



DATATRAK International, Inc.
Annual Report
December 31, 2016

(OTC Pink Basic Disclosure Guidelines)

1) Name of the issuer and its predecessors (if any)

DATATRAK International, Inc. hereinafter referred to as “DATATRAK” or the “Company”.

2) Address of the issuer’s principal executive offices

Company Headquarters

5900 Landerbrook Dr.
Suite 170
Mayfield Heights, OH 44124
Phone: (440) 443-0082
Email: marketing@datatrak.com
Website: www.datatrak.com

Investor Relations Contact

Alex Tabatabai, Chairman of the Board of Directors
5900 Landerbrook Dr.
Suite 170
Mayfield Heights, OH 44124
Phone: (440) 443-0082
Email: investor@datatrak.com
Website(s): www.datatrak.com

3) Security Information

Trading Symbol: DTRK

Exact title and class of securities outstanding as of December 31, 2016:

Common Shares

The Company is authorized to issue 25,000,000 no par value Common Shares (the “Common Shares”). The Common Shares are traded through the OTC Pink Markets under the symbol “DTRK” (CUSIP 238134209). As of December 31, 2016, 1,766,743 Common Shares were outstanding.

	<u>Dec. 31, 2016</u>	<u>Dec. 31, 2015</u>
Shares authorized	25,000,000	25,000,000
Shares outstanding	1,766,743	1,514,718
No. of beneficial shareholders	Greater than 100	Greater than 100
No. of shareholders of record	101	68

Preferred Shares

The Company is authorized to issue 1,000,000 no par value Preferred Shares (the “Preferred Shares”) with such rights and preferences and in such series as determined by the Articles of Incorporation and/or the Board of Directors at the time of issuance. No Preferred Shares were issued or outstanding as of December 31, 2016.

	<u>Dec. 31, 2016</u>	<u>Dec. 31, 2015</u>
Shares authorized	1,000,000	1,000,000
Shares outstanding	-	-
No. of beneficial shareholders	-	-
No. of shareholders of record	-	-

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Transfer Agent

By Mail:

Computershare Investor Services
P.O. Box 43078
Providence, RI 02940

By Overnight Delivery:

Computershare Investor Services
250 Royall Street
Canton, MA 02021

By Telephone:

1-800-622-6757 (toll free within the United States, Canada and Puerto Rico)
1-781-575-4735 (international direct dial)

Computershare, Inc. is currently registered under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and is an authorized transfer agent subject to regulation by the U.S. Securities and Exchange Commission (the “SEC”).

List any restrictions on the transfer of security:

DATA TRAK International, Inc. Common Shares are not registered with the SEC and, therefore, have a restricted legend affixed to the front of any share certificates. For non-affiliates, the restriction can be removed once the shares have been held for a period of one year.

Describe any trading suspension orders issued by the SEC in the past 12 months:
None

List any stock split, stock dividend, recapitalization, merger, acquisition, spin-off, or reorganization either currently anticipated or that occurred within the past 12 months:
None

4) Issuance History

As of January 1, 2015, the Company had 1,440,849 Common Shares outstanding.

On January 30, 2015, the Board of Directors of the Company made a discretionary contribution to each eligible employee’s 401(k) account in restricted Common Shares of DATA TRAK’s stock with a value equal to 3% of eligible employee’s salaries, not to exceed the amount contributed by the employee. The total number of restricted shares granted in connection with such match was 20,271. The shares were issued out of the authorized but unissued share account.

On March 17, 2015, the Board of Directors of the Company made restricted share grants to certain officers and key employees in lieu of the payment of bonus amounts under the 2014 Cash Incentive Plan. Based on the closing stock price on March 17, 2015, 46,127 restricted shares were awarded to certain officers and key employees outside of the 2013 Omnibus Plan. These shares were subject to certain restrictions, including a provision that the participant’s shares would be forfeited if such participant ceased to be employed by the Company prior to the one-year anniversary of the grant.

On November 17, 2015, as part of the Company’s retention plan, the Board of Directors of the Company made restricted share grants to certain employees. The restricted shares would be forfeited if the grantee’s employment lapsed for any reason prior to the first anniversary of the grant date. Restricted shares totaling 47,250 were granted; however, 25,800 shares have been forfeited to date.

On November 17, 2015, the Board of Directors of the Company purportedly made restricted share grants to non-employee Directors in lieu of the payment of 75% of the quarterly cash amounts purportedly due under the Director Compensation Plan. Based on the closing stock price on November 17, 2015, 2,938 restricted shares were purportedly awarded to non-employee Directors outside of the 2013 Omnibus Plan.

The total number of shares issued out of treasury shares in connection with the DATA TRAK International, Inc. Employee Stock Purchase Plan (“ESPP”) in 2015 was 4,533.

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As of December 31, 2015, the Company had 1,514,718 Common Shares outstanding.

On January 31, 2016, the Company made a discretionary contribution to each eligible employee's 401(k) account in restricted Common Shares of *DATATRAK*'s stock with a value equal to 3% of eligible employee's salaries, not to exceed the amount contributed by the employee. The total number of restricted shares granted in connection with such match was 36,105. The shares were issued out of the authorized but unissued share account.

The total number of shares issued out of treasury shares in connection with the ESPP in 2016 was 4,132.

On April 5, 2016, in connection with the Stock Purchase Agreement ("SPA") entered into with Tabatabai Investment Partners LP the Company agreed to issue Common Stock in exchange for receiving \$250,000 on April 8, 2016. It was also agreed that Tabatabai would cancel \$300,000 of indebtedness in exchange for a number of shares of Common Stock of *DATATRAK* equal to the amount of \$300,000 divided by the price per share equal to \$3.50. Restricted Common Shares totaling 157,142 were issued to Tabatabai Investment Partners LP based on a market price of \$3.50 under this agreement. For additional information regarding these financings, see Note 2. Capital Investment and Note 11. Long-Term Debt to the consolidated financial statements included in this report. These financings were private placements exempt from registration under the Securities Act of 1933, as amended.

On April 12, 2016, the Board of Directors of the Company made restricted share grants to non-employee Directors in lieu of cash payments under the Director Compensation Plan for the first quarter of 2016. Based on the closing stock price on April 12, 2016, 4,341 restricted shares were granted to non-employee Directors outside of the 2013 Omnibus Plan.

On August 5, 2016, the Board of Directors of the Company made restricted share grants to non-employee Directors under the Director Compensation Plan for the second quarter of 2016. Based on the closing stock price on August 5, 2016, 5,019 restricted shares were granted to non-employee Directors outside of the 2013 Omnibus Plan.

On October 3, 2016, the Board of Directors of the Company made restricted share grants to non-employee Directors under the Director Compensation Plan for the third quarter of 2016. Based on the closing stock price on October 3, 2016, 3,836 restricted shares were granted to non-employee Directors outside of the 2013 Omnibus Plan.

On October 3, 2016, Board of Directors of the Company granted 20,000 Common Shares of the Company to James R. Ward, the Chief Executive Officer of the Company, pursuant to his employment agreement. The Common Shares were in consideration of his service since February 23, 2016 for \$1.00 per month. The Common Shares were granted as of the close of business on October 3, 2016 at \$7.75 per share.

On November 17, 2016, 21,450 shares out of 47,250 restricted shares granted to qualified employees as part of the retention plan on November 17, 2015 vested; the remaining 25,800 shares were forfeited.

As of December 31, 2016, the Company had 1,766,743 Common Shares outstanding.

All Common Shares issued by *DATATRAK* International, Inc. contain a restrictive legend since the shares are not registered with the SEC. Common Shares must be held by non-affiliates for one year for the restrictive legend to be removed. Affiliates remain subject to the restrictions under the Rule 144 promulgated under the Securities Act of 1933, as amended, as long as they are affiliates of the Company and for 90 days thereafter.

5) Financial Statements

See the following pages for current financial information and footnotes.

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INDEPENDENT AUDITORS' REPORT

TO THE BOARD OF DIRECTORS
DATATRAK INTERNATIONAL, INC.

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of *DATATRAK* International, Inc. and Subsidiaries, which comprise the consolidated balance sheet as of December 31, 2016, and the related consolidated statements of operations and changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of *DATATRAK* International, Inc. and Subsidiaries as of December 31, 2016, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Prior Period Consolidated Financial Statements

The consolidated financial statements of *DATATRAK* International, Inc. and Subsidiaries as of December 31, 2015, were audited by other auditors whose report dated April 8, 2016, expressed an unmodified opinion on those statements

SKODA MINOTTI & CO.



Cleveland, Ohio
March 1, 2017

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CONSOLIDATED BALANCE SHEETS

	<u>December 31, 2016</u>	<u>December 31, 2015</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 2,465,721	\$ 1,354,857
Accounts receivable, net of allowance for doubtful accounts of \$15,000 and \$15,000, respectively	682,252	895,723
Prepaid expenses	183,600	303,171
Total current assets	<u>3,331,573</u>	<u>2,553,751</u>
Property and equipment		
Equipment	370,737	448,376
Software, net of impairment	3,583,168	2,650,173
Leasehold improvements	43,434	55,433
	<u>3,997,339</u>	<u>3,153,982</u>
Less accumulated depreciation and amortization	<u>2,398,798</u>	<u>2,233,864</u>
Property and equipment, net	<u>1,598,541</u>	<u>920,118</u>
Other assets		
Certificate of deposit	301,316	300,724
Deferred tax asset – noncurrent	14,096,300	14,434,800
Deferred tax asset valuation allowance - noncurrent	(14,096,300)	(14,434,800)
Deposits	11,396	56,975
Total other assets	<u>312,712</u>	<u>357,699</u>
Total assets	<u>\$ 5,242,826</u>	<u>\$ 3,831,568</u>
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current liabilities		
Accounts payable	\$ 329,364	\$ 484,666
Notes payable – current	855,853	96,875
Accrued expenses	816,936	1,212,629
Deferred revenue	3,185,319	3,121,597
Total current liabilities	<u>5,187,472</u>	<u>4,915,767</u>
Long-term liabilities		
Long-term debt	14,102	37,647
Deferred revenue - long-term	1,887,033	3,055,826
Other long-term liabilities	150,000	—
Total long-term liabilities	<u>2,051,135</u>	<u>3,093,473</u>
Shareholders' deficit		
Serial Preferred Shares, without par value, 1,000,000 shares authorized, none issued	—	—
Common Shares/Additional paid in capital, without par value, authorized 25,000,000 shares; issued 1,780,230 shares as of December 31, 2016 and 1,532,337 as of December 31, 2015; outstanding 1,766,743 as of December 31, 2016 and 1,514,718 shares as of December 31, 2015	84,723,628	83,577,223
Treasury Shares, 13,487 shares as of December 31, 2016 at cost; 17,619 shares as of December 31, 2015 at cost	(18,496,810)	(18,515,503)
Accumulated deficit	(68,222,599)	(69,239,392)
Total shareholders' deficit	<u>(1,995,781)</u>	<u>(4,177,672)</u>
Total liabilities and shareholders' deficit	<u>\$ 5,242,826</u>	<u>\$ 3,831,568</u>

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS

For the Year Ended December 31,

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Revenue	\$ 8,982,867	\$ 9,959,704	\$ 11,010,792
Direct costs	<u>1,604,219</u>	<u>2,078,246</u>	<u>2,199,756</u>
Gross profit	7,378,648	7,881,458	8,811,036
Selling, general and administrative expenses.....	6,042,427	10,574,731	10,009,461
Depreciation and amortization	<u>253,467</u>	<u>189,863</u>	<u>81,796</u>
Income (loss) from operations	1,082,754	(2,883,136)	(1,280,221)
Other income (expense):			
Interest income.....	792	2,325	1,405
Interest expense.....	(48,092)	(14,742)	(14,018)
Other	<u>(6,025)</u>	<u>(3,317)</u>	<u>—</u>
Income (loss) before income taxes.....	1,029,429	(2,898,870)	(1,292,834)
Income tax expense	<u>12,636</u>	<u>—</u>	<u>—</u>
Net income (loss)	<u>\$ 1,016,793</u>	<u>\$ (2,898,870)</u>	<u>\$ (1,292,834)</u>
Net income (loss) per share:			
Net income (loss) per share, basic.....	<u>\$ 0.60</u>	<u>\$ (1.93)</u>	<u>\$ (0.90)</u>
Weighted-average shares outstanding, basic	<u>1,680,859</u>	<u>1,498,717</u>	<u>1,430,644</u>
Net income (loss) per share, diluted.....	<u>\$ 0.55</u>	<u>\$ (1.93)</u>	<u>\$ (0.90)</u>
Weighted-average shares outstanding, diluted	<u>1,833,869</u>	<u>1,498,717</u>	<u>1,430,644</u>

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Year Ended December 31,		
	2016	2015	2014
Operating Activities			
Net income (loss)	\$ 1,016,793	\$ (2,898,870)	\$ (1,292,834)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	253,467	189,863	81,796
Loss on the disposal of assets	6,025	3,317	—
Stock-based compensation	469,230	247,534	239,186
Changes in operating assets and liabilities:			
Accounts receivable	213,471	247,322	(58,668)
Prepaid expenses and other current assets	319,088	556,353	(85,054)
Accounts payable and accrued expenses	28,982	257,928	381,508
Interest payable	36,436	—	—
Deferred revenue	(1,105,071)	6,712	1,745,544
Net cash provided by (used in) operating activities	<u>1,238,421</u>	<u>(1,389,841)</u>	<u>1,011,478</u>
Investing Activities			
Purchases of property and equipment	(6,785)	(91,111)	(22,140)
Capitalization of software development costs	(929,336)	(477,464)	(264,741)
Proceeds from the disposal of equipment	18,214	1,075	—
Certificate of deposit investment	(592)	(724)	(300,000)
Net cash used in investing activities	<u>(918,499)</u>	<u>(568,224)</u>	<u>(586,881)</u>
Financing Activities			
Proceeds from the issuance of common stock	250,000	—	—
Line of credit	750,000	—	—
Payments of long-term debt and notes payable	(224,947)	(223,256)	(269,979)
Proceeds from ESPP	15,889	25,679	50,029
Net cash provided by (used) in financing activities	<u>790,942</u>	<u>(197,577)</u>	<u>(219,950)</u>
Increase (decrease) in cash and cash equivalents	1,110,864	(2,155,642)	204,647
Cash and cash equivalents at beginning of year	1,354,857	3,510,499	3,305,852
Cash and cash equivalents at end of year	<u>\$ 2,465,721</u>	<u>\$ 1,354,857</u>	<u>\$ 3,510,499</u>
Cash paid during the year for interest	<u>\$ 11,973</u>	<u>\$ 16,351</u>	<u>\$ 11,876</u>
Supplemental Schedule of Noncash Activities:			
Noncash financing			
Oracle note payable	31,817	—	—
Insurance note payable	122,121	192,410	176,461
Dell leases	—	(2,665)	(9,931)
Bonuses paid in stock	—	260,621	174,824
401(k) match paid in stock	129,978	140,884	143,054
Non-cash payment of debt in shares	300,000	—	—

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS' DEFICIT

	<u>Common Shares/Additional Paid in Capital</u>		<u>Treasury Shares</u>		<u>Accumulated Deficit</u>	<u>Total</u>
	<u>Number of Shares</u>	<u>Stated Amount</u>	<u>Number of Shares</u>	<u>Cost</u>		
Balance at January 1, 2014	1,418,036	\$82,559,304	51,040	\$(18,779,395)	\$(65,047,688)	\$(1,267,779)
Stock-based compensation	30,141	230,357		8,829		239,186
Employer Stock Purchase Plan			(8,321)	50,029		50,029
401K match...	14,824	143,054				143,054
Management bonus			(20,567)	174,824		174,824
Net loss	_____	_____	_____	_____	<u>(1,292,834)</u>	<u>(1,292,834)</u>
Balance at December 31, 2014.....	1,463,001	\$82,932,715	22,152	\$(18,545,713)	\$(66,340,522)	\$(1,953,520)
Stock-based compensation	2,938	243,003		4,531		247,534
Employer Stock Purchase Plan			(4,533)	25,679		25,679
401K match...	20,271	140,884				140,884
Management bonus	46,127	260,621				260,621
Net loss	_____	_____	_____	_____	<u>(2,898,870)</u>	<u>(2,898,870)</u>
Balance at December 31, 2015.....	1,532,337	\$83,577,223	17,619	\$(18,515,503)	\$(69,239,392)	\$(4,177,672)
Stock-based compensation	54,646	466,427		2,803		469,230
Employee Stock Purchase Plan			(4,132)	15,890		15,890
Stock Purchase Agreement ..	157,142	550,000				550,000
401K match...	36,105	129,978				129,978
Net income	_____	_____	_____	_____	<u>1,016,793</u>	<u>1,016,793</u>
Balance at December 31, 2016.....	<u>1,780,230</u>	<u>\$84,723,628</u>	<u>13,487</u>	<u>\$(18,496,810)</u>	<u>\$(68,222,599)</u>	<u>\$(1,995,781)</u>

See notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All numbers in the Notes to the Consolidated Statements have been rounded to the nearest thousand)

1. Description of Business

DATATRAK is a leading technology and services company delivering global eClinical solutions for the clinical trials industry. The Company's services support clients in the clinical pharmaceutical, biotechnology, contract research organization ("CRO") and medical device research industries by accelerating the completion of clinical trials more efficiently and safely by providing improved data quality and real time access to information on a global scale. The Company has three wholly-owned subsidiaries, DATATRAK, Inc., CF Merger Sub, Inc. ("Merger Sub") and DTRAK, Inc., which are inactive holding companies with no employees and do not provide any services to the Company or its customers. The Company established a UK entity to support the European sales activities during 2014. DATATRAK Technologies Limited is a private limited company registered in England and Wales under number 8870946, registered office: One New Change, London, EC4M 9AF, England. Although DATATRAK Technologies Limited is an active company, it has no employees and does not provide any services.

2. Capital Investment

The Company has experienced continuous net losses, negative cash flows from operations and working capital deficiencies. In order to address any working capital needs the Company may have faced during 2016, on April 8, 2016, DATATRAK entered into a convertible promissory note (the "Note") with Tabatabai Investment Partners LP, a related party, which is controlled by Mr. Alex Tabatabai, Chairman of the Board of Directors of the Company. On August 5, 2016, the parties entered into an amendment to the Note, which changed the maximum principal amount from \$750,000 to \$1,500,000 in the aggregate. The Note provides for monthly draws on the first day of each month through March 31, 2017 when the cash balance of the Company is less than a minimum threshold amount or upon request by the Company. The maximum monthly draw is limited to the difference between the minimum threshold amount and the Company's cash balance, or a draw by the Company of up to \$750,000, up to an aggregate of \$1,500,000 during the term of the Note. The Note carries an interest rate of twelve percent on outstanding draws and matures on June 30, 2017. At any time prior to or on the maturity date, Tabatabai Investment Partners LP has the option to convert all or any portion of the principal balance and accrued but unpaid interest then outstanding under the Note into shares of the Company's Common Stock, calculated by dividing the amount being converted by \$3.50. As of the maturity date, the Note permits the repayment of draws and interest to be in the Company's Common Stock at market prices, calculating the number of shares of the Company's Common Stock to be issued by dividing the amount being converted by \$3.50. The Note includes customary default, change control and acceleration provisions. The Company made a draw under this agreement in August 2016 for \$750,000.

The Company entered into a Stock Purchase Agreement ("SPA") with Tabatabai Investment Partners LP to issue Company Common Stock in exchange for receiving \$250,000 on April 8, 2016. It was also agreed that Tabatabai would cancel \$300,000 of indebtedness in exchange for a number of shares of Common Stock of DATATRAK equal to the amount of \$300,000 divided by the price per share equal to \$3.50. Common Shares totaling 157,142 were issued to Tabatabai Investment Partners LP based on a market price of \$3.50 under this agreement as of April 5, 2016.

DATATRAK continuously evaluates its cost structure to timely match its cost structure with anticipated revenue and backlog. Although the Company has recently made strategic investments in its infrastructure in order to support longer-term growth, DATATRAK will continue to carefully evaluate its cost structure and implement cost cutting measures if its revenue and sales trend performance fall below its minimum expectations. In such an event, DATATRAK may also need to raise additional capital in order to fund its operations, or to cover liquidity needs beyond 2016. The Company may raise additional funds by selling debt or equity securities, by entering into strategic relationships or through other arrangements. Additional capital may not be available on acceptable terms, if at all. To the extent that additional equity capital is raised, it could have a dilutive effect on the existing shareholders.

3. Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

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Revenue Recognition and Deferred Revenue

DATATRAK recognizes revenue in accordance with SEC Staff Accounting Bulletin Topic 13, “Revenue Recognition,” and Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 605, “Revenue Recognition Multiple-Element Arrangements.” The Company recognizes revenue when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery of the product or service has occurred; the fee is fixed or determinable; and collectability is probable.

DATATRAK’s non-enterprise contracts provide a fixed price for each element to be delivered, and revenue is recognized as each multiple-element is delivered. In the case of multiple-element arrangements, the Company does enter into agreements that combine both professional services and application services. These revenues qualify as separate units of accounting in accordance with Accounting Standards Update (“ASU”) No. 2009-13 because they have value to the customer on a standalone basis. DATATRAK’s application services are frequently sold without professional services which indicate that they have standalone value. Professional services are also frequently sold separately by the Company or other vendors, which also indicate standalone value. The Company determines the price of individual elements included in multiple-element arrangements using objective, reliable evidence of fair value. This evidence is based on the vendor-specific price per element for which the Company would sell an item on a standalone basis.

DATATRAK recognizes revenue based on the performance or delivery of the following specified services or components of its contracts in the manner described below:

- Enterprise agreement revenue is recognized as services are performed, which is typically consistent with ratable recognition over the life of the contract.
- Licensing revenue (patient, points, randomization, inventory, safety case manager and user licensing) is recognized ratably over the life of the license agreement.
- Hosting revenue is recognized ratably over the term of the trial.
- Project management and data management (design, testing, quality assurance, consulting, report and export) service revenue is recognized proportionally over the life of a contract as services are performed, based on the contractual billing rate for those services.
- Data item revenue is earned based on a price per data unit as data items are entered into DATATRAK’s unified software suite.
- Classroom training services revenue is recognized as classroom training is completed, at rates based on the length of the training program.
- Internet-based training services revenue is recognized on a per user basis as self-study courses are completed and successfully passed.
- Help Desk revenue is recognized based on a monthly price per registered user or site under the contract.
- Clinical Trial Management System revenue is recognized based on a monthly price per authorized user, clinical trial and base fee under the contract.
- Clinical Data Management revenue is recognized proportionally over the life of a contract as services are performed based on the contractual billing rate for those services.

Services provided by DATATRAK that are in addition to those provided for in its contracts are billed on a fee for service basis as services are completed. Costs associated with contract revenue are recognized as incurred. Costs that are paid directly by the Company’s clients, and for which the Company does not bear the risk of economic loss, are excluded from revenue. The termination of a standard contract will not typically result in a material adjustment to the revenue or costs previously recognized.

Deferred revenue represents cash advances received in excess of revenue earned on contracts. Payment terms vary with each contract but may include an initial payment at the time the contract is executed, with future payments dependent upon the completion of certain contract phases or targeted milestones. In the event of contract cancellation, the Company is entitled to payment for all work performed through the point of cancellation. Likewise, in the event of contract cancellation prior to earning revenue equal to or greater than the initial payment, the Company is generally not required to refund the unused portion.

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Deferred revenue not subject to potential refund as of December 31, 2016 totaled \$4,986,000. The Company's deferred revenue balance, including the long-term portion, was \$5,072,000 at December 31, 2016, of which \$86,000 was subject to refund, compared to \$6,177,000 at December 31, 2015, of which \$547,000 was subject to refund.

Concentration of Credit Risk

The Company is subject to credit risk through accounts receivable and cash equivalents. The Company does not require collateral and its accounts receivable are unsecured. The cash equivalents are placed with high credit-quality financial institutions. The Company limits the amount of credit exposure in any one institution or type of investment instrument.

Cash and cash equivalents are maintained at financial institutions and, at times, balances may exceed federally insured limits. The Company has never experienced any losses related to these balances. Interest-bearing amounts on deposit in excess of federally insured limits at December 31, 2016 and December 31, 2015 approximated \$2,216,000 and \$1,105,000, respectively.

Accounts Receivable

The Company generally invoices its customers on a monthly basis with payment terms of net 30 days from invoice date. The accounts receivable amount is recorded net of an estimated reserve for doubtful accounts. The Company has a history of favorable collections and had a reserve for uncollectible accounts of \$15,000 at both December 31, 2016 and December 31, 2015. The Company's average collection period was 35 days as of December 31, 2016 compared to 41 days as of December 31, 2015. The net accounts receivable balance was \$682,000 and \$896,000 at December 31, 2016 and December 31, 2015, respectively.

Property and Equipment

Property and equipment are stated at cost. Depreciable assets consist of office and computer equipment, software and leasehold improvements. Depreciation and amortization on office and computer equipment and software are computed using the straight-line method over estimated useful lives of three to seven years. Leasehold improvements are amortized using the straight-line method over the lesser of the assets' estimated useful life or the lease term. Depreciation and amortization expense related to depreciable assets, including assets recorded under capital leases, was \$253,000, \$190,000 and \$82,000 for 2016, 2015 and 2014, respectively.

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with FASB ASC 718, "*Stock Compensation*," using the "modified prospective" method. On May 14, 2013, the Company's Board of Directors approved the 2013 Omnibus Equity Plan ("2013 Omnibus Plan"), thereby replacing the 2011 Omnibus Equity Plan ("2011 Omnibus Plan") as the primary share-based incentive award program for covered employees and directors. The 2011 Omnibus Plan was the primary share-based incentive award program from its approval on August 10, 2011 until the approval of the 2013 Omnibus Plan. Prior to the 2011 Omnibus Plan, the 2009 Omnibus Equity Plan (the "2009 Omnibus Plan") was the Company's primary share-based incentive award program for covered employees and directors from its approval on August 26, 2009 until the approval of the 2011 Omnibus Plan. Common Share options have been awarded under the 2013 Omnibus Plan, the 2011 Omnibus Plan and the 2009 Omnibus Plan. The Company used the Black-Scholes option valuation model to calculate the fair value of stock options granted.

Common Shares and Common Share options awarded to non-employee Directors are fully vested and compensation costs are completely expensed on the grant date. Compensation expense for share-based incentive awards granted to employees vest over the assigned vesting period and related compensation costs are amortized ratably over the vesting period. Stock compensation expense was \$469,000, \$248,000, and \$239,000 for the years ended December 31, 2016, 2015 and 2014, respectively. The Company's unamortized compensation cost, related to non-vested stock options and restricted Common Shares, at December 31, 2016, 2015 and 2014 was \$19,000, \$265,000 and \$365,000, respectively. The unamortized cost of \$19,000 at December 31, 2016 is expected to be amortized in the amounts of \$12,000 and \$7,000 in 2017 and 2018, respectively. The year-over-year increase in expense was due to the accelerated vesting of certain stock options issued under the 2013 Omnibus Plan and restricted stock awards granted to certain employees in November 2015. The 2013 Omnibus Plan was amended on December 29, 2015 to include a change in control clause that was actuated with the board resignations in February 2016.

Income Taxes

The Company follows FASB ASC 740. This accounting standard requires that the liability method be used in accounting for income taxes. Under this accounting method, deferred tax assets and liabilities are determined based on the differences between the

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financial reporting basis and the tax basis of assets and liabilities and are measured using the enacted tax rates and laws that apply in the periods in which the deferred tax asset or liability is expected to be realized or settled. A valuation allowance is provided for deferred tax assets for which realization currently is not more likely than not. Quarterly income taxes are recorded at the effective rate, based on annual forecasted income. The Company currently is in an overall cumulative loss position totaling approximately \$40 million. As a result, the Company recorded a full valuation reserve against its net deferred tax assets in 2009 and the full valuation reserve remained on the books through December 31, 2016. However, due to effect of Alternative Minimum Tax ("AMT"), the Company recorded a tax expense provision of \$12,600 for the year ended December 31, 2016. There was no provision necessary for the previous two years.

In accordance with FASB ASC 740-10, the Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likelihood of being recognized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. As of December 31, 2016, 2015 and 2014, the Company had no uncertain income tax positions.

Use of Estimates

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

Financial Instruments

The carrying values of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued expenses are reasonable estimates of fair value due to the short-term nature of these financial instruments.

Advertising Costs

Advertising costs are expensed as incurred and are included in selling, general and administrative expenses. Advertising costs were \$178,000, \$363,000 and \$356,000 for 2016, 2015 and 2014, respectively. The year-over-year decrease was due to less trade show attendance and a re-evaluation of previously used advertising methods to ensure a higher rate of return.

Software Development Costs

Development costs incurred in the research and development of new software products, enhancements to existing software products and maintenance activities are accounted for in accordance with FASB ASC 350-40, "Accounting for Cost of Internal-Use Software, Including Enterprise Software." Post-implementation stage activities such as maintenance or modifications that do not result in additional functionality are expensed as incurred. Enhancements to the software, which enable the software to perform tasks that it was previously incapable of performing, are to be capitalized based on the assigned fair value. If the project contains both elements of upgrades that provide additional functionality and maintenance, cost is allocated based on relative fair values. If the cost cannot be allocated between maintenance and upgrades on a reasonable basis, all cost is expensed as incurred.

The Company capitalized software development costs that provided additional functionality of \$929,000 during the year ended December 31, 2016 compared to \$477,000 for the year ended December 31, 2015 and \$265,000 for the year ended December 31, 2014.

Research and development expenses included in selling, general and administrative expenses were \$884,000, \$1,289,000 and \$1,286,000 in 2016, 2015 and 2014, respectively.

Subsequent Events

The Company has evaluated subsequent events through March 2, 2017. In January 2017, a lease amendment was executed for additional office space in Mayfield Heights, OH, which will adjoin the current office location. The amendment also extended the overall lease by approximately 5 years. Also in January 2017, a lease was executed for office space in College Station, TX. The College Station, TX office space will replace the office location in Bryan, TX. The lease term is 3 years. Both of the executed leases are included in Note 10. Operating Leases.

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In January 2017, the Company made a second draw of \$750,000 under the Note with Tabatabai Investment Partners LP, a related party, which is controlled by Mr. Tabatabai, Chairman of the Board of Directors of the Company. The total drawn under the Note to date is \$1,500,000, which is the maximum amount permitted to be drawn under the Note.

Reclassification

Certain prior year amounts have been reclassified to conform to the current year presentation.

4. Recently Adopted Accounting Standards

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, “*Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern*”, which explicitly requires management to assess an entity’s ability to continue as a going concern and to provide related footnote disclosures in certain circumstances. There was previously no guidance in GAAP about management’s responsibility to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern or to provide related footnote disclosures. The amendments in this update provide that guidance. In doing so, the amendments should reduce diversity in the timing and content of footnote disclosures. The amendments require management to assess an entity’s ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. Specifically, the amendments (1) provide a definition of the term “substantial doubt”, (2) require an evaluation every reporting period including interim periods, (3) provide principles for considering the mitigating effect of management’s plans, (4) require certain disclosures when substantial doubt is alleviated as a result of consideration of management’s plans, (5) require an express statement and other disclosures when substantial doubt is not alleviated and (6) require an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). The amendments in this update are effective for the first annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The Company has early adopted this ASU in the fourth quarter of 2016. The adoption did not materially impact the Company’s disclosures.

In November 2015, the FASB issued ASU 2015-17, “*Income Taxes (Topic 740)*”. This ASU simplifies the presentation of deferred income taxes by requiring that deferred tax assets and liabilities be classified as non-current in a classified statement of financial position. This ASU may be applied either prospectively to all deferred tax assets and liabilities, or retrospectively to all periods presented for annual periods beginning after December 15, 2016 and interim periods thereafter (fiscal 2018), with early adoption permitted, and may require additional disclosure based on the application method selected. The Company prospectively early adopted this ASU in the fourth quarter of 2016. The adoption did not result in a material reclassification in our statement of financial position.

5. Recently Issued Accounting Standards

In May 2014, FASB issued ASU No. 2014-09, “*Revenue from Contracts with Customers (Topic 606)*,” which established a comprehensive revenue recognition standard for virtually all industries under U.S. GAAP, including those that previously followed industry-specific guidance such as real estate, construction and software industries. The revenue standard’s core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The statement is effective for public entities for annual periods beginning after December 15, 2017. The Company has decided to adopt the revenue recognition standard using the full retrospective transition method and is still evaluating the impact the adoption of the new standard will have on its consolidated financial statements.

In February 2016, FASB issued ASU 2016-02, “*Leases*.” ASU 2016-02 establishes a right-of-use (“ROU”) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is currently evaluating the potential impact of the adoption of ASU 2016-02 on the Company’s consolidated financial statements.

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In April 2016, FASB issued ASU 2016-10, *“Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing.”* ASU 2016-10 provides more detailed guidance, including additional implementation guidance and examples, of identifying performance obligations and licenses of intellectual property. The effective date and transition requirements for ASU 2016-10 are the same as the effective date and transition requirements of Topic 606. The Company has decided to adopt the revenue recognition standard using the full retrospective transition method and is still evaluating the impact the adoption of the new standard will have on its consolidated financial statements.

In May 2016, FASB issued ASU 2016-12, *“Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients.”* ASU 2016-12 does not alter the core principle of the new revenue standard, but amends the standard to clarify the following items: assessing collectability, presenting sales taxes and other taxes collected from customers, noncash consideration, contract modifications at transition, completed contracts at transition and disclosing the accounting change in the period of adoption. The effective date and transition requirements for ASU 2016-12 are the same as the effective date and transition requirements of Topic 606. The Company has decided to adopt the revenue recognition standard using the full retrospective transition method and is still evaluating the impact the adoption of the new standard will have on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, *“Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,”* which amends the impairment model by requiring entities to use a forward-looking approach based on expected losses to estimate credit losses on certain types of financial instruments, including trade receivables. The ASU is effective for public entities for fiscal years beginning after December 15, 2019, with early adoption permitted. Management has not yet completed its assessment of the impact of the new standard on the Company’s consolidated financial statements.

In August 2016, FASB issued ASU 2016-15, *“Classification of Certain Cash Receipts and Cash Payments.”* ASU 2016-15 clarifies how certain cash receipts and cash payments are presented in the statement of cash flows. The amendments are intended to reduce diversity in practice. The Company does not expect the adoption of ASU 2016-15 to have a material impact on the consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *“Statement of Cash Flows (Topic 230), Restricted Cash”*. The ASU requires that restricted cash and restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total cash amounts shown on the statement of cash flows. Consequently, transfers between cash and restricted cash will not be presented as a separate line item in the statement of cash flows. The amendment is effective for public business entities for the fiscal years beginning after December 15, 2017, and all interim periods within those fiscal years. The amendment should be applied retrospectively to each period presented. The Company does not expect the adoption of ASU 2016-18 to have a material impact on the Company’s consolidated financial statements.

In December 2016, the FASB issued ASU 2016-20, *“Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers.”* The ASU amends the new revenue standard. The amendments do not alter the core principle of the standard, but clarify certain narrow aspects of the standard including contract cost accounting, disclosures, illustrative examples and other matters. The Company has decided to adopt the revenue recognition standard using the full retrospective transition method and is still evaluating the impact the adoption of the new standard will have on its consolidated financial statements.

6. Recent Developments

DATATRAK entered into an employment agreement with CEO and President, James R. Ward, effective October 1, 2016. The employment agreement provided for an annual salary of \$220,000 and an immediate equity grant of 20,000 Common Shares of the Company in consideration of his service since February 23, 2016 for \$1.00 per month. The Common Shares were granted as of the close of business on October 3, 2016 at \$7.75 per share.

On December 1, 2016, DATATRAK held its annual shareholder meeting. At the Annual Meeting, shareholders elected Dr. Eric J. Wilhelm, Dr. Rizvan Mirza and Mr. Ben Tabatabai as Class II Directors to hold office for two-year terms ending at the 2018 Annual Meeting of Shareholders of the Company. Shareholders also ratified the appointment of Skoda Minotti & Co. as the Company’s independent auditor.

7. Accrued Expenses

Accrued expenses consist of the following:

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	<u>2016</u>	<u>2015</u>
Payroll and other employee costs.....	\$ 270,000	\$ 396,000
Professional fees	365,000	405,000
Other	182,000	412,000
	<u>\$ 817,000</u>	<u>\$ 1,213,000</u>

8. Income Taxes

Due to its utilization of net operating loss carryforwards, the Company had no state or local income tax expense in 2016, 2015 and 2014. However, due to AMT limitations on the use of net operating loss carryforwards, *DATA TRAK* recorded \$12,600 of federal income tax expense for the year ended December 31, 2016. No federal income tax was recorded for the years ended December 31, 2015 or 2014.

A reconciliation of income tax (benefit) at the U.S. federal statutory rate to the effective income tax rate is as follows:

	<u>Year Ended December 31,</u>		
	<u>2016</u>	<u>2015</u>	<u>2014</u>
Income tax (benefit) at the United States statutory rate	\$ 350,000	\$ (986,000)	\$ (440,000)
Change in valuation allowance	(338,500)	957,000	396,000
U.S. net operating loss adjustment	(4,000)	7,000	17,000
Non-deductible permanent differences	5,100	22,000	27,000
Income tax expense at the effective income tax rate	<u>\$ 12,600</u>	<u>\$ —</u>	<u>\$ —</u>

Due to uncertainty regarding the realization of the deferred tax asset resulting from its cumulative operating losses through 2016, the Company provided for a full valuation allowance against its net deferred tax assets at December 31, 2016 and 2015.

At December 31, 2016, the Company had a net operating loss carryforward of approximately \$40,383,000 for United States income tax purposes. An equity transaction completed on January 7, 2002 has limited the Company's net operating loss carryforwards incurred prior to that date, to a maximum amount of approximately \$1,000,000 per year, under Section 382 of the Internal Revenue Code. The Company's United States net operating loss carryforwards will begin expiring in the year 2018 and will be fully expired in the year 2035. Future utilization of the net operating losses could be further limited due to Section 382 limitations.

The significant components of the Company's deferred tax assets, stated in U.S. dollars, are as follows:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Deferred tax assets:		
U.S. net operating loss carryforwards	\$ 13,730,000	\$ 14,075,000
Alternative minimum tax credit carryforward	135,000	123,000
Foreign tax credit	116,000	116,000
Allowances and accruals	5,000	20,000
Restricted stock	23,000	9,000
Depreciation and amortization	87,000	92,000
	14,096,000	14,435,000
Valuation allowance	(14,096,000)	(14,435,000)
Gross deferred tax assets recorded	—	—
Net deferred tax asset recorded	<u>\$ -0-</u>	<u>\$ -0-</u>

At December 31, 2016, a valuation allowance of approximately \$14,096,000 remains against *DATA TRAK*'s deferred tax assets, which consist primarily of net operating loss carryforwards for U.S. income taxes. Of the \$14,096,000 total allowance, approximately \$13,730,000 is recorded against the portion of *DATA TRAK*'s deferred tax assets that represent net operating loss carryforwards for U.S. income taxes. The remaining \$366,000 valuation allowance is provided for other non-current deferred tax assets.

As of December 31, 2016, and 2015, the Company had no uncertain income tax positions.

The tax years 2013 through 2016 remain subject to U.S. tax examination.

In May 2014, FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)," which established a comprehensive revenue recognition standard for virtually all industries under U.S. GAAP, including those that previously followed industry-specific guidance such as real estate, construction and software industries. The revenue standard's core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and

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obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The statement is effective for public entities for annual periods beginning after December 15, 2017. DATATRAK does not expect the new standard to have a material impact to its tax position. The Company has decided to adopt the revenue recognition standard using the full retrospective transition method.

9. Net Income (Loss) per Share

The following table sets forth the computation of basic and diluted net income (loss) per share:

	Year Ended December 31,		
	2016	2015	2014
Net income (loss) used in the calculation of basic and diluted loss per share.....	\$ 1,017,000	\$ (2,899,000)	\$ (1,293,000)
Denominator for basic net income (loss) per share — weighted-average common shares outstanding.....	1,681,000	1,499,000	1,431,000
Effect of dilutive common share options and warrants.....	153,000	—	—
Denominator for diluted net income (loss) per share.....	1,834,000	1,499,000	1,431,000
Basic net income (loss) per share.....	\$ 0.60	\$ (1.93)	\$ (0.90)
Diluted net income (loss) per share.....	\$ 0.55	\$ (1.93)	\$ (0.90)
Weighted-average common share options and warrants excluded from the computation of diluted net income (loss) per share because they would have an anti-dilutive effect on net income (loss) per share	110,000	121,000	82,000

10. Operating Leases

The Company leases certain office equipment and space, some of which are under month-to-month agreements. Net rent expense relating to the operating leases was approximately \$389,000, \$524,000 and \$327,000 in 2016, 2015 and 2014, respectively. A lease amendment was signed in January 2017 to expand the space of the Mayfield Heights, OH office. A new lease was signed in January 2017 for office space in College Station, TX to replace the office space in Bryan, TX, which was under a month-to-month agreement. Although neither lease was executed as of December 31, 2016, the expected lease payments are included below to give an accurate representation of the future minimum lease payments for the years shown. Future minimum lease payments for the Company under non-cancelable operating leases are as follows:

Year Ending December 31,	Amount*
2017.....	\$ 532,000
2018.....	730,000
2019.....	740,000
2020.....	705,000
2021.....	709,000
Remainder	2,635,000
Total	\$ 6,051,000

* DATATRAK remains responsible for the master lease for the Chicago office space. The master lease contains material monthly escalation costs of \$19,300, which are included in the future minimum lease payments above.

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On July 7, 2016, the Company entered into a sublease agreement with OERM Software, Inc., now known as Sphera Solutions, Inc., for the Chicago, IL office space ("Chicago sublease"). The Chicago sublease covers the remaining term of the original lease. Future minimum lease payments expected to be received under the Chicago sublease agreement are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2017	\$ 392,000
2018	455,000
2019	462,000
2020	470,000
2021	477,000
Remainder.....	<u>2,105,000</u>
Total	<u>\$ 4,361,000</u>

11. Long-Term Debt

Long-term debt at December 31, 2016 and December 31, 2015 is summarized below:

	<u>2016</u>	<u>2015</u>
Capital lease agreement with Dell Financial Services, LLC	\$ 38,000	\$ 90,000
Oracle note payable	—	6,000
De Lage Landen note payable	14,000	—
Insurance note payable	32,000	39,000
Tabatabai Investment, Ltd. promissory note	<u>786,000</u>	<u>—</u>
Total debt	870,000	135,000
Less current maturities	<u>(856,000)</u>	<u>(97,000)</u>
Long-term debt	<u>\$ 14,000</u>	<u>\$ 38,000</u>

The Dell Financial Services, LLC Agreements were for the purchase of certain computer equipment. The terms of the lease agreements require *DATATRAK* to make 36 monthly payments, including accrued interest, in the following amounts: \$2,760 beginning in November 2014 and ending in September 2017; \$291 beginning in June 2015 and ending in May 2018; and \$586 beginning in July 2015 and ending in June 2018. All leases include bargain purchase options at the end of the lease term.

The Company entered into a financing agreement with Oracle Credit Corporation for payment of the Company's Oracle licensing and support premiums. The note bore interest at 21.9% and was due in four quarterly installments of \$2,000, including accrued interest, beginning in January 2016 and ending in August 2016.

The Company entered into a financing agreement with De Lage Landen Financial Services for the purchase of certain office equipment. The note bears interest at 6.7% and is due in monthly installments of \$396, including accrued interest, beginning in May 2015 and ending in May 2020.

The Company entered into a financing agreement with AFCO for payment of a portion of the Company's annual insurance premiums. The note bears interest at 3.45% and is due in monthly installments of \$15,992, including accrued interest, beginning in May 2016 and ending in February 2017.

On August 5, 2016, *DATATRAK* and Tabatabai Investment Partners LP entered into the first amendment to the convertible promissory note (the "Note") originally entered into on April 8, 2016. The Note was amended to change the maximum principal amount from \$750,000 to \$1,500,000, in aggregate. The Note was further amended to allow the Company to request a draw up to \$750,000. The Company requested and received a draw of \$750,000 in August 2016. The Note carries an interest rate of 12% on outstanding draws and matures on June 30, 2017. At any time prior to or on the maturity date, Tabatabai Investment Partners LP has the option to convert all or any portion of the principal balance and accrued but unpaid interest then outstanding under the Note into shares of the Company's Common Stock, calculated by dividing the amount being converted by \$3.50. As of the maturity date, the Note permits the repayment of draws and interest to be in the Company's Common Stock at market prices, calculating the number of shares of the Company's Common Stock to be issued by dividing the amount being converted by \$3.50. The Note includes customary default, change in control and acceleration provisions.

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12. Shareholders' Deficit

At December 31, 2016, the Company had reserved 388,546 Common Shares for the exercise of Common Share options under previously established share option plans. Of the 388,546 reserved shares, 260,191 shares are reserved for future grants under the Company's previously established share option plans and 128,355 are reserved for the exercise of outstanding stock options pursuant to the established share option plans. Since the 2013 Omnibus Plan is intended to serve as the primary equity incentive compensation plan for the Company, the 204,357 Common Share options that could have been granted pursuant to the Company's previously established share option plans are not expected to be granted. All recent equity awards were granted outside of the 2013 Omnibus Plan.

Shareholder Rights Plan

Effective September 5, 2007, in connection with the adoption of the rights agreement between the Company and National City Bank, as Rights Agent, dated September 5, 2007 (the "Rights Agreement"), the Board of Directors declared a dividend of one preferred share purchase right (a "Right") for each outstanding Common Share, payable to the Company's shareholders of record as of September 17, 2007 (the "Record Date"). Following the reverse stock split that was affected in June 2013, each Right now entitles the registered holder of the Common Shares on the Record Date to buy twelve one-hundredths of a share of Series A Junior Participating Preferred stock (a "Preferred Share") at an exercise price of \$11.70, subject to adjustment as provided in the Rights Agreement.

The Rights are not exercisable until the earlier to occur of (i) ten (10) days following a public announcement that a person or group of affiliated or associated persons (an "Acquiring Person") has acquired beneficial ownership of 15% or more of the Company's outstanding Common Shares or (ii) ten (10) business days (or such later date as may be determined by action of the Board of Directors prior to such time as any person or group of affiliated persons becomes an Acquiring Person) following the commencement of, or announcement of an intention to make, a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a person or group of 15% or more of the Company's outstanding Common Shares (the earlier of such dates being called the "Distribution Date").

Until the Rights are exercised, the holder has no rights as a shareholder of the Company, including, without limitation, the right to vote or to receive dividends. Except as provided for in the Rights Agreement, the Rights shall not be traded separately from the Common Shares and will expire on the earliest of (i) the close of business on September 5, 2017, (ii) the time at which the Rights are redeemed or (iii) the time at which such Rights are exchanged. Pursuant to the Rights Agreement, the purchase price payable and number of Preferred Shares issuable upon exercise of the Rights are subject to adjustment from time to time to prevent dilution upon the occurrence of certain events such as a stock dividend on, or a subdivision, combination or reclassification of the Preferred Shares.

On April 5, 2016, the Board of Directors approved an amendment to the Rights Agreement increasing the threshold of beneficial share ownership from 15% to 25% and removing the special exception for former CEO, Laurence P. Birch.

13. Retirement Savings Plan

The Company sponsors The DATATRAK International, Inc. Retirement Savings Plan (the "Plan") as defined by Section 401(k) of the Internal Revenue Code of 1986, as amended. The Plan covers substantially all United States employees who elect to participate. Participants may contribute their annual compensation into a variety of mutual fund options. Matching and profit sharing contributions by the Company are discretionary. The Company made a discretionary contribution in 2016, 2015 and 2014 to each eligible employee's 401(k) account in restricted Common Shares of DATATRAK's stock with a value equal to 3% of eligible employee's salaries, not to exceed the amount contributed by the employee. The total number of restricted shares granted in connection with such match was 36,105, 20,271, and 14,824, respectively, for discretionary contributions awarded in the year ended December 31, 2016, 2015 and 2014, respectively. During 2016, the Company accrued a 3% match, not to exceed the amount contributed by the employee, for all active participants in the plan who qualify for the match. The 2016 match will be payable in authorized, but previously unissued shares to the employee's 401(k) account in the first quarter of 2017.

14. Quarterly Data (Unaudited)

Selected quarterly data is as follows (in thousands, except per share data):

	Year Ended December 31, 2016			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue	\$ 2,398	\$ 2,402	\$ 2,136	\$ 2,047

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Gross profit	1,967	2,021	1,745	1,645
Income from operations	138	330	429	186
Net income	135	323	399	160
Basic net income per share	0.09	0.19	0.23	0.09
Diluted net income per share*	0.07	0.17	0.22	0.09

* Due to rounding, the quarterly diluted net income per share do not add to the full year diluted net income per share of \$0.56 for the year ended December 31, 2016.

	Year Ended December 31, 2015			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue	\$ 2,489	\$ 2,345	\$ 2,639	\$ 2,487
Gross profit	1,924	1,805	2,104	2,048
Loss from operations.....	(1,015)	(1,391)	(264)	(213)
Net loss	(1,018)	(1,394)	(268)	(219)
Basic net loss per share*	(0.70)	(0.92)	(0.18)	(0.14)
Diluted net loss per share*	(0.70)	(0.92)	(0.18)	(0.14)

* Due to rounding, the quarterly basic and diluted net loss per share do not add to the full year basic and diluted net loss per share of \$(1.93) for the year ended December 31, 2015.

15. Contingencies

On November 10, 2015, *DATATRAK* postponed the annual shareholder meeting scheduled for November 11, 2015 and under the direction of the previous Board initiated a lawsuit against Alex Tabatabai and Arosa Investment Management, LLC (collectively, “Arosa”). (See Case No. CV-15-854059, Cuyahoga County, Ohio Common Pleas Court). *DATATRAK* asserted various claims in connection with Arosa’s proxy contest involving three seats on the *DATATRAK* Board of Directors. On November 25, 2015, Arosa asserted counterclaims and individual and shareholder derivative third-party claims against *DATATRAK* and five then *DATATRAK* directors, Laurence P. Birch, Timothy G. Biro, James M. Karis, Jerome H. Kaiser and Nicholas A. Loiacono, as well as Andrew T. Pitler, who Arosa claimed was unlawfully appointed to *DATATRAK*’s board, and direct claims against *DATATRAK* and Mr. Birch. Arosa asserted various claims of unlawfully delaying the Board of Directors election that Arosa’s slate of director candidates had won going into the scheduled November 11, 2015 annual shareholder meeting.

On January 8, 2016, the 2015 *DATATRAK* annual shareholders’ meeting was held following two postponements, and Arosa’s slate prevailed by receiving approximately 62% of shareholder votes cast. Following the election, Arosa, Tabatabai, *DATATRAK*, Biro, Karis, Kaiser, Loiacono, and Pitler (collectively, the “Settling Parties”) commenced settlement discussions in an effort to avoid additional litigation expenses. As a result of these discussions, Kaiser, Karis, and Pitler agreed to resign from *DATATRAK*’s Board of Directors and Arosa agreed to a mutual release and dismissal with prejudice of all claims among the Settling Parties. None of the Settling Parties made any payment as part of the settlement.

On March 4, 2016, the Court granted a preliminary order to approve the proposed settlement agreement. The preliminary order required the parties to provide notice of the proposed settlement agreement to all *DATATRAK* shareholders, and provide shareholders with time to object. The Court received two objections. One was from a shareholder and the other was from Mr. Birch, who was terminated as CEO on February 23, 2016. On March 16, 2016, Birch filed a fourth-party complaint against *DATATRAK*, alleging a breach of contract claim against *DATATRAK* related to his employment agreement. On March 25, 2016, Birch amended his fourth-party complaint to add an indemnification claim against *DATATRAK*. On April 22, 2016, *DATATRAK* responded to Birch’s fourth-party complaint, denying the allegations asserted against it, and asserting a counterclaim against Birch, alleging claims for declaratory judgment, fraud, unjust enrichment, breach of the implied covenant of good faith and fair dealing, breach of fiduciary duty, and a claim under the faithless servant doctrine that Birch breached the implied condition of employment that he would carry out his duties in good faith and not act to the detriment of *DATATRAK*. On June 30, 2016, the Court issued an order requiring the settling parties to submit a revised notice of the proposed settlement for the Court’s consideration to clarify that the claims by and against Birch would not be covered by the proposed settlement, the impact of the proposed settlement regarding the released directors, and the parties’ positions with regard to indemnification. On August 15, 2016, the settling parties submitted the revised proposed notice. The Court then directed the parties to consider whether mediation may assist the parties in reaching a global resolution of all claims in the dispute. The parties subsequently participated in a mediation and are currently finalizing a proposed global resolution of the issues not addressed by the initial proposed settlement, and plan to submit this proposed global resolution of the dispute to the Court for

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preliminary approval in the near future. If approved, the parties will provide notice of the proposed global settlement to *DATATRAK*'s shareholders in a manner determined by the Court, prior to the Court's hearing on final approval of the settlement.

On May 27, 2016, former CFO Jennifer Mabe and former VP Legal Varnesh Sritharan filed a lawsuit against *DATATRAK* in the United States District Court for the Northern District of Ohio, Case No. 1:16 CV 01286, alleging claims for breach of contract related to their employment agreements, retaliation in violation of the Sarbanes Oxley Act, defamation and wrongful termination in violation of public policy. On August 24, 2016, *DATATRAK* filed a motion to dismiss the retaliation in violation of the Sarbanes Oxley Act, defamation and wrongful termination in violation of public policy claims; filed an answer denying the substance of the remaining claims; and filed a counterclaim against Ms. Mabe and Mr. Sritharan, alleging claims for declaratory judgment, breach of the implied covenant of good faith and fair dealing, breach of fiduciary duty, and a claim under the faithless servant doctrine that they breached the implied condition of employment that they would carry out their duties in good faith and not act to the detriment of *DATATRAK*. On September 13, 2016, Ms. Mabe and Mr. Sritharan filed a first amended complaint. On September 27, 2016, *DATATRAK* filed a motion to dismiss, answer, and counterclaim in response to the first amended complaint. Ms. Mabe and Mr. Sritharan have filed papers opposing *DATATRAK*'s motion to dismiss, which remains pending, and denying *DATATRAK*'s counterclaims. The Company believes the claims asserted by Ms. Mabe and Mr. Sritharan are without merit and intends to vigorously defend the same.

In addition to the foregoing, in the ordinary course of business, the Company is involved in ordinary, routine legal proceedings. Additionally, certain of the Company's revenues may be subject to sales and use tax in certain jurisdictions. The Company has assessed its positions and is of the opinion that the ultimate resolution of such matters will not have a material adverse effect on the results of operations, cash flows or the financial position of the Company.

16. Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

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6) Describe the Issuer's Business, Products and Services

(All numbers in this section have been rounded to the nearest thousand for discussion purposes)

A. Description of the issuer's business operations:

DATA TRAK International, Inc. ("DATA TRAK" or the "Company") is one of the first and leading technology and services company delivering global *unified eClinical*[™] solutions for the clinical trials industry, including electronic data capture ("EDC") and clinical trial management software ("CTMS") solutions. DATA TRAK provides clinical enterprise solutions to safely accelerate every drug, every biologic and every device *from Concept to Cure*[®]. Customers use DATA TRAK software to collect, review, transfer and store clinical trial data electronically in a secure environment. DATA TRAK customers are companies in the pharmaceutical, biotechnology, contract research organization ("CRO"), academic research organization ("ARO") and medical device industries. The Company's services support clients in accelerating the completion of clinical research more efficiently and safely by providing improved data quality and real time access to information on a global scale.

Enhancements are routinely made to the DATA TRAK unified platform, which continue to simplify the management of data for clinical research. On November 27, 2016, the Company released its newest product, UX CTMS 360[™]. The development of UX CTMS 360[™] was directed by members of the Company's Product Advisory Council ("PAC"). The system is deployed worldwide as Software as a Service ("SaaS") through the cloud and supports pre-clinical and Phase I – Phase IV drug and device studies in multiple languages throughout the world. DATA TRAK delivers a *unified eClinical*[®] platform that leverages the power of single database architecture, removing complexities in clinical research to deliver time and cost savings.

Financial Performance

The Company's revenue decreased \$977,000, from \$9,960,000 for the year ended December 31, 2015 to \$8,983,000 for the year ended December 31, 2016. The revenue decline was mainly due to decreased revenue from new contract sales but the Company also saw a decrease in revenue from contracts in backlog due to lower change orders and contract expansions. The decrease in revenue from new contract sales was due to the Company falling short of its sales goals during the latter half of 2015 and for 2016. It is no secret that the sales effort was challenged during this time period due to a depleted sales team and the leadership transition. DATA TRAK has made changes to its product offering, pricing and contracting process which it believes will lead to stronger customer relationships through greater transparency and help to build future revenue. Direct costs decreased by 23% during this same time period due to lower employee costs. The Company's gross margin was 82% for the year ended December 31, 2016 compared to 79% for the year ended December 31, 2015. SG&A expenses decreased by \$4,532,000, or 43%, for the year ended December 31, 2016 compared to the year ended December 31, 2015. The decrease was primarily due to lower employee costs, including travel, and legal costs. The year ended December 31, 2015 included substantial expenses related to the patent defense litigation, which was settled in early 2016. The Company also cut spending for advertising, equipment and office rent. The decrease in office rent was due to the sublease of the Chicago office and the assignment of the North Carolina office lease. As a result, DATA TRAK had income from operations for the year ended December 31, 2016 of \$1,083,000 compared to a loss from operations of \$(2,883,000) for the year ended December 31, 2015.

Backlog

Backlog consists of future value from authorization letters to commence services, statements of work, technology and services agreements, change orders and other customer contracts, billed and unbilled. At December 31, 2016, the Company's backlog decreased by 17%, to \$22,241,000 from \$26,682,000 at December 31, 2015. The decrease in backlog was due to low new contract sales during 2016.

All contracts are subject to possible delays or cancellation or can change in scope in a positive or negative direction. Approximately 81% of the Company's December 31, 2016 backlog is subject to being cancelled or delayed at any time. Therefore, current backlog is not necessarily indicative of the Company's future quarterly or annual revenue. Historically, backlog has not always been an accurate predictor of the Company's short-term revenue.

Results of Operations

Year ended December 31, 2016 compared with the year ended December 31, 2015

Revenue for the year ended December 31, 2016 decreased by 10% to \$8,983,000 as compared to \$9,960,000 for the year ended December 31, 2015. During 2016, DATA TRAK recorded revenue related to 152 contracts compared to 160 contracts during 2015. For

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the year ended December 31, 2016, \$8,048,000 of revenue was the result of contracts that were in backlog at December 31, 2015 and \$935,000 was the result of new business signed since January 1, 2016. For the year ended December 31, 2015, \$8,164,000 of revenue was generated from contracts that were in backlog at December 31, 2014 and \$1,796,000 was the result of new business signed since January 1, 2015.

The Company recorded \$4,396,000 in revenue during the year ended December 31, 2016 compared to \$3,406,000 during the year ended December 31, 2015 from significant multi-year enterprise license agreements. The Company will continue to recognize the remaining, non-refundable, aggregate deferred revenue on the enterprise license agreements ratably, or in line with the acceleration of points contained in the license agreement, over the remaining lives of each respective license period. The enterprise license agreements totaled \$28.1 million of original contract value.

In 2016, only one customer individually generated 10% or more of DATATRAK's total revenue as compared to no customer individually generating 10% or more of DATATRAK's total revenue in 2015.

Direct costs of revenue decreased 23%, from \$2,078,000 for the year ended December 31, 2015, to \$1,604,000 for the year ended December 31, 2016. The \$474,000 decrease was due to lower employee costs, but was partially offset by higher Internet Service Provider ("ISP") costs. Certain expenses were reclassified during 2016 to more accurately reflect ISP costs. The Company's gross margin was 82% for the year ended December 31, 2016 compared to 79% for the year ended December 31, 2015.

SG&A expenses include all administrative personnel costs, sales and software development costs, stock compensation and all other expenses not directly chargeable to a specific contract. SG&A expenses decreased by \$4,532,000, or 43%, to \$6,043,000 from \$10,575,000 for the year ended December 31, 2016 and 2015, respectively. The decrease was primarily due to lower employee costs, including travel, and legal costs. The year ended December 31, 2015 included substantial expenses related to the patent defense litigation, which was settled in early 2016. The Company also cut spending for advertising, equipment and office rent. The decrease in office rent was due to the sublease of the Chicago office and the assignment of the North Carolina office lease. Included in SG&A costs for the year ended December 31, 2016 was \$300,000 of indebtedness for legal fees owed to Tabatabai Investment Partners LP that was cancelled in exchange for shares of the Company's Common Stock.

Depreciation and amortization expense increased by \$63,000 from \$190,000 for the year ended December 31, 2015 to \$253,000 for the year ended December 31, 2016. The increase was due to the capitalization of software development costs, especially development related to the CTMS product, which was in production at the end of November 2016, and assets purchased or acquired through capital leases.

Non-cash charges were \$729,000 for the year ended December 31, 2016 compared to \$441,000 for the year ended December 31, 2015. The year-over-year increase in non-cash charges was due to depreciation, which was caused by more asset purchases and capitalization of software development, higher stock compensation due to the purported amendment of the 2013 Omnibus Plan which accelerated the vesting of certain stock options and the loss on asset disposal.

Year ended December 31, 2015 compared with year ended December 31, 2014

Revenue for the year ended December 31, 2015 decreased \$1,051,000, or 10%, to \$9,960,000, as compared to \$11,011,000 for the year ended December 31, 2014. During 2015, DATATRAK recorded revenue related to 160 contracts compared to 174 contracts during 2014. For the year ended December 31, 2015, \$8,164,000 of revenue was the result of contracts that were in backlog at December 31, 2014 and \$1,796,000 was the result of new business signed since January 1, 2015. For the year ended December 31, 2014, \$8,517,000 of revenue was the result of contracts that were in backlog at December 31, 2013 and \$2,494,000 was the result of new business signed since January 1, 2014.

The Company recorded \$3,406,000 in revenue during the year ended December 31, 2015 compared to \$3,413,000 during the year ended December 31, 2014 from significant multi-year enterprise license agreements. While revenue continued to be negatively impacted by the extension of an enterprise license agreement, which required DATATRAK to recognize the revenue over a longer period of time, and the tapering off of a significant long-term contract that has been completed, increases in other agreements and the signing of the new 5-year agreement with a global device manufacturer mitigated the overall decrease. DATATRAK is purposefully changing the focus of its sales model to drive long-term stability through enterprise license agreements, which is affecting revenue growth in the short-term as evidenced by the decrease for the year ended December 31, 2015. The Company will continue to recognize the remaining, non-refundable, aggregate deferred revenue on the enterprise license agreements ratably, or in line with the acceleration of points contained in the license agreement, over the remaining lives of each respective license period. The enterprise license agreements totaled \$30.2 million of original contract value.

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In 2015, no customer individually generated 10% or more of *DATA^{TRAK}*'s total revenue, compared to the one customer that individually generated 11% of *DATA^{TRAK}*'s total revenue in 2014.

Direct costs of revenue decreased 6%, from \$2,200,000 for the year ended December 31, 2014, to \$2,078,000 for the year ended December 31, 2015. The \$122,000 decrease is due to outsourcing certain clinical data management work and lower ISP costs. The Company's gross margin was 79% for the year ended December 31, 2015 compared to 80% for the year ended December 31, 2014.

SG&A expenses include all administrative personnel costs, sales and software development costs, stock compensation and all other expenses not directly chargeable to a specific contract. SG&A expenses increased by \$565,000, or 6%, to \$10,574,000 from \$10,009,000 for the year ended December 31, 2015 and 2014, respectively. The increase was primarily due to higher legal costs, including substantial year-over-year expenses related to patent defense, which was settled in January 2016, and increased rent expense due to the opening of the Chicago office and the prior board and prior management's significant expenses associated with the recent proxy contest. These cost increases were partially offset by the decline of employee costs, including bonus and recruitment, and travel due to lower headcount.

Depreciation and amortization expense increased by \$108,000 from \$82,000 for the year ended December 31, 2014 compared to \$190,000 for the year ended December 31, 2015. The increase was due to the capitalization of software development costs and assets purchased or acquired through capital leases.

Non-cash charges were \$441,000 for the year ended December 31, 2015 compared to \$321,000 for the year ended December 31, 2014. The year-over-year increase in non-cash charges was due to depreciation, which was caused by more asset purchases and capitalization of software development, the loss on disposal of assets and higher stock compensation.

Liquidity and Capital Resources

The Company's principal sources of cash are existing cash and cash flow from operations. Contracts with customers usually require a portion of the contract amount to be paid at the time the contract is initiated. Additional payments are generally received monthly as work on the contract progresses. The Company records all amounts received as a liability (deferred revenue) until work has been completed and revenue is recognized. Cash receipts do not necessarily correspond to costs incurred or revenue recognized. *DATA^{TRAK}*'s primary cash needs are to fund normal working capital requirements.

On April 8, 2016, *DATA^{TRAK}* entered into a convertible promissory note (the "Note") with Tabatabai Investment Partners LP, a related party, which is controlled by Mr. Alex Tabatabai, Chairman of the Board of Directors of the Company. On August 5, 2016, the parties entered into an amendment to the Note, which changed the maximum principal amount from \$750,000 to \$1,500,000 in the aggregate. The Note provides for monthly draws on the first day of each month through March 31, 2017 when the cash balance of the Company is less than a minimum threshold amount or upon request by the Company. The maximum monthly draw is limited to the difference between the minimum threshold amount and the Company's cash balance, or a draw by the Company of up to \$750,000, up to an aggregate of \$1,500,000 during the term of the Note. The Note carries an interest rate of twelve percent on outstanding draws and matures on June 30, 2017. At any time prior to or on the maturity date, Tabatabai Investment Partners LP has the option to convert all or any portion of the principal balance and accrued but unpaid interest then outstanding under the Note into shares of the Company's Common Stock, calculated by dividing the amount being converted by \$3.50. As of the maturity date, the Note permits the repayment of draws and interest to be in the Company's Common Stock at market prices, calculating the number of shares of the Company's Common Stock to be issued by dividing the amount being converted by \$3.50. The Note includes customary default, change control and acceleration provisions. The Company made a draw under this agreement in August 2016 for \$750,000.

In January 2017, the Company made a second draw of \$750,000 under the Note with Tabatabai Investment Partners LP, a related party, which is controlled by Mr. Tabatabai, Chairman of the Board of Directors of the Company. The total drawn under the Note to date is \$1,500,000, which is the maximum amount permitted to be drawn under the Note.

The Company entered into a Stock Purchase Agreement ("SPA") with Tabatabai Investment Partners LP, to issue Company Common Stock in exchange for receiving \$250,000 on April 8, 2016. It was also agreed that Tabatabai would cancel \$300,000 of indebtedness in exchange for a number of shares of Common Stock of *DATA^{TRAK}* equal to the amount of \$300,000 divided by the price per share equal to \$3.50. Common Shares totaling 157,142 were issued to Tabatabai Investment Partners LP based on a market price of \$3.50 under this agreement as of April 5, 2016.

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Cash Flow

A summary of operating, investing and financing cash flow activities are shown in the following table for the year ended December 31, 2016 and 2015 (rounded to the nearest thousand):

	<u>12 Months Ended December 31,</u>	
	<u>2016</u>	<u>2015</u>
Cash Flow Summary:		
Provided by (used in) operating activities	\$ 1,238,000	\$ (1,390,000)
Used in investing activities	(918,000)	(568,000)
Provided by (used in) financing activities	<u>791,000</u>	<u>(197,000)</u>
Increase (decrease) in cash and cash equivalents	<u>\$ 1,111,000</u>	<u>\$ (2,155,000)</u>
Cash balance at beginning of period	<u>1,355,000</u>	<u>3,510,000</u>
Cash balance at end of period	<u>\$ 2,466,000</u>	<u>\$ 1,355,000</u>

The Company's net cash flow from operations was \$1,238,000 for the year ended December 31, 2016 compared to \$(1,390,000) for the year ended December 31, 2015. The \$2,628,000 increase in cash flow from operations was primarily due to the \$3,917,000 change in the net income during the year ended December 31, 2016 compared to the year ended December 31, 2015, which was caused by a significant reorganization of the Company and the settlement of patent defense litigation that took place during the first quarter of 2016. Operating assets and liabilities decreased by \$(1,577,000) during the year ended December 31, 2016 compared to the year ended December 31, 2015 mainly due to the decrease in deferred revenue and accrued expense changes year-over-year. The net cash flow from operations was positively impacted by a \$288,000 increase in non-cash items, which includes depreciation, stock compensation expense and loss on asset disposal, from the year ended December 31, 2015 to the year ended December 31, 2016.

The Company's net cash flow used in investing activities was \$(918,000) compared to \$(568,000) for the year ended December 31, 2016 and 2015, respectively. Capitalized software development costs increased by \$452,000, while purchases of property and equipment decreased by \$85,000 during the year ended December 31, 2016 compared to the year ended December 31, 2015. The net cash used in investing activities was positively impacted by an increase of \$17,000 from proceeds from the disposal of equipment year-over-year.

Net cash of \$791,000 was provided by financing activities for the year ended December 31, 2016 compared to \$(197,000) used during the year ended December 31, 2015. Financing activities for the year ended December 31, 2016 included cash outlays of \$(225,000) for the repayment of capital lease related debt and notes payable, which was offset by cash inflows of \$250,000 received in connection with the SPA described below, \$16,000 received from stock purchases under the Employee Stock Purchase Plan and \$750,000 drawn on the Tabatabai promissory note. During the year ended December 31, 2015, \$(223,000) was used for the repayment of capital lease related debt and notes payable, which was partially offset by the \$26,000 inflow from the Employee Stock Purchase Plan.

As a result of the changes above, the cash balance at December 31, 2016 was \$2,466,000 compared to \$1,355,000 at December 31, 2015.

DATATRAK's "days sales outstanding" was 35 days at December 31, 2016 compared to 41 days at December 31, 2015. Trade accounts receivable (net of allowance for doubtful accounts of \$15,000) was \$682,000 at December 31, 2016 and \$896,000 at December 31, 2015.

With the availability of the Note discussed below, management believes DATATRAK will have available funds in order to meet its short-term working capital requirements for at least the next 12 months. At December 31, 2016, the Company had working capital of \$(1,855,000) compared to working capital of \$(2,362,000) as of December 31, 2015. In order to address any working capital needs the Company may have faced during 2016, on April 8, 2016, DATATRAK entered into a convertible promissory note (the "Note") with Tabatabai Investment Partners LP, a related party, which is controlled by Mr. Alex Tabatabai, Chairman of the Board of Directors of the Company. On August 5, 2016, the parties entered into an amendment to the Note, which changed the maximum amount from \$750,000 to \$1,500,000 in the aggregate. The Note provides for monthly draws on the first day of each month through March 31, 2017 when the cash balance of the Company is less than a minimum threshold amount or upon request by the Company. The

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maximum monthly draw is limited to the difference between the minimum threshold amount and the Company's cash balance, or a draw by the Company of up to \$750,000, up to an aggregate of \$1,500,000 during the term of the Note. The Note carries an interest rate of twelve percent on outstanding draws and matures on June 30, 2017. At any time prior to, or on the maturity date, Tabatabai Investment Partners LP has the option to convert all or any portion of the principal balance and accrued but unpaid interest then outstanding under the Note into shares of the Company's Common Stock, calculated by dividing the amount being converted by \$3.50. As of the maturity date, the Note permits the repayment of draws and interest to be in the Company's Common Stock at market prices, calculating the number of shares of the Company's Common Stock to be issued by dividing the amount being converted by \$3.50. The Note includes customary default, change control and acceleration provisions. The Company made a draw under this agreement in August 2016 for \$750,000. In January 2017, the Company made a second draw of \$750,000 under the Note with Tabatabai Investment Partners LP, a related party, which is controlled by Mr. Tabatabai, Chairman of the Board of Directors of the Company. The total drawn under the Note to date is \$1,500,000, which is the maximum amount permitted to be drawn under the Note.

The Company entered into a Stock Purchase Agreement ("SPA") with Tabatabai Investment Partners LP, to issue Company Common Stock in exchange for receiving \$250,000 on April 8, 2016. It was also agreed that Tabatabai would cancel \$300,000 of indebtedness in exchange for a number of shares of Common Stock of *DATATRAK* equal to the amount of \$300,000 divided by the price per share equal to \$3.50. Common Shares totaling 157,142 were issued to Tabatabai Investment Partners LP based on a market price of \$3.50 under this agreement as of April 5, 2016.

Furthermore, *DATATRAK* continuously evaluates its cost structure to timely match its cost structure with anticipated revenue and backlog. Although the Company has recently made strategic investments in its infrastructure in order to support longer-term growth, *DATATRAK* will continue to carefully evaluate its cost structure and implement cost cutting measures if its revenue and sales trend performance falls below its minimum expectations. In such an event, *DATATRAK* may also require additional short-term funding. The Company may need to raise additional funds to offset delays or cancellations of existing contracts, insufficient generation of new contracts, or to cover liquidity needs beyond 2017. *DATATRAK* may raise additional funds by selling debt or equity securities, by entering into strategic relationships or through other arrangements. Additional capital may not be available on acceptable terms, if at all. To the extent that additional equity capital is raised, it could have a dilutive effect on the existing shareholders.

Inflation

To date, the Company believes the effects of inflation have not had a material adverse effect on its results of operations or financial condition.

Information about Forward-Looking Statements

Certain statements made in this annual report, written materials or orally by the Company or its representatives may constitute forward-looking statements that are based on management's current beliefs, estimates and assumptions concerning the operations, future results and prospects of the Company and the clinical pharmaceutical research industry in general. All statements that address operating performance, events or developments that management anticipates will occur in the future, including statements related to future revenue, profits, expenses, cost reductions, cash management alternatives and working capital requirements, exploration of strategic alternatives, raising additional funds, income and earnings per share or statements expressing general optimism about future results, are forward-looking statements. In addition, words such as "expects," "anticipates," "intends," "plans," "believes," "estimates," variations of such words, and similar expressions are intended to identify forward-looking statements. Factors that may cause actual results to differ materially from those in the forward-looking statements include the limited operating history on which the Company's performance can be evaluated; the ability of the Company to continue to enhance its software products to meet customer and market needs; fluctuations in the Company's quarterly results; the viability of the Company's business strategy and its stage of development; the timing of clinical trial sponsor decisions to conduct new clinical trials or cancel or delay ongoing trials; the Company's dependence on major customers; government regulation associated with clinical trials and the approval of new drugs; political climate and uncertainty surrounding the new administration; the ability of the Company to compete in the evolving EDC market; losses that potentially could be incurred from breaches of contracts or loss of customer data; the inability to protect intellectual property rights or the infringement upon other's intellectual property rights; the outcome of the Company's litigation; the costs and damages to reputation associated with any data breaches, cyber-attacks or other interference with the Company's technological systems; the costs associated with maintaining and/or developing the *DATATRAK ONE*® *Unified Experience*™ software suite; uncertain impact on customers and contracts as a result of the recent or future economic downturns; and general economic conditions such as the rate of employment, inflation, interest rates and the condition of capital markets. This list of factors is not all inclusive. In addition,

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the Company's success depends on the outcome of various strategic initiatives it has undertaken, all of which are based on assumptions made by the Company concerning trends in the clinical research market and the health care industry. Any forward-looking statement speaks only as of the date on which such statement is made and the Company does not undertake any obligation to update any statements whether as a result of new information, future events or otherwise.

B. Date and State (or Jurisdiction) of Incorporation:

Ohio, July 17, 1991

C. The issuer's primary and secondary SIC Codes;

The primary and secondary SIC codes are 7374 and 7372, respectively.

D. The issuer's fiscal year end date;

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E. Principal products or services, and their markets;

The Company's products were originally developed to provide data to sponsors of clinical research trials faster and more efficiently than other competing systems, including paper-based solutions. Automating data entry and review procedures under a single architecture can save time in the drug development and medical device approval process, and possibly result in enhanced patient safety. The *DATATRAK* system consists of numerous modules designed for custom configurability to each clinical research process. The Company initially provides a set of electronic case report forms specific to the protocol of each clinical trial. Each patient's casebook is available for data entry by the respective research site participating in the clinical trial via a secure connection over the Internet. Once clinical trial data has been collected and entered, the clinical trial sponsor, or other contracted vendor, can review the data remotely from any internet connected device. As the data is reviewed and cleansed of all entry errors, the system generates standard and ad-hoc reports to facilitate the data cleaning process and to monitor patient safety. Finally, the software's export feature allows completed data and reports to be transmitted directly to a clinical trial sponsor's in-house database or for FDA submission – all in real-time.

The *DATATRAK ONE*[®] *Unified Experience*[™] software suite provides the following capabilities: CTMS; EDC, including medical coding; digitized electrocardiograms; image collection, viewing and storing capabilities; interactive response technologies, including randomization and clinical supply management; safety case management; clinical trial design, including mid-study changes; clinical file repository for data and study assets; content-based training supported by a learning management system ("LMS"), and workgroup collaboration capabilities. Additional enhancements in late 2014 provided analysis and reporting functionality across solutions, specifically *UX EDC*[™] and *UX RTSM*[™] through the Cross-Study toolset. Work was completed in 2016 on the next generation CTMS solution, *UX CTMS 360*[™], which again leverages cross solution functionality in reporting and analysis. The Company believes the new solution will transform how the industry measures return on investment ("ROI") on software purchases, opening the door for continued increase in multi-solution purchases by current and potential clients.

DATATRAK built its multi-component, comprehensive solution through a single, unified clinical research platform leveraging a single database architecture and expanded this concept to include services delivery from the *DATATRAK* Clinical and Consulting Services ("DCCS") group. The Company delivers a complete portfolio of software products designed to accelerate the reporting of clinical research data from sites to sponsors and ultimately regulatory authorities more efficiently than loosely integrated technologies. The *DATATRAK ONE*[®] unified software solution, deployed worldwide through its cloud offering, supports pre-clinical and Phase I – Phase IV drug and device studies in multiple languages throughout the world.

DATATRAK Clinical and Consulting Services, or DCCS, offers support to our clients in the Preclinical and Phase I – Phase IV trials. Starting with the final protocol, DCCS can conduct most clinical data management services from study start-up through study close-out. In 2015, *DATATRAK* discontinued Clinical Data Manager ("CDM") services that were seen as competitive with our client base. The *DATATRAK* Project Management team tracks study deliverables, including interim data transfers if required by the client, or data cuts, data locks and ad-hoc requests. As the study comes to a close, DCCS assists in the finalization or 'locking' of the database and performs the study data archival. In addition to clinical trial specific services, DCCS also offers clinical and technology consulting as well as rescue study and migration expertise.

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DATA TRAK has partner and enterprise transfer programs to empower customers to design, deploy and manage their clinical trials independently through the Company's cloud-based delivery. DATA TRAK has found that customers desire to be as independent as possible in the performance of their clinical trials. This trend is another growth aspect of the industry that is believed to be gaining momentum.

7) Describe the Issuer's Facilities

As of December 31, 2016, the Company was leasing approximately 4,300 square feet of office space in Mayfield Heights, Ohio. This space is used for its headquarters and U.S. operations. In addition, DATA TRAK has U.S. based operations in Bryan, Texas, where the Company leases approximately 2,300 square feet of office space. The Company had leased approximately 6,400 square feet of office space in Cary, North Carolina. DATA TRAK entered into an assignment agreement for the office space in Cary, North Carolina, which was effective as of April 5, 2016 and no longer bears any financial liability for the lease. The Company entered into a sublease agreement as of July 7, 2016 for the 14,000 square feet of office space in Chicago, Illinois, in order to mitigate the expense associated with the original lease.

Subsequent to year end, the Company entered into an amendment for its Mayfield Heights lease. Pursuant to the amendment, the Company will be leasing an additional 2,170 square feet of space adjacent to its current offices. The lease term was also extended by 5 years. Also subsequent to year end, DATA TRAK entered into a 3-year lease for 2,234 square feet of office space in College Station, Texas. The office space in College Station will replace the office space in Bryan, which was month-to-month.

For additional information regarding the terms of leases, see Note 10. Operating Leases to the consolidated financial statements included in this report.

8) Officers, Directors, and Control Persons

A. The names of Officers and Directors as of December 31, 2016 are as follows:

<u>Name</u>	<u>Position</u>
Alex Tabatabai	Chairman of the Board of Directors
	Chairman of the Audit Committee
Jack H. Jacobs	Director
	Chairman of the Compensation Committee
	Chairman of the Nominating & Governance Committee
Dr. Eric J. Wilhelm	Director
Dr. Rizvan Mirza	Director
Ben Tabatabai	Director
James R. Ward	Chief Executive Officer and President
	Director
Julia Henderson	Chief Financial Officer and Treasurer

The table below sets forth information regarding the compensation received during the years ended December 31, 2016 and 2015 and the securities held at each year then ended for the current executives and directors.

Name and Principal Position	Year	Salary	Bonus	All Other Compensation	Common Shares Owned	Common Share Options
Alex Tabatabai, <i>Chairman of the Board</i> (1)	2016	—	—	\$28,538 (3)	352,648 (2)	—
	2015	—	—	—	161,023 (2)	—
Jack H. Jacobs, <i>Director</i> (1)	2016	—	—	\$28,538 (3)	4,229	—
	2015	—	—	—	—	—
Dr. Eric J. Wilhelm, <i>Director</i> (5)	2016	—	—	\$5,576 (3)	1,503	—
	2015	—	—	—	—	—

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Dr. Rizvan Mirza, <i>Director (6)</i>	2016 2015	— —	— —	— —	— —	— —
Ben Tabatabai, <i>Director (6)</i>	2016 2015	— —	— —	— —	— —	— —
James R. Ward, <i>CEO, President and Director (1)</i>	2016 2015	\$50,769 —	— —	\$171,292 (7) —	79,279 56,159	— —
Julia Henderson, <i>Chief Financial Officer and Treasurer (4)</i>	2016 2015	\$130,319 \$105,033	— \$5,000	\$7,250 (4) —	4,171 2,760	500 500

- (1) James R. Ward, Alex Tabatabai and Jack H. Jacobs received no salary, bonus or other compensation during the year ended December 31, 2015.
- (2) Mr. Alex Tabatabai's shares listed in the table are beneficially owned by Tabatabai Investment Management LLC, of which he is a managing member.
- (3) Other compensation includes director compensation paid in cash and/or Common Shares. The total compensation shown includes both cash and restricted Common Shares valued based on the closing stock price on the last day of the quarter. Director compensation for fourth quarter of 2016 was not paid as of December 31, 2016, and therefore, is not included in this table.
- (4) As of March 28, 2016, Julia Henderson was appointed CFO and Treasurer. Ms. Henderson received 1,000 restricted Common Shares valued at \$7.25 per share as part of the retention award discussed in section 4. Issuance History.
- (5) Dr. Eric Wilhelm has served as a director of the Company since August 5, 2016.
- (6) Dr. Rizvan Mirza and Mr. Ben Tabatabai were elected as directors at the Annual Meeting of Shareholders of the Company and joined the Company's Board of Directors on December 1, 2016.
- (7) Other compensation for James R. Ward includes 20,000 restricted shares issued pursuant to his employment agreement at \$7.75 per share as discussed in Note 6. Recent Developments.

The following persons are control persons as they beneficially owned 5% or more of *DATATRAK* stock as of December 31, 2016:

Tabatabai Investment Management LLC (f/k/a Arosa Investment Management LLC) ^{1 2}	540 N. Dearborn St. #101257 Chicago, IL 60610	352,648 Common Shares
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¹Tabatabai Investment Management LLC is controlled by Alex Tabatabai, Chairman of the Board of Directors of the Company.

² All Common Shares are held by Tabatabai Investment Management LLC (formerly known as Arosa Investment Management LLC), which is controlled by Mr. Alex Tabatabai, Chairman of the Board of Directors of the Company. Dr. Wilhelm, Dr. Mirza and Mr. Ben Tabatabai are limited partners in Tabatabai Investment Partners LP, whose general partner is Tabatabai Investment Management LLC. The number of Common Shares listed in the table above does not include any shares that may be received by Tabatabai Investment Partners LP upon conversion of the convertible promissory notes. There was \$750,000 drawn by the Company under this convertible note agreement as of December 31, 2016. If the draw was converted as of December 31, 2016, approximately 218,000 additional shares would be issued.

The disclosure is limited to those whose holdings the Company knows or can verify.

B. Legal/Disciplinary History.

Last five years:

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1. A conviction in a criminal proceeding or named as a defendant in a pending criminal proceeding (excluding traffic violations and other minor offenses);

None

2. The entry of an order, judgment, or decree, not subsequently reversed, suspended or vacated, by a court of competent jurisdiction that permanently or temporarily enjoined, barred, suspended or otherwise limited such person's involvement in any type of business, securities, commodities, or banking activities;

None

3. A finding or judgment by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission, the Commodity Futures Trading Commission, or a state securities regulator of a violation of federal or state securities or commodities law, which finding or judgment has not been reversed, suspended, or vacated; or

None

4. The entry of an order by a self-regulatory organization that permanently or temporarily barred suspended or otherwise limited such person's involvement in any type of business or securities activities.

None

C. Beneficial Shareholders. The following persons beneficially owned more than 10% of DATA TRAK Common Stock as of December 31, 2016:

Tabatabai Investment Management LLC (f/k/a Arosa Investment Management LLC) ^{1 2}	540 N. Dearborn St. #101257 Chicago, IL 60610	352,648 Common Shares
--	--	-----------------------

¹Tabatabai Investment Management LLC is controlled by Alex Tabatabai, Chairman of the Board of Directors of the Company.

² All Common Shares are held by Tabatabai Investment Management LLC (formerly known as Arosa Investment Management LLC), which is controlled by Mr. Alex Tabatabai, Chairman of the Board of Directors of the Company. Dr. Wilhelm, Dr. Mirza and Mr. Ben Tabatabai are limited partners in Tabatabai Investment Partners LP, whose general partner is Tabatabai Investment Management LLC. The number of Common Shares listed in the table above does not include any shares that may be received by Tabatabai Investment Partners LP upon conversion of the convertible promissory notes. There was \$750,000 drawn by the Company under this convertible note agreement as of December 31, 2016. If the draw was converted as of December 31, 2016, approximately 218,000 additional shares would be issued.

The disclosure is limited to those whose holdings the Company knows or can verify.

9) Third Party Providers

Please provide the name, address, telephone number, and email address of each of the following outside providers that advise your company on matters relating to operations, business development and disclosure:

Legal Counsel

Thompson Hine LLP
3900 Key Center, 127 Public Square
Cleveland, OH 44114
Phone: (216) 566-5500
Derek.Bork@ThompsonHine.com

Ogletree, Deakins, Nash, Smoak & Stewart, P.C.
127 Public Square #4100
Cleveland, OH 44114
Phone: (216) 241-6100
Bruce.Hearey@Ogletreedeakins.com

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The Calfee Building
1405 East Sixth St.
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Phone: (216) 622-8200
info@calfee.com

Auditor

Skoda Minotti & Co.
6685 Beta Drive.
Mayfield Village, OH 44143
Phone: (440) 449-6800
RSiebel@skodaminotti.com

Other Advisor:

DiCillo & Associates
7500 Town Centre Dr.
Suite 500
Broadview Heights, OH 44147
Phone: (216) 377-1950
ddicillo@greatlakescpa.net

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10) Issuer Certification

I, James R. Ward, Chief Executive Officer and President of *DATATRAK International, Inc.*, certify that:

1. I have reviewed this annual disclosure statement of *DATATRAK International, Inc.*;
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

Date: March 2, 2017

/s/ James R. Ward

James R. Ward

Chief Executive Officer and President

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10) Issuer Certification (continued)

I, Julia Henderson, Chief Financial Officer of *DATATRAK International, Inc.*, certify that:

1. I have reviewed this annual disclosure statement of *DATATRAK International, Inc.*;
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

Date: March 2, 2017

/s/ Julia Henderson

Julia Henderson

Chief Financial Officer, Treasurer (Principal Financial Officer)