las Colinas Boulevard in Irving, Texas.

</TABLE>

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<TABLE>

<CAPTION>

Exhibit

Number	Description
-----	-----
<C>	<S>
10.16*	Investor's Rights Agreement dated as of July 29, 1999, between Data Return Corporation and CPQ Holdings, Inc.
10.17*	ASP and Server Agreement dated June 29, 1999, between Data Return Corporation and Compaq Computer Corporation.
10.18+	Development, Licence and Co-Marketing Agreement dated September 3, 1999, between Data Return Corporation and Microsoft Corporation.
10.19	Stock Purchase Agreement dated September 2, 1999, between Data Return Corporation and Microsoft Corporation.
23.1*	Consent of Thompson & Knight L.L.P. (included in Exhibit 5.1 above)
23.2	Consent of Ernst & Young LLP
24.1*	Power of Attorney (included in Page II-5)
27.1	Financial Data Schedule
99.1*	Consent of International Data Corp. dated July 9, 1999.
99.2*	Consent of T. Geir Ramleth to being nominated to the Board of Directors of Data Return Corporation.

</TABLE>

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+ Confidential treatment has been requested with respect to certain portions of these agreements.

\* Previously filed.

\*\* To be filed by amendment.

(b) Financial Statement Schedules

None.

ITEM 17. Undertakings

The undersigned Registrant hereby undertakes to provide to the underwriters, at the closing specified in the underwriting agreement, certificates in such denominations and registered in such names as required by the underwriters to permit prompt delivery to each purchaser.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the Registrant pursuant to the foregoing provisions, or otherwise, the Registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is

against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

The undersigned Registrant hereby undertakes that:

(1) For purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the Registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at the time shall be deemed to be the initial bona fide offering thereof.

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SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the Registrant has duly caused this Amendment No. 2 to the Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Irving, State of Texas, on September 10, 1999.

Data Return Corporation

/s/ Sunny C. Vanderbeck

By: \_\_\_\_\_  
Sunny C. Vanderbeck  
Chief Executive Officer

Pursuant to the requirements of the Securities Act of 1933, as amended, this Registration Statement has been signed by the following persons on September 10, 1999 in the capacities indicated:

<TABLE>  
<CAPTION>

Signature -----	Title -----	Date ----
<S> /s/ Sunny C. Vanderbeck _____ Sunny C. Vanderbeck	<C> Chairman of the Board, Chief Executive Officer and Director (Principal Executive Officer)	<C> September 10, 1999
* _____ Michelle R. Chambers	President, Chief Operating Officer and Director	
* _____ Jason A. Lochhead	Vice President--Research and Product Development and Director	
/s/ Stuart A. Walker _____ Stuart A. Walker	Vice President--Chief Financial Officer, Treasurer and Secretary (Principal Financial and Accounting Officer)	September 10, 1999
* _____ Nathan Landow	Director	

\*By: \_\_\_\_\_  
/s/ Sunny C. Vanderbeck

September 10, 1999



Sunny C. Vanderbeck  
Attorney-in-fact

/s/ Stuart A. Walker

September 10, 1999

\*By: \_\_\_\_\_  
Stuart A. Walker, as  
Attorney-in-fact

</TABLE>

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THIS WARRANT AND THE COMMON STOCK ISSUABLE UPON THE EXERCISE HEREOF HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"). THEY MAY NOT BE SOLD, OFFERED FOR SALE, PLEDGED OR HYPOTHECATED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT AS TO THE SECURITIES UNDER THE ACT OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT REGISTRATION IS NOT REQUIRED UNDER THE ACT.

COMMON STOCK WARRANT  
of  
DATA RETURN CORPORATION

No. A-1 \_\_\_\_\_, 1999

Void after the Fifth Anniversary  
of the Above-Referenced Date

THIS CERTIFIES THAT, for value received, Microsoft Corporation (together with any permitted assigns, the "Warrantholder") is entitled to purchase from Data Return Corporation, a Texas corporation (the "Company"), [the number of shares that could be purchased for \$3.75 mm] shares of Common Stock, par value \$.001 per share, of the Company ("Common Stock"). The exercise price per share applicable to this Warrant (the "Exercise Price") shall be \$[the same per share price as under the Stock Purchase Agreement] per share of Common Stock. The Exercise Price and such number of shares shall be subject to adjustment upon the occurrence of the contingencies set forth in this Warrant.

Upon delivery of this Warrant, together with payment of the Exercise Price multiplied by the total number of shares of Common Stock thereby purchased (the "Aggregate Exercise Price"), at the principal office of the Company or at such other office or agency as the Company may designate by notice in writing to the holder hereof, the holder of this Warrant shall be entitled to receive a certificate or certificates for the shares of Common Stock so purchased. The date at which the Company receives (i) this Warrant and (ii) payment for the shares of Common Stock, either by payment in cash, or by check, or wire transfer, shall be referred to herein as the "Exercise Date". All shares of Common Stock which may be issued upon the exercise of this Warrant ("Warrant Shares") shall, upon issuance, be fully paid, validly issued and non-assessable, free from all taxes, liens and charges.

This Warrant is subject to the following terms and conditions:

1. Exercise of Warrant.
  - 1.1 Time of Exercise.

(a) This Warrant may be exercised in whole or in part commencing on the date hereof until the fifth anniversary date of the issuance of this Warrant, and if such day is not a business day, then on the next business day thereafter.

(b) The issuance of certificates for shares upon exercise of this Warrant shall be made without charge to the holder thereof for any issuance tax in respect thereof or other cost incurred by the Company in connection with such exercise and the related issuance of the shares.

(c) The Company shall not close its books against the transfer of this Warrant or of any shares issued or issuable upon the exercise of this Warrant in any manner which interferes with the timely exercise of this Warrant.

(d) The Company shall at all times reserve and keep available out of its authorized but unissued Common Stock solely for the purpose of issuance upon the exercise of this Warrant, the maximum number of shares issuable upon the exercise of this Warrant.

1.2 Method of Exercise. While this Warrant remains outstanding and exercisable in accordance with Section 1.1, the Warrantholder may exercise, in whole or in part, the purchase rights evidenced hereby. Such exercise shall be effected by:

(a) the surrender of the Warrant at the principal office of the Company; and

(b) subject to Section 1.3, the payment to the Company by wire transfer or check of the Aggregate Exercise Price for all shares of Common Stock purchased.

1.3 Net Exercise. In lieu of exercising this Warrant, the Warrantholder may elect to receive shares of Common Stock equal to the value of this Warrant (or the portion thereof being canceled) by surrender of this Warrant at the principal office of the Company together with notice of such election, in which event the Company shall issue to the holder hereof a number of shares of Common Stock computed using the following formula:

$$S = P \times \frac{(F-E)}{F}$$

Where

S = The number of shares of Common Stock to be issued to the Warrantholder.

P = The number of shares of Common Stock purchasable under this Warrant.

F = The Fair Market Value (as defined below) of 1 share of Common Stock.

E = The Exercise Price (as adjusted to the date of such calculations).

For purposes of this Section 1.3, the "Fair Market Value" of the Common Stock shall be determined in good faith by the Board of Directors of the Company; provided, that if the Common Stock is then trading on a national securities exchange or in the over-the-counter market, such

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determination shall be made with reference to the average closing price of the Common Stock in such trading over the 20 trading days immediately preceding the exercise of the Warrant.

1.4 Certificates for Shares. The Company shall, within 30 days after the Exercise Date, prepare a certificate for the shares of Common Stock purchased in the name of the holder of this Warrant, or as such holder may direct (subject to the restrictions upon transfer contained herein and upon payment by such holder hereof of any applicable transfer taxes). In case the Warrantholder shall exercise this Warrant with respect to less than all of the shares of Common Stock that may be purchased under this Warrant, the Company shall execute a new warrant in the form of this Warrant for the balance of such shares and deliver such new warrant to the Warrantholder.

1.5 Warrant Register. The Company shall maintain at its principal executive offices books for the registration and the registration of transfer of Warrants. The Company may deem and treat the Warrantholder as the absolute owner hereof (notwithstanding any notation of ownership or other writing thereon made by anyone) for all purposes and shall not be affected by any notice to the contrary.

## 2. Certain Adjustments.

2.1 Exercise Price; Adjustment of Number of Shares. The Exercise Price set forth in Section 1 hereof and the number of shares purchasable hereunder shall be subject to adjustment from time to time as hereinafter provided.

2.2 Reorganization, Reclassification, Consolidation, Merger or Sale. If any capital reorganization or reclassification of the capital stock of the Company, or any consolidation or merger of the Company with another entity, or the sale of all or substantially all of the Company's assets to another person or entity (collectively referred to as a "Transaction") shall be effected in such a way that holders of Common Stock shall be entitled to receive stock, securities, cash or assets with respect to or in exchange for Common Stock, then, as a condition of such Transaction, reasonable, lawful and adequate provisions shall be made whereby the holder of this Warrant shall thereafter

have the right to purchase and receive upon the basis and upon the terms and conditions specified in this Warrant, upon exercise of this Warrant and in lieu of the Warrant Shares immediately theretofore purchasable and receivable upon the exercise of the rights represented hereby, such number, amount and like kind of shares of stock, securities, cash or assets as may be issued or payable pursuant to the terms of the Transaction with respect to or in exchange for the number of shares of Common Stock immediately theretofore purchasable and receivable upon the exercise of the rights represented hereby as if such shares were outstanding immediately prior to the Transaction, and in any such case appropriate provision shall be made with respect to the rights and interest of the holders to the end that the provisions hereof (including, without limitation, provisions for adjustments of the Exercise Price and of the number of Warrant Shares purchasable and receivable upon the exercise of this Warrant) shall thereafter be applicable, as nearly as may be practicable, in relation to any shares of stock or securities thereafter deliverable upon the exercise hereof.

2.3 Stock Splits, Stock Dividends and Reverse Stock Splits. In case at any time the Company shall subdivide its outstanding shares of Common Stock into a greater number of shares,

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or shall declare and pay any stock dividend with respect to its outstanding stock that has the effect of increasing the number of outstanding shares of Common Stock, the Exercise Price in effect immediately prior to such subdivision or stock dividend shall be proportionately reduced and the number of Warrant Shares purchasable pursuant to this Warrant immediately prior to such subdivision or stock dividend shall be proportionately increased, and conversely, in case at any time the Company shall combine its outstanding shares of Common Stock into a smaller number of shares, the Exercise Price in effect immediately prior to such combination shall be proportionately increased and the number of Warrant Shares purchasable upon the exercise of this Warrant immediately prior to such combination shall be proportionately reduced.

2.4 Issuance of Additional Shares of Common Stock. If at any time prior to the Expiration Date the Company shall issue any Additional Shares of Common Stock for a consideration per share (the "Subsequent Issue Price") less than the Exercise Price as in effect immediately prior to such issuance, the Exercise Price shall be reduced to the lower of the prices calculated by dividing (i) an amount equal to the sum of (x) the number of shares of Common Stock outstanding immediately prior to such issuance multiplied by the Exercise Price then in effect plus (y) the aggregate consideration, if any, received by the Company in connection with such issuance by (ii) the total number of shares of Common Stock outstanding immediately after such issuance.

For purposes of this Section 2.4, "Additional Shares of Common Stock" shall mean all shares of Common Stock issued or issuable by the Company after the Original Issue Date, other than (i) shares of Common Stock issuable under the Company's employee stock option plan as approved by the Company's Board of

Directors (the "Employee Stock") and (ii) shares issued by the Company in an underwritten public offering. For purposes of this Section 2.4, in the case of convertible securities, there shall be determined the price per share for which Additional Shares of Common Stock are issuable upon the conversion or exchange thereof, such determination to be made by dividing (i) the total amount received or receivable by the Company as consideration for the issue or sale of such convertible Securities, plus the minimum aggregate amount of additional consideration, if any, payable to the Company upon conversion or exchange thereof by (ii) the maximum aggregate number of additional Shares of Common Stock issuable upon conversion or exchange of all such convertible securities for such minimum aggregate amount of additional consideration; and such issue or sale shall be deemed to be an issue or sale for cash (as of the date of issue or sale of such convertible securities, whether or not then exercisable or convertible) of such maximum number of Additional Shares of common stock at the price per share so determined.

If any rights of conversion or exchange evidenced by convertible securities the issuance of which resulted in an adjustment to the Exercise Price and the number of Warrant Shares issuable hereunder pursuant to this Section 2.4 shall expire without having been exercised, or if any such convertible securities are exercised for a consideration greater than or for a number of Additional Shares of Common Stock less than those used for purposed of determining the adjustment to the Exercise Price provided in this Section 2.4, the adjusted Exercise Price shall forthwith be readjusted to such Exercise Price as would have been in effect had an adjustment with respect to such Convertible Securities been made on the basis that the only Additional Shares of Common Stock issued or sold were those issued upon the conversion or exchange of such convertible securities, and

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that they were issued or sold for the consideration actually received by the Company upon such exercise, plus the consideration, if any, actually received by the Company for the granting of such Convertible Securities.

Notwithstanding anything to the contrary in this Section 2.4, in no event shall (i) the Exercise Price be increased or (ii) the number of Warrant Shares purchasable hereunder be decreased pursuant to the provisions of this Section 2.4.

2.5 Company to Prevent Dilution. In case at any time or from time to time conditions arise by reason of action taken by the Company which are not adequately covered by this Section 2, and which might materially and adversely affect the exercise rights of the holder hereof, unless the adjustment necessary shall be agreed by the Company and the holder hereof, the Board of Directors of the Company shall appoint a firm of independent certified public accountants of national standing, reasonably acceptable to the holder, who at the Company's expense shall give their opinion upon the adjustment necessary with respect to the Exercise Price and the number of Warrant Shares purchasable upon exercise of this Warrant, if any, so as to preserve, without dilution, the exercise rights of the holder hereof. In the event that the holder disputes such adjustment,

the holder shall be entitled to select an additional firm of independent certified public accountants of national standing and paid for by the holder to calculate such adjustment and the Company and the holder shall use their good faith best efforts to agree on such adjustment based on the reports of the two accounting firms. In the event that the Company and the holder are still unable to reach agreement as to such adjustment, the Company and the holder agree to submit such determination to binding arbitration. Upon determination of such adjustment, the Board of Directors shall forthwith make the adjustments described therein.

2.6 Dissolution, Liquidation or Wind-Up. In case the Company shall, at any time prior to the exercise of this Warrant, dissolve, liquidate or wind up its affairs, the holder hereof shall be entitled, upon the exercise of this Warrant, to receive, in lieu of the Warrant Shares which the holder would have been entitled to receive, the same kind and amount of assets as would have been issued, distributed or paid to such holder upon any such dissolution, liquidation or winding up with respect to such Warrant Shares, had such holder hereof been the holder of record of the Warrant Shares receivable upon the exercise of this Warrant on the record date for the determination of those persons entitled to receive any such liquidating distribution.

2.7 Accountant's Certificate. In each case of an adjustment in the Exercise Price, number of Warrant Shares or other stock, securities or property receivable upon the exercise of this Warrant, the Company shall compute, and upon the holder's request shall at the Company's expense cause independent public accountants of recognized standing selected by the Company and reasonably acceptable to the holder to certify such computation, such adjustment in accordance with the terms of this Warrant and prepare a certificate setting forth such adjustment and showing in detail the facts upon which such adjustment is based, including a statement of (i) the number of shares of Common Stock of each class outstanding or deemed to be outstanding, (ii) the adjusted Exercise Price and (iii) the number of Warrant Shares issuable upon exercise of this Warrant. The Company will forthwith mail a copy of each such certificate to the holder hereof. In the event that the holder disputes such adjustment, the holder shall be entitled to select an additional firm of independent certified public

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accountants of national standing and paid for by the holder to certify such adjustment and the Company and the holder shall use their good faith best efforts to agree on such adjustment based on the reports of the two accounting firms. In the event that the Company and the holder are still unable to reach agreement as to such adjustment, the Company and the holder agree to submit such determination to binding arbitration. Upon determination of such adjustment, the Board of Directors shall forthwith make the adjustments described therein.

3. Representations and Warranties of Warrantholder. Warrantholder hereby represents and warrants that:

3.1 Purchase Entirely for Own Account. This Warrant and the Common Stock issuable upon exercise hereof (collectively, the "Securities") will be acquired for investment for Warrantholder's own account, not as a nominee or agent, and not with a view to the resale or distribution of any part thereof, and Warrantholder has no present intention of selling, granting any participation in, or otherwise distributing the same. Warrantholder does not have any contract, undertaking, agreement or arrangement with any person to sell, transfer or grant participation to any person with respect to any of the Securities. Warrantholder represents that it has full power and authority to enter into this Warrant.

3.2 Investment Experience. Warrantholder acknowledges that it is able to protect its own economic interests, can bear the economic risk of its investment and has such knowledge and experience in financial or business matters that it is capable of evaluating the merits and risks of the investment in the investment in this Warrant. Warrantholder also represents it has not been organized for the purpose of acquiring this Warrant.

3.3 Accredited Investor. Warrantholder is an "accredited investor" within the meaning of Rule 501 of Regulation D promulgated under the Securities Act of 1933 (the "Act").

3.4 Restricted Securities. Warrantholder understands that the Securities are characterized as "restricted securities" under the Act inasmuch as they are being acquired from the Company in a transaction not involving a public offering, and that under the Act such securities may be resold without registration under the Act only in certain limited circumstances. In this connection, Warrantholder represents that it is familiar with Rule 144 promulgated under the Act and understands the resale limitations imposed thereby and by the Act. Warrantholder further acknowledges that it will not be able to avail itself of Rule 144 unless and until the Company effects a public offering of its Common Stock.

3.5 Further Limitations on Disposition. Without in any way limiting the representations set forth above, Warrantholder further agrees not to make any disposition of all or any portion of the Securities unless and until:

(a) there is then in effect a Registration Statement under the Act covering such proposed disposition and such disposition is made in accordance with such Registration Statement; or

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(b) (i) such Warrantholder shall have notified the Company of the proposed disposition and shall have furnished the Company with a detailed statement of the circumstances surrounding the proposed disposition, and (ii) if reasonably requested by the Company, such Warrantholder shall have furnished the Company with an opinion of counsel, reasonably satisfactory to the Company, that such disposition will not require registration of such shares under the Act.



#### 4. Miscellaneous.

4.1 Successors and Assigns. The terms of this Warrant shall be binding upon and shall inure to the benefit of any successors or assigns of the Company and of the holder hereof and of the Common Stock issued upon the exercise hereof.

4.2 No Rights as Shareholder. No Warrantholder, as such, shall be entitled to vote or receive dividends or be deemed to be a shareholder of the Company for any purpose, nor shall anything contained in this Warrant be construed to confer upon the holder of this Warrant, as such, any rights of a shareholder of the Company or any right to vote, give or withhold consent to any corporate action, receive notice of meetings, receive dividends or subscription rights, or otherwise.

4.3 No Fractional Shares. No fractional share shall be issued upon exercise of this Warrant. The Company shall, in lieu of issuing any fractional share, pay Warrantholder a sum in cash equal to the fair market value of such fraction on the date of exercise.

4.4 Lock-Up. Warrantholder hereby agrees that it shall not, without the consent of the managing underwriter, sell, transfer, pledge, hypothecate or otherwise transfer or dispose of any Common Stock or other shares of stock of the Company then owned by Warrantholder for up to 180 days following the effective date of a registration statement (other than a registration statements relating to any employee benefit plan, or with respect to a corporate reorganization or other transaction under Rule 145 promulgated under the Securities Act )of the Company for an initial public offering filed under the Securities Act; provided, however, that all officers and directors of the Company and all holders of Common Stock (or options or other rights to acquire Common Stock) equal to at least 1% of the Company's voting securities (on a fully-diluted basis) enter into similar agreements. In order to enforce the foregoing covenant, the Company shall have the right to place restrictive legends on the certificates representing the shares subject to this Section and to impose stop transfer instructions with respect to the Common Stock and such other shares of stock of Warrantholder.

4.5 Replacement. Upon receipt of evidence reasonably satisfactory to the Company of the loss, theft, destruction or mutilation of this Warrant and, in the case of any such loss, theft or destruction, upon delivery of an indemnity agreement reasonably satisfactory in form and amount to the Company, or in the case of any such mutilation, upon surrender and cancellation of such Warrant, the Company will execute and deliver, in lieu thereof, a new Warrant of like data and tenor.

4.6 Business Days. If the last or appointed day for the taking of any action or the expiration of any right required or granted herein shall be a Saturday or Sunday or shall be a legal

holiday, then such action may be taken or such right may be exercised on the next succeeding day not a legal holiday.

4.7 Governing Law. This Warrant shall be governed by the internal laws of the State of Texas, as applied to contracts between residents of Texas and to be performed entirely within Texas, without regard to the application of conflict of law rules.

4.8 Agreement by Warrantholder. Receipt of this Warrant by the holder hereof shall constitute acceptance of and agreement to the foregoing terms and conditions.

5. Amendment. Any term of this Warrant may be amended and the observance of any term of this Warrant may be waived (either generally or in a particular instance and either retroactively or prospectively) with the written consent of the Company and the holder hereof.

IN WITNESS WHEREOF, Data Return Corporation has caused this Warrant to be signed by its duly authorized officer.

DATA RETURN CORPORATION

By:

-----  
Sunny C. Vanderbeck, President

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## Development, License and Co-Marketing Agreement

This Development, License and Co-Marketing Agreement (this "Agreement") is made and entered into as of the 2/nd/ day of September, 1999 (the "Effective Date") by and between Microsoft Corporation, a Washington corporation, ("Microsoft") and Data Return Corporation, a Texas Corporation ("Data Return").

## Recitals

Whereas, Microsoft develops, markets and licenses computer software including without limitation operating system, application and server products;

Whereas, Data Return develops, markets and licenses computer software including without limitation automated install scripts based on Microsoft operating system products.

## Agreement

## 1. Definitions.

1.1 Commerce Server shall mean Microsoft's server software product known as Site Server Commerce Edition, version 3.0 and updates, upgrades and successor versions thereto.

0.2 Deliverable(s) shall mean the items to be delivered by Data Return to Microsoft pursuant to Section 2.1.

1.3 Derivative Technology shall mean: (i) for copyrightable or copyrighted material, any translation (including translation into other computer languages), portation, modification, correction, addition, extension, upgrade, improvement, compilation, abridgment or other form in which an existing work may be recast, transformed or adapted; (ii) for patentable or patented material, any improvement thereon; and (iii) for material which is protected by trade secret, any new material derived from such existing trade secret material, including new material which may be protected by copyright, patent and/or trade secret.

1.4 Error(s) shall mean defect(s) in a Deliverable which prevent it from performing in accordance with the Specifications and/or a Severity Level 1, 2 or 3 error, as such errors are defined in Exhibit B.

1.5 Exchange Server shall mean Microsoft's server software product known as Exchange Server, version 5.5 and updates, upgrades and successor versions thereto.

1.6 Initial Scripts shall have the meaning set forth on Exhibit A.

1.7 Microsoft Office shall mean Microsoft's suite of productivity application software known as Microsoft Office 98 and updates, upgrades and successor versions thereto.

1.8 Microsoft Windows NT shall mean Microsoft's operating systems software product known as Microsoft Windows NT, version 4.0 and updates, upgrades and successor versions thereto.

1.9 Microsoft Windows 2000 shall mean Microsoft's operating systems software product to be released as Microsoft Windows 2000 and updates, upgrades and successor versions thereto.

1.10 New Scripts shall have the meaning set forth in Section 7.

1.11 Training Materials shall mean speakers' notes and PowerPoint slides to be used in the training seminars described in Section 5.2, covering the usage of the Initial Scripts and the content in the related White Paper with regard to building a reliable and scalable application service within a Microsoft Windows NT-based Web farm environment.

1.12 White Paper(s) shall mean a detailed written description of the use of the Initial Scripts and New Scripts, discussing the platform, infrastructure and configuration for hosting the applicable application services in a reliable, scalable Microsoft Windows NT-based Web farm environment.

2. Development.

2.1 Development. Data Return shall develop the following Deliverables and deliver them to Microsoft no later than the dates indicated below.

2.1.1 Initial Scripts, no later than October 1, 1999;

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2.1.2 White Paper, covering all of the Initial Scripts, no later than October 30, 1999; and

2.1.3 Training Materials, no later than October 30, 1999.

2.2 Acceptance.

2.2.1 For software code Deliverables, Microsoft shall evaluate the final version of each Deliverable and shall submit a written acceptance or rejection to Data Return within twenty (20) business days after Microsoft's receipt of the final version of the Deliverable. Acceptance shall be in writing, and Microsoft shall not unreasonably withhold its acceptance. If Microsoft identifies Errors in each Deliverable prior to acceptance, then Data Return shall correct such Errors within twenty (20) business days following receipt of notice thereof during acceptance

testing for the Final Version of each Deliverable.

2.2.2 For documentation, White Paper or Training Materials Deliverables, Microsoft shall evaluate each version of such Deliverable. In the event that it requires corrections, Microsoft shall specify the corrections needed and Data Return shall deliver an amended version of such documentation within five (5) working days.

2.2.3 If Data Return fails to deliver any Deliverable within the dates specified in Section 2.1 above and if any Errors discovered before acceptance cannot be eliminated in the correction period specified in Section 2.2.1 above then Microsoft may, at its option: (i) retain the Deliverable (including any applicable documentation) with rights as set forth in Section 4; (ii) extend the correction period; or (iii) suspend its performance and/or terminate this Agreement pursuant to Section 16.2.

2.3 Upgrades. During the first two years after the Effective Date, Data Return shall provide Microsoft with any Derivative Technology of the Initial Scripts (which Derivative Technology relates to Commerce Server, Exchange Server and Microsoft Office (for Microsoft Windows NT and/or Microsoft Windows 2000)) promptly after development thereof and such Derivative Technology shall be considered part of the Initial Scripts for all purposes herein, including without limitation the license set forth in Section 4 below.

2.4 Correction of Errors. For a period of thirty (30) days following Microsoft's final acceptance of the Deliverables and at no further charge to Microsoft, Data Return will fix all Errors found in the Deliverables in accordance with the severity schedule set forth in Exhibit B. After such 30 day period, Data Return will fix all errors or bugs found in the Deliverables at an hourly rate of \$200.

2.5 Infringement. If Microsoft reasonably determines, either during the evaluation period set forth in Section 2.2 above or any time thereafter, that the Deliverables infringe any intellectual property rights of Microsoft, Microsoft shall promptly contact Data Return and provide an explanation of the claimed infringement. If such determination occurs within forty-five (45) days after delivery of the allegedly-infringing Deliverables, Data Return shall promptly replace the infringing portion of the Deliverables with a version that is non-infringing, provided that the replacement or modified version provides the same material functionality as the infringing version. If such determination by Microsoft occurs any time after forty-five (45) days have elapsed since the delivery of the allegedly-infringing Deliverables, the parties shall then discuss the options of removing the infringing portion of the Deliverables or agreeing upon a licensing arrangement. In the event that the parties cannot agree on a licensing arrangement, Data Return shall, with reasonable assistance from Microsoft, promptly replace the infringing portion of the Deliverables with a version that is non-infringing, provided that the replacement or modified version provides the same material functionality as the infringing version.

3. Microsoft Consulting Services and Assistance.

3.1 Consulting Services. To assist Data Return in developing the three (3) Initial Scripts, Microsoft shall provide Data Return technical consulting services up to a total of one hundred (100) consulting hours, which services will be performed by, and be subject to a separate agreement with Microsoft Consulting Services.

2.2 Technical Writer. Microsoft shall provide a technical writer to review and edit the White Paper for the three (3) Initial Scripts. Such technical writer shall be provided upon the delivery of the drafts of the White Paper as required in Section 2.1 above.

3.3 Schedule. The time deadlines with respect to any Deliverables to be provided under this Agreement are subject to Microsoft's timely provision of the resources as described in Sections 3.1 and 3.2.

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4. Rights.

4.1 Non-Exclusive Source License to Microsoft. Data Return hereby grants to Microsoft a nonexclusive, perpetual, irrevocable, royalty-free, fully paid up, worldwide right and license to:

4.1.1 Use, copy, edit, format, modify, translate and create Derivative Technology of the source and object code versions of the Initial Scripts;

4.1.2 Reproduce, license, rent, lease or otherwise distribute, and have reproduced, licensed, rented, leased or otherwise distributed, to and by third parties, source and/or object code versions of the Initial Scripts, and any Derivative Technology thereof;

4.1.3 Grant the rights set forth in Section 4.1.1 in the Initial Scripts to third parties; and

4.1.4 Grant to third parties the right to reproduce and distribute to further third parties, [source and/or] object code versions of the Initial Scripts, and any Derivative Technology thereof created by the third parties who are directly Microsoft's licensees pursuant to Section 4.1.3. Any license grants to a third party pursuant to Section 4.1.3 must include an agreement by the third party to license back to Microsoft and Data Return any Derivative Technology that is created pursuant to such license grant. Microsoft and Data Return shall agree on a standard license back provision to be used with such third parties. The foregoing license grants include a license under any current and future patents owned or licensable by Data Return to the extent necessary: (i) to exercise any license right granted herein; and (ii) to combine the Initial Scripts or Derivative Technology thereof with any

hardware and software.

4.2 Non-Exclusive Source License to Data Return. Microsoft hereby grants to Data Return a nonexclusive, perpetual, irrevocable, royalty-free, fully paid up, worldwide right and license to:

4.2.1 Use, copy, edit, format, modify, translate and create Derivative Technology of the source and object code versions of any improvement to the Initial Scripts created by Microsoft pursuant to Section 4.1.1 ("Microsoft Improvements");

4.2.2 Reproduce, license, rent, lease or otherwise distribute, and have reproduced, licensed, rented, leased or otherwise distributed, to and by third parties, source and/or object code versions of the Microsoft Improvements, and any Derivative Technology thereof;

4.2.3 Grant the rights set forth in Section 4.2.1 in the Microsoft Improvements to third parties; and

4.2.4 Grant to third parties the right to reproduce and distribute to further third parties, object code versions of the Microsoft Improvements, and any Derivative Technology thereof created by the third parties who are directly Data Return's licensees pursuant to Section 4.2.3.

4.3 Ownership. Except as expressly licensed to Microsoft in this Agreement, Data Return retains all right, title and interest in and to the Initial Scripts; provided, however, that, subject to the license grant in Section 4.1 and Data Return's ownership of the underlying Initial Scripts, Microsoft shall own all right, title and interest in and to any Derivative Technology of the Initial Scripts created by or for Microsoft.

5. Co-Marketing.

5.1 White Paper(s). The White Paper(s) shall be co-branded in a manner mutually agreeable to the parties. Each party may distribute such co-branded White Paper(s) to such recipients and in such manner as it desires without the consent of the other party. Each party may include, without co-branding, portions of the White Paper(s) into other materials, including without limitation marketing collateral, without the consent of the other party. Data Return may also distribute the White Paper(s) as a whole without co-branding without Microsoft's consent; however, Microsoft must obtain Data Return's prior written consent to distribute any White Paper, without co-branding, which consent may not be unreasonably withheld or delayed.

5.2 Training Seminars. Data Return and Microsoft shall provide four (4) one day (8 hour) training seminars with regard to the Initial Scripts and related White Paper, two of which shall occur at least thirty (30) days after acceptance by Microsoft of both the Initial Scripts and White Paper therefor pursuant to Section 2.2 above (the first two seminars currently anticipated to occur in mid-October of 1999) and two of which shall occur four months later (the second two

seminars currently anticipated to occur in February of 2000). The training seminars shall occur at the Microsoft Partner Center in Redmond, Washington. Data Return shall act as the primary leader of the

first two training seminars, with Microsoft assisting; Microsoft shall act as the primary leader of the second two training seminars, with Data Return assisting. The training seminars shall be provided to Microsoft's value-added provider channel, including without limitation, value-added resellers, solutions partners and system integrators. Microsoft shall determine the list of invitees.

6. Programs and Designations. The Contact Representative for Microsoft set forth in Section 9 shall use reasonable efforts assist Data Return in obtaining access to the relevant Microsoft product units to facilitate inclusion in all early adopter programs, beta programs, councils, and designations that for hosting providers using Microsoft Windows NT or Microsoft Windows 2000, and all early adopter programs, beta programs, councils, and designations that are specific to Exchange Server, Commerce Server and Microsoft Office. Data Return understands that each such program, council or designation has its own participation requirements and nothing in this provision guarantees that Data Return will be included in such programs, councils or designations.

7. Options With Respect To New Installation Scripts. During the Term of this Agreement, Data Return will provide written notice to Microsoft if and when Data Return plans to develop additional automated installation scripts which are built on Microsoft Windows 2000 and which package, utilize or include Commerce Server, Exchange Server and/or Microsoft Office. Such notice shall be provided at the time that the project scope for such installation scripts is complete. The parties shall discuss in good faith, and use their best efforts to decide within thirty (30) days after the notice is given to Microsoft, whether to include such script(s) within this Agreement and have Microsoft provide the same assistance and obtain the same rights with respect to such scripts as Microsoft has with respect to the Initial Scripts. If the parties agree to include such script(s) within this Agreement, the rights and obligations between the parties with respect to the such scripts (the "New Script(s)") shall be identical to the rights and obligations with regard to the Initial Scripts set forth in Sections 2, 3, 4 and 5 above, with the difference that the Microsoft Consulting Service support shall be limited to thirty (30) hours per New Script and that the parties shall mutually agree on the delivery schedules for the New Scripts and related White Paper(s). Should the parties decide not to include such script(s) within this Agreement, Data Return may develop the automated install scripts referenced in such notice without any further obligations to Microsoft.

8. Revenue Sharing. In consideration of the various obligations of Microsoft hereunder, Data Return agrees to pay Microsoft a percentage of the total gross Revenues as set forth in Exhibit C that Data Return receives from third parties in consideration of its licensing and other exploitation of any New Scripts for the five (5) years following acceptance of the relevant New Script by Microsoft provided such script enables a solution for a customer that



extends beyond the basic functionality inherent in Commerce Server, Exchange Server and/or Microsoft Office. For example, installation scripts designed to assist in the deployment of Exchange Server as a secure document repository for legal documents would pertain to Section 7, but installation scripts designed to facilitate the deployment of Exchange Server as an outsourced messaging platform would not. "Revenues" shall mean all kinds of consideration, including but not limited to cash, barter and any other in-kind consideration. Data Return shall submit such payments within forty-five (45) days after the end of each three month period, the first three-month period commencing with the month in which Microsoft accepts the New Script in accordance with Section 2.2. Such payment shall be accompanied by a report in the form of an affidavit, reasonably acceptable to Microsoft, detailing the sources and amount of Revenues for the preceding three-month period.

9. Contact Representatives. Each party shall designate a contact to be responsible for the administration of this Agreement. Either party may change its contact at any time upon notice to the other party. The initial contacts are: for Microsoft, David Ostroff and for Data Return, Sunny Vanderbeck.

10. Press Releases. The parties will cooperate with each other on press releases and similar communications regarding the non-confidential subject matter of this Agreement. The content, timing and necessity of all such communications will be agreed upon in writing by both parties. At least one press release shall be issued by Microsoft pertaining to this agreement, within thirty (30) days of the execution of this agreement and with content to be determined by the Contact Representatives named in Section 8.

11. Audits. During the term of this Agreement and for two (2) years thereafter, Data Return agrees to keep all usual and proper records and books of account and all usual and proper entries relating to the revenues it receives from third parties in consideration of its licensing and other exploitation of the Initial Scripts and New Scripts. Microsoft may cause an audit and/or inspection to be made of the applicable Data Return records in order to verify statements issued by Data Return. Any such audit shall be conducted by an independent certified public accountant selected by Microsoft (other than on a contingent fee basis). Such independent certified public

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accountant shall provide a summary of its findings regarding its verification of the statements issued by Data Return, but shall not provide Microsoft with any other information produced from the audit of such Data Return records. Any audit shall be conducted during regular business hours at Data Return's facilities with at least three (3) business days' notice. Data Return agrees to provide Microsoft's designated audit team access to the relevant Data Return records. Data Return shall pay Microsoft the full amount of any underpayment revealed by the audit from the date such payments were due under the terms of this Agreement. Notwithstanding the foregoing, if such audit reveals an underpayment by Data Return of more than ten percent (10%) for the period covered by the audit report, Data Return shall pay the amount underpaid with interest at the

rate of the Prime Rate as announced by Seattle First National Bank of Seattle, Washington (the "Prime Rate"), (or, if less, at a rate equal to the highest rate permitted under applicable law from the date such payment was due pursuant to this Section.

12. No Obligation/Independent Development. Notwithstanding any other provision of this Agreement, Microsoft shall have no obligation to market, sell or otherwise distribute the Initial Scripts or New Scripts, either alone or in any Microsoft product. Except as provided in Section 12, nothing in this Agreement will be construed as restricting Microsoft's ability to acquire, license, develop, manufacture or distribute for itself, or have others acquire, license, develop, manufacture or distribute for Microsoft, similar technology performing the same or similar functions as the technology contemplated by this Agreement, or to market and distribute such similar technology in addition to, or in lieu of, the technology contemplated by this Agreement.

13. Confidentiality. The parties acknowledge and agree that the terms and conditions of the Microsoft Corporation Non-Disclosure Agreement (Reciprocal) dated as of the same date as the Effective Date ("NDA") entered into by and between the Parties are incorporated into this Agreement and that all of the terms of this Agreement and all discussions and negotiations related thereto and all nonpublic information exchanged pursuant hereto are considered Confidential Information as defined in the NDA.

14. Warranties.

14.1 Data Return. Data Return warrants and represents that:

14.1.1 It has the full power to enter into this Agreement and make the assignments and license rights set forth herein;

14.1.2 It has not previously granted, and will not grant, any rights in the Deliverables to any third party that are inconsistent with the rights granted to Microsoft herein;

14.1.3 The Deliverables are original to Data Return and do not infringe any copyright, trade secret, or other proprietary right (other than patent) held by any third party, and to the best of Data Return's knowledge, do not infringe any patent held by any third party;

14.1.4 The Deliverables will be created by employees of Data Return within the scope of their employment and under obligation to assign inventions to Data Return, or by independent contractors under written obligations to assign all rights in the Deliverables to Data Return; and

14.1.5 The Services shall be performed in a good and workmanlike manner consistent with industry standards and consistent with the quality of Data Return's currently existing products.

14.2 Microsoft. Microsoft warrants and represents that it has taken the necessary steps to enter into this Agreement.

15. Indemnity.

15.1 Indemnity.

15.1.1 Data Return shall, at its expense and Microsoft's request, defend any claim or action brought against Microsoft, and Microsoft's subsidiaries, affiliates, directors, officers, employees, agents and independent contractors, which, if true, would constitute a breach of a warranty by Data Return in Section 14, and Data Return will indemnify and hold Microsoft harmless from and against any costs, damages and fees reasonably incurred by Microsoft, including but not limited to fees of attorneys and other professionals, that are attributable to such claim. Microsoft shall: (i) provide Data Return reasonably prompt notice in writing of any such claim or action and permit Data Return, through counsel mutually acceptable to Microsoft and Data Return, to answer and defend such claim or action; and (ii) provide Data

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Return information, assistance and authority, at Data Return's expense, to help Data Return to defend such claim or action. Data Return will not be responsible for any settlement made by Microsoft without Data Return's written permission, which permission will not be unreasonably withheld.

15.1.2 Microsoft shall have the right to employ separate counsel and participate in the defense of any claim or action. Data Return shall reimburse Microsoft upon demand for any payments made or loss suffered by it at any time after the date hereof, based upon the judgment of any court of competent jurisdiction or pursuant to a bona fide compromise or settlement of claims, demands, or actions, in respect to any damages related to any claim or action under this Section 15.

15.1.3 Data Return may not settle any claim or action under this Section 15 on Microsoft's behalf without first obtaining Microsoft's written permission, which permission will not be unreasonably withheld. In the event Microsoft and Data Return agree to settle a claim or action, Data Return agrees not to publicize the settlement without first obtaining Microsoft's written permission, which permission will not be unreasonably withheld.

15.2 Duty to Correct. Notwithstanding Section 15.1, should the Deliverables or any portion thereof be held to constitute an infringement and use as contemplated by this Agreement be enjoined or be threatened to be enjoined, Data Return shall notify Microsoft and immediately, at Data Return's expense: (i) procure for Microsoft the right to continue use the Product, Deliverables or portion thereof, as applicable, as licensed in this Agreement; or (ii) replace or modify the Product, Deliverables or portion thereof with a version that is non-infringing, provided that the replacement or modified version provides the

same material functionality as the allegedly infringing version. If (i) or (ii) are not available to Data Return, in addition to any damages or expenses reimbursed under Section 15.1, Data Return shall refund to Microsoft all cash sums paid to Data Return by Microsoft under this Agreement.

## 16. Termination.

16.1 Term. The term of this Agreement shall commence as of the Effective Date and shall continue until terminated as provided in this Section 16.

16.2 Termination by Microsoft. Microsoft shall have the right to cancel any Deliverable with or without cause by providing Data Return written notice of such cancellation, in which event all rights and obligations with regard to such Deliverable under Sections 3, 4, 5 and 7 shall terminate.

16.3 Partial Termination. If Microsoft determines that it will no longer market Data Return as an Application Service Provider, then the obligations set forth in Sections 2.3, 7 and 8 shall terminate.

16.4 Termination By Either Party For Cause. Either party may suspend performance and/or terminate this Agreement immediately upon written notice at any time if:

16.4.1 The other party is in material breach of any material warranty, term, condition or covenant of this Agreement, other than those contained in Section 13, and fails to cure that breach within thirty (30) days after written notice thereof; or

16.4.2 The other party is in material breach of Section 13.

## 16.5 Effect of Termination.

16.5.1 In the event of termination of this Agreement for any reason, Sections 4 (with respect to any Initial Scripts or New Scripts delivered to Microsoft hereunder, and any Derivative Technology thereof), 5.1, and 11 through 18 shall survive termination.

16.5.2 Neither party shall be liable to the other for damages of any sort resulting solely from terminating this Agreement in accordance with its terms. Any licenses or sublicenses already granted by Microsoft under this Agreement shall not be affected by any termination of this Agreement and shall remain in full force and effect.

## 17. Limitation on Liabilities.

17.1 NEITHER PARTY SHALL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, CONSEQUENTIAL, PUNITIVE OR SPECIAL DAMAGES, EVEN IF SUCH PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES.

17.2 OTHER THAN WITH RESPECT TO PUNITIVE DAMAGES, THIS SECTION 17 HAS NO APPLICATION TO SECTIONS 13 AND 15. IN NO EVENT HOWEVER WILL THE AGGREGATE AMOUNT OF LIABILITY OF EITHER PARTY EXCEED TWO HUNDRED FIFTY THOUSAND DOLLARS (\$250,000.00.)

18. General.

18.1 Notices. All notices, authorizations and requests in connection with this Agreement shall be deemed given as of the day they are deposited prepaid with DHL, Airborne, Federal Express or similar overnight air courier, and addressed as follows:

To Data Return: 222 West Las Colinas Blvd.

Irving, Texas 75039

Attention: Sunny Vanderbeck, CEO

FAX: 817 274 1141

With a copy to: Thompson & Knight

801 Cherry St. Suite 1600

Fort Worth, Texas 76102

Attention: Stephen B. Norris

FAX: 817-347-1799

To Microsoft: Microsoft Corporation

One Microsoft Way

Redmond, WA 98052-6399

Attention: Salman Ullah

FAX: 425 707 2929

With a copy to: MICROSOFT CORPORATION

One Microsoft Way

Attention: Legal Department

FAX: 425-936-7409

or to such other addresses and/or telex and telefax number as the party to receive the notice or request so designates by written notice to the other. All notices, authorizations and requests shall be simultaneously confirmed by telex or telefax, provided that failure to receive such a confirmation shall not effect in any way the validity of the notice, authorization or request sent by international air courier.

18.2 Independent Contractors. Data Return is an independent contractor for Microsoft, and nothing in this Agreement shall be construed as creating an employer-employee relationship, a partnership, or a joint venture between the parties.

18.3 Taxes.

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18.3.1 The amounts to be paid by Data Return to Microsoft herein do not include any foreign, U.S. federal, state, local, municipal or other governmental taxes, duties, levies, fees, excises or tariffs, arising as a result of or in connection with the transactions contemplated under this Agreement including, without limitation, any state or local sales or use taxes or any value added tax or business transfer tax now or hereafter imposed on the provision of services to Data Return by Microsoft under this Agreement, regardless of whether the same are separately stated by Microsoft. All such taxes (and any penalties, interest, or other additions to any such taxes), with the exception of taxes imposed on Microsoft's net income or with respect to Microsoft's property ownership, shall be the financial responsibility of Data Return. Data Return agrees to indemnify, defend and hold Microsoft harmless from any such taxes or claims, causes of action, costs (including, without limitation, reasonable attorneys' fees) and any other liabilities of any nature whatsoever related to such taxes.

18.3.2 Data Return will pay all applicable value added, sales and use taxes and other taxes levied on it by a duly constituted and authorized taxing authority on the software, services or other product provided under this Agreement or any transaction related thereto in each country in which the services and/or property are being provided or in which the transactions contemplated hereunder are otherwise subject to tax, regardless of the method of delivery. Any taxes that are owed by Data Return, (i) as a result of entering into this Agreement and the payment of the fees hereunder, (ii) are required or permitted to be collected

from Data Return by Microsoft under applicable law, and (iii) are based upon the amounts payable under this Agreement (such taxes described in (i), (ii), and (iii) above the "Collected Taxes"), shall be remitted by Data Return to Microsoft, whereupon, upon request, Microsoft shall provide to Data Return tax receipts or other evidence indicating that such Collected Taxes have been collected by Microsoft and remitted to the appropriate taxing authority. Data Return may provide to Microsoft an exemption certificate acceptable to Microsoft and to the relevant taxing authority (including without limitation a resale certificate) in which case, after the date upon which such certificate is received in proper form, Microsoft shall not collect the taxes covered by such certificate.

18.3.3 This tax section shall govern the treatment of all taxes arising as a result of or in connection with this Agreement notwithstanding any other section of this Agreement.

18.4 Governing Law. In the event an action is commenced to enforce a party's rights under this Agreement, the prevailing party in such action shall be entitled to recover its costs and reasonable attorneys' fees. Data Return and Microsoft each agree that this Agreement shall be governed by and interpreted in accordance with the laws of the State of New York, U.S.A., and Data Return and Microsoft hereby each consent to the jurisdiction of the state and federal courts sitting in the state in which the other party's corporate headquarters is located. Both parties hereby agree that any lawsuit arising hereunder brought by Data Return shall be brought exclusively in either the state or federal courts sitting in the state in which the other party's corporate headquarters is located. Both parties waive all defenses of lack of personal jurisdiction and forum inconueniens. Process may be served on either party in the manner authorized by applicable law or court rule.

18.5 Dispute Resolution. Notwithstanding the foregoing, in the event of a disagreement between Microsoft and Data Return, the Contact Representatives will first attempt to resolve the disagreement through negotiation. In the event the Representatives cannot resolve the disagreement within sixty (60) days, the President or CEO of Data Return and a representative of the upper management of Microsoft will attempt to resolve the disagreement through negotiation. In the event that the President or CEO of Data Return and a Representative of upper management of Microsoft are unable to resolve the dispute through negotiation within thirty (30) days, the Parties will try in good faith to settle the dispute by non-binding mediation under the Commercial Mediation Rules of the American Arbitration Association, prior to the commencement of litigation.

18.6 Assignment. The authorization by Microsoft for Data Return to acquire and distribute Initial Scripts in accordance with this Agreement is personal to Data Return and this Agreement shall not be assignable by Data Return. Any prohibited assignment is null and void. Microsoft may transfer its rights and obligations hereunder to any third party without prior written approval of Data Return.

18.7 Construction. If for any reason a court of competent jurisdiction finds

any provision of this Agreement, or portion thereof, to be unenforceable, that provision of the Agreement will be enforced to the maximum extent permissible so as to effect the intent of the parties, and the remainder of this Agreement will continue in full force and effect. Failure by either party to enforce any provision of this Agreement will not be deemed a waiver of future

enforcement of that or any other provision. This Agreement has been negotiated by the parties and their respective counsel and will be interpreted fairly in accordance with its terms and without any strict construction in favor of or against either party.

18.8 Entire Agreement. This Agreement supersedes and terminates any and all prior agreements or contracts, written or oral, entered into between the parties relating to the subject matter hereof, and any representations, promises, or conditions in connection therewith not in writing shall not be binding upon either party. This Agreement shall be effective from the date first set forth above, provided it has been properly executed on behalf of Microsoft and Data Return by their duly authorized officers and accepted by Microsoft at its Redmond, Washington offices.

IN WITNESS WHEREOF, the parties have entered into this Agreement as of the Effective Date written above.

MICROSOFT CORPORATION

DATA RETURN CORPORATION

/s/ Salman Ullah

/s/ Sunny C. Vanderbeck

-----  
By (Sign)

-----  
By (Sign)

Salman Ullah

Sunny C. Vanderbeck

-----  
Name (Print)

-----  
Name (Print)

Director, Corporate Development

Chairman and CEO

-----  
Title

-----  
Title

September 2, 1999

September 2, 1999

-----  
Date

-----  
Date



## Exhibit A

## Initial Scripts

Three software install scripts built on Microsoft Windows NT that provide processes to package hosted services, one script for each of three areas: (a) Commerce direct selling; (b) Commerce corporate purchasing; and (c) Line of business customer relations management services. Each of the Initial Scripts shall have the following features:

1. Provides automated installation where possible; installation that cannot be automated will be documented.
2. Details the hardware required, including without limitation the necessary configuration of the PC; and
3. Details the client/server load that service can handle.

The scripts shall be delivered in source and object code form, together with documentation detailing the methods for using the scripts.

## EXHIBIT B

## Maintenance Problem Severity and Resolutions

Severity -----	Criteria -----	Time Limit -----
1	Critical: Problem which prevents or seriously impairs the performance of substantially all major functions. (What about test blocking bugs)	24 hours
2	Severe Impact: Problem which prevents or seriously impairs the performance of a major function.	3 days
3	Degraded Operation: Problem which disables or impairs the performance of a minor function.	2 weeks

## EXHIBIT C

## Revenue Sharing

The following table outlines the percentage of gross revenues that will be paid

to Microsoft pursuant to Section 8.

Year	Percentage of Gross Revenues*
1	
2	
3	
4	
5	

\* CONFIDENTIAL PORTION OMITTED AND FILED SEPARATELY WITH THE SEC

## STOCK PURCHASE AGREEMENT

STOCK PURCHASE AGREEMENT (this "Agreement") dated as of September 2, 1999 between Microsoft Corporation, a Washington corporation ("Buyer"), and Data Return Corporation, a Texas corporation (the "Company").

WHEREAS, the Company desires to issue and sell to Buyer, and Buyer desires to purchase from the Company, shares of Common Stock of the Company;

NOW, THEREFORE, in consideration of the premises and the mutual covenants and agreements herein contained, and intending to be legally bound hereby, the Company and Buyer hereby agree as follows:

## I. TERMS OF THE TRANSACTION

1.1 Agreement to Sell and to Purchase Shares. At the Closing, and on the terms and subject to the conditions set forth in this Agreement, the Company shall issue, sell and deliver to Buyer, and Buyer shall purchase and accept from the Company, the number of shares (the "Shares") of Common Stock, par value \$0.001 per share ("Common Stock"), of the Company equal to the number obtained by dividing (A) 5,000,000 by (B) a number equal to the lesser of (i) the midpoint of the lowest filing range contained in any amendment to the Company's Registration Statement on Form S-1 (No. 333-84011) (the "Registration Statement") and (ii) the price to public specified on the cover page of the final prospectus that will be a part thereof, and rounding the number obtained thereby to the nearest whole number. If the offering to be made pursuant to the Registration Statement has not been consummated within 100 days after this Agreement, the number of shares to be purchased shall be determined in accordance with clause (i) of the immediately preceding sentence.

1.2 Purchase Price and Payment. In consideration of the sale of the Shares to Buyer, Buyer shall pay to the Company at the Closing the aggregate purchase price of \$5,000,000.00 (the "Purchase Price"). The Purchase Price shall be paid in cash by wire transfer of immediately available federal funds to an account designated in writing by the Company.

1.3 Closing. The closing of the transactions contemplated hereby (the "Closing") shall take place at the offices of the Company in Irving, Texas, at 10:00 a.m., local time, on the earlier to occur of (a) the day after the Registration Statement is declared effective and the offering made pursuant thereto is priced, and (b) 100 days after the date of this Agreement, or at such other time or place or on such other date as the parties hereto shall agree. The date on which the Closing takes place is herein referred to as the "Closing Date". At the Closing (i) the Company shall deliver to Buyer the executed stock certificate representing the Shares duly issued in the name of Buyer, and (ii) Buyer shall deliver the Purchase Price to Company. In addition, at the Closing,

(i) the Company and Buyer shall execute and deliver an Investor's Rights Agreement in the form and substance attached hereto as Exhibit A (the "Investor's Rights Agreement" and, together with this Agreement and all other writings and agreements delivered pursuant hereto or in connection herewith, the "Agreements"); and (ii) Thompson & Knight L.L.P., counsel for the

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Company, shall deliver to Buyer an opinion in the form and substance attached as Exhibit B hereto.

## II. REPRESENTATIONS AND WARRANTIES

2.1 Company Representations and Warranties. Except as set forth in the Disclosure Letter delivered to Buyer simultaneously with the execution and delivery of this Agreement (the "Disclosure Letter"), the Company hereby represents and warrants to Buyer that:

(a) Corporate Power and Agreement. The Company has full legal right, power and authority to execute, deliver and perform the Agreements and to consummate the transactions contemplated thereby, including the issuance and sale of the Shares. All corporate action on the part of the Company, its officers, directors and its shareholders necessary for the authorization, execution, delivery and performance of the Agreements by the Company, the authorization, sale, issuance and delivery of the Shares and the performance of all of the Company's obligations under the Agreements has been taken. Each of the Agreements has been duly executed and delivered by the Company and constitutes, and each other agreement, instrument, or document executed or to be executed by the Company in connection with the transactions contemplated hereby has been, or when executed will be, duly executed and delivered by the Company and constitutes, or when executed and delivered will constitute, a valid and legally binding obligation of the Company, enforceable against the Company in accordance with its respective terms, subject to the laws of general application relating to bankruptcy, insolvency and relief of debtors and applicable rules of law governing specific performance, injunctive relief or other equitable remedies, and except that the enforceability of the indemnification provisions in Section 1.6 of the Investor's Rights Agreement may be limited by applicable securities laws.

(b) Noncontravention. The execution, delivery and performance by the Company of the Agreements and the consummation by the Company of the transactions contemplated thereby do not and will not (with or without the giving of notice or the passage of time or both) (i) conflict with or result in a violation of any provision of the Company's Amended Articles of Incorporation ("Articles of Incorporation") or Bylaws or (ii) except to the extent that it would not have a material adverse effect on the business, properties, assets, operations, prospects, profits or condition (financial or otherwise) of the Company (a "Material Adverse Effect"), (A) conflict with or result in a violation of any provision of, or constitute a default under, or give rise to any right of termination, cancellation or acceleration under, any contract, agreement,

instrument or obligation to which the Company is a party or by which the Company or any of the Company's properties may be bound or (B) result in the creation or imposition of any lien, security interest, claim, restriction, claim or other encumbrance (any "Encumbrance") upon any property or asset of the Company or the suspension, revocation, impairment, forfeiture or nonrenewal of any permit, license, authorization or approval applicable to the Company, its business or operations or any of its assets or properties.

(c) Shares. The Shares to be issued by the Company at the Closing have been duly authorized for such issuance and, when issued and delivered by the Company in accordance with the provisions of this Agreement, will be validly issued, fully paid and nonassessable, free of any

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Encumbrances. The issuance of the Shares under this Agreement is not subject to any preemptive rights, rights of first refusal or similar rights.

(d) Organization, Good Standing and Qualification. The Company is a corporation duly organized, validly existing and in good standing under the laws of the State of Texas. The Company has all requisite corporate power and authority to own and operate its properties and assets, and to carry on its business as presently conducted and as presently proposed to be conducted. The Company is duly qualified and is authorized to do business and is in good standing as a foreign corporation in all jurisdictions in which the nature of its activities and of its properties (both owned and leased) makes such qualification necessary, except for those jurisdictions in which failure to do so would not have a Material Adverse Effect on the Company.

(e) Subsidiaries. The Company owns no equity securities of any other corporation, limited partnership, limited liability company or other entity. The Company is not a participant in any joint venture, partnership or similar arrangement.

(f) Capitalization; Voting Rights. The authorized capital stock of the Company, immediately prior to the Closing, will consist of 100,000,000 shares of Common Stock, 103,182 shares of which are issued and outstanding, and 24,284 shares which are reserved for future issuance pursuant to outstanding options granted under the Company's option plan and agreements, and 20,000,000 shares of preferred stock, par value \$.001 per share, none of which are issued and outstanding. All issued and outstanding shares of the Company's Common Stock (i) have been duly authorized and validly issued, (ii) are fully paid and nonassessable, and (iii) were issued in compliance with all applicable state and federal laws concerning the issuance of securities. Except as set forth in the Investor's Rights Agreement, there are no outstanding options, warrants, rights (including without limitation conversion or preemptive rights and rights of first refusal), proxy or shareholder agreements, or agreements, arrangements or understandings of any kind, whether written or oral, for the issuance by the Company or purchase or acquisition from the Company of any of its securities (including derivative securities). Attached to the Disclosure Letter is a true

and correct table setting forth, as of August 30, 1999, the Company's capitalization, and each person who owns or has a future right to acquire (whether or not contingent) any shares of the Company's capital stock or derivative securities convertible, exchangeable or exercisable for such capital stock (together with the amounts of such securities owned by each such person).

(g) Financial Statements. The Company has made available to Buyer (i) its unaudited balance sheet as of June 30, 1999 and its statements of operations for the three months ended June 30, 1999, and (ii) its audited balance sheets as of March 31, 1998 and 1999, and its statements of operations, changes in shareholders' equity and cash flows for the period from September 22, 1997 to March 31, 1998 and the year ended March 31, 1999 (all such financial statements listed in clauses (i) and (ii), collectively referred to as the "Financial Statements", and March 31, 1999 referred to as the "Statement Date"). The Financial Statements, together with the notes thereto, are complete and correct in all material respects, have been prepared in accordance with generally

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accepted accounting principles applied on a consistent basis throughout the periods indicated, and present fairly the financial condition and results of operations and cash flows of the Company as of and for the dates and periods indicated. True and correct copies of the Financial Statements, the Company's five-year strategic plan (the "Business Plan") and the Company's financial projections dated July 24, 1999 (the "July 24 Projections") are attached to the Disclosure Letter; provided, that the July 24 Projections supersede the financial projections contained in Appendix C to the Business Plan. The Company shall use commercially reasonable efforts to respond to any recommendations made by its independent public accountants in a letter to management to the extent that it deems the recommended actions are appropriate.

(h) Liabilities. To the best of the Company's knowledge, it has no material liabilities (actual or contingent) that are not disclosed in the Financial Statements.

(i) Agreements; Action.

(A) There are no agreements, understandings, instruments, contracts, proposed transactions, judgments, orders, writs or decrees to which the Company is a party or by which it or any of its property or assets are bound which may involve (i) obligations (contingent or otherwise) of, or payments to, the Company in excess of \$100,000, other than customer contracts and other contracts, in each case entered into in the ordinary course of business, or (ii) the license of any patent, copyright, trade secret or other proprietary right to or from the Company, other than licenses entered into in the ordinary course of business or (iii) provisions restricting or affecting the development, manufacture or distribution of the Company's products or services, or (iv) indemnification or contribution by the Company with respect to infringements of proprietary rights, other than license agreements entered into in the ordinary course of business.

(B) The Company has not (i) declared or paid any dividends, or authorized or made any distribution upon or with respect to any class or series of its capital stock, (ii) incurred any indebtedness for money borrowed or any other liabilities (other than with respect to indebtedness and other obligations incurred in the ordinary course of business and as disclosed in the Financial Statements) individually in excess of \$100,000 or in excess of \$500,000 in the aggregate, (iii) made any loans or advances to any person, other than ordinary advances for travel expenses, or (iv) sold, exchanged or otherwise disposed of any of its assets or rights, other than the sale of its inventory in the ordinary course of business.

(C) For the purposes of subsections (A) and (B) above, all obligations, indebtedness, liabilities, agreements, understandings, instruments, contracts, proposed transactions, judgments, orders, writs or decrees involving the same person or entity (including persons or entities the Company has reason to believe are affiliated therewith) shall be aggregated for the purpose of meeting the individual minimum dollar amounts of such subsections.

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(D) True and correct copies of the Stock Purchase Agreement and Investor's Rights Agreement between Company and CPQ Holdings, Inc. (collectively, the "CPQ Agreements") have been provided to Buyer, and (i) the CPQ Agreements are the only agreements between Company and CPQ Holdings, Inc. relating to the Company's securities (including derivative securities), and (ii) the terms and conditions of this Agreement and the Investor's Rights Agreement between Company and Buyer are identical in all material aspects with the CPQ Agreements except as otherwise set forth in the Disclosure Letter.

(E) The Company is not in active negotiations with any other person or entity regarding a private sale of its securities (including derivative securities).

(j) Obligations to Related Parties. There are no monetary or other obligations of the Company to affiliates, officers, directors, shareholders, employees or agents of the Company other than (i) for payment of salary for services rendered, (ii) reimbursement for reasonable expenses incurred on behalf of the Company and (iii) for other standard employee benefits made generally available to all employees (including stock option agreements outstanding under any stock option plan approved by the Board of Directors of the Company). Except as may be disclosed in the Financial Statements, the Company is not a guarantor or indemnitor of any indebtedness of any other person, firm, corporation, or other entity.

(k) Changes. Since the Statement Date, there has not been:

(A) Any change in the assets, liabilities, financial condition or operations, or cash flows, of the Company from that reflected in the Financial Statements, other than changes in the ordinary course of business, none of which

individually or in the aggregate has had or is expected to have a Material Adverse Effect;

(B) Any resignation or termination of any key officer of the Company; and the Company, to the best of its knowledge, does not know of the impending resignation or termination of employment of any such officer;

(C) Any material change, except in the ordinary course of business, in the contingent obligations of the Company by way of guaranty, endorsement, indemnity, warranty or otherwise;

(D) Any damage, destruction or loss, whether or not covered by insurance, materially and adversely affecting the properties, business, assets, liabilities or prospects or financial condition or operations of the Company;

(E) Any waiver by the Company of a material right or of a material debt owed to it;

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(F) Any direct or indirect loans made by the Company to any shareholder, employee, officer, director or agent of the Company, other than immaterial advances made in the ordinary course of business;

(G) Any material change in any compensation arrangement or agreement with any employee, officer, director, shareholder or agent not in the ordinary course of business;

(H) Any declaration or payment of any dividend or other distribution of the assets of the Company, or any declaration or payment of any dividend or other distribution to shareholders;

(I) Any labor organization activity, to the best of the Company's knowledge;

(J) Any debt, obligation or liability incurred, assumed or guaranteed by the Company, except for those for immaterial amounts and for current liabilities incurred in the ordinary course of business;

(K) Any sale, assignment, transfer or license of any patents, trademarks, copyrights, trade secrets or other intangible assets not in the ordinary course of business;

(L) Any change in any material agreement to which the Company is a party or by which it is bound, which change would be reasonably likely to have a Material Adverse Effect; or

(M) Any other event or condition of any character that, either individually or cumulatively, has or, to the best of the Company's knowledge, is reasonably likely to have a Material Adverse Effect.



(l) Title to Properties and Assets; Liens, etc. The Company has good and marketable title to its properties and assets, including the properties and assets reflected in the most recent balance sheet included in the Financial Statements, and good title to its leasehold estates, in each case subject to no mortgage, pledge, lien, lease, encumbrance or charge, other than (i) those resulting from taxes which have not yet become delinquent, (ii) Encumbrances that would not have a Material Adverse Effect, and (iii) those that have otherwise arisen in the ordinary course of business. All facilities, machinery, equipment, fixtures, vehicles and other properties owned, leased or used by the Company are in good operating condition and repair and are reasonably fit and usable for the purposes for which they are being used. The Company is in compliance with all material terms of each lease to which it is a party or is otherwise bound.

(m) Patents and Other Intangible Assets. The Company owns, or is licensed or otherwise possesses sufficient legal rights to use, all patents, trademarks, service marks, trade names, copyrights, trade secrets, licenses and other proprietary rights and processes (the "Intellectual Property Rights") that are material to the business of the Company as it is currently conducted. The Company has not received any communication alleging that it has violated, or that by conducting

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its business as currently conducted would violate, any of the Intellectual Property Rights of any other person or entity. No claims with respect to the Company's Intellectual Property Rights have been asserted or are, to the best of the Company's knowledge, threatened by any person or entity (i) challenging in any way the use by the Company of any of the Company's Intellectual Property Rights, (ii) challenging in any way the ownership by the Company of the Company's Intellectual Property Rights or (iii) claiming any infringement of the Intellectual Property Rights of any other person or entity. There are no outstanding options, licenses or agreements of any kind relating to the Company's Intellectual Property Rights, nor is the Company bound by or a party to any options, licenses or agreements of any kind with respect to the Intellectual Property Rights of any other person or entity, other than such licenses or agreements arising from the purchase of "off-the-shelf" products. To the best of the Company's knowledge, none of its employees is obligated under any contract (including licenses, covenants or commitments of any nature) or other agreement, or subject to any judgment, decree or order of any court or administrative agency, that would interfere with their duties to the Company or that would conflict with the Company's business as presently proposed to be conducted. Neither the execution nor delivery of the Agreements, nor, to the best of the Company's knowledge, the carrying on of the Company's business by the employees of the Company, nor the conduct of the Company's business as presently proposed will (with or without the giving of notice or the passage of time or both) conflict with or result in a breach of the terms, conditions or provisions of, or constitute a default under, any contract, covenant or instrument under which any employee is now obligated. The Company does not

believe it is or will be necessary to utilize any inventions, trade secrets or proprietary information of any of its employees made prior to their employment by the Company.

(n) Compliance with Other Instruments. The Company is not in violation or default of any term of its Amended Articles of Incorporation or Bylaws, or of any provision of any mortgage, contract, agreement, instrument or contract to which it is party or by which it or any of its property or assets is bound or of any judgment, decree, order, writ or, any statute, rule or regulation applicable to the Company. Attached to the Disclosure Letter are true and correct copies of the Company's Amended Articles of Incorporation and Bylaws.

(o) Litigation. There is no action, suit, proceeding or investigation pending, or to the best of the Company's knowledge threatened, against the Company that questions the validity of the Agreements or the right of the Company to enter into any of such agreements, or to consummate the transactions contemplated hereby or thereby, or which (i) are reasonably likely to have, either individually or in the aggregate, a Material Adverse Effect, or (ii) might result in any change in the current equity ownership of the Company, nor, to the best of the Company's knowledge, is there any basis for any of the foregoing in this sentence. The foregoing includes, without limitation, actions pending or threatened in writing (or any basis therefor known to the Company) involving the prior employment of any of the Company's employees, their use in connection with the Company's business of any information or techniques allegedly proprietary to them or any of their former employers, or their obligations under any agreements with prior employers. The Company is not a party or subject to the provisions of any order, writ, injunction, judgment or decree of any court or

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government agency or instrumentality. There is no action, suit, proceeding or investigation by the Company currently pending or which the Company intends to initiate.

(p) Tax Returns and Payments. Except to the extent that it would not have a Material Adverse Effect, the Company: (i) has timely filed all tax returns that are required to have been filed by it with all appropriate federal, state, county and local governmental agencies (and all such returns fairly reflect the Company's operations for tax purposes) and has timely paid all taxes shown to be due and payable on such returns and any assessments imposed with respect thereto; and (ii) has timely paid all taxes owed by it for which it is obligated to withhold from amounts owing to any employee (including without limitation social security taxes), creditor or third party (other than taxes the validity of which are being contested in good faith by appropriate proceedings and for which the Company has reserved against adequately). The Company has not been advised (x) that any of its returns, federal, state or other, have been or are being audited as of the date hereof, or (y) of any deficiency in assessment or proposed judgment to its federal, state or other taxes. To the best of the Company's knowledge, (i) there is no liability for any tax to be imposed upon it

or its properties or assets as of the date of this Agreement that is not adequately provided for and (ii) all other taxes due and payable by the Company on or before the Closing have been paid or will be paid prior to the time they become delinquent.

(q) Employees. The Company has no collective bargaining agreements with any of its employees. There is no labor union organizing activity pending or, to the best of the Company's knowledge, threatened with respect to the Company. No employee has any agreement or contract, written or verbal, regarding his employment. To the best of the Company's knowledge, no employee of the Company, nor any consultant with whom the Company has contracted, is in violation of any term of any employment contract, proprietary information agreement or any other agreement relating to the right of any such individual to be employed by, or to contract with, the Company because of the nature of the business to be conducted by the Company; and to the best of the Company's knowledge the continued employment by the Company of its present employees, and the performance of the Company's contracts with its independent contractors, will not result in any such violation. The Company has not received any notice alleging that any such violation has occurred. No employee of the Company has been granted the right to continued employment by the Company or to any material compensation following termination of employment with the Company. The Company is not aware that any officer or key employee, or that any group of key employees, intends to terminate their employment with the Company, nor does the Company have a present intention to terminate the employment of any officer, key employee or group of key employees.

(r) Trade Secrets Agreements. Each current employee and officer of the Company has executed a Confidentiality and Trade Secrets Agreement and an Employee Noncompete and Confidentiality Agreement in form and substance as attached to the Disclosure Letter. There are no other agreements or understandings between the Company and any current employee or officer thereof regarding proprietary information and/or inventions.

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(s) Registration Rights. Except as required pursuant to the Investor's Rights Agreement, the Company is not under any obligation, and has not granted any rights, to register any of the Company's presently outstanding securities or any of its securities that may hereafter be issued.

(t) Compliance with Laws; Permits. The Company is not in violation of any applicable statute, rule, regulation, order or restriction of any domestic or foreign government or any instrumentality or agency thereof in respect of the conduct of its business or the ownership of its properties which violation is reasonably likely to have a Material Adverse Effect. No governmental orders, permissions, consents, approvals or authorizations are required to be obtained and no registrations or declarations are required to be filed in connection with the execution and delivery of the Agreements and the issuance of the Shares, except for any filings pursuant to Federal or state securities laws (which filings the Company will timely complete) and other governmental orders,

permissions, consents, approvals, authorizations, registrations or filings as have been duly and validly obtained or filed. The Company has all franchises, permits, licenses and any similar authority necessary for the conduct of its business as now being conducted by it, the lack of any of which individually is reasonably likely to have a Material Adverse Effect, and believes it can obtain, without undue burden or expense, any similar authority for the conduct of its business as planned to be conducted.

(u) Offering Valid. Assuming the accuracy of the representations and warranties of Buyer contained in Section 2.2(c), (d), (e), (f) and (g) hereof, the offer, sale and issuance of the Shares will be exempt from the registration requirements of the Securities Act and will have been registered or qualified (or are exempt from registration and qualification) under the registration, permit or qualification requirements of all applicable state securities laws. Neither the Company nor any agent on its behalf has solicited or will solicit any offers to sell or has offered to sell or will offer to sell all or any part of the Shares to any person or persons so as to bring the sale of such Shares by the Company within the registration provisions of the Securities Act or any state securities laws.

(v) Environmental and Safety Laws. To the best of the Company's knowledge, there are no violations by the Company, its employees or agents of any environmental or safety statute, law or regulation that individually or in the aggregate would have a Material Adverse Effect, and, to the best of its knowledge, no material expenditures are or will be required in order to comply with any such existing statute, law or regulation.

(x) Insurance. The Company maintains fire, casualty and liability insurance policies, in such amounts and with such coverage as it believes are reasonable for the business in which it is engaged.

(y) Brokers; Finders. The Company has not authorized or retained any person or entity to act as a broker or finder or in any similar capacity in connection with the transactions contemplated by this Agreement. The Company shall indemnify and hold harmless Buyer from and against any and all losses, claims, damages and liabilities (including legal and other expenses reasonably incurred in connection with investigating or defending any claims or actions) with respect

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to any finder's fee, brokerage commission or similar payment in connection with any transaction contemplated hereby asserted by any person or entity on the basis of any act or statement made or alleged to have been made by the Company.

(z) Accounting Controls. Except to the extent that it would not have a Material Adverse Effect, the Company maintains a system of internal accounting controls sufficient to provide assurance that: (i) all transactions are executed in accordance with management's general or specific authorizations; (ii) all transactions are recorded as necessary to permit preparation of

financial statements in conformity with generally accepted accounting principles and to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management's general or specific authorization; and (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

2.2 Buyer Representations and Warranties. Buyer hereby represents and warrants to the Company that:

(a) Authority Relative to This Agreement. Buyer has full legal right, power and authority to execute, deliver and perform the Agreements and to consummate the transactions contemplated thereby. Each of the Agreements has been duly executed and delivered by Buyer and constitutes, and each other agreement, instrument, or document executed or to be executed by Buyer in connection with the transactions contemplated hereby has been, or when executed will be, duly executed and delivered by Buyer and constitutes, or when executed and delivered will constitute, a valid and legally binding obligation of Buyer, enforceable against Buyer in accordance with its respective terms, subject to the laws of general application relating to bankruptcy, insolvency and relief of debtors and applicable rules of law governing specific performance, injunctive relief or other equitable remedies, and except that the enforceability of the indemnification provisions in Section 1.6 of the Investor's Rights Agreement may be limited by applicable securities laws.

(b) Noncontravention. The execution, delivery and performance by Buyer of the Agreements and the consummation by Buyer of the transactions contemplated thereby do not and will not (with or without the giving of notice or the passage of time or both) except to the extent it would not have a material adverse effect on the business, assets or financial condition of Buyer (i) conflict with or result in a violation of any provision of, or constitute a default under, or give rise to any right of termination, cancellation, or acceleration under, any contract, agreement, instrument or obligation to which Buyer is a party or by which Buyer or any of Buyer's properties may be bound, or (ii) result in the creation or imposition of any Encumbrance upon the property or assets of Buyer or the suspension, revocation, impairment, forfeiture or nonrenewal of any permit, license, authorization or approval applicable to the Buyer, its business or operations or any of its assets or properties.

(c) Investment Intent. Buyer is acquiring the Shares with its own funds for its own account for investment and not with a view to any sale or other disposition in connection with any

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distribution of all or any part thereof and it has no present intention of selling, granting participation in, or otherwise distributing the same, except (i) in an offering covered by a registration statement filed with the Securities and Exchange Commission under the Securities Act of 1933, as amended (the "Securities Act"), covering the Shares or (ii) pursuant to an applicable

exemption under the Securities Act. By executing this Agreement, Buyer further represents that Buyer does not have any contract, undertaking, agreement or arrangement with any person to sell, transfer or grant participations to any other parties with respect to the Shares.

(d) Disclosure of Information. Buyer represents that it has had an opportunity to ask questions of and receive answers from the Company regarding the Company and its business, assets, results of operation and financial condition and the terms and conditions of the issuance of the Shares.

(e) Investment Experience. Buyer acknowledges that it is able to fend for itself, can bear the economic risk of its investment in the Shares, and has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of an investment in the Shares. Buyer represents that Buyer is an "Accredited Investor" for purposes of Regulation D under the Securities Act.

(f) Restricted Securities. Buyer understands that the Shares will not have been registered pursuant to the Securities Act or any applicable state securities laws, that the Shares will be characterized as "restricted securities" under federal securities laws, and that under such laws and applicable regulations the Shares cannot be sold or otherwise disposed of without registration under the Securities Act or an exemption therefrom. In this connection, Buyer represents that it is familiar with Rule 144 promulgated under the Securities Act, as currently in effect, and understands the resale limitations imposed thereby and by the Securities Act. Stop transfer instructions may be issued to the transfer agent for securities of the Company (or a notation may be made in the appropriate records of the Company) in connection with the Shares for purposes of compliance with federal securities laws.

(g) Legend. It is agreed and understood by Buyer that the certificates representing the Shares shall each conspicuously set forth on the face or back thereof, in addition to any legends required by applicable law or other agreement to which Buyer is a signatory, a legend in substantially the following form:

THE SHARES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED PURSUANT TO THE SECURITIES ACT OF 1933, AS AMENDED, OR ANY STATE SECURITIES LAWS. SUCH SHARES MAY NOT BE SOLD OR OTHERWISE TRANSFERRED UNLESS THEY ARE FIRST REGISTERED PURSUANT TO THAT ACT AND APPLICABLE STATE SECURITIES LAWS UNLESS THE CORPORATION RECEIVES A WRITTEN OPINION OF COUNSEL, WHICH OPINION AND COUNSEL ARE REASONABLY SATISFACTORY TO THE CORPORATION, TO THE EFFECT THAT SUCH REGISTRATION IS NOT REQUIRED.

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It is agreed that the Company will not require opinions of counsel for transactions made pursuant to Rule 144 under the Securities Act except in unusual circumstances.

### III. MISCELLANEOUS

3.1 Notices. All notices, requests, demands and other communications required or permitted to be given or made hereunder by any party hereto shall be in writing and shall be deemed to have been duly given or made if delivered personally, transmitted by first class registered or certified mail, postage prepaid, return receipt requested, sent by prepaid overnight delivery service or sent by cable, telegram, telefax or telex, to the parties at the addresses set forth next to their names on the signature page hereof (or at such other addresses as shall be specified by the parties by like notice).

3.2 Entire Agreement. The Agreements and the other writings referred to herein or delivered pursuant hereto, constitute the entire agreement between the parties hereto with respect to the subject matter hereof and supersede all prior agreements and understandings, both written and oral, between the parties with respect to the subject matter hereof.

3.3 Binding Effect; Assignment. This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective heirs, legal representatives, successors and permitted assigns. Except as otherwise expressly provided in this Agreement, neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned by any party hereto without the prior written consent of the other party hereto; provided that the provisions hereof shall inure to the benefit of and be enforceable by each person or entity who shall be a holder of the Shares from time to time.

3.4 Amendment; Waivers. This Agreement may not be amended, waived or otherwise modified except by an instrument in writing signed by or on behalf of all the parties. No failure or delay by a party hereto in exercising any right, power, or privilege hereunder shall operate as a waiver thereof nor shall any single or partial exercise thereof preclude any other or further exercise thereof or the exercise of any other right, power or privilege.

3.5 Survival. The representations and warranties of the parties hereto contained in this Agreement or in any certificate, instrument or document delivered pursuant hereto shall survive the Closing without contractual limitation, regardless of any investigation made by or on behalf of any party.

3.6 Severability. If any provision of this Agreement is held to be unenforceable, this Agreement shall be considered divisible and such provision shall be deemed inoperative to the extent it is deemed unenforceable, and in all other respects this Agreement shall remain in full force and effect; provided, however, that if any such provision may be made enforceable by limitation thereof, then such provision shall be deemed to be so limited and shall be enforceable to the maximum extent permitted by applicable law.

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3.7 GOVERNING LAW . THIS AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED

AND ENFORCED IN ACCORDANCE WITH THE LAWS OF THE STATE OF TEXAS, WITHOUT REGARD TO THE PRINCIPLES OF CONFLICTS OF LAWS THEREOF.

3.8 Further Assurances. From time to time following the Closing, at the request of any party hereto and without further consideration, the other party or parties hereto shall execute and deliver to such requesting party such instruments and documents and take such other action (but without incurring any material financial obligation) as such requesting party may reasonably request in order to consummate more fully and effectively the transactions contemplated hereby.

3.9 Descriptive Headings. The descriptive headings herein are inserted for convenience of reference only, do not constitute a part of this Agreement and shall not affect in any manner the meaning or interpretation of this Agreement.

3.10 Counterparts. This Agreement may be executed by the parties hereto in any number of counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same agreement. Each counterpart may consist of a number of copies hereof each signed by less than all, but together signed by all, the parties hereto.

3.11 Enforcement. The prevailing party in any action to enforce this Agreement shall be entitled to attorneys' fees and costs. The parties agree that damages are not an adequate remedy for breach hereof and the parties shall be entitled to specific performance of this Agreement.

3.12 Review; Notification. Buyer and its affiliates shall have the right to review, prior to the release thereof, all press releases or other written disclosures made by or on behalf of the Company naming or regarding Buyer or any of its affiliates, and the Company shall not unreasonably refuse to revise any such disclosures as requested by Buyer and its affiliates. The Company shall give Buyer and its affiliates a copy of any such proposed disclosure at least five business days prior to the proposed release thereof.

[Signature page to follow.]

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IN WITNESS WHEREOF, the parties have executed this Agreement as of the day and year first above written.

Address:

Data Return Corporation

222 Las Colinas Boulevard



Irving, Texas 75039

By: /s/ Sunny C. Vanderbeck

-----  
Sunny C. Vanderbeck,

Chief Executive Officer

Address:

One Microsoft Way

Microsoft Corporation

Redmond, Washington 98052

Attention: Chief Financial Officer

With a copy to: General Counsel,

Finance and Operations

By: \_\_\_\_\_

Name:

Title:

EXHIBIT A

#### INVESTOR'S RIGHTS AGREEMENT

This Investor's Rights Agreement (this "Agreement") is made and entered into as of July 29, 1999, by and between Data Return Corporation, a Texas corporation (the "Company"), and CPQ Holdings, Inc., a Delaware corporation ("Investor").

#### RECITALS

A. Investor has agreed to purchase from the Company, and the Company has agreed to sell to Investor, 4,356 shares (the "Shares") of the Company's Common Stock pursuant to that certain Stock Purchase Agreement, dated of even date herewith by and among the Company and Investor (the "Stock Purchase Agreement").

B. Investor has conditioned its purchase of the Shares on the Company granting Investor certain registration and other rights, all as more fully set forth herein.

NOW, THEREFORE, in consideration of the foregoing recitals and the mutual promises hereinafter set forth, the parties hereto agree as follows:

#### 1. REGISTRATION RIGHTS.

1.1 Definitions. For purposes of this Agreement:

(a) Common Stock. The term "Common Stock" means the common stock of the Company, par value \$.001 per share.

(b) Exchange Act. The term "Exchange Act" means the Securities and Exchange Act of 1934, as amended.

(c) Holder. For purposes hereof, the term "Holder" means any Investor holding Registrable Securities and any transferee or assignee of Registrable Securities to whom the rights under this Section 1 have been transferred or assigned in accordance with Section 3 of this Agreement.

(d) Initiating Holder(s). The term "Initiating Holder(s)" means (i) any Holders who in the aggregate are Holders of more than 50% of the Registrable Securities or (ii) Investor.

(e) Registrable Securities. The term "Registrable Securities" means all the Shares and any additional Common Stock or other securities issued as a dividend or other distribution with respect to, or in exchange for, or in replacement of or in connection with such Common Stock, that are now owned or may hereafter be acquired by Investor or Holder, excluding in all cases, however, any Registrable Securities (y) sold by a person in a transaction in which rights under this Section 1 are not assigned in accordance with this Agreement or (z) sold

in a registered public offering under the Securities Act or sold pursuant to Rule 144 promulgated under the Securities Act.

(f) Registration. The terms "register," "registered," and "registration" refer to a registration effected by preparing and filing a registration statement in compliance with the Securities Act, and the declaration or ordering of effectiveness of such registration statement by the SEC.

(g) SEC. The term "SEC" or "Commission" means the U.S. Securities and Exchange Commission.

(h) Securities Act. The term "Securities Act" means the Securities Act of 1933, as amended.

1.2 Piggyback Registrations. The Company shall notify all Holders of Registrable Securities in writing at least 15 days prior to filing any registration statement under the Securities Act for purposes of effecting a public offering of securities of the Company (including, but not limited to, registration statements relating to secondary offerings of securities of the Company, but excluding registration statements relating to any employee benefit plan, or with respect to a corporate reorganization or other transaction under Rule 145 promulgated under the Securities Act) and will afford each such Holder an opportunity to include in such registration statement all or any part of the

Registrable Securities then held by such Holder. Each Holder desiring to include in any such registration statement all or any part of the Registrable Securities held by such Holder shall, within 15 days after receipt of the above-described notice from the Company, so notify the Company in writing, and in such notice shall inform the Company of the number of Registrable Securities such Holder wishes to include in such registration statement. If a Holder decides not to include all of its Registrable Securities in any registration statement thereafter filed by the Company, such Holder shall nevertheless continue to have the right to include any Registrable Securities in any subsequent registration statement or registration statements as may be filed by the Company with respect to offerings of its securities, all upon the terms and conditions set forth herein.

If a registration statement under which the Company gives notice under this Section 1.2 is for an underwritten offering, then the Company shall so advise the Holders of Registrable Securities. In such event, the right of any such Holder's Registrable Securities to be included in a registration pursuant to this Section 1.2 shall be conditioned upon such Holder's participation in such underwriting and the inclusion of such Holder's Registrable Securities in the underwriting to the extent provided herein. All Holders proposing to distribute their Registrable Securities through such underwriting shall enter into an underwriting agreement in customary form with the managing underwriter or underwriter(s) selected for such underwriting. Notwithstanding any other provision of this Agreement, if the managing underwriter determines in good faith that marketing factors require a limitation of the number of shares to be underwritten, then the managing underwriter(s) may, in their sole discretion, exclude such portion of the shares (including Registrable Securities) that it deems necessary from the registration and the underwriting, and the number of shares that may be included in the registration and the underwriting shall be allocated, first, to the Company, and second, to each person contractually entitled to participate before the Holders, and third, to each of the Holders requesting inclusion of

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their Registrable Securities in such registration statement on a pro rata basis based on the total number of Registrable Securities then held by each such Holder. If any Holder disapproves of the terms of any such underwriting, such Holder may elect to withdraw therefrom by written notice to the Company and the underwriter. Any Registrable Securities excluded or withdrawn from such underwriting shall be excluded and withdrawn from the registration.

### 1.3 Demand Registration.

(a) If the Company shall receive at any time after the earlier of (i) three years from the date hereof and (ii) 180 days after the effective date of an initial public offering of its Common Stock ("IPO") a written request from Initiating Holder(s), then the Company shall, within 20 business days of the receipt of such written request, give written acknowledgment of such request ("Request Acknowledgment") to all Holders, and use its best efforts to effect,

as soon as practicable, the registration under the Securities Act of all Registrable Securities then owned of record by all Holders and which such Holders request to be registered and included in such registration by written notice given by such Holders to the Company within 20 days after receipt of the Request Acknowledgment; provided, however, that the Company shall not be obligated to effect any such registration, qualification or compliance pursuant to this Section 1.3:

(i) if the aggregate value of the Registrable Securities proposed to be sold by such Holders in such offering is less than \$1,000,000;

(ii) if such offering would (y) require disclosure of material nonpublic information that the Board of Directors of the Company determines in good faith would be in the best interests of the Company not to disclose or (z) have a material adverse effect (as determined by the Board of Directors in good faith) on the Company or its shareholders in relation to any financing, acquisition, corporate reorganization or other material transaction actively pursued by the Board of Directors of the Company, involving the Company or any of its affiliates, in which event, in the case of both (y) and (z), the Company shall have the right to defer the filing of the registration statement no more than once during any 12-month period for a period of not more than 120 days after receipt of the request of such Holders under this Section 1.3 (the Company must furnish to the Holders requesting registration a certificate signed by its Chairman of the Board of Directors, Chief Executive Officer or Chief Financial Officer certifying as to any such determination made by the Board of Directors);

(iii) if the request is made during the period starting with the filing of, and ending on a date 90 days following the effective date of, a registration statement pertaining to an underwritten public offering of securities for the account of the Company, provided that the Company is actively employing in good faith all reasonable efforts to cause such registration statement to become effective; or

(iv) The Company is obligated to effect only one such registration pursuant to this Section 1.3 (which registration must be declared or ordered effective).

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(b) If Initiating Holder(s) submit a registration request under this Section 1.3 and intend to distribute the Registrable Securities covered by such request by means of an underwriting (an "Underwritten Offering"), then the Initiating Holder(s) shall so advise the Company as a part of the request made pursuant to this Section 1.3 and the Company shall include such information in the written notice referred to in Section 1.3(a). In such event, the right of Investor and the other Holders to include their Registrable Securities in such registration shall be conditioned upon such Holders' participation in such underwriting and the inclusion of the Holders' Registrable

Securities in the underwriting to the extent provided herein. If Investor or the other Holders propose to distribute their securities through such underwriting, they shall enter into an underwriting agreement in customary form with the managing underwriter or underwriters selected for such underwriting by a majority in interest of the Initiating Holder(s) from a list of three nationally-recognized underwriters proposed by the Company. Any Registrable Securities excluded and withdrawn from such underwriting shall be withdrawn from the registration. If the representative of such underwriters determines in good faith that marketing factors require a limitation of the number of shares to be underwritten and so advises Investor and the Holders in writing, the Registrable Securities to be sold by Investor shall be the last securities (including any other registrable securities of any other shareholder with registration rights) to be excluded from such registration.

#### 1.4 Obligations of the Company.

##### (a) Expenses.

(i) All expenses incurred in connection with a registration pursuant to Section 1.2 including, without limitation, all registration and qualification fees, printers' and accounting fees, fees and disbursements of counsel for the Company, and reasonable fees and expenses of one special counsel for the selling Holders (up to a maximum of \$25,000) (but excluding underwriters' and brokers' discounts and commissions with respect to Registrable Securities to be sold by Holders), shall be borne by the Company. Each Holder participating in a registration pursuant to Section 1.2 of this Agreement shall bear such Holder's proportionate share (based on the total number of shares sold in such registration other than for the account of the Company) of all underwriting discounts or commissions payable to underwriters or brokers in connection with such offerings with respect to Registrable Securities to be sold by Holders.

(ii) All expenses incurred in connection with a registration pursuant to Section 1.3 including, without limitation, all registration and qualification fees, printers' and accounting fees, fees and disbursements of counsel for the Company, and fees and expenses of counsel for the selling Holders, including underwriters' and brokers' discounts and commissions with respect to Registrable Securities to be sold by Holders, shall be borne by the selling Holders; provided, however, that the Company shall pay (i) all of its accounting fees and fees and disbursements of counsel for the Company that are, in the aggregate, greater than \$250,000 and (ii) compensation to its employees. Each Holder participating in a registration pursuant to Section 1.3 of this Agreement shall bear

such Holder's proportionate share (based on the total number of shares sold in such registration other than for the account of the Company) of all such

expenses.

(b) Registration. Whenever required to effect the registration of any Registrable Securities under this Agreement, the Company shall:

(i) Prepare and file with the SEC a registration statement with respect to such Registrable Securities and use its best efforts to cause such registration statement to become effective (provided, that the Company shall not be required to use such efforts with respect to a registration pursuant to Section 1.2), and, upon the request of the Holders of a majority of the Registrable Securities registered thereunder, keep such registration statement effective for (y) with respect to a registration statement filed on the SEC Form S-3 or any replacement form thereof, 120 days with respect to an offering initiated by the Holders or for the period contemplated by the plan of distribution in the case of a registration initiated by the Company or another shareholder or until the Holders, as applicable, have completed the distribution described in the registration statement relating thereto, whichever first occurs and (z) with respect to a registration statement filed on any other SEC form (including the SEC's Form S-1 or any replacement form thereof) 60 days with respect to an offering initiated by the Holders or for the period contemplated by the plan of distribution in the case of a registration initiated by the Company or another shareholder or until the Holders, as applicable, have completed the distribution described in the registration statement relating thereto, whichever first occurs plus any additional periods represented by any "Black-Out Period" (as defined in the last paragraph of Section 1.4(b)(vi)).

(ii) Prepare and file with the SEC such amendments and supplements to such registration statement and the prospectus used in connection with such registration statement as may be necessary to comply with the provisions of the Securities Act with respect to the disposition of all securities covered by such registration statement.

(iii) Furnish to the Holders such number of copies of a prospectus, including a preliminary prospectus, in conformity with the requirements of the Securities Act, and such other documents as they may reasonably request in order to facilitate the disposition of the Registrable Securities owned by them that are included in such registration.

(iv) Use its best efforts to register and qualify the securities covered by such registration statement under such other securities or blue sky laws of such jurisdictions as shall be reasonably requested by the Holders, provided that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business or to file a general consent to service of process in any such states or jurisdictions.

(v) In the event of any underwritten public offering, enter into and perform its obligations under an underwriting agreement, in

with the managing underwriter(s) of such offering. Each Holder participating in such underwriting shall also enter into and perform its obligations under such an agreement.

(vi) Notify each Holder, at any time when a prospectus relating thereto is required to be delivered under the Securities Act, of the happening of any event as a result of which the prospectus included in such registration statement contains an untrue statement of a material fact or omits any fact required to be stated therein or necessary to make the statements therein not misleading, and, at the request of the Holder, the Company will prepare a supplement or amendment to such prospectus so that, as thereafter delivered to the purchasers of such Registrable Securities, such prospectus will not contain an untrue statement of a material fact required to be stated therein or omit to state any fact necessary to make the statements therein not misleading, or of the determination by the Company that a post-effective amendment to a registration statement would be required under the Securities Act, and, at the request of the Holder, the Company will prepare and file a post-effective amendment to the registration statement as required under the Securities Act; provided, however, that the Company may postpone preparing and delivering any such prospectus supplement or amendment or preparing and filing any post-effective amendment to a registration statement if the Board of Directors of the Company in good faith determines that such prospectus supplement or amendment or post-effective amendment (A) would have a material adverse effect on any active proposal or plan by the Company to engage in any acquisition of assets (other than in the ordinary course) or any merger, consolidation, tender offer or similar transaction, or (B) would require disclosure of material nonpublic information that would be in the best interests of the Company not to disclose; provided, that the Company shall have such right to postpone no more than once during any 12-month period for a period of not more than 120 days. Any such postponement under this Section shall count as a deferral under Section 1.3(a)(ii), and vice versa. The period during which the Company exercises its rights as described in this paragraph to postpone, delay or interrupt the offer and sale of the Registrable Securities or during the pendency of any stop order, injunction or other order or requirement of the SEC or any other governmental agency or court shall be referred to herein as "Black-out Period".

(vii) Furnish, at the request of any Holder requesting registration of Registrable Securities, on the date that such Registrable Securities are delivered to the underwriters for sale, if such securities are being sold through underwriters, or, if such securities are not being sold through underwriters, on the date that the registration statement with respect to such securities becomes effective, an opinion, dated as of such date, of the counsel representing the Company for the purposes of such registration, in form and substance as is customarily given to underwriters

in an underwritten public offering and reasonably satisfactory to such underwriters, addressed to the underwriters, if any, and to the Holders requesting registration of Registrable Securities.

(viii) Use its best efforts to cause a "comfort" letter, dated as of such date, from the independent certified public accountants of the Company, to be issued in form and substance as is customarily given by independent certified public accountants to

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underwriters in an underwritten public offering and reasonably satisfactory to Holders, addressed to the underwriters, if any, and to the Holders requesting registration of Registrable Securities.

1.5 Furnish Information. It shall be a condition precedent to the obligations of the Company to take any action pursuant to Sections 1.2 or 1.3 that the selling Holders shall furnish to the Company such information regarding themselves, the Registrable Securities held by them, and the intended method of disposition of such securities and such other information as the Company may reasonably request to timely effect the registration of their Registrable Securities.

1.6 Indemnification. In the event any Registrable Securities are included in a registration statement under Sections 1.2 or 1.3:

(a) By the Company. To the extent permitted by law, the Company will defend, indemnify and hold harmless Investor and each other Holder, the shareholders, members, managers, partners, officers and directors of Investor and each other Holder, any underwriter (as defined in the Securities Act) for Investor and each such other Holder and each person, if any, who controls Investor or any such other Holder or underwriter within the meaning of the Securities Act or the Exchange Act against any losses, claims, damages or liabilities (joint or several) to which they may become subject under the Securities Act, the Exchange Act or other federal or state law, insofar as such losses, claims, damages or liabilities (or actions in respect thereof) arise out of or are based upon any of the following statements, omissions or violations (collectively a "Violation"):

(i) any untrue statement or alleged untrue statement of a material fact contained in such registration statement, including any preliminary prospectus or final prospectus contained therein or any amendments or supplements thereto;

(ii) the omission or alleged omission to state therein a material fact required to be stated therein, or necessary to make the statements therein not misleading; or

(iii) any violation or alleged violation by the Company of the Securities Act, the Exchange Act, any federal or state securities



law or any rule or regulation promulgated under the Securities Act, the Exchange Act or any federal or state securities law in connection with the offering covered by such registration statement,

and the Company will reimburse Investor and each other such Holder and such other indemnitees for any legal or other expenses reasonably incurred by them, as incurred, in connection with investigating or defending any such loss, claim, damage, liability or action; provided however, that the indemnity agreement contained in this Section 1.6(a) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of the Company (which consent shall not be unreasonably withheld), nor shall the Company be liable in any such case for any such loss, claim, damage, liability or action to the extent that it arises out of or is based upon a Violation which occurs in reliance upon and

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in conformity with written information furnished expressly for use in connection with such registration by such Holder, or partner, officer, director or controlling person of such Holder.

(b) By Selling Holders. To the extent permitted by law, each selling Holder will defend, indemnify and hold harmless the Company, each of its directors, each of its officers who have signed the registration statement, each person, if any, who controls the Company within the meaning of the Securities Act or the Exchange Act, any underwriter, each person, if any, who controls such underwriter within the meaning of the Securities Act or the Exchange Act, and any other Holder selling securities under such registration statement or any of such other Holder's partners, directors or officers or any person who controls such Holder within the meaning of the Securities Act or the Exchange Act, against any losses, claims, damages or liabilities (joint or several) to which the Company or any such director, officer, underwriter or other such Holder, partner, or director, officer or controlling person of the Company, such underwriter or such other Holder may become subject under the Securities Act, the Exchange Act or other federal or state securities law, insofar as such losses, claims, damages or liabilities (or actions in respect thereof) arise out of or are based upon any Violation, in each case to the extent (and only to the extent) that such Violation occurs in reliance upon and in conformity with written information furnished by such Holder expressly for use in connection with such registration; and each such Holder will reimburse any legal or other expenses reasonably incurred by the Company or any such director, officer, controlling person, underwriter or other Holder, partner, officer, director or controlling person of such other Holder in connection with investigating or defending any such loss, claim, damage, liability or action; provided, however, that the indemnity agreement contained in this Section 1.6(b) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of the Holder, which consent shall not be unreasonably withheld; and provided further, that the total amounts payable in indemnity and reimbursement by a Holder under this Section 1.6(b) in respect of all Violations shall not exceed the proceeds (net of underwriters'

and brokers' discounts and commissions) received by such Holder in the registered offering out of which such Violations arise.

(c) Notice. Promptly after receipt by an indemnified party under this Section 1.6 of notice of the commencement of any action (including any governmental action), such indemnified party will, if a claim in respect thereof is to be made against any indemnifying party under this Section 1.6, deliver to the indemnifying party a written notice of the commencement thereof and the indemnifying party shall have the right to participate in, and, to the extent the indemnifying party so desires, jointly with any other indemnifying party similarly noticed, to assume the defense thereof with counsel mutually satisfactory to the parties; provided, however, that an indemnified party shall have the right to retain its own counsel, with the fees and expenses to be paid by the indemnifying party, if representation of such indemnified party by the counsel retained by the indemnifying party would be inappropriate due to actual or potential conflict of interests between such indemnified party and any other party represented by such counsel in such proceeding; and provided, further, that under no circumstances shall the indemnifying party be required to pay the fees and expenses of more than one counsel for all indemnified parties. The failure to deliver written notice to the indemnifying party within a reasonable time of the commencement of any such action, if materially prejudicial to its ability to defend such action, shall relieve such indemnifying party of liability to the extent caused by such

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failure to deliver written notice to the indemnified party under this Section 1.6, but the omission so to deliver written notice to the indemnifying party will not relieve it of any liability that it may have to any indemnified party otherwise than under this Section 1.6.

(d) Contribution. If the indemnification provided in this Section 1.6 is unavailable or insufficient to hold harmless an indemnified party under Section 1.6(a) or (b), then each indemnifying party shall contribute to the amount paid or payable by such indemnified party as a result of the losses, claims, damages or liabilities referred to above (i) in such proportion as is appropriate to reflect the relative benefits received by the indemnifying party on the one hand and the indemnified party on the other from the offering of the securities or (ii) if the allocation provided by clause (i) above is not permitted by applicable law, in such proportion as is appropriate to reflect not only the relative benefits referred to in clause (i) above but also the relative fault of the indemnifying party on the one hand and the indemnified party on the other in connection with the Violations that resulted in such losses, claims, damages or liabilities, such relative fault to be determined considering, among other items, the relative access to information and opportunity to correct or prevent misstatements or omissions of each party, as well as any other equitable considerations. Notwithstanding the provisions of this section, no selling Holder shall be required to contribute any amount in excess of the amount of the total net proceeds (net of underwriters' and brokers' discounts and commissions) received by such Holder in the registered offering out of which the Violation

arises. No person guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from any person who is not guilty of such fraudulent misrepresentation.

(f) Survival. The obligations of the Company and selling Holders under this Section 1.6 shall survive the completion of any offering of Registrable Securities in a registration statement, the termination of this Agreement and otherwise.

1.7 "Market Stand-Off" Agreement. Each Holder hereby agrees that it shall not, without the consent of the managing underwriter, sell, transfer, pledge, hypothecate or otherwise transfer or dispose of any Registrable Securities or other shares of stock of the Company then owned by such Holder (other than those included in an applicable registration and other than to donees or partners of the Holder who agree to be similarly bound) for up to 180 days following the effective date of a registration statement (other than a registration statements relating to any employee benefit plan, or with respect to a corporate reorganization or other transaction under Rule 145 promulgated under the Securities Act )of the Company for an IPO filed under the Securities Act; provided, however, that all officers and directors of the Company and all holders of Common Stock (or options or other rights to acquire Common Stock) equal to at least 1% of the Company's voting securities (on a fully-diluted basis) enter into similar agreements. In order to enforce the foregoing covenant, the Company shall have the right to place restrictive legends on the certificates representing the shares subject to this Section and to impose stop transfer instructions with respect to the Registrable Securities and such other shares of stock of each Holder (and the shares or securities of every other person or entity subject to the foregoing restriction).

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1.8 Rule 144 Reporting. With a view to making available the benefits of certain rules and regulations of the Commission which may at any time permit the sale of the Registrable Securities to the public without registration, the Company agrees to:

(a) Make and keep public information available, as those terms are understood and defined in Rule 144 under the Securities Act or any similar or analogous rule promulgated under the Securities Act, at all times after the effective date of the first registration under the Securities Act filed by the Company for an offering of its securities to the general public; and

(b) Use its best efforts to file with the Commission in a timely manner all reports and other documents required of the Company under the Securities Act and the Exchange Act (at any time after it has become subject to such reporting requirements).

(c) So long as a Holder owns any Registrable Securities, furnish to such Holder upon written request: a written statement by the Company as to its compliance with the provisions of clauses (a) and (b); a copy of the

most recent annual or quarterly report of the Company; and such other reports and documents as a Holder may reasonably request in availing itself of any rule or regulation of the SEC allowing it to sell any such securities without registration.

1.9 Termination of the Company's Obligations. The Company shall have no obligations pursuant to Sections 1.2 or 1.3 with respect to the Registrable Securities of a Holder if in the reasonable written opinion of counsel to the Company (which opinion shall also be addressed and provided to the Holders), all Registrable Securities then owned by or issuable to such Holder (and its affiliates, partners, former partners, members and former members) may be sold in one three month period without registration under the Securities Act pursuant to Rule 144 under the Securities Act (without giving effect to the provisions of Rule 144(k)).

## 2. RIGHT OF FIRST REFUSAL.

2.1 General. As long as Investor or any other Holder continues to own any Registrable Securities, Investor or such other Holder shall have the right of first refusal to purchase Investor's then-current Pro Rata Share (as defined below), of all (or any part) of any "New Securities" (as defined in Section 2.2) that the Company may from time to time propose to issue after the date of this Agreement. An Investor's "Pro Rata Share" for purposes of this right of first refusal shall mean, at any time of determination, the ratio of (a) the number of Registrable Securities owned by Investor to (b) that number of shares of Common Stock of the Company then outstanding.

2.2 New Securities. "New Securities" shall mean, whether now authorized or not, any capital stock of the Company, any rights, options or warrants to purchase or acquire such capital stock, and securities of any type whatsoever that are, or may become, convertible or exchangeable into such capital stock; provided, however, that the term "New Securities" does not include:

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(a) shares of Common Stock (and/or options or warrants therefor) issued after the date of this Agreement to employees, officers, directors, contractors, advisors or consultants of the Company pursuant to agreements or plans approved by the Board of Directors of the Company.

(b) shares of the Company's capital stock issued in connection with any stock split or stock dividend;

(c) securities offered by the Company to the public pursuant to its IPO; or

(d) securities issued for consideration other than cash pursuant to the acquisition of another corporation or entity by the Company by consolidation, merger, purchase of all or substantially all of the assets, or

other business combination in which the Company acquires, in a single transaction or series of related transactions, all or substantially all of the assets of such other corporation or entity or more than 50% of the voting power of such other corporation or entity or more than 50% of the equity ownership of such other entity.

2.3 Procedures. In the event that the Company proposes to undertake an issuance of New Securities, it shall give to Investor written notice of its intention to issue New Securities (the "Notice"), describing the type of New Securities and the price and the general terms upon which the Company proposes to issue such New Securities. Investor shall have 20 days from the date of receipt of any such Notice to agree in writing to purchase Investor's Pro Rata Share of such New Securities for the price and upon the general terms specified in the Notice by giving written notice to the Company and stating therein the quantity of New Securities to be purchased (not to exceed such Investor's Pro Rata Share).

2.4 Termination. This right of first refusal shall terminate upon the earlier to occur of (i) the closing of its IPO; or (ii) (a) the acquisition of all or substantially all the assets of the Company by another unaffiliated entity or (b) an acquisition of the Company by an unaffiliated corporation or person by share purchase, consolidation, merger or other business combination in which the holders of the Company's outstanding voting stock immediately prior to such transaction own, immediately after such transaction, securities representing less than 50% of the voting power of the corporation or other entity surviving such transaction pursuant to this Section 2.

### 3. ASSIGNMENT.

The rights to cause the Company to register Registrable Securities pursuant to Section 1 and the rights of first refusal contained in Section 2 may be assigned by Investor or any other Holder to a transferee or assignee of Registrable Securities which (a) is a subsidiary, parent, general partner, limited partner, retired partner, member or retired member of a Holder, (b) is a Holder's family member or trust for the benefit of an individual Holder, (c) is a Holder of any Registrable Securities or (d) acquires at least 20% of the Registrable Securities (as adjusted for stock splits and dividends); provided, however, (i) the transferor shall, within 10 days after such transfer, furnish to the Company written notice of the name and address of such transferee or assignee and the securities with respect to which such registration or first refusal rights are being

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assigned and (ii) such transferee shall agree to be subject to all restrictions set forth in this Agreement.

### 4. AFFIRMATIVE COVENANTS OF THE COMPANY

The Company hereby covenants and agrees as follows:

4.1 Financial Information. Subject to Section 4.3, the Company will mail the following reports to the Investor or any other Holder for so long as the Investor or any other Holder is a Holder of any Registrable Securities:

(a) As soon as practicable after the end of each fiscal year, and in any event within 90 days thereafter, consolidated balance sheets of the Company and its subsidiaries, if any, as of the end of such fiscal year, and consolidated statements of operations and consolidated statements of cash flows of the Company and its subsidiaries, if any, for such year prepared in accordance with generally accepted accounting principles and setting forth in each case in comparative form similar information for the previous fiscal year, all in reasonable detail and audited by independent public accountants of national standing selected by the Company's Board of Directors. Such financial statements shall be accompanied by a report and opinion thereon from such accountants.

(b) As soon as practicable after the end of the first, second and third quarterly accounting periods in each fiscal year of the Company and in any event within 45 days thereafter, a consolidated balance sheet of the Company and its subsidiaries, if any, as of the end of each such quarterly period, and consolidated statements of operations and consolidated statements of cash flows of the Company and its subsidiaries, if any, for such period and for the current fiscal year to date, prepared in accordance with GAAP (other than for accompanying notes), all in reasonable detail and certified by the principal financial or accounting officer of the Company, subject to changes resulting from year-end audit adjustments.

(c) Contemporaneously with their delivery to holders of the Company's Common Stock, a copy of each report or other communication delivered to holders of its Common Stock.

4.2 Additional Information. Subject to Section 4.3, as long as Investor or any other Holder holds any Registrable Securities, the Company will deliver or provide to the Investor:

(a) Within 30 days prior to the beginning of each fiscal year, an "Annual Plan." The Annual Plan shall set forth full and complete forecasted balance sheets, statements of operations, and statements of cash flows for such fiscal year and for each month within that year. The Annual Plan shall also describe the marketing, production, research and development, organization and staffing, and financial strategies which support the Annual Plan's forecasted figures.

(b) With reasonable promptness, such other information and data with respect to the Company and its subsidiaries, if any, as the Investor may from time to time reasonably request.

(c) For so long as Investor or any other Holder is eligible to receive

reports under this Section 4.2, it shall also have the right, at its expense, to visit and inspect any of the properties of the Company or any of its subsidiaries, to examine its books of account and records, and to discuss their affairs, finances and accounts with their officers, all at such reasonable times as often as may be reasonably requested.

4.3 Termination of Covenants. The covenants set forth in Sections 4.1 and 4.2 shall terminate and be of no further force or effect at such time as the Company is required to file reports pursuant to Sections 13 or 15(d) of the Exchange Act.

## 5. GENERAL PROVISIONS.

5.1 Successors and Assigns. Subject to Section 3 hereof, the terms and conditions of this Agreement shall inure to the benefit of and be binding upon the parties hereto and the respective successors and assigns of the parties hereto and shall inure to the benefit of and be enforceable by each person or entity who shall be a Holder of Registrable Securities from time to time.

5.2 Third Parties. Except as set forth in Section 5.1, nothing in this Agreement, express or implied, is intended to confer upon any person or entity, other than the parties hereto and their successors and assigns, any rights or remedies under or by reason of this Agreement.

5.3 Governing Law and Venue. This Agreement shall be governed by and construed under the internal laws of the state of Texas as applied to agreements among Texas residents entered into and to be performed entirely within Texas, without reference to principles of conflict of laws or choice of laws. Venue of any action arising out of this Agreement shall be had in Dallas County, Texas.

5.4 Counterparts. This Agreement may be executed in two or more counterparts each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

5.5 Headings. The headings and captions used in this Agreement are used for convenience only and are not to be considered in construing or interpreting this Agreement. All references in this Agreement to sections, paragraphs, exhibits and schedules shall, unless otherwise provided, refer to sections and paragraphs hereof and exhibits and schedules attached hereto, all of which exhibits and schedules are incorporated herein by this reference.

5.6 Notices. All notices, requests, demands or other communications which are required or may be given pursuant to the terms of this Agreement shall be in writing and shall be deemed to have been duly given: (i) on the date of delivery if personally delivered by hand, (ii) upon the third day after such notice is (a) deposited in the United States mail, if mailed by registered or certified mail, postage prepaid, return receipt requested, or (b) sent by a nationally recognized overnight express courier:

If to Investor: One Microsoft Way #Bldg 8  
North Office 2211  
Redmond, Washington 98052

If to Company: Data Return Corporation  
801 Stadium Drive, Suite 117  
Arlington, Texas 76011

With a copy (which shall not constitute notice) to:

Thompson & Knight, P.C.  
801 Cherry Street, Suite 1600  
Fort Worth, Texas 76102  
Attention: Stephen B. Norris

Such addresses may be changed, from time to time, by means of a notice given in the manner provided in this Section 5.6.

5.7 Amendments and Waivers. Any term of this Agreement may be amended and the observance of any term of this Agreement may be waived (either generally or in a particular instance and either retroactively or prospectively), only with the written consent of Company and Investor. Any amendment or waiver effected in accordance with this Section shall be binding upon the Company, Investor, each other Holder, each successor or assignee of Investor or Holders and the Company. No waiver of any of the provisions of this Agreement shall be deemed to be or shall constitute a waiver of any other provisions hereof, whether or not similar, nor shall any such waiver constitute a continuing waiver. No waiver shall be binding unless expressed as such in a document executed by the party making the waiver.

5.8 Severability. If one or more provisions of this Agreement are held to be unenforceable under applicable law, such provision(s) shall be excluded from this Agreement and the balance of the Agreement shall be interpreted as if such provision(s) were so excluded and shall be enforceable in accordance with its terms.

5.9 Entire Agreement. This Agreement and the documents referred to herein constitute the entire agreement among the parties and no party shall be liable or bound to any other party in any manner by any warranties, representations, or covenants except as specifically set forth herein or therein.

5.10 Indemnification. The Company will indemnify Investor and each other Holder for any claims brought against Investor or any other Holder by any third party (including without limitation any other shareholder of the Company), or any other liabilities, in any case as a result of or related to the issuance and sale by the Company of the Shares to Investor.

5.11 No Inconsistent Agreements. The Company shall not, after the date of this Agreement, enter into any agreement with respect to any of its



securities that is inconsistent with the rights granted to Investor or the other Holders in this Agreement or otherwise

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conflicts with the provisions hereof. In furtherance but not in limitation of the preceding sentence, after the date of this Agreement, the Company shall not, without the prior written consent of Investor and the Holders of a majority of the Registrable Securities then outstanding, enter into any agreement with any holder or prospective holder of any securities of the Company that would grant such holder registration rights senior to those granted to Investor and Holders hereunder.

\* \* \* \*

[Remainder of page intentionally left blank.]

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IN WITNESS HEREOF, the parties hereto have entered into and executed this Agreement as of the date and year first above written.

DATA RETURN CORPORATION

By:

-----  
Sunny C. Vanderbeck, Chief Executive Officer

Investor:

MICROSOFT CORPORATION

By: /s/ SALMAN ULLAH

-----  
Name: Salman Ullah  
Title: Director, Corporate Development

We consent to the reference to our firm under the captions "Summary Financial Information", "Selected Financial Data" and "Experts" and to the use of our report dated May 18, 1999, except for Note 9, as to which the date is September 10, 1999, in Amendment No. 2 to the Registration Statement (Form S-1 No. 333-84011) and related Prospectus of Data Return Corporation dated September 10, 1999.

/s/ Ernst & Young LLP

Dallas, Texas

September 10, 1999

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