



**QUARTERLY REPORT**  
For the Fiscal Quarter Ended March 31, 2012

**UNAUDITED – See Notice to Reader**

**NOTICE TO READER**

The accompanying unaudited interim financial statements have been prepared by the Company's management. Independent auditors have not performed a review of these financial statements.

DATATRAK International, Inc. and Subsidiaries  
QUARTERLY REPORT  
MARCH 31, 2012  
UNAUDITED

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**ITEM 1. NAME OF ISSUER**

DATATRAK International, Inc.  
6150 Parkland Boulevard, Suite 100, Mayfield Heights, Ohio 44124  
Office: (440) 443-0082  
Fax: (440) 442-3482  
Web: [www.datatrak.net](http://www.datatrak.net)

Investor inquires should be directed to:

Varnesh Sritharan  
6150 Parkland Boulevard, Suite 100  
Mayfield Heights, Ohio 44124  
Office: (440) 443-0082  
Fax: (440) 442-3482  
Email: [Varnesh.Sritharan@datatrak.net](mailto:Varnesh.Sritharan@datatrak.net)

**ITEM 2. SHARES OUTSTANDING**

DATATRAK's common shares are traded on OTC Markets under the symbol "DATA."

A. Common Shares

	<u>Mar. 31, 2012</u>	<u>Dec. 31, 2011</u>
Shares authorized	25,000,000	25,000,000
Shares outstanding	15,310,819	14,594,686
Freely tradable shares	13,148,264	13,098,748
No. of beneficial shareholders	1,523	1,545
No. of shareholders of record	97	94

B. Preferred Shares

	<u>Mar. 31, 2012</u>	<u>Dec. 31, 2011</u>
Shares authorized	1,000,000	1,000,000
Shares outstanding	-	-
Freely tradable shares	-	-
No. of beneficial shareholders	-	-
No. of shareholders of record	-	-

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**ITEM 3. INTERIM FINANCIAL STATEMENTS**

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**CONDENSED CONSOLIDATED BALANCE SHEETS**

	<u>March 31, 2012</u>	<u>December 31, 2011</u>
	(Unaudited)	(Note A)
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 1,431,612	\$ 2,298,690
Accounts receivable, net	1,076,547	758,727
Deferred tax assets— current	29,600	38,500
Prepaid expenses	150,638	351,124
Total current assets	<u>2,688,397</u>	<u>3,447,041</u>
Property and equipment		
Equipment	876,709	861,293
Software, net of impairment	2,029,159	2,029,159
Leasehold improvements	650,329	650,329
	<u>3,556,197</u>	<u>3,540,781</u>
Less accumulated depreciation	<u>3,392,940</u>	<u>3,361,461</u>
Property and equipment, net	163,257	179,320
Other assets		
Deposits	45,949	41,949
Total other assets	<u>45,949</u>	<u>41,949</u>
Total assets	<u>\$ 2,897,603</u>	<u>\$ 3,668,310</u>
<b>LIABILITIES AND SHAREHOLDERS' DEFICIT</b>		
Current liabilities		
Accounts payable	\$ 311,856	\$ 279,277
Notes payable	39,840	37,117
Accrued expenses	875,292	1,307,320
Deferred revenue	1,537,949	1,665,631
Total current liabilities	<u>2,764,937</u>	<u>3,289,345</u>
Long-term liabilities		
Long-term debt	29,976	29,557
Deferred revenue — long-term	1,372,713	1,493,616
Deferred tax liabilities	29,600	38,500
Total long-term liabilities	<u>1,432,289</u>	<u>1,561,673</u>
Shareholders' deficit		
Serial Preferred Shares, without par value, 1,000,000 shares authorized, none issued	—	—
Common Shares, without par value, authorized 25,000,000 shares; issued 17,147,759 shares as of March 31, 2012 and 17,109,595 as of December 31, 2011; outstanding 15,310,819 as of March 31, 2012 and 14,594,686 shares as of December 31, 2011	80,834,359	80,701,182
Treasury Shares, 1,836,940 shares as of March 31, 2012 at cost; 2,514,909 shares as of December 31, 2011 at cost	(19,373,575)	(19,640,283)
Additional paid-in capital	1,135,831	838
Common Share warrants	—	1,134,993
Accumulated deficit	(63,896,238)	(63,379,438)
Total shareholders' deficit	<u>(1,299,623)</u>	<u>(1,182,708)</u>
Total liabilities and shareholders' deficit	<u>\$ 2,897,603</u>	<u>\$ 3,668,310</u>

Note A: The condensed consolidated balance sheet at December 31, 2011 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

*See notes to condensed consolidated financial statements.*

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**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

	Three Months Ended March 31,	
	2012	2011
Revenue	\$ 2,119,198	\$ 1,888,321
Direct costs	396,647	350,978
Gross profit	1,722,551	1,537,343
Selling, general and administrative expenses	2,199,002	1,695,105
Depreciation and amortization	38,826	40,197
Loss from operations	(515,277)	(197,959)
Interest income	132	180
Interest expense	(1,655)	(2,674)
Net loss	\$ (516,800)	\$ (200,453)
Net loss per share:		
Net loss per share, basic and diluted	\$ (0.04)	\$ (0.01)
Weighted-average shares outstanding, basic and diluted	14,714,947	14,107,807

*See notes to condensed consolidated financial statements.*

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**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Three Months Ended	
	March 31,	
	2012	2011
<b>Operating activities</b>		
Net loss	\$ (516,800)	\$ (200,453)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	38,826	40,197
Stock-based compensation	121,821	71,955
Changes in operating assets and liabilities:		
Accounts receivable	(317,820)	377,203
Prepaid expenses and other current assets	196,486	18,295
Accounts payable and accrued expenses	(132,738)	49,320
Deferred revenue	(248,585)	(175,131)
Net cash (used in) provided by operating activities	(858,810)	181,386
<b>Investing activities</b>		
Purchases of property and equipment	(8,141)	—
Net cash used in investing activities	(8,141)	—
<b>Financing activities</b>		
Payments of notes payable	(11,481)	(28,563)
Proceeds from ESPP	11,354	4,558
Net cash used in financing activities	(127)	(24,005)
(Decrease) increase in cash and cash equivalents	(867,078)	157,381
Cash and cash equivalents at beginning of period	2,298,690	1,026,369
<b>Cash and cash equivalents at end of period</b>	\$ 1,431,612	\$ 1,183,750

*See notes to condensed consolidated financial statements.*

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**CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' DEFICIT**

	Common Shares			Treasury Shares		Common Share Warrants		Accumulated Deficit	Total
	Number of Shares	Stated Amount	Additional Paid-in Capital	Number of Shares	Cost	Number of Shares	Cost		
<b>Balance at December 31, 2010</b>	17,013,568	\$ 80,258,674	\$ 838	2,942,143	\$ (20,000,075)	327,743	\$ 1,134,993	\$ (62,372,551)	\$ (978,121)
Stock-based compensation.....		404,068							404,068
ESPP.....	92,694	37,207							37,207
Exercise of stock options.....	3,333	1,233							1,233
401(k) match.....				(85,999)	79,979				79,979
Management bonus				(341,235)	279,813				279,813
Net loss.....								(1,006,887)	(1,006,887)
<b>Balance at December 31, 2011</b>	17,109,595	\$ 80,701,182	\$ 838	2,514,909	\$ (19,640,283)	327,743	\$ 1,134,993	\$ (63,379,438)	\$ (1,182,708)
Stock-based compensation.....		121,821							121,821
ESPP.....	38,164	11,356							11,356
Expiration of warrants.....			1,134,993			(327,743)	(1,134,993)		
401(k) match.....				(229,861)	91,944				91,944
Management bonus.....				(448,108)	174,764				174,764
Net loss.....								(516,800)	(516,800)
<b>Balance at March 31, 2012</b>	<u>17,147,759</u>	<u>\$ 80,834,359</u>	<u>\$ 1,135,831</u>	<u>1,836,940</u>	<u>\$ (19,373,575)</u>	<u>—</u>	<u>\$ —</u>	<u>\$ (63,896,238)</u>	<u>\$ (1,299,623)</u>

*See notes to condensed consolidated financial statements.*

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements of DATATRAK International, Inc. and subsidiaries (“DATATRAK” or the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the guidelines from OTC Markets for providing adequate current information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The accompanying unaudited interim financial statements have been prepared by the Company’s management and independent auditors have not performed a review of these financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s Annual Report for the year ended December 31, 2011.

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.

The Company has evaluated subsequent events through May 10, 2012 and concluded that there are no additional significant events requiring recognition or disclosure.

**2. Recent Developments**

In March 2012, the Company made a discretionary matching contribution to each eligible employee’s 401(k) account in restricted Common Shares of DATATRAK’s stock with a value at the time of grant equal up to 3% of employee’s salaries. The total number of restricted shares granted in connection with such match was 229,861 and the value of the Common Shares was \$92,000.

On March 20, 2012, the Company valued restricted share grants to certain officers and key employees in lieu of the payment of bonus amounts under the 2011 Cash Incentive Plan. Based on the closing stock price on March 20, 2012, 448,108 restricted shares were awarded to certain officers and key employees outside of the 2011 Omnibus Plan. These shares are subject to certain restrictions, including a provision that the participant’s shares shall be forfeited if such participant ceases to be employed by the Company prior to the one-year anniversary of the grant.

**3. Recently Issued Accounting Standards**

In June 2011, the FASB issued ASU No. 2011-05, “*Presentation of Comprehensive Income*,” which required that comprehensive income be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In December 2011, the FASB issued ASU No. 2011-12, which indefinitely deferred certain provisions of ASU No. 2011-05. The provisions of ASU No. 2011-05 that remain eliminated the option for companies to present components of other comprehensive income only in the statement of equity. This standard is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance did not have an impact on the Company’s consolidated financial statements.

**4. Net (Loss) Income Per Share**

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

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
Net loss used in the calculation of basic and diluted earnings per share	\$ (517,000)	\$ (200,000)
Denominator for basic net loss per share — weighted-average common shares outstanding	14,715,000	14,108,000
Effect of dilutive common share options and warrants	—	—

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Denominator for diluted net loss per share	<u>14,715,000</u>	<u>14,108,000</u>
Basic net loss per share	<u>\$ (0.04)</u>	<u>\$ (0.01)</u>
Diluted net loss per share	<u>\$ (0.04)</u>	<u>\$ (0.01)</u>
Weighted-average common share options and warrants excluded from the computation of diluted net loss per share because they would have an anti-dilutive effect on net loss per share	<u>1,470,000</u>	<u>1,028,000</u>

#### 5. Shareholders' Deficit

In connection with a March 2007 financing, the Company granted registration rights for 1,986,322 purchased common shares and for 327,743 common shares issuable upon the exercise of warrants. The proceeds were allocated between common shares and common share warrants based on their fair values. Although the warrants were outstanding as of December 30, 2011, they expired on March 19, 2012. As a result, the value of the warrants was transferred to additional paid-in capital as of March 31, 2012.

#### 6. Operating Leases

The Company leases certain office equipment and space. Rent expense relating to these operating leases was approximately \$110,000 and \$111,000 for the quarters ended March 31, 2012 and 2011, respectively. Future minimum lease payments for the Company under non-cancelable operating leases are \$165,000 for the twelve months ended March 31, 2013.

#### 7. Income Taxes

Due to its net operating loss carryforwards, the Company had no federal, state or local income tax expense for the three months ended March 31, 2012 and 2011.

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

	<u>Three Months Ended March 31,</u>	
	<u>2012</u>	<u>2011</u>
Income tax benefit at the United States statutory rate	\$ (176,000)	\$ (68,000)
Change in valuation allowance	168,000	63,000
Non-deductible permanent differences	8,000	5,000
	<u>\$ —</u>	<u>\$ —</u>

Due to uncertainty regarding the realization of the deferred tax asset resulting from its cumulative operating losses, as well as the closing of the office of DATATRAK's German subsidiary in 2008, the Company provided for a full valuation allowance against all of its net deferred tax assets at March 31, 2012 and March 31, 2011.

#### 8. Long-Term Debt

Long-term debt at March 31, 2012 and December 31, 2011 is summarized below:

	March 31, <u>2012</u>	December 31, <u>2011</u>
Capital lease agreement with Presidio Technology Capital, LLC	\$ —	\$ 2,000
Capital lease agreement with GE Capital Corporation	40,000	48,000
Capital lease agreement with Dell Financial Services, LLC	<u>30,000</u>	<u>17,000</u>
Total debt	70,000	67,000
Less current maturities	<u>(40,000)</u>	<u>(37,000)</u>
Long-term debt	<u>\$ 30,000</u>	<u>\$ 30,000</u>

During June 2009 the Company entered into a lease agreement with Presidio Technology Capital, LLC for the purchase of certain computer equipment. The terms of the financing agreement required DATATRAK to make 12 quarterly payments of \$2,400, including accrued interest, beginning in July 2009 and ending in April 2012. The Company made the final lease payment in March 2012. The lease contained a bargain purchase option at the end of the lease term.

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During July 2010 the Company entered into a lease agreement with GE Capital Corporation for the purchase of certain computer equipment. The terms of the financing agreement require DATATRAK to make 36 monthly payments of \$2,800, including accrued interest, beginning in August 2010 and ending in July 2013. The lease contains a bargain purchase option at the end of the lease term.

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 of \$974, including accrued interest. All leases included bargain purchase options at the end of the lease term.

#### **9. Software Development Costs**

Development costs incurred in the research and development of new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. After technological feasibility is established, any additional costs are capitalized in accordance with FASB ASC 985, “*Costs of Software to be Sold, Leased, or Marketed.*” Such costs are amortized over the lesser of three years or the economic life of the related product. The Company performs an annual review of the recoverability of such capitalized software costs. At the time a determination is made that capitalized amounts are not recoverable based on the estimated cash flows to be generated from the applicable software, any remaining capitalized amounts are expensed. No software development costs were capitalized in 2012 or 2011.

Research and development expenses included in selling, general and administrative expenses were \$311,000 and \$273,000 for the three months ended March 31, 2012 and 2011, respectively.

#### **10. Reclassification**

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

#### **11. Contingencies**

On June 6, 2011, DATATRAK served a complaint for patent infringement on Medidata Solutions, Inc. (“Medidata”) for unauthorized use of DATATRAK’s intellectual property in the Medidata Rave® platform. (Civil Action No. 1:11-CV-00458, U.S. District Court for the Northern District of Ohio). The patented technologies, as described in U.S. Patent No. 7,464,087, cover methods and systems for unifying data from a plurality of heterogeneous databases with each having business-context related data and a data access mechanism. DATATRAK’s lawsuit was filed in the United States District Court for the Northern District of Ohio. In its answer to the complaint, Medidata denied the allegations of infringement and counterclaimed to invalidate DATATRAK’s patent. On October 28, 2011 Medidata requested *ex parte* reexamination of the patent-in-suit by the U.S. Patent & Trademark Office, challenging the validity of the patent’s claims, and moved to stay the litigation pending same. The Court granted Medidata’s motion to stay the litigation, and the Company subsequently received notice from the U.S. Patent & Trademark Office that Medidata’s request for *ex parte* reexamination of the patent was granted. The Company recently received a final office action from the U.S. Patent and Trademark Office rejecting the claims of the patent-in-suit. The Company intends to contest such office action. Although there can be no assurance as to the final outcome of the reexamination process, the Company intends to continue to vigorously protect its intellectual property, including any applicable claims against Medidata after the conclusion of the patent reexamination process.

In addition to the foregoing, in the ordinary course of its business, the Company is involved in ordinary, routine legal proceedings. The Company 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.

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**ITEM 4. MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The information set forth and discussed below for the three month period ended March 31, 2012 is derived from, and should be read in conjunction with, the condensed consolidated financial statements included elsewhere herein. The financial information set forth and discussed below is unaudited, but in the opinion of management, reflects all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of such information. The accompanying unaudited interim financial statements have been prepared by the Company's management and independent auditors have not performed a review of these financial statements. The Company's results of operations for a particular quarter may not be indicative of results expected during the other quarters or for the entire year.

**General**

DATATRAK International, Inc., an Ohio corporation, was formed in 1991 and is a technology and services company focused on global eClinical solutions for the clinical trials industry. DATATRAK's vision is to be the clinical enterprise solution to safely accelerate every drug, every biologic and every device *from Concept to Cure*<sup>™</sup>. Customers use DATATRAK's software to collect, review, transmit and store clinical trial data electronically. The existence of a multi-component suite of applications in this industry is commonly referred to as an eClinical offering. DATATRAK's customers are companies in the clinical pharmaceutical, biotechnology, contract research organization ("CRO") and medical device industries. The Company's services assist these companies in 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 DATATRAK ONE<sup>™</sup> unified software solution, deployed worldwide through an Application Service Provider ("ASP") or Enterprise Transfer offering, supports Phase I – Phase IV drug and devices studies in multiple languages throughout the world. DATATRAK has offices located in Mayfield Heights, Ohio; Bryan, Texas; and Cary, North Carolina.

**Business Developments**

On March 1, 2012, the Company announced that it had added PRC Clinical as a CRO Connect Partner. PRC Clinical's extensive experience in a broad range of therapeutic areas makes them an ideal partner in the expansion of the DATATRAK ONE<sup>™</sup> software suite and services.

Effective March 31, 2012, the Company entered into a five-year Enterprise Agreement with an existing customer. The signing of this agreement had a significant impact on DATATRAK's backlog at March 31, 2012.

On April 2, 2012, the Company announced that ReSearch Pharmaceutical Services, Inc. ("RPS") had selected DATATRAK as a preferred vendor and will standardize its Clinical Enterprise Solution on DATATRAK ONE<sup>™</sup>. Further growth opportunities will benefit both companies through DATATRAK's CRO Connect Partner<sup>™</sup> program. The partnership was a natural progression as a result of the work DATATRAK has done with RPS on client studies and their participation in the Company's Product Advisory Council.

**Financial Performance**

The Company's gross profit margin remained stable at 81% for the three months ended March 31, 2012 and 2011. The stable gross profit margin reflects a 12% increase in revenue and a 13% increase in direct costs for 2012 compared to 2011. Operating expenses increased 30% for the three months ended March 31, 2012 compared to the three months ended March 31, 2011. The Company's loss from operations for the first quarter of 2012 was \$(515,000) compared to a loss from operations of \$(198,000) for the first quarter of the prior year. The operating losses for both years reflect the Company's strategic investments in Sales, Marketing and Software Development to position the business for future growth, the accrual of management incentive plan awards, as well as costs incurred to protect the Company's intellectual property for its customers and partners.

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### Revenue Recognition and Deferred Revenue

DATATRAK recognizes revenue in accordance with SEC Staff Accounting Bulletin Topic 13, “*Revenue Recognition*,” and FASB 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 license contracts provide a fixed price for each element to be delivered, and revenue is recognized as each multiple-element is delivered. 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 per element price the Company would sell an item for 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 license revenue is recognized ratably over the life of the license agreement.
- Licensing revenue (patient, 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.
- Help Desk revenue is recognized based on a monthly price per registered user or site under the contract.

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 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, generally the Company is required to refund the unused portion.

Deferred revenue not subject to potential refund as of March 31, 2012 on the enterprise agreements totaled \$1,867,000. The Company’s deferred revenue balance including the long-term portion was \$2,911,000 at March 31, 2012 of which \$1,044,000 was subject to refund, compared to \$3,159,000 at December 31, 2011 of which \$1,052,000 was subject to refund.

### 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 March 31, 2012, the Company’s backlog increased by 21%, to \$13,975,000 compared to \$11,567,000 at December 31, 2011. New contract sales for the three months ended March 31, 2012 outpaced new contract sales for the three months ended March 31, 2011 by 170%. The increase in backlog from December 31, 2011 to March 31, 2012 was primarily a result of the new five-year Enterprise Agreement described in the “Business Developments” section above.

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DATATRAK has previously disclosed that it had experienced significant trial delays from certain clients. As of March 31, 2012, four trials with the same client, representing \$1,010,000 of the March 31, 2012 backlog, or approximately 7%, have not generated any revenue to date. All contracts are subject to possible delays or cancellation or can change in scope in a positive or negative direction. Approximately 75% of the Company's March 31, 2012 backlog is individual contracts and subject to being cancelled or delayed at anytime. Therefore, current backlog is not necessarily indicative of the Company's future quarterly or annual revenue. Historically, backlog has been a poor predictor of the Company's short-term revenue.

### **Critical Accounting Policies**

The Company has identified the most critical accounting policies upon which its financial status depends. Critical accounting policies were determined by considering accounting policies that involve the most complex or subjective decisions or assessments. The most critical accounting policies were identified to be those related to revenue recognition, accounts receivable, software development costs, stock-based compensation, and income taxes.

A summary of the Company's critical accounting policies related to revenue recognition, accounts receivable, stock-based compensation, and income taxes can be found in the Company's Annual Report filed with OTC Markets on March 16, 2012 under the heading "Critical Accounting Policies" in Management's Discussion and Analysis of Financial Condition and Results of Operations.

### **Off-Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements.

### **Results of Operations**

*Three months ended March 31, 2012 compared with three months ended March 31, 2011*

Revenue for the three months ended March 31, 2012 increased by \$231,000, or 12%, to \$2,119,000, compared to revenue of \$1,888,000 for the three months ended March 31, 2011. During the first quarter of 2012, the Company recorded revenue related to 113 contracts compared to 101 contracts during the three months ended March 31, 2011. For the three months ended March 31, 2012, \$1,920,000 of revenue was the result of contracts that were in backlog at December 31, 2011, and \$199,000 was the result of new business signed since January 1, 2012. For the three months ended March 31, 2011, \$1,735,000 of revenue was generated from contracts that were in backlog at December 31, 2010 and \$153,000 of revenue was the result of new business signed since January 1, 2011.

The Company recorded \$562,000 in revenue during the first quarter of 2012 from significant multi-year enterprise license agreements. The Company will continue to recognize the remaining, non-refundable, aggregate deferred revenue of \$1,867,000 on the enterprise license agreements ratably over the remaining lives of each respective license period. The enterprise license agreements totaled \$9.5 million of original contract value and are non-cancelable.

Direct costs of revenue increased 13%, from \$351,000 in the first quarter of 2011, to \$397,000 in the first quarter of 2012. The \$46,000 increase is the result of additional services needed to support DATATRAK's clinical and consulting services business. Despite these additional costs, the Company's gross margin remained stable at 81% for both the three months ended March 31, 2012 and the three months ended March 31, 2011.

Selling, general and administrative expenses ("SG&A") include all administrative personnel costs, sales and software development costs, and all other expenses not directly chargeable to a specific contract. SG&A expenses increased by \$504,000, or 30%, to \$2,199,000 from \$1,695,000 for the three months ended March 31, 2012 and 2011, respectively. The increase was due primarily to employee costs related to the expansion of the Sales, Marketing, Software Development, Systems Development, and Quality Assurance departments, the accrual of management incentive plan awards, increased advertising costs, as well as costs incurred to protect the Company's intellectual property for its customers and partners.

Depreciation and amortization expense remained flat at \$39,000 and \$40,000 for the three months ended March 31, 2012 and March 31, 2011, respectively.

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**Liquidity and Capital Resources**

The Company's principal sources of cash are existing cash, cash flow from operations and proceeds from the sale of equity securities. 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. DATATRAK's primary cash needs are to fund normal working capital requirements and repay indebtedness.

The Company's financial assets include cash equivalents in the form of highly liquid money market funds with maturities of three months or less. The Company only invests in treasuries or commercial papers that are of A1/P1 quality or higher. Cash equivalents totaled \$448,000 at March 31, 2012 and December 31, 2011. The Company has the positive intent and ability to hold the investments to maturity.

**Cash Flow**

A summary of operating, investing and financing cash flow activities are shown in the following table for the three month periods ended March 31, 2012 and March 31, 2011:

	<u>Three Months Ended March 31,</u>	
	<u>2012</u>	<u>2011</u>
Cash Flow Summary:		
(Used in) provided by operating activities	\$ (859,000)	\$ 181,000
Used in investing activities	(8,000)	—
Used in financing activities	—	(24,000)
(Decrease) increase in cash and cash equivalents	<u>\$ (867,000)</u>	<u>\$ 157,000</u>
Cash Balance at Period End	\$ 1,432,000	\$ 1,184,000

The Company's net cash flow from operations was \$(859,000) for the three months ended March 31, 2012 compared to \$181,000 for the three months ended March 31, 2011. The \$(1,040,000) decline in cash flow from operations was primarily due to the Company's net loss and decrease in operating assets and liabilities during the first quarter of 2012. Operating assets and liabilities decreased by \$(503,000) for the three months ended March 31, 2012 compared to a \$270,000 increase in operating assets and liabilities for the three months ended March 31, 2011. Cash flow from operations for the three months ended March 31, 2012 and March 31, 2011 was favorably impacted by non-cash items totaling \$161,000 and \$112,000, respectively. The reduction in cash flow from operations for the three months ended March 31, 2012 was furthered by the net loss of \$(517,000) while the improvement in cash flow from operations for the three months ended March 31, 2011 was offset to some degree by the net loss of \$(201,000).

The Company's net cash flow from investing activities was \$(8,000) due to an equipment purchase which took place during the three months ended March 31, 2012. There were no purchases of equipment during the three months ended March 31, 2011.

There was no cash used in financing activities for the three months ended March 31, 2012 compared to net cash used in financing activities of \$(24,000) for the three months ended March 31, 2011. Financing activities for 2012 included cash outlays of \$(11,000) for the repayment of capital lease related debt and notes payable and cash inflows of \$11,000 from the Employee Stock Purchase Plan. In the three months ended March 31, 2011, the Company had cash outflows of \$(29,000) for the repayment of capital lease related debt and notes payable and a cash inflow of \$5,000 from the Employee Stock Purchase Plan.

As a result of the changes above, the cash balance at March 31, 2012 was \$1,432,000 compared to \$1,184,000 at March 31, 2011.

At March 31, 2012, DATATRAK's "days sales outstanding" was 41 days compared to 37 days at December 31, 2011. Trade accounts receivable (net of allowance for doubtful accounts) was \$1,077,000 at March 31, 2012 and \$759,000 at December 31, 2011.

The Company intends to continue to invest in the development, enhancement and testing of the DATATRAK ONE™ unified software suite. For the three months ended March 31, 2012, DATATRAK expensed approximately \$311,000 for research and

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development compared to \$273,000 for the three months ended March 31, 2011.

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 March 31, 2012, the Company had negative working capital of \$(77,000) compared to working capital of \$158,000 as of December 31, 2011. In an effort to address ongoing working capital needs, DATATRAK continuously evaluates its cost structure to timely match its cost structure with anticipated revenue and backlog. The Company plans to 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 2012. 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 quarterly 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, exploration of strategic alternatives, raising additional funds, income and earnings per share or statements expressing general optimism about future results, are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended ("Exchange Act"). 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. Forward-looking statements are subject to the safe harbors created in the Exchange Act. 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 early 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; 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 costs associated with maintaining and/or developing the DATATRAK ONE™ product 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, 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.

### **ITEM 5. LEGAL PROCEEDINGS**

On June 6, 2011, DATATRAK served a complaint for patent infringement on Medidata Solutions, Inc. ("Medidata") for unauthorized use of DATATRAK's intellectual property in the Medidata Rave® platform. (Civil Action No. 1:11-CV-00458, U.S. District Court for the Northern District of Ohio). The patented technologies, as described in U.S. Patent No. 7,464,087, cover methods and systems for unifying data from a plurality of heterogeneous databases with each having business-context related data and a data access mechanism. DATATRAK's lawsuit was filed in the United States District Court for the Northern District of Ohio. In its answer to the complaint, Medidata denied the allegations of infringement and counterclaimed to invalidate DATATRAK's patent. On October 28, 2011 Medidata requested *ex parte* reexamination of the patent-in-suit by the U.S. Patent & Trademark Office, challenging

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the validity of the patent's claims, and moved to stay the litigation pending same. The Court granted Medidata's motion to stay the litigation, and the Company subsequently received notice from the U.S. Patent & Trademark Office that Medidata's request for *ex parte* reexamination of the patent was granted. The Company recently received a final office action from the U.S. Patent and Trademark Office rejecting the claims of the patent-in-suit. The Company intends to contest such office action. Although there can be no assurance as to the final outcome of the reexamination process, the Company intends to continue to vigorously protect its intellectual property, including any applicable claims against Medidata after the conclusion of the patent reexamination process.

In addition to the foregoing, in the ordinary course of its business, the Company is involved in ordinary, routine legal proceedings. The Company 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.

**ITEM 6. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 7. OTHER INFORMATION**

None.

**ITEM 8. EXHIBITS**

There are no updates to the Exhibit Index listed in the Company's Annual Report for the year ended December 31, 2011 except for the following:

- (i) The DATATRAK International, Inc. Restricted Stock Agreement

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**ITEM 9. CERTIFICATIONS**

I, Laurence P. Birch, Chief Executive Officer of DATATRAK International, Inc., certify that:

1. I have reviewed this quarterly 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: May 10, 2012

/s/ Laurence P. Birch  
\_\_\_\_\_  
Laurence P. Birch,  
Chief Executive Officer

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**ITEM 9. CERTIFICATIONS (continued)**

I, Jennifer M. Fox, Vice President, Finance and Quality Assurance of DATATRAK International, Inc., certify that:

1. I have reviewed this quarterly 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: May 10, 2012

/s/ Jennifer M. Fox

Jennifer M. Fox

VP, Finance and Quality Assurance, Treasurer, (Principal Financial Officer)

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**DATATRAK INTERNATIONAL, INC.**

**RESTRICTED STOCK AGREEMENT**

THIS RESTRICTED STOCK AGREEMENT (this “Agreement”), is entered into as of this 20th day of March, 2012 (the “Effective Date”), by and between DATATRAK International, Inc., an Ohio corporation (the “Company”), and \_\_\_\_\_ (the “Grantee”).

WITNESSETH:

WHEREAS, the Compensation Committee of the Company’s Board of Directors (the “Compensation Committee”) has determined to award the Grantee restricted common shares (“Restricted Shares”) of the Company, the vesting of which shall occur as described herein; and

WHEREAS, the Compensation Committee has determined that the award of Restricted Shares will be subject to the terms and conditions set forth in this Agreement;

NOW, THEREFORE, the Company and the Grantee agree as follows:

1. Grant of Restricted Shares. As of the Effective Date, the Company grants to the Grantee, upon the terms and conditions set forth in this Agreement and subject to the restrictions in Section 2, \_\_\_\_\_ (\_\_\_\_\_) Restricted Shares. The Restricted Shares are granted in accordance with, and subject to, all the terms, conditions and restrictions of this Agreement. The Grantee irrevocably agrees to, and accepts, the terms, conditions and restrictions of this Agreement on his own behalf and on behalf of any heirs, successors and assigns.

2. Restrictions. Except as otherwise provided in Section 10 hereof, the Grantee cannot sell, transfer, assign, hypothecate or otherwise dispose of the Restricted Shares or pledge it as collateral for a loan. In addition, the Restricted Shares will be subject to such other restrictions as the Compensation Committee deems necessary or appropriate.

3. Lapse of Restrictions on Stock. Except as provided in Section 5, the restrictions described in Section 2 shall lapse and be of no further force or effect with respect to each Restricted Share if the Grantee remains in the continuous employ of the Company until the first anniversary of the Effective Date.

4. Forfeiture. Except as provided in Section 5, if the Grantee’s employment with the company is terminated for any reason prior to the first anniversary of the Effective Date, then the Grantee shall forfeit the Restricted Shares as of the date of his or her termination of employment, and the Grantee and all persons who might claim through the Grantee will have no further interests under this Agreement of any kind whatsoever.

5. Change in Control. Notwithstanding anything herein to the contrary, if a Change in Control has occurred or an event has occurred that the Board of Directors, in the good faith exercise of its discretion, determines to be a Change in Control prior to the vesting of the Grantee’s interest in the Restricted Shares, the restrictions described in Section 2 will immediately lapse.

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6. Issuance of Stock. As soon as practicable after lapse of the restrictions set forth in Section 2 hereof, the Company will deliver to the Grantee (or his or her beneficiary or beneficiaries) the common shares to which the Grantee is entitled free and clear of any restrictions (except any applicable securities law restrictions).
7. Tax Withholding. The Company shall withhold, or require the Grantee to remit to the Company, an amount sufficient to satisfy any applicable federal, state or local tax withholding requirements. The Company shall deliver withholding proceeds to the Internal Revenue Service and other taxing authorities.
8. Shareholder Rights. Prior to the lapse of the restrictions set forth in Section 2 hereof, the Grantee will be entitled to vote the Restricted Shares.
9. Section 83(b) Elections. The Grantee will not make an election under Section 83(b) of the Internal Revenue Code to recognize taxable ordinary income in the year the Restricted Shares are granted. The Grantee understands that by not making such an election, he or she will recognize taxable ordinary income at the time the restrictions lapse in an amount equal to the fair market value of the common shares at that time.
10. Designation of Beneficiary. By properly executing and delivering a designation of beneficiary form as may be required from time to time by the Compensation Committee, the Grantee may designate an individual or individuals as his or her beneficiary or beneficiaries. In the event that the Grantee fails to properly designate a beneficiary, his or her interests will pass to the person or persons in the first of the following classes in which there are any survivors: (i) spouse at the time of death; (ii) issue, *per stirpes*; (iii) parents; and (iv) the executor or administrator of estate. Except as the Compensation Committee may determine in its sole and exclusive discretion, a properly completed designation of beneficiary form shall be deemed to revoke all prior designations.
11. Non-Transferability and Legends. The Restricted Shares have not been registered for resale under the Securities Act of 1933, as amended (the "Act"), and may not be sold, transferred or otherwise disposed of unless a registration statement under the Act with respect to the Restricted Shares has become effective or unless the Grantee establishes to the satisfaction of the Company that an exemption from such registration is available. The Restricted Shares will bear a legend stating the substance of such restrictions, as well as any other restrictions the Compensation Committee deems necessary or appropriate.
12. Termination of Agreement. This Agreement will terminate on the earliest of: (i) the date the restrictions described in Section 2 lapse; or (ii) such date as may be designated by the Company's Board of Directors or Compensation Committee. Any terms or conditions of this Agreement that the Company determines are reasonably necessary to effectuate its purposes will survive the termination of this Agreement.
13. Miscellaneous Provisions.
- a. Effect of Corporate Reorganization or Other Changes Affecting Number or Kind of Restricted Shares. The provisions of this Agreement will be applicable to the Restricted Shares and to any Restricted Shares or other securities which may be acquired by the Grantee as a result of a liquidation, recapitalization, reorganization, redesignation or reclassification, split-up, reverse split, merger, consolidation, share dividend,

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combination or exchange of Restricted Shares, exchange for other securities, a sale of all or substantially all assets or the like. The Compensation Committee shall appropriately adjust the number and kind of Restricted Shares under this Agreement to reflect such a change. As used in this Agreement, the term "Restricted Shares" will be deemed to include any such Restricted Shares or other securities.

- b. Successors and Legal Representatives. This Agreement will bind and inure to the benefit of the Company and the Grantee, and their respective successors, assigns and legal representatives.
- c. Integration. This Agreement constitutes the entire agreement between the Grantee and the Company with respect to the subject matter hereof, and may not be modified, amended, renewed or terminated, nor may any term, condition or breach of any term or condition be waived, except by a writing signed by the person or persons sought to be bound by such modification, amendment, renewal, termination or waiver. Any waiver of any term, condition or breach thereof will not be a waiver of any other term or condition or of the same term or condition for the future, or of any subsequent breach.
- d. Notice. Any notice relating to this grant must be in writing.
- e. No Employment Right Created. Nothing in this Agreement will be construed to confer upon the Grantee the right to continue in the employment or service of the Company, or to be employed or serve in any particular position therewith, or affect any right which the Company may have to terminate the Grantee's employment or service with or without Cause.
- f. Separability. In the event of the invalidity of any part or provision of this Agreement, such invalidity will not affect the enforceability of any other part or provision of this Agreement.
- g. Section Headings. The section headings of this Agreement are for convenience and reference only and are not intended to define, extend or limit the contents of the sections.
- h. Amendment, Waiver and Revocation of Terms. The Compensation Committee may waive any term or condition in this Agreement that could have been excluded on the date of grant. No such waiver will be deemed to be a waiver of similar terms under other agreements. The Compensation Committee may amend this Agreement to include or exclude any provision which could have been included in, or excluded from, this Agreement on the date of grant, but only with the Grantee's written consent. Similarly, the Compensation Committee may revoke this Agreement at any time except that, after execution of the Agreement, revocation may only be accomplished with the Grantee's written consent.