

DATATRAK INTERNATIONAL INC

Form 10-Q

May 10, 2007

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**Securities and Exchange Commission**  
**Washington, D.C. 20549**  
**Form 10-Q**  
**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
**For the Quarterly Period Ended March 31, 2007**  
**Commission file number 000-20699**  
**DATATRAK International, Inc.**  
 (Exact name of registrant as specified in its charter)

Ohio	34-1685364
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
6150 Parkland Boulevard Mayfield Heights, Ohio	44124
(Address of principal executive offices)	(Zip Code)
(440) 443-0082	
(Registrants telephone number, including area code)	

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (See definition of "large accelerated filer" and "accelerated filer" in Exchange Act Rule 12b-2).

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).  Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

The number of Common Shares, without par value, outstanding as of April 30, 2007 was 13,562,437.

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CONDENSED CONSOLIDATED BALANCE SHEETS**

	March 31, 2007 (Unaudited)	December 31, 2006 (Note A)
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 3,302,273	\$ 3,019,184
Short-term investments	9,351,703	1,996,393
Accounts receivable, net	1,874,766	2,226,317
Deferred tax asset - current	113,100	113,100
Prepaid expenses and other current assets	381,792	488,112
Total current assets	15,023,634	7,843,106
Property and equipment, at cost net of accumulated depreciation and amortization	4,476,207	4,736,233
Other assets		
Restricted cash	78,785	78,005
Deferred tax asset	1,602,100	1,745,700
Deposit	39,549	39,549
Other intangible assets, net of accumulated amortization	1,688,373	1,914,206
Goodwill	10,863,383	10,863,383
	14,272,190	14,640,843
Total assets	\$ 33,772,031	\$ 27,220,182
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities		
Accounts payable	\$ 219,079	\$ 568,697
Current portion of long-term debt	939,756	733,548
Accrued expenses	1,680,008	1,419,065
Deferred revenue	1,051,295	988,175
Total current liabilities	3,890,138	3,709,485
Long-term liabilities		
Long-term debt	3,320,572	3,811,903
Deferred tax liability	1,517,500	1,634,800
	4,838,072	5,446,703
Shareholders' equity		

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Serial Preferred Shares, without par value, 1,000,000 shares authorized, none issued		
Common shares, without par value, authorized 25,000,000 shares; issued 16,862,437 shares as of March 31, 2007 and 14,862,473 shares as of December 31, 2006; outstanding 13,562,437 shares as of March 31, 2007 and 11,562,473 shares as of December 31, 2006	78,500,659	70,742,073
Treasury shares, 3,300,000 shares at cost	(20,188,308)	(20,188,308)
Common share warrants	1,835,108	700,176
Accumulated deficit	(34,810,926)	(32,915,699)
Foreign currency translation	(292,712)	(274,248)
Total shareholders equity	25,043,821	18,063,994
Total liabilities and shareholders equity	\$ 33,772,031	\$ 27,220,182

Note A: The condensed consolidated balance sheet at December 31, 2006 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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**DATATRAK INTERNATIONAL, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

	Three Months Ended March 31,	
	2007	2006
Revenue	\$ 3,542,095	\$ 4,500,868
Direct costs	1,337,471	1,171,876
Gross profit	2,204,624	3,328,992
Selling, general and administrative expenses	3,422,671	2,981,212
Depreciation and amortization	622,403	438,682
Loss from operations	(1,840,450)	(90,902)
Other income (expense):		
Interest income	70,192	81,101
Interest expense	(98,669)	(50,269)
Loss before income taxes	(1,868,927)	(60,070)
Income tax expense	26,300	21,000
Net loss	\$ (1,895,227)	\$ (81,070)
Net loss per share:		
Basic:		
Net loss per share	\$ (0.16)	\$ (0.01)
Weighted average shares outstanding	11,858,949	10,845,627
Diluted:		
Net loss per share	\$ (0.16)	\$ (0.01)
Weighted average shares outstanding	11,858,949	10,845,627

*See notes to condensed consolidated financial statements.*



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**DATATRAK INTERNATIONAL, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	Three Months Ended March 31,	
	2007	2006
<b>Operating Activities</b>		
Net loss	\$ (1,895,227)	\$ (81,070)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	622,403	438,682
Stock-based compensation	136,057	193,283
Accretion of discount on investments	(35,282)	(36,558)
Changes in operating assets and liabilities:		
Accounts receivable	351,551	(21,150)
Prepaid expenses and other current assets	106,320	41,921
Deferred taxes, net	26,300	21,000
Accounts payable and accrued expenses	(284,839)	(127,254)
Deferred revenue	63,120	(306,817)
Net cash (used in) provided by operating activities	(909,597)	122,037
<b>Investing activities</b>		
Acquisition of business, less cash acquired		(3,901,381)
Purchases of property and equipment	(47,787)	(209,721)
Maturities of short-term investments	4,500,000	3,000,000
Purchases of short-term investments	(11,820,028)	(42,681)
Net cash used in investing activities	(7,367,815)	(1,153,783)
<b>Financing activities</b>		
Proceeds from exercise of stock option and warrants	30,384	50,139
Proceeds from issuance of common shares, net of paid issuance costs	8,916,105	
Payments of long-term debt	(364,747)	(118,184)
Net cash provided by (used in) financing activities	8,581,742	(68,045)
Effect of exchange rate changes on cash	(21,241)	(16,464)
Increase (decrease) in cash and cash equivalents	283,089	(1,116,255)
Cash and cash equivalents at beginning of period	3,019,184	4,407,431
<b>Cash and cash equivalents at end of period</b>	<b>\$ 3,302,273</b>	<b>\$ 3,291,176</b>



<b>Unpaid acquisition costs</b>	\$	\$ 824,486
<b>Unpaid share issuance costs</b>	\$ 189,028	\$

*See notes to condensed consolidated financial statements.*

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**DATATRAK INTERNATIONAL, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**March 31, 2007**  
**(Unaudited)**

**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 instructions to Form 10-Q and Article 10 of Regulation S-X. 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. 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, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Form 10-K for the year ended December 31, 2006.

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.

**2. ClickFind Acquisition**

On February 13, 2006, DATATRAK acquired all of the outstanding stock of ClickFind, Inc. ( ClickFind ), a technology company focused on the clinical trials industry, located in Bryan, Texas.

The negotiated terms of the acquisition were for an aggregate purchase price of \$18,000,000, less approximately \$328,000 in certain transaction expenses and certain indebtedness of ClickFind. A component of the purchase price was paid with 1,026,522 common shares of the Company, priced at \$9.25 per share, as determined by the terms of the acquisition agreement. The acquisition was recorded as a purchase, and as such, for the purpose of recording the acquisition, the value of the common shares used in the acquisition were valued at \$7.66 per share, based on the average closing price per share of the Company s common shares for the five business day period from February 9 through February 15, 2006.

Based on the common share valuation of \$7.66 per share, the total recorded acquisition cost, including acquisition related expenses of \$796,000, was \$16,619,000. The cash portion of the purchase price, less cash acquired of \$87,000, was approximately \$4,669,000. The remainder of the purchase price consisted of \$4,000,000 in notes payable and the issuance of approximately \$7,863,000 in common shares (1,026,522 common shares), both of which are excluded from the Company s condensed consolidated statement of cash flows. The notes payable bear interest at prime plus 1%, and principal payments are due in installments of \$500,000, \$500,000 and \$3,000,000 on February 1, 2007, 2008 and 2009, respectively.

The acquisition was accounted for as a purchase, and accordingly, fair value adjustments to the assets acquired and liabilities assumed were recorded as of the date of acquisition. The Company has obtained a third party valuation of certain tangible and intangible assets acquired.

DATATRAK s acquisition resulted in deferred tax liabilities of \$2,054,000. The Company will utilize its deferred tax assets to offset its acquisition related deferred tax liability.

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The following table summarizes the fair values of the assets acquired and liabilities assumed as of the date of the acquisition.

Cash, accounts receivable and other current assets	\$ 254,000
Amortizable intangible assets	6,040,000
Goodwill	10,863,000
Accounts payable and other current liabilities	(421,000)
Long-term debt	(117,000)
Total acquisition cost	\$ 16,619,000

Goodwill decreased by \$2,054,000 from the original purchase allocation as the deferred tax liabilities acquired in the acquisition are fully offset by the Company's realizable deferred tax assets. Subsequent to the acquisition, the \$117,000 of assumed long-term debt was paid in full.

The \$6,040,000 of acquired amortizable intangible assets were assigned as follows: (i) \$3,330,000 to the software now known as DATATRAK eClinical; (ii) \$1,160,000 to employee non-compete agreements; and (iii) \$1,550,000 to contracts and customer relationships. The acquired intangible assets are being amortized as follows: (i) the software over seven years; (ii) the employee non-compete agreements over three years; and (iii) the contracts and customer relationships over three years. The \$10,863,000 of goodwill is not deductible for income tax purposes.

In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill is deemed to have an indefinite life and is not amortized but is subject to an impairment test at least annually. The Company performed its initial annual goodwill and other intangible assets impairment test as of October 31, 2006. For purposes of impairment testing, the Company determined that it has one reporting unit. The Company compared the estimated fair value of the reporting unit to its carrying value, including goodwill. The fair value of the reporting unit exceeded its carrying value at October 31, 2006, and therefore goodwill was not deemed to be impaired as of the impairment testing date.

The operating results of ClickFind have been included in the Company's consolidated results of operations for all periods subsequent to February 13, 2006. Unaudited pro forma operating results for the three months ended March 31, 2006, as though the Company had acquired ClickFind at the beginning of 2006, are set forth below. The unaudited pro forma operating results are not necessarily indicative of what would have occurred had the transaction taken place on January 1, 2006.

	<b>Three Months Ended March 31, 2006</b>
Pro forma revenue	\$ 4,709,000
Pro forma net loss	\$ (359,000)
Pro forma basic loss per share	\$ (0.03)
Pro forma diluted loss per share	\$ (0.03)

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**3. Net Loss per Share**

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

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>
Net loss used in the calculation of basic and diluted earnings per share	\$ (1,895,227)	\$ (81,070)
Denominator for basic net loss per share weighted average common shares outstanding	11,858,949	10,845,627
Effect of dilutive common share options and warrants		
Denominator for diluted net loss per share	11,858,949	10,845,627
Basic net loss per share	\$ (0.16)	\$ (0.01)
Diluted net loss per share	\$ (0.16)	\$ (0.01)
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	1,548,463	1,774,825

**4. Comprehensive Loss**

The following table sets forth comprehensive loss.

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>
Net loss	\$ (1,895,227)	\$ (81,070)
Foreign currency translation	(18,464)	(13,147)
Comprehensive loss	\$ (1,913,691)	\$ (94,217)

**5. Shareholders Equity**

In March of 2007, the Company completed a private placement financing with a group of institutional investors. In connection with this financing, the Company sold 1,986,322 common shares at a price of \$4.75 per share. The terms of the financing included the issuance of five-year warrants to purchase a total of 297,948 common shares at \$6.00 per share to investors in the private placement, and the issuance of five-year warrants to purchase a total of 29,795 common shares at \$6.00 per share to the placement agents who assisted the Company in the private placement. The net proceeds from the sale of the common shares were approximately \$8,727,000 (after deducting the commissions and certain expenses of the placement agents and legal fees). The proceeds were allocated between common shares and common share warrants based on their relative fair values. All the warrants are outstanding as of March 31, 2007.

In connection with the March 2007 financing, we have granted registration rights for the purchased common shares and the common shares issuable upon exercise of the warrants. The registration rights specify filing and effectiveness deadlines and require the Company to maintain (e.g. maintenance requirement) sufficient number of common shares

to satisfy all the warrants if they were exercised now or in the future. DATATRAK has sufficient authorized, unregistered commons shares to permit exercise of the warrants. Accordingly, the Company classified the warrants as equity instruments.

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In the event the Company fails to meet a filing, effectiveness or maintenance requirement, DATATRAK shall pay each holder an amount equal to 1% of the aggregate purchase price. The aggregate amount of these registration delay payments shall not exceed a total of 10% of the aggregate purchase price of the shares. The Company believes it is not probable that it will be required to pay a registration delay payment and thus has not recorded a liability with respect to the registration payment arrangement.

On April 13, 2007, the Company filed its S-3 registration statement to register sufficient common shares to cover the purchased common shares and the common shares issuable upon exercise of the warrants issued as part of the private placement financing. The Company fully expects that it will meet all applicable registration requirements.

There are 157,079 warrants outstanding at March 31, 2007 from prior year issuances which have original terms of 3 to 5 years and exercise prices ranging from \$3.20 to \$9.60 per share.

During the three months ended March 31, 2007, the holders of 7,548 common share options, at a weighted average exercise price of \$4.03, exercised the options and purchased 7,548 shares.

**6. Operating Leases**

The Company leases certain office equipment and space. Future minimum lease payments for the Company under noncancelable operating leases as of March 31, 2007 are as follows:

<b>Twelve Months ended March 31,</b>	<b>Amount</b>
2008	\$ 933,000
2009	937,000
2010	648,000
2011	597,000
2012	604,000
Subsequent to March 31, 2012	351,000
	<b>\$ 4,070,000</b>

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**7. Income Taxes**

Income tax expense consists of the following:

	<b>Three Months Ended March</b>	
	<b>31,</b>	
	<b>2007</b>	<b>2006</b>
Deferred:		
Federal	\$	\$ 21,000
State and local		
Foreign	26,300	
	\$ 26,300	\$ 21,000

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

	<b>Three Months Ended March</b>	
	<b>31,</b>	
	<b>2007</b>	<b>2006</b>
Income tax (benefit) provision at the United States statutory rate	\$ (635,400)	\$ (21,000)
Increase in valuation allowance	587,800	
Foreign taxes	26,300	
Non-deductible permanent differences	47,600	42,000
	\$ 26,300	\$ 21,000

For the three months ended March 31, 2007, the Company's pretax loss was \$1,869,000. Due to uncertainty regarding the realization of the deferred tax asset resulting from this loss, DATATRAK provided for a full valuation allowance against this deferred tax asset.

In July 2006, the FASB issued Financial Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*. FIN No. 48 clarifies the accounting for uncertain tax positions recognized in an entity's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. This interpretation was effective for the Company on January 1, 2007. There was no impact upon adoption.

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**8. Long-term Debt**

Long-term debt at March 31, 2007 and December 31, 2006 is summarized below:

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
Insurance note payable	\$	\$ 74,000
Notes payable ClickFind (the ClickFind Notes )	3,753,000	4,000,000
Financing agreement with Oracle Credit Corporation (the Oracle Agreement )	211,000	234,000
Capital lease agreements with Dell Financial Services (the Dell Agreements )	296,000	238,000
	4,260,000	4,546,000
Less current maturities	940,000	734,000
	\$ 3,320,000	\$ 3,812,000

The ClickFind Notes are held by certain former shareholders of ClickFind. They bear interest at prime plus 1% and principal payments are due in installments of \$500,000, \$500,000 and \$3,000,000 on February 1, 2007, 2008 and 2009, respectively. Of the \$3,753,000, \$2,570,000 is held by an executive officer of the Company who was the founder of ClickFind. Of the remaining \$1,183,000 of ClickFind Notes, \$871,000 is held by other current employees of the Company

The Oracle Agreement is for the purchase of certain computer equipment. The terms of the financing agreement require DATATRAK to make 36 monthly payments of \$9,012, including accrued interest, beginning in July 2006 through June 2009.

The Dell Agreements are for the purchase of certain computer equipment. The terms of the lease agreements require DATATRAK to make monthly payments, currently totaling \$11,000, for the 36 month term of each lease.

The Oracle Agreement and the Dell Agreement transactions are excluded from the Company's condensed consolidated statement of cash flows. During the first three months of 2007 the Company entered into new Dell Agreements totaling \$87,000.

In connection with the Datasci claim, as further detailed in Note 12 herein, an arrangement was entered into with certain former ClickFind shareholders for sharing of the expenses associated with that litigation. Under that arrangement, a certain portion of principal payments due under the notes would be used to offset a certain portion of the expenses related to the litigation. Of the \$500,000 payment due on February 1, 2007, \$327,000 was held by the Company to be used to satisfy these expenses as they are incurred. As of March 31, 2007, approximately \$74,000 of the \$327,000 has been used to satisfy such expenses. The remaining amount, or \$253,000, will be paid to a former ClickFind shareholder in the second quarter of 2007. The Company is permitted to withhold additional portions of future principal payments to cover further costs associated with this claim.

**9. Restricted Cash**

The Company's wholly owned subsidiary, DATATRAK GmbH, is required to provide a bank guarantee to the lessor of its office space equal to three months of rent. The terms of the bank guarantee require DATATRAK GmbH to maintain a restricted cash balance of 59,000 euros with the bank. The U.S. dollar equivalent of this amount was \$78,785 at March 31, 2007 and \$78,005 at December 31, 2006.



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**10. 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 SFAS No. 86,

Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise 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.

Research and development expenses included in selling, general and administrative expenses were \$669,000 and \$596,000 for the three months ended March 31, 2007 and 2006, respectively.

**11. Reclassification**

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

**12. Contingencies**

In the ordinary course of business, the Company is involved in employment related legal proceedings. The Company is of the opinion that the ultimate resolution of these matters will not have a material adverse effect on the results of operations, cash flows or the financial position of DATATRAK.

On July 17, 2006, Datasci, LLC ( Datasci ) filed a complaint against the Company, ClickFind, and CF Merger Sub, Inc. ( Merger Sub ) alleging a patent infringement. As previously disclosed, on February 13, 2006, the Company acquired ClickFind pursuant to a merger agreement between the Company, ClickFind and Merger Sub, a wholly owned subsidiary of the Company. The Company believes Datasci's claims are without merit and intends to defend this matter vigorously. On August 14, 2006, the Company filed an answer and counterclaim denying infringement of the patent in suit, asserting numerous affirmative defenses and counterclaiming for a declaratory judgment of non-infringement and invalidity of the patent. Because the litigation is in a preliminary stage, the Company cannot assess the likelihood of an adverse outcome or determine whether potential damages, if any, could have a material adverse impact on the Company's results of operations in a future period or the Company's financial position or liquidity.

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**Item 2. Management's 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, 2007 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 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 is a provider of software and other related services, commonly referred to as an application service provider, or ASP. DATATRAK's customers use the software known as DATATRAK EDC(R) and DATATRAK eClinical (TM) to collect and transmit clinical trial data, commonly referred to as electronic data capture, or EDC. The Company's services assist companies in the clinical pharmaceutical, biotechnology, contract research organization and medical device industries, in accelerating the completion of clinical trials. Approximately 37% of the Company's assets, or \$12,654,000, is held in cash, cash equivalents and short-term investments, and goodwill accounts for approximately 32% or, \$10,863,000, of the Company's total assets. The Company is continuing to enhance and commercialize its business and software, and anticipates that its operating results may fluctuate significantly from period to period. There can be no assurance of the Company's long-term future prospects.

On February 13, 2006, we acquired all of the outstanding stock of ClickFind, a company focused on the application of a unified technology platform for clinical trials, located in Bryan, Texas. As a result of the acquisition, we believe we have the most extensive software suite in the clinical trials industry.

The cash portion of the purchase price, less cash acquired of \$87,000, was approximately \$4,669,000. The remainder of the purchase price consisted of \$4,000,000 in notes payable and the issuance of approximately \$7,863,000 in common shares (1,026,522 common shares), both of which are excluded from the Company's condensed consolidated statement of cash flows. The notes payable bear interest at prime plus 1%, and principal payments are due in installments of \$500,000, \$500,000 and \$3,000,000 on February 1, 2007, 2008 and 2009, respectively. In connection with the Datasci claim, an arrangement was entered into with certain former ClickFind shareholders for sharing of the expenses associated with that litigation. Under that arrangement, a certain portion of principal payments due under the notes would be used to offset a certain portion of the expenses related to the litigation. Of the \$500,000 payment due on February 1, 2007, \$327,000 was held by the Company to be used to satisfy these expenses as they are incurred. As of March 31, 2007, approximately \$74,000 of the \$327,000 has been used to satisfy such expenses. The remaining amount, or \$253,000, will be paid to a certain former ClickFind shareholder in the second quarter of 2007. The Company is permitted to withhold additional portions of future principal payments to cover further costs associated with this claim.

The operating results of ClickFind have been included in our consolidated results of operations for all periods subsequent to February 13, 2006.

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DATATRAK recognizes revenue in accordance with Staff Accounting Bulletin 104, *Revenue Recognition* and Emerging Issues Task Force ( EITF ) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*. 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 collectibility is probable. DATATRAK 's contracts provide a fixed price for each element to be delivered, and revenue is recognized as these multiple-elements are delivered. The Company determines the price of items 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 or other methods allowable under EITF No. 00-21. DATATRAK recognizes revenue based on the performance or delivery of the following specified services or components of its contracts in the manner described below:

Project management and data management (design, report and export) service revenue is recognized proportionally over the life of a contract as services are performed, based on the contractual billing rate per hour for those services.

Data items revenue is earned based on a price per data unit as data items are entered into our hosting facility.

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 under the contract.

Services provided by us that are in addition to those provided for in our 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 our clients, and for which we do 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.

Backlog consists of anticipated revenue from authorization letters to commence services and signed contracts yet to be completed. Potential contracts or authorization letters that have passed the verbal stage, but have not yet been signed, are excluded from backlog. At March 31, 2007, DATATRAK 's backlog was \$13,510,000. DATATRAK 's contracts can be cancelled or delayed at anytime and, therefore, the Company 's backlog, at any point in time, is not an accurate predictor of future levels of revenue. As a result of DATATRAK 's transactional and service-based business model combined with the dynamic nature of the clinical trials market where changes in scope are common, backlog has historically not been an accurate predictor of short-term revenue.

**Critical Accounting Policies**

In response to the SEC 's Release No. 33-8040, *Cautionary Advice Regarding Disclosure About Critical Accounting Policies*, the Company has identified the most critical accounting principles upon which its financial status depends. Critical principles 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, software development costs, stock-based compensation, income taxes and goodwill and other intangible assets.

A summary of the Company 's critical accounting policies related to revenue recognition, software development costs, stock-based compensation, goodwill and other intangible assets and income taxes can be found in the Company 's Annual Report on Form 10-K, filed on March 16, 2007, ( *Annual Report* ) under the heading *Critical Accounting Policies* in Management 's Discussion and Analysis of Financial Condition and Results of Operations.

**Table of Contents****Results of Operations***Three months ended March 31, 2007 compared with three months ended March 31, 2006*

Revenue for the three months ended March 31, 2007 decreased \$959,000, or 21.3%, to \$3,542,000, as compared to \$4,501,000 for the three months ended March 31, 2006. During the first quarter of 2007, DATATRAK recorded revenue related to 122 contracts compared to 93 contracts during the three months ended March 31, 2006. For the three months ended March 31, 2007, \$3,181,000 of revenue was the result of contracts that were in backlog at December 31, 2006, \$119,000 was the result of new business signed since January 1, 2007, and \$242,000 was the result of contracts acquired from ClickFind. For the first quarter of 2006, \$4,070,000 of revenue was generated from contracts that were in backlog at December 31, 2005, \$205,000 of revenue was the result of new business signed since January 1, 2006, and \$226,000 was the result of contracts acquired from ClickFind. Accounting for the acquisition of ClickFind as though it occurred on January 1, 2006, actual revenue for the three month period ended March 31, 2007 would have decreased 24.8% over pro forma revenue of \$4,709,000 for the three month period ended March 31, 2006. The reduction in revenue for the three months ended March 31, 2007 compared to the same prior year three month period was primarily the result of a significant decrease attributable to one client, Otsuka Research Institute, which accounted for 24% of our total revenue in the first quarter of 2007 compared to 51% of total revenue in the first quarter of 2006. For the remainder of 2007 we expect revenue from Otsuka Research Institute to be significantly lower, as a percent of our total revenue, compared to 2006 as a result of the successful early completion of several large trials.

Direct costs of revenue, mainly personnel costs, were \$1,337,000 and \$1,172,000 during the three months ended March 31, 2007 and 2006, respectively. The net increase of \$165,000, or 14.1%, included higher staff and other payroll cost of \$268,000 offset by reductions in other direct costs. DATATRAK's gross margin decreased to 62.2% for the three months ended March 31, 2007 compared to 74.0% for the three months ended March 31, 2006 primarily as a result of the decrease in revenue and to a lesser extent the increase in primarily direct fixed costs. Accounting for the acquisition of ClickFind as though it occurred on January 1, 2006, actual gross margin would have decreased to 62.2% for the three month period ended March 31, 2007 from pro forma gross margin of 73.1% for the three month period ended March 31, 2006.

Selling, general and administrative expenses ( SG&A ) include all administrative personnel costs, business and software development costs, and all other expenses not directly chargeable to a specific contract. SG&A expenses increased by \$442,000, or 14.8% to \$3,423,000 from \$2,981,000 for the three months ended March 31, 2007 and 2006, respectively. Additional staff and other payroll cost increases accounted for \$299,000, or 67.6%, of the \$442,000 net increase. The increase in personnel costs was caused by additional hiring and the addition of employees from the acquisition of ClickFind offset by 10 terminated employees in June of 2006. The additional personnel were necessary to bring certain development functions in-house and to allow for the discontinuation of outsourced research and development. The discontinuation of outsourced research and development resulted in a cost savings of \$199,000 in the first three months of 2007 compared to the same period of the prior year. Also contributing to the SG&A increase was higher office rent of \$191,000, resulting primarily from the impact of entering into a new lease for additional space at our Mayfield Heights, Ohio executive office location in early 2006 and the addition of the Bryan, TX. office. Higher professional services cost and higher marketing expense aimed at additional brand awareness added to the SG&A increase.

Depreciation and amortization expense increased \$184,000, or 41.9%, primarily as a result of the software and intangible assets acquired in the ClickFind acquisition. Depreciation and amortization expense was \$622,000 for the three months ended March 31, 2007 compared to \$439,000 for the three months ended March 31, 2006. The first three months of 2007 includes a full quarter of depreciation and amortization expense, or \$345,000, on the \$3.3 million of software and \$2.7 million of intangible assets acquired in the ClickFind acquisition compared to only a partial quarter, or \$197,000, in the first three months of 2006.

Interest expense increased 96.0%, or \$48,000, to \$99,000 in the first quarter of 2007 compared to

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\$50,000 in the first quarter of 2006 mainly as a result of the ClickFind Notes being outstanding for the entire quarter compared to only a half-quarter in the first three months of 2006.

**Liquidity and Capital Resources**

Since its inception, the Company's principal sources of cash have been cash flow from operations and proceeds from the sale of equity securities. The Company's investing activities primarily reflect capital expenditures and sales and purchases of short-term investments. During 2006, the Company used approximately \$4,669,000 in cash for the ClickFind acquisition.

On March 19, 2007, we completed a private placement financing with a group of institutional investors. In connection with this financing, we sold 1,986,322 common shares at a price of \$4.75 per share. The terms of this financing included the issuance of five-year warrants to purchase a total of 297,948 common shares at \$6.00 per share to investors in the private placement, and the issuance of five-year warrants to purchase a total of 29,795 common shares at \$6.00 per share to the placement agents who assisted the Company in the private placement. The net proceeds from the sale of the common shares was approximately \$8,727,000 (after deducting the commissions and certain expenses of the placement agents and legal fees). In connection with the agreement executed by the parties, we granted registration rights for the purchased common shares and the common shares issuable upon exercise of the warrants.

Contracts with our 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. We record 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. We typically receive a low volume of large-dollar receipts. Our accounts receivable will fluctuate due to the timing and size of cash receipts. Our contracting and collection practices are designed to maintain an average collection period for accounts receivable of one to three months. Any increase in our normal collection period for accounts receivable will negatively impact our cash flow from operations and our working capital. At March 31, 2007, our average collection period for accounts receivable was 53 days compared to 51 days at December 31, 2006. Accounts receivable (net of allowance for doubtful accounts) was \$1,875,000 at March 31, 2007 and \$2,226,000 at December 31, 2006. Deferred revenue was \$1,051,000 at March 31, 2007 compared to \$988,000 at December 31, 2006.

Cash and cash equivalents increased \$283,000 during the three months ended March 31, 2007. This was the net result of \$910,000 used in operating activities, \$7,368,000 used in investing activities and \$8,582,000 provided by financing activities. Foreign currency fluctuations caused a \$21,000 decrease in cash and cash equivalents. Cash used in operating activities was mainly the net result of our net loss of \$1,895,000 offset primarily by non-cash depreciation and amortization of \$622,000, non-cash stock-based compensation of \$136,000 and a reduction in accounts receivable of \$352,000. Investing activities included \$48,000 used to purchase property and equipment, and net purchases of short-term investments totaling \$7,320,000 (primarily the net proceeds from our March 19, 2007 private placement. In addition to the \$48,000 used to purchase property and equipment we entered into lease agreements during the first three months of 2007 to purchase \$87,000 of property and equipment which is excluded from the Company's consolidated statement of cash flows. Financing activities primarily consist of net proceeds of \$8,916,000 (excluding \$189,000 of unpaid share issuance costs to be paid in the second quarter of 2007) from the March 19, 2007 private placement, offset by debt repayments of \$247,000 for the ClickFind Notes, \$74,000 repayment of an insurance note and \$44,000 for the repayment of capital expenditure equipment leases and financing agreements.

At March 31, 2007, we had working capital of \$11,133,000, and our cash, cash equivalents and short-term investments totaled \$12,654,000. Our working capital increased by \$7,000,000 since December 31, 2006. The increase was primarily the result of the \$7,355,000 increase in our short-term investments, caused mainly by the \$8,727,000 of net proceeds from the March 19, 2007 private placement.

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We are party to a lease agreement that requires us to maintain a restricted cash balance. Our restricted cash balance was \$79,000 at March 31, 2007.

We have established two lines of credit with two separate banks. One of the lines allows us to borrow up to a certain percentage of our investments, as determined by the type of investment, held at the bank. The line of credit bears interest at rates based on the prime rate, and is payable on demand. The other line of credit allows us to borrow up to \$2,000,000 at an interest rate equal to the prime rate minus 100 basis points for U.S. dollar borrowings and the euro dollar rate plus 125 basis points for euro borrowings, payable on demand. The \$2,000,000 in available borrowing would be collateralized by certain assets held by us. We had no amounts outstanding against these lines of credit at March 31, 2007.

At December 31, 2006, we had a note payable of \$73,807 due to Westfield Bank. The final payment on this note of \$75,233, including accrued interest, was made in January 2007. At March 31, 2007, we had a note payable in the amount of \$211,000 to Oracle Credit Corporation, payable in monthly payments of \$9,012, including accrued interest through June 2009. Additionally, at March 31, 2007, we had various capital lease agreements in the amount of \$296,000 with Dell Financial Services, payable in 36 monthly installments currently totaling \$11,000, including accrued interest.

The terms of our acquisition of ClickFind required us to pay approximately \$4,000,000 of cash to the former shareholders of ClickFind in February 2006. We also issued notes payable to the former shareholders of ClickFind in the amount of \$4,000,000 that bear interest at prime plus 1.0%, and are payable in installments of \$500,000, \$500,000 and \$3,000,000 on February 1, 2007, 2008 and 2009, respectively. In connection with the Datasci claim, an arrangement was entered into with certain former ClickFind shareholders for sharing of the expenses associated with that litigation. Under that arrangement, a certain portion of principal payments due under the notes would be used to offset a certain portion of the expenses related to the litigation. Of the \$500,000 payment due on February 1, 2007, \$327,000 was held by the Company to be used to satisfy these expenses as they are incurred. As of March 31, 2007, approximately \$74,000 of the \$327,000 has been used to satisfy such expenses. The remaining amount of \$253,000 will be paid to a former ClickFind shareholder in the second quarter of 2007. The Company is permitted to withhold additional portions of future principal payments to cover further costs associated with this claim. Of the \$3,753,000 of ClickFind Notes outstanding at March 31, 2007, \$2,570,000 is held by one of our executive officers who was the founder of ClickFind. Of the remaining \$1,183,000 of ClickFind Notes, \$871,000 is held by other current employees of DATATRAK..

We intend to continue to fund the maintenance and testing of the DATATRAK EDC® software, as well as invest in the development, enhancement and testing of DATATRAK eClinical(TM). In 2007, we expect revenue from our largest customer to significantly decrease due to the successful early completion of several large trials. We expect to have negative cash flow from operations during 2007 as we transition from dependence on a major customer to a broader customer base with the expansion of our eClinical product offering. We also expect to record a net loss in 2007. We anticipate cash expenditures for property and equipment of approximately \$1,000,000 during 2007, for the continued commercialization, enhancement and maintenance of our two clinical trial product offerings as well as improvements to our internal operating systems. We anticipate financing approximately 50% of the \$1,000,000 of property and equipment. A portion of the anticipated property and equipment expenditures are dependent on our growth, and are therefore discretionary in nature.

We record our research and development expenditures as part of SG&A expenses. Our research and development expenditures will be for the maintenance and testing of our DATATRAK EDC® software and the development, enhancement and testing of our DATATRAK eClinical(TM) software products. For the three months ended March 31, 2007, we expensed approximately \$669,000 for research and development. During 2007, we anticipate that our research and development expenditures will increase by approximately \$200,000 to \$400,000 compared to the full year 2006 amount of \$2,310,000.

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We expect to fund our working capital requirements from existing cash and cash equivalents, maturities of short-term investments, cash flow from operations, borrowings against our lines of credit and the net proceeds from our March 2007 private placement of approximately \$8,727,000. We believe that, with the net proceeds from our March 2007 private placement, our cash and cash equivalents, maturities of short-term investments and cash flow from operations will be sufficient to meet our working capital and capital expenditure requirements for the foreseeable future. However, we may need to raise additional funds to offset delays or cancellations of contracts, support expansion, respond to competitive pressures, acquire complementary businesses or technology or take advantage of unanticipated opportunities. We 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 our 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 Form 10-Q, other SEC filings, 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, 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, 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 emerging 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 Company's success in integrating ClickFind's operations into its own operations and the costs associated with maintaining and/or developing two product suites; 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.

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**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The Company is exposed to market risk from changes in interest rates and foreign currency exchange rates since it funds its operations through short-term investments, has issued variable rate debt and has business transactions in euros. A summary of the Company's market risk exposures is presented below.

*Interest Rate Risk*

DATATRAK has fixed income investments consisting of cash equivalents and short-term investments, and short and long-term notes payable which may be affected by changes in market interest rates. The Company does not use derivative financial instruments in its investment portfolio. The Company places its cash equivalents and short-term investments with high-quality financial institutions, limits the amount of credit exposure to any one institution and has established investment guidelines relative to diversification and maturities designed to maintain safety and liquidity. Investments are reported at amortized cost, which approximates fair value. A 1.0 percentage point change in interest rates during the three months ended March 31, 2007, would have resulted in a \$89,000 change in DATATRAK's interest income during the period.

The Company's notes payable to certain former shareholders of ClickFind bear interest at prime plus 1%, and interest is paid quarterly. A 1.0 percentage point change in the prime rate during the three month ended March 31, 2007, would have resulted in a \$10,000 change in DATATRAK's interest expense during the period.

*Foreign Currency Risk*

DATATRAK's foreign results of operations are subject to the impact of foreign currency fluctuations through both foreign currency transaction and foreign currency translation adjustments. The Company manages its risk to foreign currency transaction adjustments by maintaining foreign currency bank accounts in currencies in which we regularly transact business. DATATRAK does not currently hedge against the risk of exchange rate fluctuations.

DATATRAK's financial position and results of operations are impacted by translation adjustments caused by the conversion of foreign currency accounts and operating results into U.S. dollars for financial reporting purposes. A 1.0% fluctuation in the exchange rate between the U.S. dollar and the euro at March 31, 2007, would have resulted in a \$6,000 change in the foreign currency translation amount recorded on the Company's balance sheet, due to foreign currency translations. A 1.0% fluctuation in the average exchange rate between the U.S. dollar and the euro for the three months ended March 31, 2007, would have resulted in a \$12,000 change in the Company's net loss for the three months ended March 31, 2007, due to foreign currency transactions. During the three months ended March 31, 2007, the average exchange rate between the euro and the U.S. dollar increased by approximately 9.0% compared to the three months ended March 31, 2006. The conversion of the Company's foreign operations into U.S. dollars upon consolidation resulted in a net loss that was approximately \$96,000 more than would have been recorded had the exchange rate between the euro and the U.S. dollar remained consistent with 2006 rates.



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**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures*

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the chief executive officer and chief financial officer, of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-14(e)) as of the end of the period covered by this report. Based upon that evaluation the Company's management, including the chief executive officer and chief financial officer, have concluded that, as of March 31, 2007, the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in the reports it files and submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

*Changes in Internal Controls*

There were no changes in the Company's internal controls over financial reporting that occurred during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

**Part II. Other Information**

**Item 1. Legal Proceedings**

On July 17, 2006, Datasci, LLC ( "Datasci" ) filed a complaint against the Company, ClickFind, Inc. ( "ClickFind" ) and CF Merger Sub, Inc. ( "Merger Sub" ) (Civil Docket No. 8:06-cv-01820-MJG, United States District Court, District of Maryland) alleging infringement of United States Patent No. 6,496,827. As previously disclosed, on February 13, 2006, the Company acquired ClickFind pursuant to a merger agreement between the Company, ClickFind and Merger Sub, a wholly owned subsidiary of the Company. Datasci seeks injunctive relief and money damages in an unspecified amount. The Company believes Datasci's claims are without merit and intends to defend this matter vigorously. On August 14, 2006, the Company filed an answer and counterclaim denying infringement of the patent in suit, asserting numerous affirmative defenses and counterclaiming for a declaratory judgment of non-infringement and invalidity of the patent. Because the litigation is in a preliminary stage, the Company cannot assess the likelihood of an adverse outcome or determine whether potential damages, if any, could have a material adverse impact on the Company's results of operations in a future period or the Company's financial position or liquidity.

**Item 1A. Risk Factors**

There are no material changes to the Risk Factors described under the title "Risk Factors" in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The information required to be filed pursuant to this Item 2 was previously included in the Current Report on Form 8-K filed with the Securities and Exchange Commission on March 19, 2007.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

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**Item 5. Other Information**

None.

**Item 6. Exhibits**

- 4.1 Form of Warrant, dated March 19, 2007, which is incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission on March 20, 2007.
- 10.2 Securities Purchase Agreement by and among the Company and the Purchasers named on Schedule A(3) thereto, dated March 16, 2007, which is incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission on March 20, 2007.
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
- 32.1 Section 1350 Certification of Chief Executive Officer
- 32.2 Section 1350 Certification of Chief Financial Officer

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**SIGNATURES**

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

DATATRAK International, Inc.

Registrant

Date: May 10, 2007

/s/ Jeffrey A. Green

Jeffrey A. Green,  
President and Chief Executive Officer  
and a Director  
(Principal Executive Officer)

Date: May 10, 2007

/s/ Terry C. Black

Terry C. Black,  
Vice President of Finance, Chief  
Financial Officer, Treasurer and  
Assistant Secretary  
(Principal Financial and Accounting  
Officer)

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