

DATATRAK INTERNATIONAL INC

Form 10-K

March 16, 2009

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-K**

**FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTIONS 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

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

**For the fiscal year ended December 31, 2008**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 001-33688**

**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 Hts., Ohio

44124

(Address of principal executive offices)

(Zip code)

Registrant's telephone number, including area code: (440) 443-0082

Securities registered pursuant to Section 12(b) of the Act:

| Title of Each Class   | Name of Exchange on Which Registered |
|---|--------------------------------------|
| Common Shares, without par value                              | The NASDAQ Stock Market LLC          |
| Series A Junior Participating Preferred Stock Purchase Rights | The NASDAQ Stock Market LLC          |

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller

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reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

As of June 30, 2008, the aggregate market value of the 12,203,992, common shares then outstanding, which together constituted all of the voting shares of the registrant, held by non-affiliates was \$5,491,796 (based upon the closing price of \$0.45 per common share on the Nasdaq Capital Market on June 30, 2008). For purposes of this calculation, the registrant deems the common shares held by all of its Directors and executive officers to be the common shares held by affiliates. As of February 27, 2009, the registrant had 13,751,901 common shares issued and outstanding.

**Documents Incorporated by Reference**

Portions of the registrant's definitive Proxy Statement to be used in connection with its Annual Meeting of Shareholders to be held in June 2009 are incorporated by reference into Part III (Items 10, 11, 12, 13 and 14) of this report. Except as otherwise stated, the information contained in this Form 10-K is as of December 31, 2008.

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**PART I**

**ITEM 1. BUSINESS**

**General**

DATATRAK International, Inc. ( DATATRAK or the Company ) is a technology and services company focused on global eClinical solutions for the clinical trials industry. DATATRAK's mission is to provide clinical research data to sponsors of clinical trials faster and more efficiently than manual information-processing. Our customers use our 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. Our customers are companies in the clinical pharmaceutical, biotechnology, contract research organization ( CRO ) and medical device industries. Our 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.

We currently operate in one business segment as an Application Service Provider ( ASP ) providing electronic clinical trials technology often referred to as electronic data capture ( EDC ) to the clinical trials industry. Since we began our current operations in 1997, we have devoted the majority of our efforts to developing and improving our platform offerings and establishing the market presence necessary to compete in this evolving sector.

At this time, the Company has two distinct software offerings. The first offering is a legacy-based point solution known as DATATRAK EDC®. This software product has provided electronic solutions for the global clinical trials industry since 1993. It was acquired by DATATRAK in January of 1998 from the German Division of Electronic Data Systems. This product served as the primary offering of the Company from 1998 through February 13, 2006. This legacy-based product will be providing electronic data collection services until ongoing trials come to an expected completion at the end of 2009.

On February 13, 2006, the Company acquired all of the outstanding stock of ClickFind, Inc. ( ClickFind ), a company focused on the application of a unified technology platform for clinical trials, located in Bryan, Texas, for a total negotiated aggregate purchase price of \$18,000,000, less approximately \$328,000 in certain transaction expenses and certain indebtedness of ClickFind. As part of the acquisition of ClickFind, the Company issued notes payable to the former shareholders of ClickFind (the ClickFind Notes ) in the amount of \$4,000,000. Of the \$4,000,000 note amount, \$1,000,000 was repaid and the remaining \$3,000,000 was forgiven.

The acquired product suite is now known as DATATRAK eClinical<sup>0</sup>. This acquisition was made in order to appropriately react to market maturations that we believe are transitioning from point solution offerings to overall suites of capabilities encompassed in a broader information platform. The Company believed that their competitiveness in this market could be enhanced more quickly and cost effectively through an acquisition rather than internal development. As a result of the acquisition, we believe we have the most extensive software suite in the clinical trials industry.

By the middle of 2009 we believe only one trial will be running on our DATATRAK EDC® legacy product and it is scheduled to conclude at the end of 2009. As such, we will support two different architectures for the use of technology in clinical trials until the trials using the legacy platform are completed. We will continue to support and provide, as needed, appropriate service packs for the maintenance of DATATRAK EDC®. However, no extensive, future development efforts are planned for DATATRAK EDC®, and following the conclusion of all clinical trials using DATATRAK EDC®, that product suite will be retired. DATATRAK will focus its future development efforts on the continuous enhancement of its core product platform the DATATRAK eClinical<sup>0</sup> software suite.

Effective January 31, 2009, DATATRAK, Inc., a wholly owned subsidiary of the Company, terminated its non-exclusive Marketing Services Agreement ( Agreement ) with DATATRAK Deutschland GmbH ( Deutschland GmbH ) and DATATRAK Inc. As of December 31, 2008, Deutschland GmbH recorded accrued expenses for lease and other obligations incurred through January 31, 2009 totaling \$218,000. As a result of the termination of the Agreement, Deutschland GmbH was required under applicable German law to file a petition for voluntary bankruptcy in the German courts and has on hand \$218,000, designated as restricted cash, to fund these liabilities as of December 31, 2008. Also as part of this liquidation of the Company's foreign investment in Deutschland GmbH, the Company reversed its cumulative currency translation adjustment and recorded additional operating expense of \$381,000 as of December 31, 2008.



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**Overview of the Clinical Research Industry**

Our customers are companies that perform clinical trials in the pharmaceutical, biotechnology, CRO and medical device industries. These industries are driven by regulatory requirements which mandate that new drugs and medical devices be adequately tested in clinical trials prior to marketing these drugs and devices.

Competitive pressures are forcing the pharmaceutical and biotechnology industries to become more efficient when developing new products. To improve returns on research and development investments, pharmaceutical and biotechnology companies are continuing to develop new products, while at the same time attempting to shorten product development timelines. These efforts have placed more drugs into the clinical development process and have increased the pressure for companies to develop products faster in order to maintain growth and continue to achieve acceptable returns on research and development expenditures. Sponsors of clinical trials have attempted to create process efficiencies, control fixed costs and expand capacity by outsourcing clinical research activities.

**DATATRAK Software and Services**

Under the traditional method of clinical research, clinical trial data from each patient is recorded and maintained on paper in a binder, known as a case report form. A separate case report form is maintained for each patient. Clinical research associates then visit research sites to review the clinical trial data for accuracy and integrity. During these visits, known as monitoring visits, the research associate must review each page of each case report form. These visits may last several days, and corrections to the case report forms are frequently required before the data can be delivered to the clinical trial sponsor. Several weeks, or even months, of data may be reviewed during each monitoring visit. At the completion of a monitoring visit, the completed case report form pages are physically transferred to a central location where the data is then entered into a database for statistical compilation. Using this method of data collection and quality control, the duration of the clinical trial process, from patient visit to delivery of clean data to the clinical trial sponsor, can range from six to nine months. Such delays are significant because errors or trends may not be detected until long after the interaction between the patient and clinical investigator.

During the performance of clinical trials, a variety of technology applications are used for the collection, management and storage of information. Many of these applications perform limited but important functions that contribute to the overall successful accomplishment of a clinical trial. Because the use of technology in this industry is relatively new, as compared to others, the specific functionalities of individual technology applications have advanced as single point solutions rather than an overall product suite, existing under a single application, architecture and corporate offering. As the global clinical trial market transitions from a paper-based data collection and management process to a technology-enabled process over the next several years, we believe that the clinical trials industry will increasingly demand multiple applications. As the demand for multiple applications increase, we believe sponsors of clinical research will gravitate from the challenges encountered with information collected and residing in several disparate applications to one that houses multiple applications under a single software architecture and corporate structure. This would represent a simplified approach from the workflow process of clinical trials itself and would also yield contracting advantages by being able to deal with only one vendor for a variety of necessary software applications.

Our products were developed to provide clinical research data to sponsors of clinical research trials faster and more efficiently than other forms of information-processing that utilize paper. Automating data entry and review procedures can save time in the drug development and medical device approval process, and possibly result in enhanced patient safety. Our system consists of numerous modules designed for flexible adaptation to the clinical research process. We initially provide a set of electronic data forms that can be modeled to suit the needs of each particular clinical trial. Each form is then made available through data entry capability to each research site participating in the clinical trial via the Internet. Once clinical trial data has been collected and entered, the clinical trial sponsor, or other contracted vendor, can review the data remotely via the Internet. After the data is reviewed and cleansed of all entry errors, the software's report capability can generate customized reports. Finally, the software's export feature allows completed data and reports to be transmitted directly to a clinical trial sponsor's in-house database. Under this model, research data is collected quicker and with greater accuracy than with physical review of paper reports.

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Our DATATRAK eClinical<sup>0</sup> software suite provides the following capabilities: EDC, interactive voice response systems ( IVRS ) (via phone or Internet), medical coding, web-based randomization, clinical trial management system ( CTMS ), clinical data management system ( CDMS ), drug inventory management, digitized electrocardiograms, image collection, viewing and storing capabilities and workgroup collaboration capabilities. In comparison to the legacy product, DATATRAK EDC<sup>®</sup>, several of these new capabilities will represent additional revenue opportunities for the Company as the DATATRAK eClinical<sup>0</sup> product offering matures.

Our software products have successfully supported hundreds of international clinical trials involving thousands of patients in 59 countries. DATATRAK products have been utilized in some aspect of the clinical development of 16 separate drugs and one medical device that have received regulatory approval from either the United States Food and Drug Administration ( FDA ) or counterpart European regulatory bodies ( EMEA ).

Our CRO Connect and Enterprise Transfer program allows customers to become empowered to design, set up and manage their clinical trials independently through our ASP delivery. The Company believes that our customers' desire to be as independent as possible in the performance of their clinical trials is another growth aspect of this industry that is gaining momentum. We intend to support the DATATRAK EDC<sup>®</sup> software as necessary from time to time, as well as invest in the development and enhancement of the DATATRAK eClinical<sup>0</sup> software suite. Research and development expenses were \$1,428,000, \$2,405,000 and \$2,310,000 in 2008, 2007 and 2006, respectively.

**Customers and Marketing**

Our customers are largely comprised of clinical trial sponsors and CROs. We market our software and services through a sales staff located in the United States and Europe. The market for the deployment of electronic clinical trials in general and for our services specifically, has been an emerging one. Our marketing efforts have included selective participation in scientific and medical meetings to promote our services and we have occasionally used direct mail and journal advertisements to build awareness of our capabilities.

Our marketing and sales efforts have been focused upon building reference accounts with key customers and leveraging these relationships into new divisions of our current customers, and growing new customers through maintaining a high level of satisfaction in the delivery of our DATATRAK eClinical<sup>0</sup> product suite on a worldwide basis.

In December 2007, the Company signed a five-year Enterprise Transfer Agreement with NTT DATA Corporation ( NTT DATA ) of Japan. The structure of this relationship includes the pre-purchase of a fixed volume of data items from DATATRAK formulated as a license subscription and NTT Data may also elect to purchase additional data items subject to the terms of the Enterprise Transfer Agreement. This relationship enables NTT DATA to directly utilize this volume of data items and will also permit them to market and sublicense such data items to clinical trial sponsors and CROs. As such, NTT DATA has become a value-added-reseller of DATATRAK eClinical in the country of Japan, and this relationship has enabled DATATRAK to expand into the Japanese market in a cost-effective manner. During 2008, NTT DATA sublicensed data items to several customers in the Japanese market.

The market for electronic clinical trials has been slow to develop. The growth of the Internet has drastically altered business strategies and pricing models in this specific sector. Most vendors in this market have insignificant revenues and are classified as start-ups. Nonetheless, we believe that some type of automation in the collection and review of clinical trial data is inevitable.

It is our belief that our software platform can be competitive in this emerging marketplace. Our products have been tested and verified to be in compliance with FDA and other regulations. Our software offering is delivered primarily via the Internet and supports multiple languages. Furthermore, many clinical trial sponsors have published statistics indicating that the use of technology can reduce the length of time to complete a clinical trial and improve the quality of the clinical trial data.

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The extent to which we rely on revenue from any one customer varies from period to period, depending upon, among other things, our ability to generate new business, and the timing and size of clinical trials. In light of our small revenue base, we are more dependent on major customers than many of the larger participants in the EDC industry. The table below sets forth the percentage of revenue generated from customers who accounted for more than 10% of our revenue during 2008, 2007 and 2006.

| <b>Customer</b>           | <b>Year ended December 31,</b> |             |             |
|---------------------------|--------------------------------|-------------|-------------|
|                           | <b>2008</b>                    | <b>2007</b> | <b>2006</b> |
| Otsuka Research Institute | *                              | 15%         | 44%         |
| Gilead Sciences, Inc.     | 18%                            | 14%         | *           |
| Allergan, Inc.            | *                              | 12%         | *           |
| Seattle Genetics, Inc.    | 15%                            | *           | *           |

\* Less than 10% of revenue.

**Contracts**

Our contracts provide a fixed price for each component or service to be delivered, and revenue is recognized as these components or services are delivered. We recognize revenue based on the performance or delivery of the following specified services or components in the manner described below:

Enterprise license revenue is recognized ratably over the life of the license agreement.

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 for those services.

Data items revenue is earned based on a price per data unit as data items are entered into DATATRAK's 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 or site 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.

**Competition**

We compete in this market on the strength of our software's functionality, design architecture and data entry and review tools, which we believe equal or exceed those available in the market. We believe that our greatest strength is directly related to our offering of a broad information platform that can be used throughout an organization to efficiently manage its clinical trials. The Company is working hard to accomplish its goal of becoming the Desktop for the clinical trials industry.

The Company's competition is paper as well as other technology solutions. The electronic clinical trials technology market is highly competitive and fragmented. The largest competitor is the traditional paper-based method of collecting clinical trial data. In addition, technology applications in this and every industry are always



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emerging and are characterized by rapid evolutions. At times, the Company also competes with both internal initiatives at our customers as well as those in the CRO industry.

Our major competitors include other software vendors, clinical trial data service companies and large pharmaceutical companies currently developing their own in-house technology. Our DATATRAK eClinical suite has a variety of unified offerings which includes: EDC, IVRS, medical coding, web-based randomization, CTMS, CDMS, drug inventory management, digitized electrocardiograms, image collection, viewing and storing capabilities and workgroup collaboration capabilities. Each of these individual offerings has distinct single point solution competitors in the clinical trial market. Sponsors of clinical research have a variety of choices with which to satisfy each of these capabilities for their clinical trials from many different organizations. We are not aware of any competitors that have all of these individual components contained under one software architecture.

Many current and potential future competitors have or may have substantially greater financial and technical resources, greater name recognition and more extensive customer bases that could be leveraged, thereby gaining market share or product acceptance to our detriment. We may not be able to capture or establish the market presence necessary to effectively compete in this emerging sector of the clinical research industry. Clinical trial sponsors also may continue to contract with individual vendors instead of utilizing our single software solution.

We are aware of other EDC systems that compete or, in the future, may compete directly with one or more of the software product offerings included in our DATATRAK eClinical<sup>0</sup> software suite. There are other companies that have developed or are in the process of developing technologies that are, or, in the future, may be, the basis for competitive products. Some of those technologies may have an entirely different approach or means of accomplishing the desired effects as our product offerings. Either existing or new competitors may also develop products that are superior to or that otherwise achieve greater market acceptance than our software. In addition, we believe that certain large companies in the information technology industry may be forming alliances and attempting to capitalize on the data delivery options offered by the Internet. To the extent that our approach to EDC may gain market acceptance, larger companies in the information technology industry may develop competing technology to our detriment.

### **Regulatory Matters**

The FDA has issued guidance and regulations on the use of computer systems in clinical trials relating to standard operating procedures, data entry, system design, security, system dependability and controls, personnel training, records inspection and certification of electronic signatures. Based on our review, we believe that our software products comply with this guidance and regulations. Any release of FDA guidance that is significantly inconsistent with the design of our software may cause us to incur substantial costs to remain in compliance with FDA guidance and regulations. We are continuing to monitor the FDA guidance to ensure compliance.

In addition to FDA guidance and regulations, we also comply with International Conference on Harmonization ( ICH ) Regulations guidance for good clinical practices. This guidance has been developed by the ICH and has been subject to consultation by regulatory parties, in accordance with the ICH process. The regulatory bodies consist of representatives from the European Union, Japan and the U.S.

The Health Insurance Portability and Accountability Act of 1996 ( HIPAA ) applies to health care providers, health plans and health care clearinghouses or covered entities. Under HIPAA, covered entities are required to protect the confidentiality, integrity and availability of certain electronic patient information they collect, maintain, use or transmit. Although we are not a covered entity under HIPAA, we have taken steps, including encryption techniques, to ensure the confidentiality of all electronic patient information that is captured and transmitted through the use of our software.

### **Potential Liability and Insurance**

Our services are supported by telecommunications equipment, software, operating protocols and proprietary applications for high-speed transmission of large quantities of data among multiple locations. In such operations, it is possible that data files may be lost, altered or distorted. Our software and its future enhancements or adaptations may contain undetected design faults and software bugs that, despite our testing, are discovered only after the system has been deployed and used by customers. Such faults or errors could cause delays or require design modifications on our part. In addition, clinical pharmaceutical and medical device research requires the review and handling of large amounts of patient data. Potential liability may arise from a breach of contract or a loss of or



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unauthorized release of clinical trial data. Contracts with our customers are designed to limit our liability for damages resulting from errors in the transportation and handling of patient data. Nevertheless, we may still be subject to claims for data losses in the transportation and handling of data over our information technology network.

If we were forced to undertake the defense of, or were found financially responsible for, claims based upon the foregoing or related risks, we could incur significant costs relating to these claims, and our financial resources could be diminished. We maintain an errors and omissions professional liability insurance policy to cover claims in an amount up to \$5,000,000 that may be brought against us. This coverage may not be adequate, and insurance may not continue to be available to us in the future.

### **Intellectual Property**

Intellectual property rights are significant to our ongoing operations and future opportunities. We have taken steps to secure patent protection for recently-developed database technology. Our software and business processes embody numerous trade secrets which we protect through various physical and technical security measures, as well as through our agreements. Modules of our product suite, related manuals and other written and graphical materials are subject to copyright protection. Our DATATRAK® brand is at the heart of a family of registered trademarks and service marks that identify and distinguish our software and services in the market. We sell our services and license the use of our software and the right to market DATATRAK products and services subject to contract provisions intended to provide appropriate protection to these valuable intellectual property assets.

### **Employees**

As of February 27, 2009, we had 47 full-time employees. None of our employees are represented by a union, and we consider relations with our employees to be satisfactory. We have employment agreements with all of our executive officers except for Laurence P. Birch who is our interim Chief Executive Officer and Chairman of the Board of Directors. Due to the early stage of development of our industry and business, the loss of the services of any of our executive officers could put us at a competitive disadvantage, since we would need to attract a qualified new executive to fill the vacancy. To address these risks, we must, among other things, continue to attract, retain and motivate qualified personnel.

### **Available Information**

Our Internet address is [www.datatrak.net](http://www.datatrak.net). Annual Reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports are accessible through the Investor Relations section of our Web site as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission ( SEC or the Commission ). The information on our Web site is not, and shall not be deemed to be, a part of this report or incorporated into any other report we file with or furnish to the SEC.

Upon the receipt of a written request from any shareholder we will mail, at no charge to the shareholder, a copy of our Annual Report, including the financial statements and schedules required to be filed with the Commission pursuant to Rule 13a-1 under the Exchange Act, for our most recent fiscal year.

### **ITEM 1A. RISK FACTORS**

Certain statements made in this Annual Report on Form 10-K contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 ( Exchange Act ). All statements that address operating performance, events or developments that we anticipate will occur in the future, including statements related to future revenue, liquidity, profits, expenses, income, cash flow and earnings per share or statements expressing general optimism about future results are forward-looking statements. In addition, words such as expects, anticipates, intends, plans, believes, estimates, variations of such words, and similar expressions are intended to identify forward-looking statements. Forward-looking statements are subject to the safe harbors created in the Exchange Act.

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Forward-looking statements are subject to numerous assumptions and risks and uncertainties that may cause our actual results, performance or liquidity to be materially different from any future results or performance expressed or implied by the forward-looking statements. We have identified the following important factors, which could cause our actual operational, financial results or liquidity to differ materially from any projections, estimates, forecasts or other forward-looking statements made by or on our behalf. Under no circumstances should the factors listed below be construed as an exhaustive list of all factors that could cause actual results to differ materially from those expressed in forward-looking statements. We undertake no obligation to review or confirm analysts' expectations or estimates or to release publicly any revisions to forward-looking statements contained herein to take into account events or circumstances that occur after the date of this Annual Report on Form 10-K. In addition, we do not undertake any responsibility to update publicly the occurrence of unanticipated events, which may cause actual results to differ from those expressed or implied by the forward-looking statements contained herein.

**Our independent registered public accounting firm have expressed doubt about our ability to continue as a going concern .**

Our independent registered public accounting firm have included an explanatory paragraph in their unqualified report on our December 31, 2008 financial statements that expresses substantial doubt about our ability to continue as a going concern. A going concern opinion indicates that the financial statements have been prepared assuming we will continue as a going concern and do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty. This going concern opinion could adversely affect our ability to raise additional capital or could have an adverse impact on our relationships with customers and therefore could have a material effect on our business.

**Disruptions in the financial and credit markets may adversely impact the availability and cost of credit and the spending of our customers as well as our ability to raise additional capital, which could adversely affect our business, results of operations and financial condition.**

As noted in the discussions of other risks that we face, demand for our products and services depends in large part upon the level of capital and research and development expenditures by many of our customers. Decreased capital and customer spending as well as our potentially limited access to additional funds could have a material adverse effect on the demand for our services and our business, results of operations and financial condition. Disruptions in the financial markets, including the bankruptcy or restructuring of certain financial institutions, may adversely impact the availability of credit already arranged and the availability and cost of credit in the future, which could result in the delay or cancellation of clinical trials on which our business depends. Our failure to obtain additional funds, if need be, to meet payment obligations and working capital requirements could have a material adverse effect on our business. In addition, the disruptions in the financial markets may also have an adverse impact on regional economies or the world economy, which could negatively impact the capital and maintenance expenditures of our customers. There can be no assurance that government responses to the disruptions of the financial markets will restore confidence, stabilize markets or increase liquidity and the availability of credit.

**We may need to raise additional funds and take further cost-cutting initiatives to meet our working capital requirements and there can be no assurance that we will be able to obtain new business and/or maintain existing trials in the current economic climate.**

The failure to maintain our existing customer relationships and related backlog and obtain ample new business from existing or new customers could have a material adverse effect on our business, financial condition and results of operations. There can be no assurance that we will be able to increase the Company's backlog during this very difficult business environment. Furthermore, additional cost-cutting initiatives could materially harm our long-term prospects.

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**We may lose revenue if we experience delays in clinical trials or if we lose contracts.**

Although our contracts provide that we are entitled to receive revenue earned through the date of termination, our customers generally may delay or terminate a clinical trial or our contract related to such trial at any time. The length of a typical clinical trial contract varies from several months to several years. Clinical trial sponsors may delay or terminate clinical trials for several reasons, including:

unexpected results or adverse patient reactions to a potential product;

inadequate patient enrollment or investigator recruitment;

manufacturing problems resulting in shortages of a potential product; or

sponsor decisions to de-emphasize or terminate a particular trial or drug.

We may lose revenues if a clinical trial sponsor decides to delay or terminate a trial in which we participate.

**We may lose future revenue if our major customers decrease their research and development expenditures, or if we lose any of our major customers.**

Our primary customers are companies in the pharmaceutical industry. Our business is substantially dependent on the research and development expenditures of companies in that industry. The extent to which we rely on revenue from one customer varies from period to period, depending upon, among other things, our ability to generate new business and the timing and size of clinical trials. In light of our small revenue base, we are more dependent on major customers than many of the larger participants in the EDC industry. In fiscal 2008, our three largest customers accounted for 18%, 15% and 8% of our revenues, or 41% in the aggregate.

Our operations could be materially and adversely affected by, among other things:

any economic downturn or consolidation in the pharmaceutical or biotechnology industries;

any decrease in these industries' research and development expenditures;

changes in the regulatory environment in which we operate; or

any decline in business with any of our major customers.

**Our quarterly results fluctuate significantly.**

We are subject to significant fluctuations in quarterly results caused by many factors, including:

our success in obtaining new contracts;

the size and duration of the clinical trials in which we participate; and

the timing of clinical trial sponsor decisions to conduct new clinical trials or cancel or delay ongoing trials.

Our expense levels are based in part on our expectations as to future revenue and to a certain extent are fixed. We cannot make assurances as to our revenues in any given period, and we may be unable to adjust expenses in a timely manner to compensate for any unexpected revenue shortfall. As a result of our relatively small revenue base, any significant shortfall in revenue recognized during a particular period could have an immediate adverse effect on our income from operations and financial condition. Volatility in our quarterly results may adversely affect the market price of our common shares.

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**Our business strategies are unproven and we are in an early stage of development.**

Our efforts to establish a standardized EDC process for collection and management of clinical research data represent a significant departure from the traditional clinical research practices of clinical trial sponsors. The long-term viability of our business remains unproven. Our strategy may not gain acceptance among sponsors of clinical research, research sites or investigators. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in their early stages of development, particularly companies in new and rapidly evolving markets. Although we were profitable in 2004 and 2005, we had previously recognized operating losses in each year since 1997, and again recorded losses in 2006 through 2008. Our cumulative operating loss since 1997 totaled \$71,253,000 at December 31, 2008. Any number of factors, including, but not limited to, termination or delays in contracts, inability to grow and convert backlog into revenue or being unable to quickly reduce costs if required, could cause us to record losses in future periods.

**If we fail to continue to meet all applicable Nasdaq Capital Market requirements, our common shares could be delisted. If delisting occurs, it would adversely affect the market liquidity of our common shares.**

Our common shares are currently traded on the Nasdaq Capital Market under the symbol DATA. If we fail to meet any of the continued listing standards of the Nasdaq Capital Market, our common shares could be delisted from the Nasdaq Capital Market. These continued listing standards include specifically enumerated criteria, such as:

a \$1.00 minimum closing bid price;

shareholders' equity of \$2.5 million, market value of publicly-held shares of \$35 million, or net income from continuing operations of \$500,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years;

500,000 shares of publicly-held common stock with a market value of at least \$1 million;

300 round-lot shareholders; and

compliance with Nasdaq's corporate governance requirements, as well as additional or more stringent criteria that may be applied in the exercise of Nasdaq's discretionary authority.

On June 16, 2008, the Company received a notice (the "Notice") from NASDAQ indicating the Company is not in compliance with NASDAQ's requirements for continued listing because, for the 30 consecutive business days prior to June 10, 2008, the bid price of the Company's common shares closed below the minimum \$1.00 per share requirement for continued inclusion under NASDAQ Marketplace Rule 4310(c)(4) (the "Minimum Bid Price Rule"). The bid price of our common shares has remained below the minimum \$1.00 per share requirement since the receipt of the Notice. NASDAQ stated in the Notice that in accordance with NASDAQ Marketplace Rule 4310(c)(8)(D), the Company would be provided 180 calendar days, or until December 8, 2008 (the "Cure Period"), to regain compliance with the Minimum Bid Price Rule. On October 22, 2008, the Company received a second notice (the "Second Bid Price Notice") from NASDAQ stating as a result of unprecedented turmoil in U.S. and world financial markets NASDAQ was suspending its bid price requirement for a period of time which would extend the Company's Cure Period until March 13, 2009. The Second Bid Price Notice has no effect on the listing of the Company's common shares at this time.

The Second Bid Price Notice also stated that if, at any time before March 13, 2009, the bid price of the Company's common shares closes at \$1.00 per share or more for a minimum of 10 consecutive business days, NASDAQ will provide the Company written notification that it has achieved compliance with the Minimum Bid Price Rule. However, NASDAQ has the discretion to require a period in excess of ten consecutive business days, but generally no more than twenty consecutive business days, before determining that the ability to maintain long-term compliance has been demonstrated. In addition, the Notice stated that if the Company does not regain compliance with the Minimum Bid Price rule by March 13, 2009, NASDAQ will determine whether the Company meets all other NASDAQ Capital Market initial listing criteria set forth in NASDAQ Marketplace Rule 4310(c). If the Company meets all other initial listing criteria at that time, NASDAQ will notify the Company that it has been granted an additional 180 calendar days

to comply with the Minimum Bid Price Rule. If the Company is not eligible

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for an additional compliance period, NASDAQ will provide the Company with written notification that the Company's common shares will be delisted. At that time, the Company may, pursuant to NASDAQ rules, appeal any delisting determination by NASDAQ to a NASDAQ Listings Qualifications Panel. The Company has been monitoring the bid price for its common shares since receipt of the Notice, and on January 7, 2009, it received a letter from NASDAQ that it had decided to extend the suspension of the Minimum Bid Price Rule and enforcement of such rule is scheduled to resume on April 20, 2009. Further, this letter from NASDAQ indicated that the Company will receive another notice from NASDAQ prior to the resumption of the Minimum Bid Price Rule and such letter will specify the number of calendar days remaining in the Company's compliance period and the specific date by which it needs to regain compliance. The Company will continue to monitor the bid price for its common shares while it awaits NASDAQ's follow-up letter, but has not determined what action, if any, it will take in response to the NASDAQ notifications.

The Cure Period described above relates exclusively to our non-compliance with the Minimum Bid Price Rule. We may be delisted during the Cure Period for failure to maintain compliance with any other continued listing requirements that occur during this period including the stockholders' equity requirement discussed below. Even if we are successful in curing a non-compliance, NASDAQ may seek to delist us for our failure to meet the enumerated conditions for continued listing.

On August 18, 2008, the Company received a notice (the "Stockholders' Equity Notice") from NASDAQ indicating the Company is not in compliance with NASDAQ's requirements for continued listing because the Company was not in compliance with Marketplace Rule 4310(c)(3) (the "Minimum Equity Rule"), which requires the Company to have a minimum of \$2,500,000 in stockholders' equity or \$35,000,000 market value of listed securities or \$500,000 of net income from continuing operations for the most recently completed fiscal year or two of the three most recently completed fiscal years. NASDAQ requested in the Stockholders' Equity Notice that the Company submit a plan to regain compliance under the Minimum Equity Rule on or before September 3, 2008. The Company subsequently submitted a proposal to NASDAQ outlining its plan to achieve and sustain compliance with the Minimum Equity Rule and requested an extension of time in order to execute its proposal. On December 2, 2008, the Company received a letter from NASDAQ informing it that the NASDAQ staff could not provide the Company with additional time to regain compliance with the Minimum Equity Rule, and unless the Company filed an appeal to the NASDAQ staff's determination, the Company's common shares would be suspended at the opening of business on December 11, 2008 and a Form 25-NSE would be filed with the SEC which would remove the Company common shares from listing and registration on the NASDAQ Stock Market. On December 9, 2008, the Company filed a request for a hearing in front of the NASDAQ Listing Qualifications Panel (the "Panel") to appeal the NASDAQ staff's determination pursuant to the procedures set forth in the NASDAQ Marketplace Rule 4800 Series. This request stayed the suspension of the Company's common shares and the filing of the Form 25-NSE pending the Panel's decision. On January 8, 2009, the Company presented its plan to regain compliance with the Minimum Equity Rule and all other applicable requirements for continued listing on the NASDAQ Capital Market to the Panel, and requested an exception until June 1, 2009 by which date the Company believes that it will be able to demonstrate such compliance. The Company is currently awaiting the Panel's final determination as to whether it will grant the Company's request for exception.

If our common shares are delisted from the Nasdaq Capital Market, trading of our common shares most likely will be conducted in the over-the-counter market on an electronic bulletin board established for unlisted securities, such as the Pink Sheets or the OTC Bulletin Board. Such delisting could also adversely affect our ability to obtain financing.

**If we do not continue to enhance our software, we may not be able to meet the evolving needs of our customers.**

Although our proprietary software solutions have been used in clinical trials, continued enhancement is necessary to provide additional functions and services to meet the ever-changing needs and expectations of our customers. To date we have had limited revenue from which to support the costs of this continued software enhancement. Our potential future revenue may not be sufficient to absorb corporate overhead and other fixed operating costs that will be necessary for our future success.

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**Changes in government regulations relating to the health care industry could have a material adverse effect on the demand for our services.**

Demand for our services is largely a function of the regulatory requirements associated with the approval of a New Drug Application by the FDA. In recent years, efforts have been made to streamline the drug approval process and coordinate U.S. standards with those of other developed countries. Changes in the level of regulation, including a relaxation in regulatory requirements or the introduction of simplified drug approval procedures could reduce the demand for our services. Several competing proposals to reform the system of health care delivery in the United States have been considered by Congress from time to time. To date, none of these proposals have been adopted.

The FDA's guidelines and rules related to the use of computerized systems in clinical trials are still in the early stages of development. Our software may not continue to comply with these guidelines and rules as they develop, and corresponding changes to our product may be required. Any release of FDA guidance that is significantly inconsistent with the design of our software may cause us to incur substantial costs to remain in compliance with FDA guidance and regulations.

**We may not be able to capture or establish the market presence necessary to compete in the EDC market.**

The EDC market, which is still developing and must compete with the traditional paper method of collecting clinical trial data, is highly fragmented. The major competitors in the EDC market include:

EDC software vendors;

clinical trial data service companies that use paper for data collection;

vendors offering single component solutions; and

in-house development efforts within large pharmaceutical companies.

Our current and potential future competitors have or may have substantially greater resources, greater name recognition and more extensive customer bases that could be leveraged, thereby gaining market share or product acceptance to our detriment. We may not be able to capture or establish the market presence necessary to effectively compete in this emerging sector of the clinical research industry.

**We may be subject to liability for potential breaches of contracts or a loss of or unauthorized release of clinical trial data.**

Our services are supported by telecommunications equipment, software, operating protocols and proprietary applications for high-speed transmission of large quantities of data among multiple locations. In addition, clinical pharmaceutical and medical device research requires the review and handling of large amounts of patient data. Potential liability may arise from a breach of contract or a loss of or unauthorized release of clinical trial data. If we were forced to undertake the defense of, or were found financially responsible for, claims based upon these types of losses, our financial resources could be diminished. We maintain a \$5,000,000 errors and omissions professional liability insurance policy to cover claims that may be brought against us. This coverage may not be adequate, and insurance may not continue to be available to us in the future.

**Our competitive position and business may be adversely affected if we are unable to protect our intellectual property rights or if we infringe upon the intellectual property rights of others.**

Intellectual property rights, including patent rights, are significant to our ongoing operations and future opportunities. Our success will depend, in part, on our ability to secure our own intellectual property rights (*e.g.*, patents, copyrights, trademarks, trade secrets), obtain licenses to technology owned by third parties when necessary, and conduct our business without infringing on the proprietary rights of others. There can be no assurance, however, that our proprietary rights will provide us significant protection or commercial advantage or that measures taken to protect our confidential information will adequately prevent the disclosure or misuse of such confidential information. In addition, there can be no assurance that, in the future, a third party will not assert that we are violating their proprietary rights, including that our technologies, products or services infringe their patents. In the event of a claim, we could incur substantial costs and diversion of the time and attention of management and



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technical personnel in defending ourselves against any such claims. Any meritorious claim of intellectual property infringement against us could have a material adverse effect on our competitive position and business.

**We have Anti-takeover Provisions and Preferred Share Purchase Rights.**

Our Articles of Incorporation and Code of Regulations contain provisions that may discourage a third party from acquiring, or attempting to acquire us. These provisions could limit the price that certain investors might be willing to pay for our common shares. In addition, preferred shares of our stock can be issued by our Board of Directors, without shareholder approval, whether under our shareholder rights plan or for other uses determined by the Board. The issuance of preferred shares may adversely affect the rights of common shareholders, the market price of our common shares and may make it more difficult for a third party to acquire a majority of our outstanding common shares. At the present time, we do not plan to issue any preferred shares.

**If we do not continue to attract and retain key personnel, we will be unable to effectively conduct our business.**

The market for technical, regulatory and other personnel essential to the development of our software, delivery of our services and management of our business is very competitive. If we cannot retain the employees we need, or replace key employees following their departure, our ability to develop and manage our business will be impaired, and this could adversely affect our business, prospects, results of operations and financial condition.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

As of December 31, 2008, we were leasing approximately 13,000 square feet of office space in Mayfield Heights, Ohio. This space is used for our executive offices and U.S. operations. In March 2009 we reduced our Mayfield Heights, Ohio office space to approximately 10,000 square feet. In addition, we have U.S. based operations in Bryan, Texas, where we lease approximately 6,000 square feet of office space. This lease expires in April 2009 and we are seeking smaller, less expensive space as a result of continued cost cutting initiatives. In connection with the closing of our German office in July 2008, we exited our 17,000 square feet of office space in Bonn, Germany. We believe that our facilities are suitable and adequate for the current and anticipated conduct of our operations.

**ITEM 3. LEGAL PROCEEDINGS**

In the ordinary course of business, we are involved in ordinary, routine legal proceedings. We are 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 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2008.

**Table of Contents****ITEM 4A. EXECUTIVE OFFICERS OF THE COMPANY\***

The name, age and positions of each of the Company's executive officers, as of February 27, 2009, are as follows:

| <b>Name</b>       | <b>Age</b> | <b>Position</b>   |
|-------------------|------------|---|
| Laurence P. Birch | 49         | Interim Chief Executive Officer and Chairman of the Board of Directors                    |
| Matthew Delaney   | 49         | Interim President   |
| Raymond J. Merk   | 49         | Vice President of Finance, Chief Financial Officer, Chief Operating Officer and Treasurer |

\* Included pursuant to Instruction 3 to Item 401(b) of Regulation S-K.

*Laurence P. Birch.* Mr. Birch has been a Director since April 16, 2007, the Chairman of the Board of Directors since May 15, 2008, and effective January 21, 2009, was appointed Interim Chief Executive Officer. Since March 2007, Mr. Birch has been serving as the President, Chief Executive Officer and a director of NeoPharm, Inc., a biopharmaceutical company dedicated to the research, development and commercialization of new and innovative cancer drugs for therapeutic applications, and was also appointed Acting Chief Financial Officer in April 2007. Prior to joining NeoPharm, Mr. Birch served as Sr. Vice President and CFO, and Interim President and CEO, of AKSYS, Ltd., a hemodialysis developer and manufacturer from 2005 to 2006. Prior to that, Mr. Birch served as co-founder and managing director of Stratego Partners, a cost management consulting firm, from 2003 to 2005, Sr. Vice President Business Development and CFO of Technology Solutions, Inc., a systems integration and consulting company, from 2000 to 2002, CFO of Brigade, Inc., an internet support company, from 1999 to 2000, and five years with MCI Systemhouse where he held a variety of senior finance and general management positions. Mr. Birch began his career with Baxter Healthcare, a manufacturer and supplier of pharmaceuticals and medical devices, where, over the course of 13 years, he held a variety of positions. Mr. Birch holds a Bachelor of Science-Finance from the University of Illinois and a MBA from Northwestern University Kellogg Graduate Business of Management. Mr. Birch is also a Certified Public Accountant.

*G. Matthew Delaney.* Mr. Delaney has served as the Company's Vice President, Global Marketing and Sales since June 24, 2007, and effective May 15, 2008, was appointed the Company's Interim President. Prior to joining the Company in February 2007, Mr. Delaney served as Chief Operating Officer for 360training.com from November 2005 to December 2006 and held various executive positions with Dell Computer, including Director of Corporate Strategy, from August 1996 to June 2005.

*Raymond J. Merk, CPA, MBA.* Mr. Merk joined DATATRAK in July 2006 as our Controller and has been our Chief Financial Officer since August 2007, and, effective January 21, 2009, was appointed our Chief Operating Officer. From April 2000 to July 2006 Mr. Merk served as Director of Finance for EmployOn, Inc., an aggregator of online job postings.

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**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON SHARES AND RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common shares are traded on The NASDAQ Capital Market under the symbol DATA.

Our common shares were initially offered to the public on June 11, 1996 at a stock split adjusted price of \$9.00 per share and commenced trading on NASDAQ on that date. On July 20, 2005, our Board of Directors approved a three-for-two share split that was distributed in the form of a 50% share dividend. Our shareholders of record at the close of business on August 15, 2005 received one additional common share for every two common shares held on that date. The new common shares were distributed on or around August 31, 2005 and began trading ex-dividend on September 1, 2005. We have restated all prior reported common share and per share amounts as if the share split had occurred at the beginning of the earliest period being reported. The following table sets forth, for the years ended December 31, 2008 and 2007, the high and low sale prices per common share, as reported by NASDAQ. These prices do not include retail markups, markdowns or commissions.

|                | <b>High</b> | <b>Low</b> |
|----------------|-------------|------------|
| 2008           |             |            |
| First Quarter  | \$1.94      | \$1.14     |
| Second Quarter | \$1.25      | \$0.26     |
| Third Quarter  | \$0.87      | \$0.20     |
| Fourth Quarter | \$0.47      | \$0.01     |
|                | <b>High</b> | <b>Low</b> |
| 2007           |             |            |
| First Quarter  | \$6.67      | \$4.85     |
| Second Quarter | \$5.77      | \$4.01     |
| Third Quarter  | \$4.69      | \$1.70     |
| Fourth Quarter | \$3.40      | \$1.35     |

On February 27, 2009, the last sale price of our common shares as reported by NASDAQ was \$0.12 per share. As of February 27, 2009, we had 80 shareholders of record.

We have never declared or paid cash dividends on our common shares. Any determination to pay cash dividends in the future will be at the discretion of our Board of Directors after taking into account various factors, including our financial condition, results of operations, current and anticipated cash needs and plans for expansion.

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**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA**

|   | 2008      | Year Ended December 31, |           |           | 2004      |
|---|-----------|-------------------------|-----------|-----------|-----------|
|   |           | 2007                    | 2006      | 2005      |           |
| <b>(In thousands, except per share data)</b>                          |           |                         |           |           |           |
| <b>Statement of Operations Data (1):</b>                              |           |                         |           |           |           |
| Revenue   | \$ 8,826  | \$ 10,562               | \$ 17,690 | \$ 15,735 | \$ 11,305 |
| Direct costs  | 2,833     | 4,583                   | 5,222     | 3,789     | 2,634     |
| Gross profit  | 5,993     | 5,979                   | 12,468    | 11,946    | 8,671     |
| Selling, general and administrative expenses                          | 10,179    | 13,097                  | 13,266    | 10,025    | 7,229     |
| Severance expense (2)   | 775       | 915                     | 295       |           |           |
| Depreciation and amortization   | 1,343     | 2,722                   | 2,306     | 748       | 651       |
| Liquidation of foreign subsidiary                                     | 381       |                         |           |           |           |
| Impairment loss   | 12,788    | 213                     |           |           |           |
| (Loss) income from operations   | (19,473)  | (10,968)                | (3,399)   | 1,173     | 791       |
| Other income (expense)  | 61        | 68                      | (115)     | 182       | 35        |
| Settlement of ClickFind lawsuit (3)                                   | 3,000     |                         |           |           |           |
| (Loss) income before income taxes                                     | (16,412)  | (10,900)                | (3,514)   | 1,355     | 826       |
| Income tax expense (benefit)  | 385       | (46)                    | 976       | (1,183)   | 9         |
| Net (loss) income   | (16,797)  | (10,854)                | (4,490)   | 2,538     | 817       |
| Net (loss) income per share: basic                                    | \$ (1.23) | \$ (0.82)               | \$ (0.40) | \$ 0.25   | \$ 0.09   |
| Shares used in the computation of basic net (loss) income per share   | 13,682    | 13,198                  | 11,273    | 10,204    | 9,149     |
| Net (loss) income per share: diluted                                  | \$ (1.23) | \$ (0.82)               | \$ (0.40) | \$ 0.22   | \$ 0.08   |
| Shares used in the computation of diluted net (loss) income per share | 13,682    | 13,198                  | 11,273    | 11,386    | 10,237    |

(1) The operating results of ClickFind have been included in the Company's consolidated results of operations for all periods subsequent to February 13, 2006.

- (2) In 2008, the Company recorded severance charges of \$775,000 primarily due to the termination of 26 employees. In 2007, the Company recorded severance charges of \$915,000 due to the termination of 45 employees. In 2006, the Company recorded a severance charge of \$295,000 due to the termination of 10 employees.
- (3) In December 2008, the Company and certain of the former ClickFind shareholders agreed to settle all claims against each other relating to a dispute regarding the ClickFind acquisition. As a result, the Company was discharged and released from paying the remaining \$3,000,000 balloon payment on certain

promissory  
notes.

|   | December 31,                          |          |          |          |          |
|---|---------------------------------------|----------|----------|----------|----------|
|   | 2008                                  | 2007     | 2006     | 2005     | 2004     |
|   | (In thousands, except per share data) |          |          |          |          |
| <b>Balance Sheet Data:</b>                        |                                       |          |          |          |          |
| Cash, cash equivalents and short-term investments | \$ 2,372                              | \$ 8,514 | \$ 5,023 | \$ 9,363 | \$ 7,919 |
| Working capital                                   | 860                                   | 6,136    | 4,141    | 10,796   | 8,575    |
| Total assets                                      | 4,647                                 | 26,473   | 27,220   | 16,107   | 11,941   |
| Long-term liabilities                             | 1,447                                 | 5,932    | 5,447    |          |          |
| Accumulated deficit                               | (60,566)                              | (43,769) | (32,916) | (28,425) | (30,964) |
| Total shareholders equity                         | 321                                   | 16,569   | 18,064   | 13,697   | 10,117   |
| Book value per common share (1)                   | \$ 0.02                               | \$ 1.21  | \$ 1.56  | \$ 1.33  | \$ 1.02  |

(1) Book value per common share is calculated by dividing total shareholders equity as of December 31 by the number of common shares outstanding as of December 31.

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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**General**

DATATRAK is a provider of software and other related services, commonly referred to as an application service provider, or ASP. The Company's customers use the software known as DATATRAK ED<sup>®</sup> 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.

The Company has a concentration of a small number of customers that made up a significant portion of its revenue over the past three years. Revenue from the three largest customers as a percentage of the Company's total revenue for each year was 41%, 41% and 58% in the years 2008, 2007 and 2006, respectively. The 58% in 2006 was higher due to one major customer who represented 44% of our total revenue in 2006.

During 2008, overall economic conditions continued to decline as a result of the subprime mortgage crisis and other factors. These unfavorable market conditions have made it more difficult in 2008 for the Company to increase its backlog through the signing of new customer contracts. Our backlog decreased approximately \$1.6 million from \$13.0 million as of December 31, 2007 to \$11.4 million as of December 31, 2008. Other than the two large enterprise license agreements of \$2.1 million and \$800,000 at the end of 2007 and beginning of 2008, respectively, there were no other enterprise license agreements signed in 2008, but rather most of our new customer contracts in 2008 have been in the form of smaller individual trials. We believe that our sales growth of new trials has been inhibited by both the poor economic climate and limited working capital of approximately \$860,000 at December 31, 2008. While the economic conditions have been difficult, the Company managed to show significant improvement in its 2008 fourth quarter operating results compared to those recorded in the fourth quarter of 2007.

**Financial Performance Improvement**

In an effort to partially offset our revenue decline of approximately \$8.9 million from 2006 to 2008 and improve our cash flow from operations, the Company made substantial headcount reductions and other cost cutting measures. Since June of 2007 we have eliminated approximately 70 positions representing approximately \$5.9 million of anticipated recurring annual cost savings. We believe our results for the fourth quarter of 2008 are an early indication of the progress we have made. Our gross profit margin improved to 80% in the fourth quarter of 2008 compared to 48% for the fourth quarter of 2007. In addition, our loss from operations in the fourth quarter of 2008 was \$109,000 compared to \$2,632,000 in the fourth quarter of 2007.

**German Office Closure**

During 2008 we continued to optimize our operational efficiencies and streamline our cost structure with the closure of our German office and the transition of our global Help Desk and European client support operations to our Cleveland, Ohio office. The anticipated recurring annual cost savings from this closure is approximately \$2.0 million compared to 2008 and \$4.5 million per year when compared to both 2007 and 2006. We have experienced no disruption in service to our customers as a result of transitioning the Help Desk function to our Cleveland office. Effective January 31, 2009, DATATRAK, Inc., a wholly owned subsidiary of the Company, terminated its non-exclusive Marketing Services Agreement ( Agreement ) with DATATRAK Deutschland GmbH ( Deutschland GmbH ) and DATATRAK Inc. As of December 31, 2008, Deutschland GmbH recorded accrued expenses for lease and other obligations incurred through January 31, 2009 totaling \$218,000. As a result of the termination of the Agreement, Deutschland GmbH was required under applicable German law to file a petition for voluntary bankruptcy in the German courts and has on hand \$218,000, designated as restricted cash, to fund these liabilities as of December 31, 2008. Also as part of this liquidation of the Company's foreign investment in Deutschland GmbH, the Company reversed its cumulative currency translation adjustment and recorded additional operating expense of \$381,000 as of December 31, 2008.

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### **Going Concern**

Our financial statements for the year ended December 31, 2008 have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. As highlighted in the section above titled Financial Performance Improvement we have made significant financial performance improvements during the last three months of 2008. Nevertheless, we have experienced losses from operations in each of the last three fiscal years totaling approximately \$34 million and, as a result, our independent registered public accounting firm has issued an unqualified opinion, for the year ended December 31, 2008, which includes a paragraph stating that there is substantial doubt about our ability to continue as a going concern. DATATRAK is considering various initiatives to continue as a going concern and to ensure the Company's future success. Future initiatives may include further restructuring and cost control, additional financing opportunities or strategic transactions or alliances.

### **Strategic Alternatives**

On July 21, 2008, we announced we had retained Healthcare Growth Partners, LLC as a strategic and financial advisor to assist the Board of Directors in evaluating a variety of potential opportunities directed at maximizing shareholder value. These potential opportunities may include, but are not limited to: a sale, merger or other business combination of the Company; strategic partnerships or alliances; or raising of additional capital, if the Company determines it is in the best interest of its shareholders to continue as a stand alone entity. This review process is ongoing and we undertake no obligation to make any further announcement regarding the exploration of strategic alternatives unless and until the Board of Directors has approved a specific course of action. There can be no assurance that this process will result in any specific transaction or in any changes to the Company's current direction.

### **Restructured Senior Management Team**

On January 21, 2009, the Company announced the retirement of Dr. Jeffrey Green as Chief Executive Officer of DATATRAK and also as a member of our Board of Directors. Mr. Laurence Birch, Chairman of the Board of DATATRAK, will provide support in the interim for the functions of the Chief Executive Officer position until a permanent CEO is named. Also on January 21, 2009, our Chief Financial Officer, Mr. Raymond J. Merk, assumed the role and responsibilities of Chief Operating Officer in addition to his Chief Financial Officer responsibilities.

### **Litigation**

On February 13, 2006, in accordance with the provisions of the merger agreement between DATATRAK International, Inc. and ClickFind (the Merger Agreement), the Company acquired all of the outstanding stock of ClickFind. A portion of the purchase price consisted of \$4,000,000 in notes payable (the ClickFind Notes), \$3,000,000 of which would have been due and payable on February 1, 2009.

As previously disclosed, the Company and certain former shareholders of ClickFind (the Indemnifying Shareholders) were involved in a dispute relating to certain representations and warranties in the Merger Agreement (United States District Court for the Northern District of Ohio, Eastern Division, Case No. 1:08CV02182) (the Lawsuit). On December 18, 2008, we announced the dispute had been resolved and that an agreement to settle all claims with the defendants in the case had been reached. In connection with such resolution, the \$3,000,000 balloon payment due on February 1, 2009 and accrued interest of \$180,000 due the Indemnifying Shareholders was forgiven. The Company's consolidated balance sheet as of December 31, 2008 reflects the removal of the \$3,000,000 obligation and \$180,000 in accrued interest and the resulting improvement in working capital. Our consolidated statements of operations for the 2008 full year, and fourth quarter, reflect the forgiveness of the \$3,000,000 obligation and \$180,000 in accrued interest.

### **Change in Company's Filing Status from Accelerated to Non-Accelerated**

As of June 30, 2008, the Company had less than \$50 million in public float and was eligible, under Rule 12b-2 of the Securities and Exchange Act of 1934, (the Exchange Act) to exit accelerated filer status beginning with its 2008 Form 10-K. The Company qualifies as a smaller reporting company under the Exchange Act and will file its 2008 Form 10-K as a non-accelerated filer.

**Table of Contents****Impairment of Certain Assets**

As a result of consecutive quarterly operating losses since the first quarter of 2006 and continued decline in market capitalization during 2008, the Company determined that impairment indicators existed as of each quarter-end in 2008. The Company conducted impairment testing of its goodwill, software and finite-lived tangible and intangible assets as of each quarter-end in 2008 and determined that significant impairment had occurred. The Company recorded an impairment loss of \$12,788,000 including (i) \$10,856,000 for a full impairment charge of its goodwill, (ii) \$1,700,000 on its DATATRAK eClinical software, (iii) \$144,000 on its ClickFind non-compete intangible asset and (iv) \$88,000 on its finite-lived tangible assets as of December 31, 2008. Any significant future changes in our forecasted undiscounted cash flows could result in impairment in future years.

**Backlog**

Backlog consists of anticipated revenue from authorization letters to commence services, statements of work and other 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 December 31, 2008, the Company's backlog was \$11,400,000 compared to \$13,040,000 at December 31, 2007. The Company's individual trial contracts can be cancelled or delayed at anytime. Approximately 80% of the Company's December 31, 2008 backlog is individual contracts and subject to being cancelled or delayed at anytime. The Company's individual contract backlog, at any point in time, is not an accurate predictor of future levels of revenue. As a result of the Company'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.

**Possible Delisting of Company's Common Shares**

The Company is subject to applicable Nasdaq Capital Market requirements and failure to comply with these requirements could result in the Company's common shares being delisted from the Nasdaq Capital Market. As of December 31, 2008, the Company was not in compliance with the Nasdaq requirements of: (i) a \$1.00 minimum closing bid price ( Minimum Bid Price Rule ); and (ii) shareholders' equity of \$2.5 million, market value of publicly-held shares of \$35 million, or net income from continuing operations of \$500,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years. Nasdaq has notified the Company of its non-compliance with these requirements. On January 8, 2009, the Company presented its plan to the Nasdaq Listing Qualifications Panel (the Panel ) to regain compliance and is awaiting the Panel's determination as to whether it will grant the Company's request for exception.

On January 7, 2009, the Company received a letter from Nasdaq informing DATATRAK that Nasdaq had decided to extend the suspension of the Minimum Bid Price Rule and that enforcement of such rule is scheduled to resume on April 20, 2009. Further, this letter from Nasdaq indicated that the Company will receive another notice prior to the resumption of the Minimum Bid Price Rule and such letter will specify the number of calendar days remaining in the Company's compliance period and the specific date by which it needs to regain compliance with the Minimum Bid Price Rule which prior to the January 7, 2009, notice was March 13, 2009. Nasdaq could delist the Company's common shares at any time for failure to maintain compliance with any other continued listing requirements including the shareholders' equity requirement noted in (ii) above.

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**Critical Accounting Policies**

In response to the SEC's Release No. 33-8040, *Cautionary Advice Regarding Disclosure About Critical Accounting Policies*, we have identified the most critical accounting principles upon which our 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 and deferred revenue, accounts receivable, short-term investments, software development costs, stock-based compensation, goodwill and finite-lived tangible and intangible assets and income taxes.

*Revenue Recognition and Deferred Revenue*

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 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.

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 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 or site under contract.

Services provided by the Company 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 would not result in a material adjustment to the revenue or costs previously recognized. The Company provides a nominal reserve against revenue for potential pricing adjustments.

Deferred revenue represents cash advances received in excess of revenue earned on contracts. Payment terms vary with each contract but typically 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. Generally, the cash advances or deposits are 25% of the total contract amount. The deferred revenue account is reduced monthly as revenue is recognized on each individual contract. In the event of contract cancellation, the Company is entitled to payment for all work performed through the point of cancellation. Likewise, in the event of contract cancellation prior to earning revenue equal to or greater than the initial payment, the Company is required to refund the unused portion. The Company's deferred revenue balance including the long-term portion was \$2,313,000 at December 31, 2008.

**Table of Contents***Accounts Receivable*

The Company generally invoices its customers on a monthly basis with payment terms of net 30 days from invoice date. The accounts receivable amount is recorded net of an estimated reserve for doubtful accounts. The Company has a history of favorable collections and had a nominal reserve for uncollectible accounts of approximately \$14,000 at December 31, 2008. The Company's average collection period was 39 days as of December 31, 2008. The net accounts receivable balance was \$927,000 at December 31, 2008.

*Short-term Investments*

The Company's investments or financial assets include both cash equivalents in the form of highly liquid money market funds and other short-term investments including corporate obligations in the form of commercial paper of the highest grades with maturities of one year or less. On January 1, 2008, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements . The investments are recorded at fair-value and are classified under a three level hierarchy based upon inputs market participants would use when pricing a financial asset in accordance with SFAS No. 157. All the Company's investments and cash equivalents totaling \$1,719,000 at December 31, 2008 had quoted market prices which are the highest priority (e.g. Level I) investment input.

*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 a review of the recoverability of such capitalized software costs when impairment indicators arise. 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 impairment amounts are expensed. No software development costs were capitalized in 2008 or 2007.

*Stock-Based Compensation*

The Company accounts for stock-based compensation in accordance with SFAS No. 123(R), Share-Based Payment ( FAS 123(R) ) using the modified prospective method. The 2005 Omnibus Equity Plan (the Omnibus Plan ) is the Company's primary share-based award program for covered employees and directors. Restricted common stock, common share options and common shares have been awarded under the Omnibus Plan share-based award program exclusively since 2005. During 2008, the Company issued 185,557 common share options to non-employee directors, 295,000 common share options to key employees and 35,000 restricted common shares to one employee. In 2007, the Company issued 33,323 common shares to non-employee directors, 42,000 common share options to non-employee directors and 35,000 restricted common shares to three employees.

*Goodwill and Finite-Lived Tangible and Intangible Assets*

The Company acquired goodwill, software (the DATATRAK eClinical software ) and other intangible assets, consisting of customer relationship and non-compete intangible assets, from ClickFind totaling \$10,856,000, \$3,330,000 and \$2,710,000, respectively. These assets as well as the Company's finite-lived tangible assets are subject to impairment testing at least annually and quarterly if impairment indicators arise. Impairment indicators were present in all four quarters during 2008. The goodwill amount of \$10,856,000 was fully impaired and written off in 2008. The DATATRAK eClinical software was partially impaired and has a net remaining balance of \$428,000 at December 31, 2008. The customer relationship intangible asset was fully amortized and the remaining non-compete intangible asset balance was impaired and written off during 2008. Accordingly, these other intangible assets are \$-0- at December 31, 2008. The Company's other finite-lived assets consist primarily of equipment, leasehold improvements and software and have a net book value of \$358,000 at December 31, 2008.

**Table of Contents***Income Taxes*

The Company follows SFAS No. 109, Accounting for Income Taxes. This accounting standard requires that the liability method be used in accounting for income taxes. Under this accounting method, deferred tax assets and liabilities are determined based on the differences between the financial reporting basis and the tax basis of assets and liabilities and are measured using the enacted tax rates and laws that apply in the periods in which the deferred tax asset or liability is expected to be realized or settled. A valuation allowance is provided for deferred tax assets for which realization currently is not certain. Quarterly income taxes are recorded at the effective rate, based on annual forecasted income. The Company currently is in a three-year cumulative operating loss position totaling approximately \$34 million. As a result, the Company recorded a full valuation reserve against its net deferred tax assets at December 31, 2008.

In accordance with Financial Interpretation ( FIN ) No. 48, *Accounting for Uncertainty in Income Taxes*, the Company recorded an unrecognized tax benefit of \$130,000 at December 31, 2007 related to DATATRAK Deutschland GmbH's disallowed losses and treatment of such as a constructive dividend to the U.S. parent company, DATATRAK International, Inc. This liability was adjusted to \$115,000 in 2008 and paid in full in 2008. The Company has no unrecognized tax benefit at December 31, 2008.

**Results of Operations**

*Year ended December 31, 2008 compared with year ended December 31, 2007*

The following table shows, for the periods indicated, selected items from our Consolidated Statements of Operations, expressed as a percentage of revenue.

|  | <b>Year Ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2008</b>                    | <b>2007</b> | <b>2006</b> |
| Revenue                                      | 100.0%                         | 100.0%      | 100.0%      |
| Direct costs                                 | 32.1                           | 43.4        | 29.5        |
| Gross profit                                 | 67.9                           | 56.6        | 70.5        |
| Selling, general and administrative expenses | 115.3                          | 124.0       | 75.0        |
| Severance expense                            | 8.8                            | 8.7         | 1.7         |
| Depreciation and amortization                | 15.2                           | 25.8        | 13.0        |
| Liquidation of foreign subsidiary            | 4.3                            | 0.0         | 0.0         |
| Impairment loss                              | 144.9                          | 2.0         | 0.0         |
| Loss from operations                         | (220.6)                        | (103.9)     | (19.2)      |
| Other income (expense), net                  | 0.7                            | 0.7         | (0.7)       |
| Settlement of ClickFind lawsuit              | 34.0                           | 0.0         | 0.0         |
| Loss before income taxes                     | (185.9)                        | (103.2)     | (19.9)      |
| Income tax expense (benefit)                 | 4.4                            | (.4)        | 5.5         |
| Net loss                                     | (190.3)                        | (102.8)     | (25.4)      |

Revenue for the year ended December 31, 2008 decreased \$1,736,000, or 16%, to \$8,826,000, as compared to \$10,562,000 for the year ended December 31, 2007. During 2008, DATATRAK recorded revenue related to 129 contracts compared to 152 contracts during 2007. For the year ended December 31, 2008, \$6,554,000 of revenue was the result of contracts that were in backlog at December 31, 2007 and \$2,272,000 was the result of new business signed during 2008. For the year ended December 31, 2007, \$8,798,000 of revenue was generated from contracts that were in backlog at December 31, 2006 and \$1,764,000 was the result of new business signed during 2007.

The Company recorded \$653,000 in revenue during 2008 from two significant multi-year enterprise license agreements which commenced during the first quarter of 2008. The Company will continue to recognize revenue on

these enterprise license agreements ratably over the life of each respective license period. These two enterprise license agreements are non-cancelable and one of them included a lump-sum upfront payment of \$2.1 million representing the total contract value.

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As previously disclosed, our recent historical operating results have depended significantly on revenue from one major client. Dependency on this client, Otsuka Research Institute, reached as high as 59% in 2005 and has decreased significantly since then as follows:

|      | Total Revenue | Otsuka Revenue | Otsuka percentage | Non-Otsuka Revenue |
|------|---------------|----------------|-------------------|--------------------|
| 2006 | \$ 17,690,000 | \$ 7,784,000   | 44%               | \$ 9,906,000       |
| 2007 | \$ 10,562,000 | \$ 1,603,000   | 15%               | \$ 8,959,000       |
| 2008 | \$ 8,826,000  | \$ 464,000     | 5%                | \$ 8,362,000       |

In 2008, two customers individually generated more than 10% of our total revenue. Gilead Sciences, Inc. accounted for 18% of our total 2008 revenue and Seattle Genetics, Inc. another 15%.

We believe our ability to sign new business in 2008 was impacted by three factors: (i) the overall economic conditions triggered by the subprime mortgage crisis; (ii) the Lawsuit with certain former shareholders of ClickFind and the ongoing uncertainty throughout the year regarding the resolution of the \$3,000,000 balloon payment that was originally due February 1, 2009, and for which the Company had previously disclosed it would not have the financial resources to make such payment (see next paragraph for resolution of Lawsuit); and (iii) DATATRAK's overall long-term financial viability and clients' willingness to initiate longer-term clinical trials.

As previously disclosed, the Company issued a press release on December 18, 2008 announcing that it and the Defendants had agreed to settle all claims against each other relating to the Lawsuit. In connection with such resolution, the \$3,000,000 balloon payment due on February 1, 2009 and \$180,000 in accrued interest due Defendants was forgiven. Management believes that sufficient time has not lapsed since the date of the Lawsuit settlement and the date of this report to ultimately understand the impact of the settlement on the Company's ability to sign new business.

Our registered independent public accounting auditor report issued for the year ended December 31, 2008, states that there is substantial doubt about the Company's ability to continue as a going concern. As highlighted above, we believe the uncertainty surrounding our longer-term financial viability had a negative impact, to some degree, on our ability to sign new business in 2008. Management believes certain clients of the Company who continued to contract for new business in 2008 will continue to do so in 2009, but that penetrating additional new clients will be more difficult until longer-term financial stability is achieved. We expect this trend to continue in 2009 until a strategic alternative is identified, additional capital is raised or we demonstrate a consistent ability to generate positive cash flows from operations. New signed customer contracts totaled \$6.5 million in 2008 compared to \$10.2 million and \$9.3 million in 2007 and 2006, respectively.

We previously disclosed that we had experienced significant trial delays from certain clients during the second half of 2007 for nine trials. During 2008, one client with two of the nine delayed trials canceled both trials. As a result of these cancellations, we reduced our backlog by approximately \$900,000 in the first quarter of 2008 and refunded approximately \$220,000 of unearned initial payments in the third quarter of 2008. The Company believes the cancellations were the result of internal client business factors beyond our influence. During 2008, the Company signed new contracts with this client for approximately \$1.7 million. Also, in early 2008 another client with two of the nine delayed trials entered into an \$800,000 three-year enterprise license agreement with us. As part of this enterprise license agreement, the Company agreed to exchange the two delayed trials for two current trials resulting in a minimal increase to backlog. The two new trials generated approximately \$200,000 of revenue in the second half of 2008. We increased our backlog by \$800,000 in early 2008 for the enterprise license agreement. Of the remaining five trials, all with the same client, one of them was recently canceled in February 2009. The remaining four delayed trials represent \$1,010,000 of our December 31, 2008 backlog of \$11,400,000, or approximately 9%.

Direct costs of revenue, mainly personnel costs, decreased 38% to \$2,833,000 in 2008 compared to \$4,583,000 in 2007. Of the net decrease of \$1,750,000, \$711,000 was a result of a reduction in our German personnel costs due to the closure of the Company's German office in 2008 and the consolidation of our Help Desk services into our Cleveland office. In addition to the savings related to the elimination of our German personnel, we experienced a \$920,000 reduction in our U.S. personnel costs in 2008 compared to 2007. DATATRAK's gross margin increased to

68% for the year ended December 31, 2008 compared to 57% for the year ended December 31, 2007 primarily as a  
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result of the reduction in direct personnel costs offset to some extent by the \$1,736,000 decrease in revenue. Gross margins for our 2008 third quarter and fourth quarters were 76% and 80%, respectively. We believe this trend will continue at similar revenue levels. The net decrease in direct costs of \$1,750,000, would have been \$32,000 greater had the exchange rates between the U.S. dollar and the Euro remained consistent from 2007 to 2008.

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 decreased by a net \$2,918,000, or 22%, to \$10,179,000 in 2008 from \$13,097,000 in 2007. Staff and other payroll costs decreased \$2,024,000 primarily as a result of headcount reductions we have implemented over the last 24 months. Our SG&A headcount was 27 on December 31, 2008, compared to 63 on January 1, 2007.

In addition to the reduction in SG&A personnel expenses of \$2,024,000, we were able to reduce non-personnel related SG&A expenses by approximately \$1.7 million in 2008 compared to 2007. These non-personnel reductions were primarily a result of various cost cutting measures introduced by our restructured senior management team and normal reductions typically associated with downsizing a company s infrastructure.

Together, the personnel and non-personnel SG&A reductions in 2008 compared to 2007 totaled approximately \$3.7 million and were offset by higher legal costs associated with the Lawsuit and related matters totaling approximately \$750,000. The Company announced settlement of the Lawsuit on December 18, 2008, and as such does not anticipate any additional expense related to this matter in the future. The net decrease in SG&A expenses of \$2,918,000 would have been approximately \$72,000 greater had the exchange between the U.S. dollar and the Euro been the same in 2008 as it was in 2007.

During 2008 and 2007, the Company recorded charges of \$775,000 and \$915,000, respectively, for severance benefits due to terminated employees. The \$775,000 charge in 2008 includes \$360,000 for two former executive officers of the Company, \$55,000 for 10 former U.S. employees and \$360,000 for 14 former employees of our German office. As of December 31, 2008, the Company has accrued severance obligations of \$245,000 which is expected to be paid out by November 2009. In January of 2009 we announced the retirement of our Chief Executive Officer, Dr. Jeffrey A. Green. The Company will record a severance charge of approximately \$463,000 in the first quarter of 2009 related to Dr. Green s retirement which is scheduled to be paid over a two-year period.

Depreciation and amortization expense decreased approximately \$1.4 million, or 51%, to \$1,343,000 in 2008 compared to \$2,722,000 in 2007. The decrease was comprised primarily of two components: (i) amortization expense on the ClickFind acquired amortizable intangible assets, including the DATATRAK eClinical software, decreased \$989,000; and (ii) depreciation expense on hardware, furniture & fixtures and leasehold improvements decreased \$387,000. The decrease in amortization expense on the ClickFind acquired amortizable intangible assets was mainly a result of a \$1.84 million impairment charge we recorded in the second quarter of 2008. The impairment charge consisted of a \$1.7 million reduction in the value of DATATRAK eClinical software and a \$144,000 write down of the remaining value of the non-compete intangible for certain key employees. The reduction in depreciation expense for hardware, furniture & fixtures and leasehold improvements was a result of certain assets reaching fully depreciated status during the 2008 year, a \$63,000 impairment charge for certain German office fixed assets deemed to have no future value upon the closing of our German office and a \$25,000 impairment charge related to our U.S. corporate office space reduction.

As fully described in Note 6 to the consolidated financial statements, the Company recorded an impairment loss of \$12,788,000 in 2008 including \$10,856,000 for goodwill, \$1,700,000 for the DATATRAK eClinical software, \$144,000 for its ClickFind non-compete intangible assets and \$88,000 related to certain finite-lived tangible assets. During 2007, the Company recorded an impairment charge of \$213,000 for its non-compete intangible asset. The impairment losses are separately recorded on the Company s statement of operations for years ended December 31, 2008 and 2007.

Interest income decreased by \$324,000, to \$116,000, in 2008 from \$440,000 in 2007 primarily as a result of lower investment rates and a reduction of the Company s short-term investment balances which are being used to fund its operations.

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Interest expense decreased by \$336,000 to \$34,000 in 2008 from \$370,000 in 2007 primarily from the settlement of the Lawsuit in December 2008 and the related forgiveness of all remaining interest owed the ClickFind Note holders. The Company accrued, but did not pay interest on the remaining ClickFind Note obligation throughout the first nine months of 2008 and reversed the entire accrual of approximately \$180,000 in the 2008 fourth quarter upon settlement of the Lawsuit.

As part of the Lawsuit settlement announced on December 18, 2008, the remaining \$3,000,000 balloon payment originally due February 1, 2009 under the ClickFind Notes was forgiven. As such, we recorded a \$3,000,000 non-operating gain in the fourth quarter of 2008 representing the forgiveness of the remaining \$3,000,000 obligation.

During 2008 DATATRAK recorded income tax expense of \$385,000. The \$385,000 tax expense is made up of two primary components: (i) a full valuation allowance reserve of \$400,000 against all our German net deferred tax assets due to uncertainty regarding the realization of the deferred tax asset resulting from cumulative operating losses through 2008 as well as the closing of the German office in 2008; and (ii) a \$15,000 reduction of the Company's previously recorded unrecognized tax benefit. During 2007 DATATRAK recorded an income tax benefit of \$46,000. This net benefit amount was due to a \$319,000 reduction in the Company's deferred tax valuation allowance on its foreign net operating losses which was offset by \$143,000 for the use of foreign net operating losses to reduce foreign taxable income and a \$130,000 unrecognized tax benefit for an uncertain tax position.

*Year ended December 31, 2007 compared with year ended December 31, 2006*

Revenue for the year ended December 31, 2007 decreased \$7,128,000, or 40%, to \$10,562,000, as compared to \$17,690,000 for the year ended December 31, 2006. During 2007, DATATRAK recorded revenue related to 152 contracts compared to 147 contracts during 2006. For the year ended December 31, 2007, \$8,798,000 of revenue was the result of contracts that were in backlog at December 31, 2006 and \$1,764,000 was the result of new business signed since January 1, 2007. Of the \$8,798,000 of revenue from backlog, \$675,000 was the result of contracts acquired from ClickFind. For the year ended December 31, 2006, \$13,813,000 of revenue was generated from contracts that were in backlog at December 31, 2005, \$2,442,000 of revenue was the result of new business signed since January 1, 2006, and \$1,435,000 was the result of contracts acquired from ClickFind. The reduction in revenue for the year ended December 31, 2007 compared to the prior year was primarily the result of a significant decrease attributable to one client, Otsuka Research Institute, which accounted for 15% of our total revenue in 2007 compared to 44% of total revenue in 2006. Of the overall \$7,128,000 decrease in revenue, the decrease in Otsuka revenue accounted for approximately \$6,172,000 of the reduction, or 87%. Otsuka revenue decreased primarily as a result of the successful early completion of several large trials. In 2005 Otsuka accounted for 59% of our total revenue. We believed less than 10% of our total 2008 revenue would come from Otsuka. To date, DATATRAK has been unable to generate sufficient new sales to offset the decline in revenue from the Otsuka projects.

We continued our efforts to enhance our sales and marketing organization and had experienced significant turnover in our sales team. Five of the Company's then current nine person sales and marketing staff had been with DATATRAK a year or less. The Company replaced its Vice President of Marketing and Sales in June of 2007 and added a Director of Marketing in the third quarter of 2007 to aggressively pursue sales growth in future periods.

We have previously disclosed that we had experienced significant trial delays from certain clients during the third quarter of 2007. Approximately 21% of our June 30, 2007 backlog produced no revenue during the three months ended September 30, 2007 compared to 4% of our June 30, 2006 backlog not producing revenue in the third quarter of 2006. These delays were a result of internal decisions on the part of the client as to when to begin certain trials. Approximately 26% of our September 30, 2007 backlog produced no revenue during the three months ended December 31, 2007 compared to 4% of our September 30, 2006 backlog not producing revenue in the fourth quarter of 2006. Subsequent to December 31, 2007, one client with two of the nine delayed trials canceled both trials. As a result of these cancellations we reduced our backlog in early 2008 by approximately \$900,000. We were required to refund approximately \$220,000 of unearned initial payments in 2008 related to these cancellations.

Direct costs of revenue, mainly personnel costs, were \$4,583,000 and \$5,222,000 during the years ended December 31, 2007 and 2006, respectively. The net decrease of \$639,000, or 12%, was mainly a result of lower software license costs. DATATRAK's gross margin decreased to 57% for the year ended December 31, 2007 compared to 71% for the year ended December 31, 2006 primarily as a result of the 40% decrease in revenue. The net

decrease in direct costs was partially offset by the difference in exchange rates between the U.S. dollar and the euro. Had the exchange rates remained consistent year-over-year, direct costs would have been \$101,000 lower.

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Direct costs for our German subsidiary, primarily wages, were paid in euro and converted to U.S. dollars for consolidated financial reporting purposes using the average exchange rate for each period.

Selling, general and administrative ( SG&A ) expenses decreased by \$170,000, or 1.3%, to \$13,097,000 from \$13,267,000 for the years ended December 31, 2007 and 2006, respectively. Staff and other payroll costs increased \$536,000. The net increase in personnel costs, which includes recruiting costs, was mainly a result of steps we took to enhance our sales and marketing organization. The increase in personnel costs also reflected the impact of the difference in exchange rates between the U.S. dollar and the euro. Wages for our German entity employees were paid in euro and converted to U.S. dollars for consolidated financial reporting purposes using the average exchange rate for the period. Our personnel costs would have been lower by approximately \$138,000 in 2007 if the exchange rate was the same as it was in 2006. The discontinuation of outsourced research and development resulted in a cost savings of \$546,000 for the year ended, December 31, 2007 compared to the same period of the prior year. Overall, other non-personnel SG&A expenses were \$94,000 higher in 2007 as a result of the higher average exchange rate.

During the year ended December 31, 2007, DATATRAK recorded a charge of \$915,000 for severance benefits due to terminated employees as a result of the Company's actions to reduce costs. A portion of our severance charge was for employees of our Germany entity. Because of the change in the average exchange rate between the U.S. dollar and euro in 2007 the \$915,000 of severance benefits was \$54,000 higher than it would have been using the 2006 average exchange rate. During the year ended December 31, 2006, DATATRAK recorded a charge of \$295,000 for severance benefits due to terminated employees.

Depreciation and amortization expense for the year ended December 31, 2007 increased by \$629,000, or 27%, to \$2,935,000 compared to \$2,306,000 for the year ended December 31, 2006. The increase was primarily a result of \$316,000 of additional amortization expense related to a change in estimate for one of our intangible assets and a \$213,000 impairment charge for another intangible asset. The \$316,000 of additional amortization was related to the shift in timing of actual revenue recognition, as compared to our original estimate at the time of the ClickFind acquisition, from our contract and customer relationship intangible asset. The impairment charge of \$213,000 was against the non-compete agreements related to the ClickFind acquisition. As a result of consecutive quarterly operating losses since the first quarter of 2006 and forecasted continuing operating losses based on current sales trends, the Company determined that impairment indicators existed as of June 30, 2007, September 30, 2007 and also as of December 31, 2007. The Company conducted impairment testing of its goodwill and finite-lived tangible and intangible assets as of all three dates. As a result of its testing, the Company recorded an impairment charge of \$213,000 against the non-compete agreements for the three months ended September 30, 2007. Depreciation and amortization expense on the software and intangible assets acquired in the ClickFind acquisition, including the additional \$316,000 and the \$213,000 impairment charge, was \$1,869,000 for the year ended December 31, 2007 compared to \$1,232,000 in the same time period of 2006, an \$637,000 increase.

Interest income increased by \$202,000, to \$440,000 in 2007 from \$238,000 in 2006 primarily due to the average investment balance for 2007 being larger than that in 2006. Our average investment balance grew in 2007 as a result of our March 16, 2007 private placement financing which raised net proceeds of approximately \$8.6 million.

Interest expense increased by \$17,000 to \$370,000 in 2007 compared to \$353,000 in 2006 primarily as a result of the ClickFind Notes being outstanding for all of 2007 compared to only ten-and-a-half months in 2006.

During 2007 DATATRAK recorded an income tax benefit of \$46,000. This net benefit amount was due to a \$319,000 reduction in the Company's deferred tax valuation allowance on its foreign net operating losses and was offset by \$143,000 as a result of the use of foreign net operating losses to reduce foreign taxable income. In addition, the Company recorded a reserve of \$130,000 for an uncertain tax position identified in the fourth quarter of 2007. During 2006, DATATRAK recorded income tax expense of \$976,000 as a result of an increase in our deferred tax valuation allowance and foreign income tax expense of \$126,000.

**Table of Contents****Liquidity and Capital Resources**

The Company's principal sources of cash have been cash flow from operations and proceeds from the sale of equity securities. 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 received over the life of the contract. 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 and our accounts receivable will fluctuate due to the timing and size of cash receipts. Any increase in our days sales outstanding is an indicator that our cash flow from operations and our working capital has been negatively impacted. At December 31, 2008, our days sales outstanding was 39 days as compared with 51 days calculated at December 31, 2007. Trade accounts receivable (net of allowance for doubtful accounts) was \$922,000 at December 31, 2008 and \$1,018,000 at December 31, 2007.

During the fourth quarter of 2008 our cash and investments balance decreased slightly, by approximately \$60,000, from \$2,432,000 at September 30, 2008, to \$2,372,000 at December 31, 2008. The change in our cash and investments balance between December 31, 2008 and September 30, 2008 was impacted by various items including: (i) we received a previously anticipated tax refund of \$390,000 from the German tax authorities related to a gross tax payment of \$568,000 we disbursed in the third quarter of 2008; (ii) we transferred approximately \$218,000 into our German bank account as an anticipated eventual settlement regarding certain leases we abandoned as part of our German office closure. Although the \$218,000 appears on our December 31, 2008 consolidated balance sheets as

Restricted cash current we are treating it as having been already disbursed for this discussion on cash and investment balances because of certain restrictions. As of March 13, 2009, the entire \$218,000 had been disbursed; (iii) we made severance payments totaling \$106,000 during the quarter. As of December 31, 2008, we had remaining severance obligations of approximately \$245,000 to be paid on or before November 30, 2009. In addition, on January 21, 2009, we announced the retirement of our Chief Executive Officer, Dr. Jeffrey A. Green. The Company will record a severance charge of approximately \$463,000 in the first quarter of 2009 related to Dr. Green's retirement. The \$463,000 will be paid out evenly over a two-year period concluding in January 2011; and (iv) we paid \$252,000 of legal fees during the quarter relating to the disputes with the ClickFind Note holders.

Our cash and investments balance decreased by approximately \$6.1 million this year, from \$8,514,000 at December 31, 2007, to \$2,372,000 at December 31, 2008. Our losses from ongoing operations are the primary reason for the decrease in cash and investments. The \$6.1 million decrease includes the following significant items: (i) severance payments totaling \$1,053,000; (ii) the \$568,000 German tax payment netted by the \$390,000 refund; (iii) in the first quarter we made the annual installment, including interest, on the ClickFind Notes of approximately \$500,000; (iv) in the third quarter we refunded a \$220,000 unearned initial payment to one client; (v) we paid \$666,000 of legal fees relating to the disputes with the ClickFind Note holders; and (vi) we made lease payments of \$270,000 on previously financed property and equipment.

Our audited financial statements for the fiscal year ended December 31, 2008, were prepared under the assumption that we will continue our operations as a going concern. We have a history of losses and negative cash flows from operations over the past three years. As a result, our independent registered accounting firm has issued an unqualified opinion, for the year ended December 31, 2008, which includes a paragraph stating that there is substantial doubt about our ability to continue as a going concern. Continued operations are dependent primarily on three key factors: (i) our ability to maintain our current business already under contract and reflected in our backlog amount; (ii) our ability to market and sell new business currently not reflected in our backlog amount; and (iii) our ability to raise additional capital or complete one of the strategic alternatives identified earlier in this section titled Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations .

Without additional funding, our ability to meet short-term working capital requirements during the current fiscal year, and our ability to meet longer-term working capital requirements, will depend entirely on the cash generation of existing trials currently in backlog and our ability to sell and contract for new trials. Our existing trials are subject to delay or cancellation at any time. Because of the exposure to unforeseen delays or cancellations our ability to accurately forecast future cash receipts from existing trials is limited. We believe our ability to sell and contract for new trials with longer term durations is influenced to some degree by our current financial uncertainty. We previously

believed that the uncertainty surrounding the resolution of the ClickFind litigation also impacted our

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ability to sell and contract for new trials. We further believe that sufficient time has not lapsed since the date of the litigation settlement and the date of this report to ultimately understand the impact of the settlement on our ability to sell and contract for new trials. Because of the uncertainty of our longer term financial stability, and not knowing how the current economy will impact our clients, our ability to accurately forecast future cash receipts from new trials is limited. Because of the uncertainty that exists surrounding our ability to forecast cash generation from our operations, and the uncertainty of being able to raise additional funding or complete a strategic alternative, we cannot provide assurances that we will have sufficient funds to meet our working capital requirements for the next 12 months or beyond.

We are uncertain as of the date of this report as to our ability to raise additional capital or complete any strategic alternative previously discussed. On July 21, 2008, we announced we had retained Healthcare Growth Partners, LLC as a strategic and financial advisor to assist the Board of Directors in evaluating a variety of potential opportunities directed at maximizing shareholder value. These potential opportunities may include, but are not limited to, a sale, merger or other business combination of the Company; strategic partnerships or alliances; or raising of additional capital. This review process is ongoing and we undertake no obligation to make any further announcement regarding the exploration of strategic alternatives unless and until the Board of Directors has approved a specific course of action. There can be no assurance that this process will result in any specific transaction or in any changes to the Company's current direction. In mid-September 2008 the ongoing subprime mortgage crisis in the United States accelerated into a global financial crisis causing turmoil in the United States and world financial markets. Current financial market conditions may have an adverse impact on the Company's ability to achieve any strategic alternatives including the raising of additional funding. We believe the December 18, 2008, settlement of the ClickFind litigation and forgiveness of the \$3,000,000 balloon payment, originally due February 1, 2009, will have a positive impact on our strategic alternative and/or fund raising efforts. We further believe that sufficient time has not lapsed since the date of the litigation settlement and the date of this report to ultimately understand the impact of the settlement on our strategic alternative and fund raising efforts.

We have established a line of credit with a bank. This line only allows us to borrow up to a certain percentage of our investments, as determined by the type of investment, held at the bank. As of December 31, 2008, approximately \$468,000 was available to be borrowed. The line of credit bears interest at rates based on the prime rate, and is payable on demand. We had no amounts outstanding against the line of credit at December 31, 2008.

We intend to continue to support the DATATRAK EDC<sup>®</sup> software, as well as invest in the development, enhancement and testing of our DATATRAK eClinical software. Until our financial resources are more stable, future enhancements will be focused upon those advancements that are associated with a sound business case demanded by our clients. For fiscal 2008 we expensed approximately \$1,428,000 for research and development compared to \$2,405,000 for fiscal 2007.

We anticipate expenditures for property and equipment of approximately \$250,000 for 2009, for the continued commercialization, enhancement and maintenance of our eClinical product suite as well as improvements to our internal operating system. We are uncertain about how much of the estimated \$250,000 may be financed given the limited availability in the credit markets today.

The Company's financial assets primarily consist of money market funds and highest grade commercial paper securities totaling \$1,719,000 at December 31, 2008. In spite of the recent credit crisis and disruptions in the financial markets, the Company's investment portfolio was not impaired. The underlying securities of the Company's money market investments included various U.S. government and treasury securities and other sound securities that held their trading value at \$1/share.

We may need to raise additional funds to offset delays or cancellations of existing contracts. 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.

**Table of Contents****Contractual Obligations**

The table below shows our contractual cash obligations, expressed in thousands, at December 31, 2008.

| Contractual Obligations            | Total    | Payments Due by Period |           |           | More than 5 years |
|------------------------------------|----------|------------------------|-----------|-----------|-------------------|
|                                    |          | Less than 1 year       | 1-3 years | 3-5 years |                   |
| Operating lease obligations        | \$ 1,272 | \$ 412                 | \$ 860    | \$        | \$                |
| Debt and capital lease obligations | 237      | 196                    | 41        |           |                   |
| Total contractual cash obligations | \$ 1,509 | \$ 608                 | \$ 901    | \$        | \$                |

**Off-Balance Sheet Arrangements**

The Company is not a party to any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on the Company's financial condition, sales or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

**Inflation**

To date, we believe that the effects of inflation have not had a material adverse effect on our results of operations or financial condition.

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**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to market risk from changes in interest rates and foreign currency exchange rates since we fund our operations through short-term investments and have had business transactions in Euros. A summary of our primary 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 year ended December 31, 2008 would have resulted in a \$54,000 change in DATATRAK's interest income during the year.

In December 2008, the Company entered into a settlement agreement with certain former ClickFind shareholders whereby the Company's remaining \$3 million note payable and accrued interest obligation on the note was forgiven and the related interest expense for 2008 was reversed. Thus, there is no interest rate risk associated with the ClickFind notes or any of the Company's other debt holdings as of December 31, 2008.

**Foreign Currency Risk**

DATATRAK's foreign results of operations have been subject to the impact of foreign currency fluctuations through both foreign currency transaction and foreign currency translation adjustments. The Company managed its risk to foreign currency transaction adjustments by maintaining foreign currency bank accounts in currencies in which we regularly transacted business. Effective January 31, 2009, DATATRAK Inc., a wholly owned subsidiary of the Company, terminated its Marketing Services Agreement ( Agreement ) with DATATRAK Deutschland GmbH ( Deutschland GmbH) and DATATRAK Inc. In early January 2009, following the termination of the Agreement, Deutschland GmbH was required under applicable German law to file a petition for voluntary bankruptcy in the German courts. The Company has liquidated Deutschland GmbH as of December 31, 2008 and will no longer be subject to foreign currency risk related to this entity.

DATATRAK's results of operations have been 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 average exchange rate between the U.S. dollar and the Euro for the year ended December 31, 2008 would have resulted in a \$20,000 change in the Company's net loss for the year ended December 31, 2008 due to foreign currency transactions. During 2008 the average exchange rate between the Euro and the U.S. dollar was 1.471 compared to 1.371 for the year ended December 31, 2007. The conversion of the Company's 2008 foreign operations into U.S. dollars upon consolidation resulted in a net loss that was approximately \$137,000 more than would have been recorded had the exchange rate between the Euro and the U.S. dollar remained consistent with 2007 rates.

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**Table of Contents****ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

## Index to Consolidated Financial Statements

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| <u>Consolidated Balance Sheets at December 31, 2008 and 2007</u>   | F - 3       |
| <u>Consolidated Statements of Operations for each of the three years in the period ended December 31, 2008</u>           | F - 4       |
| <u>Consolidated Statements of Shareholders' Equity for each of the three years in the period ended December 31, 2008</u> | F - 5       |
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Quarterly results of operations for the years ended December 31, 2008 and 2007, are included in Note 19 of the Consolidated Financial Statements.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. 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 Annual Report on Form 10-K. Based upon that evaluation, the Company's management, including the chief executive officer and chief financial officer, have concluded that, as of December 31, 2008, the Company's disclosure controls and procedures were effective at a reasonable assurance level 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.

**Management's Report on Internal Control over Financial Reporting**

The management of DATATRAK International, Inc. ( "DATATRAK" or the "Company" ) is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. DATATRAK's internal control system was designed to provide reasonable assurance to the Company's management and Board of Directors regarding the reliability of financial reporting and the preparation and fair presentation of financial statements issued for external purposes in accordance with U.S. generally accepted accounting principles.

All internal control systems, no matter how well designed, have inherent limitations and may not prevent or detect misstatements. Therefore, even those systems determined to be effective can only provide reasonable assurance with respect to financial reporting reliability and financial statement preparation and presentation. DATATRAK's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. In making our assessment, we used the criteria set forth by the Committee of Sponsoring Organizations ( "COSO" ) of the Treadway Commission in Internal Control - Integrated Framework. Based on our assessment we believe that, as of December 31, 2008, the Company's internal control over financial reporting is effective, at the reasonable assurance level, based on the COSO criteria.

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This annual report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's independent registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

**Changes in Internal Control**

There were no changes in the Company's internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**ITEM 9B. OTHER INFORMATION**

None.

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**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information appearing under the captions Election of Directors, Corporate Governance Matters and Section 16(a) Beneficial Ownership Reporting Compliance in our definitive Proxy Statement to be used in connection with our Annual Meeting of Shareholders to be held in June 2009 (the 2009 Proxy Statement ) is incorporated herein by reference. Information regarding our executive officers is included as Item 4A of Part I of this Annual Report on Form 10-K as permitted by Instruction 3 to Item 401(b) of Regulation S-K.

We have adopted a code of ethics, as such phrase is defined in Item 406 of Regulation S-K, that applies to all of our directors, officers and employees and all employees of our subsidiaries. The code of ethics, entitled Code of Business Conduct and Ethics, has been filed as an exhibit hereto.

Additionally, we have adopted a code of ethics, as such phrase is defined in Item 406 of Regulation S-K, that applies to our principal executive officer, principal financial officer, principal accounting officer or controller or persons performing similar functions. The code of ethics, entitled Financial Code of Ethics, has been filed as an exhibit hereto.

**ITEM 11. EXECUTIVE COMPENSATION**

The information appearing under the captions Compensation of Directors, Executive Officer Compensation, Compensation Committee Report and Compensation Committee Interlocks and Insider Participation in the 2009 Proxy Statement is incorporated herein by reference.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information appearing under the captions Equity Compensation Plan Information and Security Ownership of Certain Beneficial Holders and Management in the 2009 Proxy Statement is incorporated herein by reference.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

To the extent applicable, the information appearing under the caption Certain Related Party Transactions and Director Independence in the 2009 Proxy Statement is incorporated herein by reference.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information appearing under the caption Independent Registered Public Accounting Firm in the 2009 Proxy Statement is incorporated herein by reference.

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**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a)(1) Financial Statements

See Item 8 of Part II of this Annual Report on Form 10-K.

(a)(2) Financial Statement Schedules

All financial statement schedules for the Company and its subsidiaries have been included in the consolidated financial statements or the related footnotes, or such schedules are either inapplicable or not required.

(a)(3) Exhibits

See the Index to Exhibits at page E-1 of this Annual Report on Form 10-K.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.**

/s/ Laurence P. Birch  
Laurence P. Birch  
Interim Chief Executive Officer and Chairman of the  
Board

Date: March 16, 2009

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| <b>Signature</b>                           | <b>Title</b>   |
|--|--|
| /s/ Laurence P. Birch<br>Laurence P. Birch | Interim Chief Executive Officer and Chairman of the Board (Principal Executive Officer)  |
| /s/ Raymond J. Merk<br>Raymond J. Merk     | Vice President of Finance, Chief Financial Officer, Chief Operating Officer and Treasurer (Principal Financial and Accounting Officer) |
| /s/ Timothy G. Biro<br>Timothy G. Biro     | Director   |
| /s/ Seth B. Harris<br>Seth B. Harris       | Director   |
| /s/ Robert M. Stote<br>Robert M. Stote     | Director   |
| /s/ Jerome H. Kaiser<br>Jerome H. Kaiser   | Director   |

Date: March 16, 2009

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**Report of Independent Registered Public Accounting Firm**

To the Shareholders and Board of Directors of  
DATATRAK International, Inc

We have audited the accompanying consolidated balance sheets of DATATRAK International, Inc. as of December 31, 2008 and 2007, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of DATATRAK International, Inc. at December 31, 2008 and 2007, and the consolidated results of its operations and cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

The consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company's losses from operations and accumulated deficit raise substantial doubt about its ability to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*.

Cleveland, Ohio

March 13, 2009

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**Table of Contents****DATATRAK INTERNATIONAL, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS**

|  | <b>December 31,</b> |               |
|--|---------------------|---------------|
|  | <b>2008</b>         | <b>2007</b>   |
| <b>ASSETS</b>  |                     |               |
| Current assets   |                     |               |
| Cash and cash equivalents                                | \$ 1,872,358        | \$ 1,919,316  |
| Restricted cash – current                                | 218,276             |               |
| Short-term investments                                   | 499,936             | 6,595,045     |
| Accounts receivable, net                                 | 927,490             | 1,070,688     |
| Deferred tax asset – current                             | 61,700              | 71,200        |
| Prepaid expenses and other current assets                | 158,582             | 451,222       |
| <br>   |                     |               |
| Total current assets                                     | 3,738,342           | 10,107,471    |
| Property and equipment                                   |                     |               |
| Equipment  | 2,120,621           | 2,663,021     |
| Software, net of impairment                              | 4,588,781           | 6,325,496     |
| Leasehold improvements                                   | 660,321             | 696,571       |
|  | 7,369,723           | 9,685,088     |
| Less accumulated depreciation                            | 6,584,174           | 6,150,289     |
| <br>   |                     |               |
| Property and equipment, net                              | 785,549             | 3,534,799     |
| Other assets   |                     |               |
| Restricted cash – non current                            |                     | 87,021        |
| Deferred tax asset                                       | 83,700              | 1,327,800     |
| Deposit  | 39,549              | 39,549        |
| Other intangible assets, net of accumulated amortization |                     | 520,458       |
| Goodwill   |                     | 10,856,113    |
| <br>   |                     |               |
| Total other assets                                       | 123,249             | 12,830,941    |
| <br>   |                     |               |
| Total assets   | \$ 4,647,140        | \$ 26,473,211 |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>              |                     |               |
| Current liabilities                                      |                     |               |
| Accounts payable   | \$ 525,293          | \$ 415,415    |
| Notes payable  | 195,858             | 246,627       |
| Current portion of long-term debt                        |                     | 425,304       |
| Accrued expenses   | 1,104,584           | 1,607,261     |
| Deferred revenue   | 1,053,096           | 1,277,276     |
| <br>   |                     |               |
| Total current liabilities                                | 2,878,831           | 3,971,883     |
| Long-term liabilities                                    |                     |               |
| Long-term debt   | 41,523              | 3,252,962     |
| Deferred revenue – long-term                             | 1,260,000           | 1,680,000     |
| Deferred tax liability                                   | 145,400             | 999,000       |
| Shareholders' equity                                     |                     |               |

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|  |              |               |
|--|--------------|---------------|
| Serial Preferred Shares, without par value; authorized 1,000,000 shares; none issued   |              |               |
| Common shares, without par value, authorized 25,000,000; issued 17,051,901 shares as of December 31, 2008 and 17,016,901 shares as of December 31, 2007; outstanding 13,751,901 shares as of December 31, 2008 and 13,716,901 shares as of December 31, 2007 | 79,940,507   | 79,618,366    |
| Treasury shares, 3,300,000 shares at cost  | (20,188,308) | (20,188,308)  |
| Common share warrants  | 1,134,993    | 1,191,284     |
| Accumulated deficit  | (60,565,806) | (43,769,201)  |
| Foreign currency translation   |              | (282,775)     |
| Total shareholders' equity   | 321,386      | 16,569,366    |
| Total liabilities and shareholders' equity   | \$ 4,647,140 | \$ 26,473,211 |

*See accompanying notes.*

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**Table of Contents****DATATRAK INTERNATIONAL, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS**

|  | <b>For the Year Ended December 31,</b> |                 |                |
|--|--|-----------------|----------------|
|  | <b>2008</b>                            | <b>2007</b>     | <b>2006</b>    |
| Revenue                                      | \$ 8,826,060                           | \$ 10,561,868   | \$ 17,690,336  |
| Direct costs                                 | 2,832,971                              | 4,582,829       | 5,221,665      |
| Gross profit                                 | 5,993,089                              | 5,979,039       | 12,468,671     |
| Selling, general and administrative expenses | 10,178,631                             | 13,096,953      | 13,266,618     |
| Severance expense                            | 775,361                                | 915,117         | 294,974        |
| Depreciation and amortization                | 1,343,298                              | 2,721,966       | 2,306,382      |
| Liquidation of foreign subsidiary            | 380,798                                |                 |                |
| Impairment loss                              | 12,787,834                             | 213,209         |                |
| Loss from operations                         | (19,472,833)                           | (10,968,206)    | (3,399,303)    |
| Other income (expense):                      |  |                 |                |
| Interest income                              | 115,967                                | 440,158         | 237,763        |
| Interest expense                             | (34,044)                               | (369,755)       | (352,870)      |
| Other  | (20,695)                               | (1,700)         |                |
| Settlement of ClickFind lawsuit              | 3,000,000                              |                 |                |
| Loss before income taxes                     | (16,411,605)                           | (10,899,503)    | (3,514,410)    |
| Income tax expense (benefit)                 | 385,000                                | (46,000)        | 976,000        |
| Net loss                                     | \$ (16,796,605)                        | \$ (10,853,503) | \$ (4,490,410) |
| Net loss per share:                          |  |                 |                |
| Basic:                                       |  |                 |                |
| Net loss per share                           | \$ (1.23)                              | \$ (0.82)       | \$ (0.40)      |
| Weighted-average shares outstanding          | 13,681,901                             | 13,197,706      | 11,273,382     |
| Diluted:                                     |  |                 |                |
| Net loss per share                           | \$ (1.23)                              | \$ (0.82)       | \$ (0.40)      |
| Weighted-average shares outstanding          | 13,681,901                             | 13,197,706      | 11,273,382     |

*See accompanying notes.*

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**Table of Contents****DATATRAK INTERNATIONAL, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

|                                     | Common Shares    |               | Treasury Shares  |                 | Common Share Warrants |            | Accumulated Deficit | Foreign Currency Translation | Total       |
|-------------------------------------|------------------|---------------|------------------|-----------------|-----------------------|------------|---------------------|------------------------------|-------------|
|                                     | Number of Shares | Stated Amount | Number of Shares | Cost            | Number of Shares      | Cost       |                     |                              |             |
| <b>Balance at January 1, 2016</b>   | 10,313,161       | \$ 61,810,321 | 3,300,000        | \$ (20,188,308) | 160,337               | \$ 711,872 | \$(28,425,289)      | \$(211,608)                  | \$ 13,696,9 |
| Acquisition of business             | 1,026,522        | 7,863,158     |                  |                 |                       |            |                     |                              | 7,863,1     |
| Exercise of common share options    | 173,064          | 472,637       |                  |                 |                       |            |                     |                              | 472,6       |
| Exercise of common share warrants   | 3,258            | 22,122        |                  |                 | (3,258)               | (11,696)   |                     |                              | 10,4        |
| Stock-based compensation            | 46,468           | 573,835       |                  |                 |                       |            |                     |                              | 573,8       |
| Comprehensive income:               |                  |               |                  |                 |                       |            |                     |                              |             |
| Foreign currency translation        |                  |               |                  |                 |                       |            |                     | (62,640)                     | (62,64      |
| Income                              |                  |               |                  |                 |                       |            | (4,490,410)         |                              | (4,490,4    |
| Comprehensive income                |                  |               |                  |                 |                       |            |                     |                              | (4,553,0    |
| <b>Balance at December 31, 2016</b> | 11,562,473       | 70,742,073    | 3,300,000        | (20,188,308)    | 157,079               | 700,176    | (32,915,699)        | (274,248)                    | 18,063,9    |
| Private placement of common shares  | 1,986,322        | 7,512,920     |                  |                 | 327,743               | 1,134,931  |                     |                              | 8,647,8     |
| Exercise of common share options    | 99,783           | 266,596       |                  |                 |                       |            |                     |                              | 266,5       |
| Expiration of common share warrants |                  | 643,823       |                  |                 | (141,399)             | (643,823)  |                     |                              |             |
| Stock-based compensation            | 68,323           | 452,954       |                  |                 |                       |            |                     |                              | 452,9       |
| Comprehensive income:               |                  |               |                  |                 |                       |            |                     |                              |             |
| Foreign currency translation        |                  |               |                  |                 |                       |            |                     | (8,527)                      | (8,5        |

|  |            |               |           |                 |          |              |                 |           |              |
|--|------------|---------------|-----------|-----------------|----------|--------------|-----------------|-----------|--------------|
| loss                                   |            |               |           |                 |          |              | (10,853,502)    |           | (10,853,502) |
| Comprehensive income                   |            |               |           |                 |          |              |                 |           | (10,862,000) |
| <b>Balance at December 31, 2017</b>    | 13,716,901 | 79,618,366    | 3,300,000 | (20,188,308)    | 343,423  | 1,191,284    | (43,769,201)    | (282,775) | 16,569,300   |
| Expiration of common share warrants    |            | 56,291        |           |                 | (15,680) | (56,291)     |                 |           |              |
| Stock-based compensation               | 35,000     | 265,850       |           |                 |          |              |                 |           | 265,850      |
| Comprehensive income                   |            |               |           |                 |          |              |                 |           |              |
| Translation of foreign subsidiary loss |            |               |           |                 |          |              |                 | (98,023)  | (98,023)     |
| Liquidation of foreign subsidiary loss |            |               |           |                 |          |              |                 | 380,798   | 380,798      |
| <b>Balance at December 31, 2018</b>    | 13,751,901 | \$ 79,940,507 | 3,300,000 | \$ (20,188,308) | 327,743  | \$ 1,134,993 | \$ (60,565,806) | \$        | \$ 321,300   |

*See accompanying notes.*

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**DATATRAK INTERNATIONAL, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

|   | <b>For the Year Ended December 31,</b> |                 |                |
|---|--|-----------------|----------------|
|   | <b>2008</b>                            | <b>2007</b>     | <b>2006</b>    |
| <b>Operating Activities</b>   |  |                 |                |
| Net loss  | \$ (16,796,605)                        | \$ (10,853,503) | \$ (4,490,410) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: |  |                 |                |
| Depreciation and amortization   | 1,343,298                              | 2,721,966       | 2,306,382      |
| Impairment loss   | 12,787,834                             | 213,209         |                |
| Settlement of ClickFind lawsuit   | (3,000,000)                            |                 |                |
| Liquidation of foreign subsidiary   | 380,798                                |                 |                |
| Accretion of discount on investments  | (57,754)                               | (319,922)       | (107,718)      |
| Stock-based compensation  | 265,851                                | 452,954         | 573,835        |
| Other   | 16,332                                 | 1,700           | 4,521          |
| Changes in operating assets and liabilities:  |  |                 |                |
| Accounts receivable   | 143,145                                | 1,160,372       | 773,766        |
| Prepaid expenses and other current assets   | 222,861                                | 42,603          | 502,638        |
| Deferred taxes, net   | 400,000                                | (176,000)       | 976,000        |
| Accounts payable and accrued expenses   | (382,927)                              | 11,280          | 364,139        |
| Deferred revenue  | (644,180)                              | 1,969,101       | (241,636)      |
| Net cash (used in) provided by operating activities                                       | (5,321,347)                            | (4,776,240)     | 661,517        |
| <b>Investing Activities</b>   |  |                 |                |
| Acquisition of business, less cash acquired   |  |                 | (4,668,925)    |
| Decrease in restricted cash   | 86,927                                 |                 |                |
| Purchases of property and equipment   | (26,561)                               | (94,198)        | (502,748)      |
| Maturities of short-term investments  | 38,607,121                             | 42,250,000      | 9,836,194      |
| Purchases of short-term investments   | (32,454,258)                           | (46,774,001)    | (6,516,837)    |
| Net cash provided (used in) investing activities  | 6,213,229                              | (4,618,199)     | (1,852,316)    |
| <b>Financing Activities</b>   |  |                 |                |
| Payments of long-term debt and notes payable  | (836,055)                              | (871,635)       | (335,758)      |
| Gross excess tax benefits from share-based payment awards                                 |  | (7,162)         | 8,000          |
| Proceeds from issuance of common shares   |  | 8,647,852       |                |
| Proceeds from exercise of stock options and warrants                                      |  | 273,760         | 475,063        |
| Net cash (used in) provided by financing activities                                       | (836,055)                              | 8,042,815       | 147,305        |
| Effect of exchange rate changes on cash   | (102,785)                              | (785)           | (92,212)       |
| Decrease in cash and cash equivalents   | (46,958)                               | (1,352,409)     | (1,135,706)    |
| Cash and cash equivalents at beginning of year  | 1,919,316                              | 3,271,725       | 4,407,431      |
| Cash and cash equivalents at end of year  | \$ 1,872,358                           | \$ 1,919,316    | \$ 3,271,725   |
| Cash paid during the year for interest  | \$ 107,440                             | \$ 391,215      | \$ 258,654     |

*See accompanying notes.*



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**DATATRAK INTERNATIONAL, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Years Ended December 31, 2008, 2007 and 2006**

**1. Description of Business and Going Concern**

*Description of Business*

DATATRAK International, Inc. ( DATATRAK or the Company ) is a technology and services company focused on global eClinical solutions, which assist companies in the clinical pharmaceutical, biotechnology, contract research organization ( CRO ) and medical device research industries in accelerating the completion of clinical trials. The Company s two wholly-owned subsidiaries, DATATRAK, Inc. and CF Merger Sub, Inc. ( Merger Sub ), are inactive holding companies with no employees that do not provide any services to the Company or its customers.

*Going Concern*

The financial statements for the year ended December 31, 2008, have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. The Company has experienced losses from operations in each of the last three fiscal years totaling approximately \$34 million that raises substantial doubt about DATATRAK s ability to continue as a going concern. The auditors report issued for the year ended December 31, 2008, states that there is substantial doubt about the Company s ability to continue as a going concern. DATATRAK is considering various initiatives to continue as a going concern and to ensure the Company s future success. Future initiatives may include further restructuring and cost control, additional financing opportunities or strategic transactions or alliances.

DATATRAK s continued operations are dependent primarily on three key factors: (i) its ability to maintain current business already under contract and reflected in its backlog amount; (ii) its ability to market and sell new business currently not reflected in the backlog amount; and (iii) its ability to raise additional capital or complete a strategic alternative.

On July 21, 2008, the Company announced it had retained Healthcare Growth Partners, LLC as a strategic and financial advisor to assist the Board of Directors in evaluating a variety of potential opportunities directed at maximizing shareholder value. The potential opportunities may include, but are not limited to, a sale, merger or other business combination of the Company; strategic partnerships or alliances; or raising of additional capital.

On February 13, 2006, in accordance with the provisions of a merger agreement between DATATRAK International, Inc. and ClickFind (the Merger Agreement ), the Company acquired all of the outstanding stock of ClickFind. A portion of the purchase price consisted of \$4,000,000 in notes payable (the ClickFind Notes ), \$3,000,000 of which would have been due and payable on February 1, 2009.

The Company and certain former shareholders of ClickFind (the Defendants ) were involved in a dispute relating to certain representations and warranties in the Merger Agreement (United States District Court for the Northern District of Ohio, Eastern Division, Case No. 1:08CV02182) (the Lawsuit ). On December 18, 2008, DATATRAK announced the dispute had been resolved and that an agreement to settle all claims with the Defendants in the case had been reached. In connection with such resolution the \$3,000,000 balloon payment due on February 1, 2009 and \$180,000 in accrued interest due the Defendants was forgiven.

Effective January 31, 2009, DATATRAK, Inc., a wholly owned subsidiary of the Company, terminated its non-exclusive Marketing Services Agreement ( Agreement ) with DATATRAK Deutschland GmbH ( Deutschland GmbH ) and DATATRAK Inc. As of December 31, 2008, Deutschland GmbH recorded accrued expenses for lease and other obligations incurred through January 31, 2009 totaling \$218,000. As a result of the termination of the Agreement, Deutschland GmbH was required under applicable German law to file a petition for voluntary bankruptcy in the German courts and has on hand \$218,000, designated as restricted cash, to fund these liabilities as of December 31, 2008. Also as part of this liquidation of the Company s foreign investment in Deutschland GmbH, the Company reversed its cumulative currency translation adjustment and recorded additional operating expense of \$381,000 as of December 31, 2008.

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### **2. Accounting Policies**

#### *Principles of Consolidation*

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

#### *Revenue Recognition and Deferred Revenue*

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 objective and reliable evidence of fair value for the price of items included in its multiple-element arrangements based on vendor-specific objective evidence of the 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:

Enterprise license revenue is recognized ratably over the life of the license agreement.

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 for those services.

Data items revenue is earned based on a price per data unit as data items are entered into DATATRAK's 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 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. The Company provides a nominal reserve against revenue for potential pricing adjustments.

Deferred revenue represents cash advances received in excess of revenue earned on contracts. Payment terms vary with each contract but may include an initial payment at the time the contract is executed, with future payments dependent upon the completion of certain contract phases or targeted milestones. In the event of contract cancellation, the Company is entitled to payment for all work performed through the point of cancellation. Likewise, in the event of contract cancellation prior to earning revenue equal to or greater than the initial payment, the Company is required to refund the unused portion.

#### *Concentration of Credit Risk*

The Company is subject to credit risk through accounts receivable and short-term investments. The Company does not require collateral and its accounts receivable are unsecured. Short-term investments are placed with high credit-quality financial institutions or in short-duration, high credit-quality debt securities. The Company limits the amount of credit exposure in any one institution or type of investment instrument.

**Table of Contents***Cash Equivalents and Short-term Investments*

The Company's investments or financial assets include both cash equivalents in the form of highly liquid money market funds with maturities of three months or less and other short-term investments including corporate obligations in the form of commercial paper of the highest grades with maturities of one year or less. On January 1, 2008, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements . The investments are recorded at fair-value and are classified under a three level hierarchy based upon inputs market participants would use when pricing a financial asset in accordance with SFAS No. 157. All the Company's investments and cash equivalents totaling \$1,719,000 at December 31, 2008 had quoted market prices which are the highest priority (e.g. Level I) investment input. The Company has the positive intent and ability to hold the investments to maturity.

*Accounts Receivable*

The Company generally invoices its customers on a monthly basis with payment terms of net 30 days from invoice date. The accounts receivable amount is recorded net of an estimated reserve for doubtful accounts. The Company has a history of favorable collections and had a nominal reserve for uncollectible accounts of approximately \$14,000 at December 31, 2008. The Company's average collection period was 39 days as of December 31, 2008. The net accounts receivable balance was \$927,000 and \$1,071,000 at December 31, 2008 and 2007, respectively.

*Property and Equipment*

Property and equipment are stated at cost. Depreciable assets consist of office and computer equipment, software and software development costs, and leasehold improvements. Depreciation and amortization on office and computer equipment and software, and software development costs is computed using the straight-line method over estimated useful lives of 3 to 7 years. Leasehold improvements are amortized using the straight-line method over the lesser of the assets' estimated useful life or the lease term. Depreciation and amortization expense related to depreciable assets, including assets recorded under capital leases, was \$967,000, \$1,541,000 and \$1,510,000 for 2008, 2007 and 2006, respectively.

*Impairment of Long-Lived Assets*

The Company evaluates long-lived assets for impairment in accordance with Financial Accounting Standards Board ( FASB ) Statement of Financial Accounting Standards ( SFAS ) No. 144, Accounting for the Impairment of Long-Lived Assets. As such, the carrying values of long-lived assets are evaluated if circumstances indicate a possible impairment in value. If undiscounted cash flows over the remaining amortization period indicate that long-lived assets may not be recoverable, the carrying value will be reduced by the estimated shortfall of cash flows on a discounted basis.

*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 2006 consolidated statement of cash flows. The notes payable bore interest at prime plus 1%, and principal payments were due in installments of \$425,000 and \$3,000,000 on February 1, 2008

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and 2009, respectively. In February 2008, the Company made a \$425,000 installment that was due on February 1, 2008. On December 18, 2008, the Company issued a press release announcing that it and the Defendants had agreed to settle all claims against each other relating to the Lawsuit. The Company and the Defendants have entered into a settlement agreement (the Settlement Agreement) whereby the parties provided each other with mutual releases, agreed to file a stipulated dismissal of the Lawsuit with prejudice and made certain other agreements. In connection with the Settlement Agreement, the \$3 million balloon payment due on February 1, 2009 and \$180,000 in accrued interest due the Defendants was forgiven.

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.

DATATRAK's acquisition resulted in deferred tax liabilities of \$2,054,000 and \$145,000 related to the DATATRAK eClinical software remains outstanding at December 31, 2008. The Company utilized its gross deferred tax assets to offset this remaining acquisition related deferred tax liability.

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 | \$ 261,000        |
| Amortizable intangible assets                      | 6,040,000         |
| Goodwill   | 10,856,000        |
| Accounts payable and other current liabilities     | (421,000)         |
| Long-term debt                                     | (117,000)         |
| <br>Total acquisition cost                         | <br>\$ 16,619,000 |

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 software is being amortized over seven years and has a remaining balance of \$428,000 at December 31, 2008. The employee non-compete and contracts and customer relationship intangible assets, which were previously amortized over three years, are fully amortized as of December 31, 2008. These assets are subject to impairment testing when impairment indicators arise as more fully detailed in Note 6 below.

The following table summarizes the activity of the Company's acquired infinite and finite-lived intangible assets since the acquisition date of February 13, 2006:

|                            | DATATRAK<br>eClinical | Employee     | Contract<br>and<br>customer |                   | Total acquired<br>intangible<br>assets |
|----------------------------|-----------------------|--------------|-----------------------------|-------------------|--|
|                            | Software              | non-compete  | relationship                | Goodwill          |  |
| Acquired Balance @ 2/13/06 | \$ 3,330,000          | \$ 1,160,000 | \$ 1,550,000                | \$ 10,856,000     | \$ 16,896,000                          |
| 2006 Amortization          | (436,000)             | (341,000)    | (455,000)                   | N/A               | (1,232,000)                            |
| Balance @ 12/31/06         | 2,894,000             | 819,000      | 1,095,000                   | \$ 10,856,000     | 15,664,000                             |
| 2007 Amortization          | (476,000)             | (347,000)    | (833,000)                   | N/A               | (1,656,000)                            |
| Impairment                 |                       | (213,000)    |                             |                   | (213,000)                              |
| <br>Balance @ 12/31/07     | <br>2,418,000         | <br>259,000  | <br>262,000                 | <br>\$ 10,856,000 | <br>13,795,000                         |
| 2008 Amortization          | (290,000)             | (115,000)    | (262,000)                   | N/A               | (667,000)                              |
| Impairment                 | (1,700,000)           | (144,000)    |                             | (\$10,856,000)    | (12,700,000)                           |
| Balance @ 12/31/08         | \$ 428,000            | \$           | \$                          | \$                | \$ 428,000                             |

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 year ended December 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.

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|                                  | <b>Year Ended<br/>December 31,<br/>2006</b> |
|----------------------------------|---|
| Pro forma revenue                | \$ 17,899,000                               |
| Pro forma net loss               | \$ (4,774,000)                              |
| Pro forma basic loss per share   | \$ (0.42)                                   |
| Pro forma diluted loss per share | \$ (0.42)                                   |

*Stock-Based Compensation*

The Company accounts for stock-based compensation in accordance with SFAS No. 123(R), *Share-Based Payment ( FAS 123(R) )* using the modified prospective method. The 2005 Omnibus Equity Plan (the Omnibus Plan ) is the Company's primary share-based award program for covered employees and directors. Restricted common stock, common share options and common shares have been awarded under the Omnibus Plan share-based award program exclusively since 2005. The Company used the Black-Scholes option valuation model to calculate the fair value of stock options granted.

Common shares and common share options awarded to non-employee directors are fully vested and compensation costs are completely expensed on the grant date. Compensation expense for share-based awards granted to employees vest over the assigned vesting period and related compensation costs are amortized ratably over the vesting period. The Company's unamortized compensation cost, related to non-vested stock options and restricted common shares, at December 31, 2008, 2007 and 2006 was \$107,000, \$263,000 and \$676,000, respectively. The unamortized cost of \$107,000 at December 31, 2008 is expected to be amortized in the amounts of \$65,000, \$26,000 and \$16,000 in 2009, 2010 and 2011, respectively.

*Income Taxes*

The Company follows SFAS No. 109, *Accounting for Income Taxes*. This accounting standard requires that the liability method be used in accounting for income taxes. Under this accounting method, deferred tax assets and liabilities are determined based on the differences between the financial reporting basis and the tax basis of assets and liabilities and are measured using the enacted tax rates and laws that apply in the periods in which the deferred tax asset or liability is expected to be realized or settled. A valuation allowance is provided for deferred tax assets for which realization currently is not certain. Quarterly income taxes are recorded at the effective rate, based on annual forecasted income. The Company currently is in a three-year cumulative loss position totaling approximately \$34 million. As a result, the Company recorded a full valuation reserve against its net deferred tax assets at December 31, 2008.

In accordance with Financial Interpretation ( FIN ) No. 48, *Accounting for Uncertainty in Income Taxes*", the Company recorded an unrecognized tax benefit of \$130,000 at December 31, 2007 related to DATATRAK Deutschland GmbH's disallowed losses and treatment of such as a constructive dividend to the U.S. parent company, DATATRAK International, Inc. This liability was adjusted to \$115,000 and paid in full in 2008. The Company has no unrecognized tax benefit at December 31, 2008.

*Use of Estimates*

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

*Financial Instruments*

The carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses are reasonable estimates of fair value due to the short-term nature of these financial instruments. Investments are reported at amortized cost, which approximates fair value.

*Advertising Costs*

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Advertising costs are expensed as incurred and are included in selling, general and administrative expenses. Advertising expenses were \$230,000, \$391,000 and \$336,000 for 2008, 2007 and 2006, respectively.

*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. No software development costs were capitalized in 2008 or 2007.

Research and development expenses included in selling, general and administrative expenses were \$1,428,000, \$2,405,000 and \$2,310,000 in 2008, 2007 and 2006, respectively.

*Foreign Currency Translation*

The assets and liabilities of the Company's foreign subsidiary are translated into U.S. dollars at current exchange rates. Revenue and expense accounts of these operations are translated at average rates prevailing during the period. These translation adjustments are accumulated in a separate component of shareholders' equity. Foreign currency transaction gains and losses are included in determining net (loss) income when realized. In December 2008, the Company liquidated its foreign subsidiary, DATATRAK Deutschland GmbH. As a result, the Company eliminated its currency translation adjustment and recorded an operating loss from the liquidation of its foreign subsidiary in the amount of \$381,000 as of December 31, 2008.

*Recently Issued Accounting Standards*

In February 2008, the FASB issued FASB Staff Position ( FSP ) No. 157, Effective Date of FASB Statement No. 157. FSP No. 157 delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008. The Company's significant nonfinancial assets and liabilities that could be impacted by this deferral include assets and liabilities initially measured at fair value in a business combination. The adoption of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities is not expected to have a material impact on the Company's results of operations and financial condition.

*Reclassification*

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

**3. Short-term Investments**

The following is a summary of held-to-maturity securities:

|  | December 31, 2008 |                | December 31, 2007 |                |
|--|-------------------|----------------|-------------------|----------------|
|  | Cost              | Amortized Cost | Cost              | Amortized Cost |
| Obligations of U.S. government sponsored enterprises | \$                | \$             | \$ 1,996,003      | \$ 1,998,140   |
| Corporate obligations                                | 499,457           | 499,936        | 4,590,750         | 4,596,905      |
|  | \$ 499,457        | \$ 499,936     | \$ 6,586,753      | \$ 6,595,045   |

**4. Fair Value Measurements**

On January 1, 2008, the Company adopted the provisions of Statement of Financial Accounting Standards ( SFAS ) No. 157, *Fair Value Measurements* as required for financial assets and liabilities. The adoption of SFAS No. 157 had no material impact on the Company's financial position, results of operations or cash flows during the year ended December 31, 2008. SFAS No. 157 was effective January 1, 2008 for financial assets and liabilities and will be effective January 1, 2009 for non-financial assets and liabilities. The standard provides guidance for establishing a frame work for measuring fair values of assets and liabilities. Under the standard, fair value refers to the price that

would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e. an exit price). The standard clarifies the principle that fair value should be based on the assumptions or inputs market participants would use when pricing the asset or liability.

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In support of this principle, SFAS No. 157 establishes a three level hierarchy for fair value measurements based on the quality or transparency of inputs used to measure the fair value of an asset or liability at the measurement date.

The three levels are defined as follows:

Level 1 (the highest priority) inputs to the valuation methodology are quoted market prices (unadjusted) for identical financial assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted market prices for similar assets and liabilities in active markets, and inputs that are observable for an asset or liability, either directly or indirectly, for substantially the full term of a financial instrument.

Level 3 (the lowest priority) inputs to the valuation methodology are unobservable and significant to the fair value measurement. These inputs reflect management's own assumptions about the assumptions a market participant would use in pricing a financial instrument.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level or priority of input that is significant to the fair value measurement of the financial asset or liability.

The Company's only financial assets or liabilities subject to SFAS No. 157 are its investments in cash equivalents and short-term investment instruments consisting primarily of corporate obligations in the form of commercial paper, grade A1 or better. Following is a description of the valuation methodologies used to determine the fair value of the Company's financial assets including the general classification of such instruments pursuant to the valuation hierarchy.

**Cash equivalents** The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The Company's cash equivalents consist of various money market funds. The money market funds are recorded based on quoted market prices in active markets multiplied by the number of shares owned. The money market funds are classified in Level 1 of the valuation hierarchy.

**Short-term investments** The Company's short-term investments consist primarily of corporate obligations in the form of commercial paper of the highest grade which have maturities of one year or less. There is an active market for these commercial paper securities at quoted market prices determined by the issuer of the commercial paper. The short-term investments are classified in Level 1 of the valuation hierarchy.

The following table presents the financial instruments carried at fair value as of December 31, 2008 by caption on the consolidated balance sheet and by SFAS No. 157 valuation hierarchy as described above.

**Fair Value Measurements at Reporting Date Using**

| Description  | December 31,<br>2008 | Quoted Prices<br>in<br>Active Markets<br>for<br>Identical<br>Assets<br>(Level 1) |  |  | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|--|----------------------|--|--|--|---|--|
|  |                      |  |  |  |   |  |
| Cash Equivalents - Money Market Funds                                  | \$ 1,218,647         | \$ 1,218,647   |  |  | \$  | \$   |
| Short-term Investments - Corporate Obligations (i.e. Commercial Paper) | 499,936              | 499,936  |  |  |   |  |
| Total  | \$ 1,718,583         | \$ 1,718,583   |  |  | \$  | \$   |

**5. Accounts Receivable**

Accounts receivable consist of the following:

**December 31,**  
**2008**                      **2007**

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|                           |            |              |
|---------------------------|------------|--------------|
| Trade accounts receivable | \$ 935,697 | \$ 1,023,526 |
| Other                     | 5,318      | 52,162       |

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|                                 | <b>December 31,</b> |              |
|---------------------------------|---------------------|--------------|
|                                 | <b>2008</b>         | <b>2007</b>  |
| Allowance for doubtful accounts | (13,525)            | (5,000)      |
|                                 | \$ 927,490          | \$ 1,070,688 |

Included in trade accounts receivable at December 31, 2008 and 2007 is \$168,000 and \$232,000, respectively, from a primary customer. This amount represents the loss the Company would incur in the event that all trade receivables from this customer were deemed uncollectible.

**6. Goodwill and Finite-Lived Tangible and Intangible Assets**

As a result of consecutive quarterly operating losses since the first quarter of 2006 and continued decline in market capitalization during 2008, the Company determined that impairment indicators existed as of each quarter-end in 2008. As required by SFAS No. 142, Goodwill and Other Intangible Assets, the Company conducted a two-step impairment test to assess the carrying value of its goodwill. The results of the test and other qualitative factors negatively impacting the Company's expected future performance resulted in a full impairment loss of its goodwill in the amount of \$10,856,000 as of December 31, 2008.

In accordance with SFAS No. 144, Accounting for the Impairment of Long-Lived Assets, the carrying values of long-lived assets are evaluated if circumstances indicate a possible impairment in value. As a result of consecutive quarterly operating losses since the first quarter of 2006 and forecasted continuing operating losses based on current sales trends, the Company determined that impairment indicators for its finite-lived tangible and intangible assets, including its eClinical software, existed as of each quarter-end beginning with June 30, 2007 and continuing through December 31, 2008. The Company conducted impairment testing of its finite-lived tangible and intangible assets as of all these dates. As a result of its testing, the Company recorded an impairment losses of \$144,000 on its ClickFind non-compete intangible asset, \$63,000 for certain German fixed assets, \$25,000 related to our U.S. corporate office space reduction and \$1,700,000 on its DATATRAK eClinical software as of December 31, 2008. Similarly, the Company recorded an impairment charge of \$213,000 against non-compete intangible asset as of December 31, 2007.

**7. Accrued Expenses**

Accrued expenses consist of the following:

|                                  | <b>December 31,</b> |              |
|----------------------------------|---------------------|--------------|
|                                  | <b>2008</b>         | <b>2007</b>  |
| Office rent and utilities        | \$ 58,278           | \$ 30,947    |
| Payroll and other employee costs | 709,956             | 1,076,438    |
| Professional fees                | 255,268             | 226,784      |
| FIN No. 48 tax liability         |                     | 130,000      |
| Interest                         |                     | 73,558       |
| Other                            | 81,082              | 69,534       |
|                                  | \$ 1,104,584        | \$ 1,607,261 |

**8. Income Taxes**

Income tax expense (benefit) consists of the following:

|                                    | <b>Year Ended December 31,</b> |             |             |
|------------------------------------|--------------------------------|-------------|-------------|
|                                    | <b>2008</b>                    | <b>2007</b> | <b>2006</b> |
| Current United States and foreign  | \$ (15,000)                    | \$ 130,000  | \$          |
| Deferred United States and foreign | 400,000                        | (176,000)   | 976,000     |

\$ 385,000      \$ (46,000)      \$ 976,000

Due to its net operating loss carryforwards, the Company had no state or local income tax expense in 2008, 2007 and 2006.

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

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|  | <b>Year Ended December 31,</b> |                |                |
|--|--------------------------------|----------------|----------------|
|  | <b>2008</b>                    | <b>2007</b>    | <b>2006</b>    |
| Income tax benefit at the United States statutory rate | \$ (5,580,000)                 | \$ (3,706,000) | \$ (1,195,000) |
| Change in valuation allowance                          | 2,289,000                      | 2,073,000      | 2,025,000      |
| FIN No. 48 liability                                   | (130,000)                      | 130,000        |                |
| Foreign tax rate change                                |                                | 839,000        |                |
| Foreign net operating loss adjustment                  |                                | 485,000        |                |
| Foreign taxes (benefit)                                | (35,000)                       | 13,000         | 12,000         |
| Goodwill impairment                                    | 3,691,000                      |                |                |
| Non-deductible permanent differences                   | 150,000                        | 120,000        | 162,000        |
| Other  |                                |                | (28,000)       |
|  | \$ 385,000                     | \$ (46,000)    | \$ 976,000     |

Due to uncertainty regarding the realization of the deferred tax asset resulting from its cumulative operating losses through 2008, as well as the closing of its German office in 2008, the Company provided for a full valuation allowance against all its net deferred tax assets at December 31, 2008. The deferred foreign tax provision of \$400,000 in 2008 was the result of additional valuation reserve provided against German deferred tax assets.

At December 31, 2008 the Company had a net operating loss carryforward of approximately \$33,003,000 for United States income tax purposes. An equity transaction completed on January 7, 2002 has limited the Company's net operating loss carryforwards, incurred prior to that date, to a maximum amount of approximately \$1,000,000 per year, under Section 382 of the Internal Revenue Code. All of the Company's United States net operating loss carryforwards will begin expiring in the year 2018 and will be fully expired in the year 2028. The Company also has a net operating loss carryforward of approximately \$5,155,000 euro for German income tax purposes with no expiration date pending the outcome of the liquidation proceedings of Deutschland GmbH.

Due to uncertainty regarding the realization of the deferred tax asset resulting from its cumulative operating losses through 2007, the Company provided a full valuation allowance against its net U.S. deferred tax assets at December 31, 2007. During 2007, the Company reevaluated its valuation allowance and reduced its German valuation allowance by \$319,000 which resulted in an income tax benefit and increased the overall unreserved German deferred tax assets to \$400,000 at December 31, 2007. The \$319,000 benefit was partially offset by a \$130,000 FIN No. 48 liability recorded in the fourth quarter of 2007, a \$22,000 reduction of the net German deferred tax assets due to a decrease in the future German income tax rate and the use of \$121,000 of foreign net operating losses to reduce foreign taxable income.

In August 2007, Germany passed a tax reform bill that lowered the Company's foreign corporate tax rate from 38% to 30%. As a result of this tax rate change, the Company recorded a \$22,000 reduction in its foreign net deferred tax asset. In addition, the Company reduced its foreign deferred tax asset and corresponding valuation reserve by \$817,000.

During 2007 the German tax authority began an audit of the Company's German subsidiary, DATATRAK Deutschland GmbH. In the fourth quarter of 2007 the German tax authority established a position to disallow losses recognized in 2002 and 2003 and to classify such treatment as a constructive dividend to the U.S. parent company. In accordance with FIN No. 48 guidelines, the Company recorded an unrecognized tax benefit in the amount of \$130,000 in association with this examination. This expense along with the associated reduction of the fully reserved deferred tax assets associated with the net operating losses for 2002 and 2003 was recorded in the fourth quarter of 2007.

During the first quarter of 2008, the Company received the German tax audit report associated with the German tax audit of DATATRAK Deutschland GmbH ( Deutschland GmbH ) for the years 2003 through 2005. The report concluded that only the 2003 loss was disallowed and should be classified as a constructive dividend. As a result, the estimated tax assessment due to the German tax authority was \$115,000 and the corresponding FIN No. 48 liability of \$130,000 recorded at December 31, 2007 was adjusted to \$115,000 which was paid in September 2008.

In 2006, DATATRAK reported a net operating loss which placed the Company in a three year cumulative loss position. This cumulative loss resulted in sufficient negative evidence to require a full valuation allowance against the Company's net U.S. deferred tax assets. The tax provision in 2006 primarily resulted from the reinstatement of the Company's U.S. and German valuation allowances.

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As part of the ClickFind acquisition in 2006, DATATRAK acquired \$6,040,000 of amortizable intangible assets. The only remaining intangible asset is the Company's DATATRAK eClinical software in the amount of \$428,000 as of December 31, 2008. The amortization expense related to these intangible assets is not deductible for income tax purposes. The Company will use its net operating loss carryforwards to offset the remaining deferred tax liability of \$145,000 related to the DATATRAK eClinical software which the Company expects to realize fully by 2013.

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

|   | <b>December 31,</b> |               |
|---|---------------------|---------------|
|   | <b>2008</b>         | <b>2007</b>   |
| Deferred tax assets:                        |                     |               |
| U.S. net operating loss carryforwards       | \$ 11,221,000       | \$ 10,043,000 |
| Foreign net operating loss carryforwards    | 2,032,000           | 2,284,000     |
| Alternative minimum tax credit carryforward | 123,000             | 123,000       |
| Foreign tax credit                          | 115,000             |               |
| Allowances and accruals                     | 62,000              | 71,000        |
| Depreciation and amortization               | 215,000             | 212,000       |
|   | 13,768,000          | 12,733,000    |
| Valuation allowance                         | (13,623,000)        | (11,334,000)  |
| Gross deferred tax assets recorded          | \$ 145,000          | \$ 1,399,000  |

At December 31, 2008, a valuation allowance of approximately \$13,623,000 remains against DATATRAK's deferred tax assets, which consist primarily of net operating loss carryforwards for both U.S. and foreign income taxes. Of the \$13,623,000 total allowance, approximately \$11,221,000 is recorded against the portion of DATATRAK's deferred tax assets that represent net operating loss carryforwards for U.S. income taxes, and approximately \$2,032,000 is recorded against the portion of DATATRAK's deferred tax assets that represent net operating loss carryforwards for German income taxes. The remaining \$370,000 valuation allowance is provided for other non-current deferred tax assets.

The increase in the valuation allowance of approximately \$2.3 million from 2007 to 2008 is primarily due to (i) \$300,000 added reserve against its previous unreserved German deferred tax asset, (ii) \$1,200,000 added reserve against its U.S. net operating loss carryforwards which resulted from 2008 operating losses, (iii) \$900,000 decrease in deferred liabilities resulting from 2008 impairment charges and amortization of its finite-lived intangible assets, (iv) \$200,000 reserve reduction due to income recorded against foreign loss carryforwards and (v) \$100,000 added reserve for a foreign tax credit resulting from its FIN No. 48 liability payment made in 2008.

Effective January 1, 2007, the Company adopted Financial Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes." In accordance with FIN No. 48, the Company recorded an unrecognized tax benefit of \$130,000 at December 31, 2007 related to DATATRAK Deutschland GmbH's disallowed losses and treatment of such as a constructive dividend to the U.S. parent company, DATATRAK International, Inc. This liability was adjusted to \$115,000 and paid in full in 2008. The Company has no unrecognized tax benefit at December 31, 2008.

A reconciliation of the Company's beginning, at adoption, and ending amount of unrecognized tax benefits is as follows:

|  |            |
|--|------------|
| Balance @ January 1, 2008  | \$ 130,000 |
| Gross amount of increases/(decreases) in 2008 for prior years' tax positions | (15,000)   |
| Gross amount of increases/(decreases) for current year's tax positions       |            |
| Amount of decreases related to settlement                                    | (115,000)  |
| Reductions due to lapse of statute of limitations                            |            |

Balance @ December 31, 2008 \$ 0

Tax years 2006 through 2008 remain subject to German tax examination. Similarly, tax years 2005 through 2008 remain subject to U.S. tax examination.

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**Table of Contents****9. Restructuring Costs**

During 2008, the Company terminated 14 employees due to the closing of its German office and 12 others as a result of its cost cutting initiatives. Significant employee terminations also took place in the second, third and fourth quarters of 2007. As a result, the Company accrued severance charges for severance benefits due to terminated employees in both the years ending December 31, 2008 and 2007. All the accrued severance costs of \$245,000 at December 31, 2008 are expected to be paid by November 30, 2009. Reconciliations of the Company's accrued severance balances for the years ended December 31, 2008 and 2007 are as follows:

| <b>Description</b>           | <b>Accrued Severance Reconciliation</b> |             |
|------------------------------|---|-------------|
|                              | <b>2008</b>                             | <b>2007</b> |
| Accrued severance at Jan. 1  | \$ 523,000                              | \$ 7,000    |
| Charges                      | 775,000                                 | 915,000     |
| Payments                     | (1,053,000)                             | (399,000)   |
| Accrued severance at Dec. 31 | \$ 245,000                              | \$ 523,000  |

The Company accounts for termination benefits in accordance with Statement of Financial Accounting Standards ( FAS ) No. 146, *Accounting for the Cost of Exit or Disposal Activities*, which requires that termination benefit expenses be recorded ratably over the period during which employees must provide future services in order to obtain the benefit. Termination benefits for employees who will not be retained to render service beyond the minimum notification period are recognized at the communication date. There were no future service requirements in connection with the above noted terminations.

On July 31, 2008, the Company exited its German premises and is in default of certain operating lease agreements. In accordance with FAS No. 146, the Company was required to record rent expense of \$835,000 representing the fair value of the future minimum lease payments including fixed costs of its office and telephone operating leases. No lease payments have been made since the Company recorded this obligation on July 31, 2008. The Company was not able to reach a termination settlement with our German landlord. The original office lease term expires in August 2012.

Effective January 31, 2009, DATATRAK, Inc., a wholly owned subsidiary of the Company, terminated its non-exclusive Marketing Services Agreement ( Agreement ) with DATATRAK Deutschland GmbH ( Deutschland GmbH ) and DATATRAK Inc. As of December 31, 2008, Deutschland GmbH recorded accrued expenses for lease and other obligations incurred through January 31, 2009 totaling \$218,000. As a result of the termination of the Agreement, Deutschland GmbH was required under applicable German law to file a petition for voluntary bankruptcy in the German courts and has on hand \$218,000, designated as restricted cash, to fund these liabilities as of December 31, 2008. Also as part of this liquidation of the Company's foreign investment in Deutschland GmbH, the Company reversed its cumulative currency translation adjustment and recorded additional operating expenses of \$381,000 as of December 31, 2008. Due to the termination of the Agreement and subsequent insolvency filing in January 2009, the Company is no longer liable for previous lease commitments beyond January 31, 2009. As a result, the Company reversed \$692,000 of rent expense related to the previous GmbH lease obligations in December 2008.

**10. Long-term Debt**

Long-term debt at December 31, 2008 and December 31, 2007 is summarized below:

|  | <b>December 31, 2008</b> | <b>December 31, 2007</b> |
|--|--------------------------|--------------------------|
| Insurance note payable   | \$ 8,000                 | \$                       |
| ClickFind Notes  |                          | 3,425,000                |
| Financing agreement with Oracle Credit Corporation (the Oracle Agreement ) | 44,000                   | 143,000                  |
| Capital lease agreement with Dell Financial Services (the Dell Agreement ) | 185,000                  | 357,000                  |

|                         |           |              |
|-------------------------|-----------|--------------|
|                         | 238,000   | 3,925,000    |
| Less current maturities | 196,000   | 672,000      |
|                         | \$ 41,000 | \$ 3,253,000 |

The ClickFind Notes were held by certain former shareholders of ClickFind. They earned interest at prime plus 1% and the remaining balloon principal payment of \$3,000,000 would have been due on February 1, 2009. During 2008 the Company had been involved in a dispute relating to certain representations and warranties in the ClickFind Merger Agreement.

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On December 18, 2008, DATATRAK announced the dispute had been resolved and that an agreement to settle all claims with the Defendants in the case had been reached. In connection with such resolution the \$3,000,000 balloon payment due on February 1, 2009 and \$180,000 in accrued interest due the Defendants was forgiven.

On July 17, 2006, Datasci, LLC ( Datasci ) filed a complaint against the Company, 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 (the Datasci claim ). As previously disclosed, on July 31, 2007, the parties entered into a settlement agreement whereby Datasci agreed to dismiss its claims against the Company with prejudice, and no payment was required then or in the future in connection with DATATRAK EDC® or DATATRAK eClinical<sup>0</sup> in their current forms. 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 that was due on February 1, 2007, \$79,000 was held by the Company to satisfy these expenses. As of December 31, 2007, an additional \$75,000 had been recorded as a reduction to the notes payable reducing the February 1, 2008 installment to \$425,000 from the original \$500,000 payment that was due. In July 2007, DATATRAK settled its litigation related to Datasci s patent infringement claim with no liability against 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 \$9,000, 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 \$16,000, for the 36 month term of each lease. Certain of these leases include bargain purchase options while the more recent ones entered into include fair value purchase options at the end of the lease term.

The Oracle Agreement and the Dell Agreement transactions totaling \$229,000 and \$256,000 for the years ended December 31, 2007 and 2006, respectively, are excluded from the Company s condensed consolidated statement of cash flows. There were no such agreements entered into during 2008.

During May 2008, the Company entered into two separate financing agreements (the Insurance Notes ) with Westfield Bank, FSB for the payment of the Company s insurance premiums. The notes bear interest at 6.9% and 7.2%, respectively, and are due in monthly installments of \$11,000 and \$8,000, including accrued interest, respectively. The origination of the Insurance Notes are excluded from the Company s 2008 condensed consolidated statement of cash flows. At December 31, 2008, \$8,000 was due to Westfield Bank, FSB.

The following table sets forth the future minimum lease payments on the Oracle Agreement, Dell leases and Insurance Notes for the next five years and overall aggregate.

| <b>2009</b> | <b>2010</b> | <b>2011</b> | <b>2012</b> | <b>2013</b> | <b>Total</b> |
|-------------|-------------|-------------|-------------|-------------|--------------|
| \$213,000   | \$35,000    |             |             |             | \$248,000    |

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**Table of Contents****11. Operating Leases**

The Company leases certain office equipment and space. Rent expense relating to these operating leases was approximately \$1,171,000, \$1,075,000 and \$795,000 in 2008, 2007 and 2006, respectively. Future minimum lease payments for the Company under non-cancelable operating leases as of December 31, 2008 are as follows:

| <b>Year Ending December 31,</b> | <b>Amount</b> |
|---------------------------------|---------------|
| 2009                            | \$ 412,000    |
| 2010                            | 280,000       |
| 2011                            | 287,000       |
| 2012                            | 293,000       |
| Subsequent to 2012              |               |
|                                 | \$ 1,272,000  |

**12. Line of Credit**

We have established a line of credit with a bank. This line allows us to borrow up to a certain percentage of our investments, as determined by the type of investment, held at the bank. As of December 31, 2008, \$468,000 was available to be borrowed. The line of credit bears interest at rates based on the prime rate, and is payable on demand. We had no amounts outstanding against the line of credit at December 31, 2008 or 2007.

**13. 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 \$8,648,000 (after deducting offering related expenses). The proceeds were allocated between common shares and common share warrants based on their relative fair values. All the warrants totaling 327,743 were outstanding as of December 31, 2008 and 2007.

In connection with March 2007 financing, we granted registration rights for the purchased common shares and the common shares issuable upon exercise of the warrants. The registration rights agreement specifies filing and effectiveness deadlines and requires the Company to, except under certain limited circumstances, keep the registration statement effective until certain threshold dates. The registration rights agreement also requires the Company to maintain (e.g. maintenance requirement) a sufficient number of common shares to satisfy all the warrants if they were exercised now or in the future. DATATRAK has sufficient authorized, unregistered common shares to permit exercise of the warrants. Accordingly, the Company classified the warrants as equity instruments. 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 registration statement was declared effective on May 14, 2007 by the Securities and Exchange Commission.

In the event the Company fails to meet the registration maintenance requirement, DATATRAK will have to pay each holder an amount equal to 1.0% of the aggregate purchase price for each month of such failure. The aggregate amount of these registration failure payments will 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 failure payment and thus has not recorded a liability with respect to the registration payment arrangement. The registration maintenance requirement expires in May 2009.

During 2008, 15,680 warrants expired which had an exercise price of \$3.20 per share. There are 327,743 warrants outstanding at December 31, 2008 which have original terms of 5 years and an exercise price of \$6.00 per share. In December 2007, 141,399 warrants expired which had an exercise price of \$9.60 per share.

**Table of Contents***Reserved Shares*

At December 31, 2008, the Company had reserved 1,469,326 common shares for the exercise of common share options and warrants. Of the 1,469,326 reserved shares, 411,750 shares are reserved for future grants under the Company's previously established share option plans. Because the Omnibus Plan was approved, the 411,750 common share options that could have been granted pursuant to the Company's previously established share option plans are not expected to be granted.

In addition, at December 31, 2008 the Company had reserved a total of 844,092 common shares including 366,376 for future awards and 477,716 for the exercise of stock options pursuant to the Omnibus Plan.

*Shareholder Rights Plan*

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

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

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

**14. Share-Based Payment Awards****The 2005 Omnibus Plan**

On July 22, 2005, the Company's shareholders approved the DATATRAK International, Inc. 2005 Omnibus Equity Plan (the Omnibus Plan). The Omnibus Plan is intended to be the primary share-based award program for covered employees and directors. The Omnibus Plan gives the Compensation Committee of the Board of Directors flexibility to grant a wide variety of share-based awards by taking into account such factors as the type and level of employee, relevant business and performance goals and the prevailing tax and accounting treatments.

*Restricted Stock Awards*

Pursuant to the Omnibus Plan, restricted common shares were granted to a few key employees. These restricted stock awards vest ratably over a period of 12, 24 and 12 months following the grant date for the 2008, 2007 and 2006 restricted stock grants, respectively.

The following table summarizes the status of restricted stock awards as of December 31, 2008 and 2007 and changes during the year then ended:

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|  | <b>Number<br/>of Shares</b> | <b>Weighted-<br/>Average<br/>Fair Value</b> |
|--|-----------------------------|---|
| Restricted stock awards at January 1, 2007   | 21,364                      | \$4.65                                      |
| Granted                                      | 35,000                      | 4.53  |
| Vested                                       | (21,364)                    | 4.65  |
| Forfeited                                    | -0-                         | -0-   |
| Restricted stock awards at December 31, 2007 | 35,000                      | 4.53  |
| Granted                                      | 35,000                      | 0.70  |
| Vested                                       | -0-                         | -0-   |
| Forfeited                                    | -0-                         | -0-   |
| Restricted stock awards at December 31, 2008 | 70,000                      | \$2.62                                      |

During 2006, there were 21,364 restricted shares granted with a weighted-average fair value of \$4.65 per share.

We recognize compensation expense related to restricted stock awards on a straight-line basis over the vesting periods. Total compensation expense related to restricted stock awards was \$95,000, \$124,000 and \$25,000 for the years ended December 31, 2008, 2007 and 2006, respectively. As of December 31, 2008, there was \$39,000 of unrecognized compensation cost related to non-vested restricted stock awards. We expect to recognize all of that cost in 2009.

*Director and Key Employee Stock Option Awards*

During the fourth quarter of 2007, the Board of Directors decided that it would be in the best interest of the Company to conserve cash by modifying its then existing director compensation program which consisted of payments in the form of cash and fully vested stock to non-employee Directors. Under the prior model of the director compensation program, in consideration of their services to the Company, each non-employee member of the Board of Directors received, in addition to certain cash payments, an annual compensation grant of \$16,000 worth of fully-vested common shares. In addition, non-employee Directors received additional awards of common shares as compensation for attendance at Board and Committee meetings, as well as for chairing a Committee of the Board. Under the modified director compensation program, non-employee members of the Board of Directors receive fully vested common share options for the above mentioned services limited to an aggregate 42,000 common share options per quarter effective beginning with the fourth quarter of 2007. During 2008, the Board of Directors approved the annual grant of additional common share options (to be granted during the last quarter of the year) to Mr. Birch in connection with his position as Chairman. This annual grant is an amount equal to the difference between 50,000 and the number of options he has been granted during the year in connection with the standard board compensation program.

The following tables summarize the status of the director and key employee common share option awards as of December 31, 2008 and changes during the year then ended:

|                                   | <b>Director<br/>Options</b> | <b>Key<br/>Employee<br/>Options</b> | <b>Total<br/>Options</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> | <b>Weighted-Average<br/>Remaining<br/>Contractual<br/>Life</b> |
|-----------------------------------|-----------------------------|-------------------------------------|--------------------------|--|--|--|
| Outstanding at<br>January 1, 2008 | 42,000                      | -0-                                 | 42,000                   | \$ 2.20  | \$ (4,000)                               | 9.9 years  |
| Granted                           | 185,557                     | 295,000                             | 480,557                  | \$ 0.44  |  |  |
| Exercised                         | -0-                         | -0-                                 | -0-                      | -0-  |  |  |
| Cancelled                         | (19,841)                    | (25,000)                            | (44,841)                 | \$ 1.56  |  |  |
|                                   | 207,716                     | 270,000                             | 477,716                  | \$ 0.61  | \$ (191,000)                             | 9.5 years  |

Outstanding at  
December 31, 2008

Vested or expected to  
vest at December 31,  
2008

|         |         |         |    |      |    |           |           |
|---------|---------|---------|----|------|----|-----------|-----------|
| 207,716 | 270,000 | 477,716 | \$ | 0.61 | \$ | (191,000) | 9.5 years |
|---------|---------|---------|----|------|----|-----------|-----------|

Exercisable at  
December 31, 2008

|         |     |         |    |      |    |           |           |
|---------|-----|---------|----|------|----|-----------|-----------|
| 207,716 | -0- | 207,716 | \$ | 0.92 | \$ | (148,000) | 9.4 years |
|---------|-----|---------|----|------|----|-----------|-----------|

The Director common share options are fully vested and the key employee options vest one-third per year. Stock compensation expense of \$103,000 and \$10,000 related to the 2008 Director and key employee option

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grants, respectively, was recognized in 2008. As of December 31, 2008, there was \$68,000 of unrecognized compensation cost related to the non-vested key employee option awards. We expect to recognize all this cost by August 2011 when all the key employee options are expected to be fully vested.

During 2007, the Company granted 42,000 options to Directors at a strike price of \$2.20 per share. As a result, the Company recorded compensation expense of \$71,400 in the fourth quarter of 2007. There were no common share options exercised or cancelled in 2007 under the Omnibus Plan.

*Director common share awards*

During the year ended December 31, 2007, non-employee Directors were awarded 33,323 common shares. Stock compensation expense of \$136,000 was recorded in 2007 as a result of the common shares granted under the previous model of the director compensation program.

During the year ended December 31, 2006, non-employee Directors were awarded 25,104 common shares. Stock compensation expense of \$153,000 was recorded in 2006 as a result of the common shares granted under the previous model of the director compensation program.

**Share Option Plans (pre- Omnibus Plan)**

The Company has three original share option plans with unexpired options that may be exercised by the holders of such options. At December 31, 2008, the Company had reserved 1,141,583 common shares for the exercise of options outstanding and future option grants. The Company has granted 2,162,384 options to purchase common shares to employees, directors and others of which 1,432,551 have been previously exercised. There are 411,750 options to purchase common shares available for future grants; however, no future option grants are expected to be made under these share option plans. All future grants are expected to be made under the Company's Omnibus Plan or any successor plan. The weighted-average remaining contractual life of all options outstanding was 2.9 years as of December 31, 2008.

The Amended and Restated 1996 Outside Directors' Stock Option Plan, as amended (the 1996 Director Plan) was established by the Company to provide common share options as compensation to directors of the Company. This option plan terminated on September 20, 2006 and as a result no future option grants can be made from this plan. All options outstanding at the time of the termination of the 1996 Director Plan shall continue in full force and effect in accordance with and subject to the terms and conditions of the Plan. All compensation expense related to these common share options has been previously recognized by the Company. Vesting of options awarded under the 1996 Director Plan ranged from 6 to 36 months. All options granted under the 1996 Director Plan expire ten years after the grant date. At December 31, 2008 there were no options outstanding under the 1996 Director Plan.

The Amended and Restated 1996 Key Employees' and Consultants Stock Option Plan (the 1996 Plan) provides for the granting of options to purchase common shares to key employees and consultants of the Company and its affiliates. This option plan terminated on February 29, 2007 and as a result no future option grants can be made from this Plan. All options outstanding at the time of the termination of the 1996 Plan shall continue in full force and effect in accordance with and subject to the terms and conditions of the Plan. Vesting of options awarded under the 1996 Plan ranges from two to four years, as determined by the Board of Directors' Compensation Committee, and all options granted under the 1996 Plan expire ten years after the grant date. At December 31, 2008 there were 410,333 options outstanding under the 1996 Plan all of which were 100% vested. These options had a weighted-average remaining contractual life of 3.0 years and a weighted-average exercise price of \$3.22.

The Amended and Restated Outside Director Stock Option Plan (the Director Plan) provides for the granting of options to purchase common shares to outside directors of the Company. All compensation expense related to these common share options has been previously recognized by the Company. Options fully vest one year following the grant date. All options granted under the Director Plan expire ten years after the grant date. At December 31, 2008 there were 319,500 options outstanding under the Director Plan all of which were 100% vested. These options had a weighted-average contractual life of 2.8 years and a weighted-average exercise price of \$3.06.

The Company's share option activity for these plans and related information for the year ended December 31, 2008 is summarized below:

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|   | <b>Options</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> | <b>Weighted-Average<br/>Remaining<br/>Contractual<br/>Life</b> |
|---|----------------|--|--|--|
| Outstanding at January 1, 2008                  | 1,106,110      | \$ 3.31  |  |  |
| Granted   | -0-            | -0-  |  |  |
| Exercised                                       | -0-            | -0-  |  |  |
| Cancelled                                       | (376,277)      | (3.61)   |  |  |
| Outstanding at December 31, 2008                | 729,833        | \$ 3.15  | \$ (2,148,000)                           | 2.9 Years  |
| Vested or expected to vest at December 31, 2008 | 729,833        | \$ 3.15  | \$ (2,148,000)                           | 2.9 Years  |
| Exercisable at December 31, 2008                | 729,833        | \$ 3.15  | \$ (2,148,000)                           | 2.9 Years  |

Total compensation expense recognized to these share options plans was \$54,000, \$160,000 and \$388,000 in 2008, 2007 and 2006, respectively.

There were no options granted under these share option plans in 2007. During 2007, options totaling 99,783 were exercised at a weighted-average price of \$2.74 per share and had an aggregate intrinsic value of \$133,000. Also during 2007, there were 184,556 options cancelled at a weighted-average of \$5.20 per share.

**Stock Option Valuation Method and Assumptions**

We estimate the fair-value of stock options using the Black-Scholes valuation model. Significant assumptions used in the model are: (i) expected volatility based on the historical volatility of our common stock prices, (ii) risk-free interest rate based on the U.S. Treasury yield curve in effect at the time of the grant and (iii) expected term of the option based on past history of the average time from the grant date to the option exercise date.

The fair-value of stock option awards were calculated at their respective grant dates using the Black-Scholes model which incorporated the following assumptions:

|                          | December 31,<br>2008 | December 31,<br>2007 |
|--------------------------|----------------------|----------------------|
| Expected volatility      | 84.1% to 86.3%       | 84.0%                |
| Risk-free interest rate  | 3.36% to 3.78%       | 4.28%                |
| Expected term (in years) | 7 years              | 7 years              |
| Expected dividend yield  | 0.0%                 | 0.0%                 |

The Company began granting options under the Omnibus Plan in the fourth quarter of 2007.

**15. Retirement Savings Plan**

The Company sponsors The DATATRAK International, Inc. Retirement Savings Plan (the Plan) as defined by Section 401(k) of the Internal Revenue Code of 1986, as amended. The Plan covers substantially all United States employees who elect to participate. Participants may contribute their annual compensation into a variety of mutual fund options. Matching and profit sharing contributions by the Company are discretionary. The Company did not make any matching or profit sharing contributions in 2008 or 2007.

**16. Net Loss Per Share**

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

|  | <b>Year Ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2008</b>                    | <b>2007</b> | <b>2006</b> |

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|   |      |                 |                 |                |
|---|------|-----------------|-----------------|----------------|
| Net loss used in the calculation of basic and diluted loss per share                |      | \$ (16,796,605) | \$ (10,853,503) | \$ (4,490,410) |
| Denominator for basic net loss per share weighted-average common shares outstanding |      | 13,681,901      | 13,197,706      | 11,273,382     |
|   | F-23 |                 |                 |                |

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|  | <b>Year Ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2008</b>                    | <b>2007</b> | <b>2006</b> |
| Effect of dilutive common share options and warrants   |                                |             |             |
| Denominator for diluted net loss per share   | 13,681,901                     | 13,197,706  | 11,273,382  |
| Basic net loss per share   | \$ (1.23)                      | \$ (0.82)   | \$ (0.40)   |
| Diluted net loss per share   | \$ (1.23)                      | \$ (0.82)   | \$ (0.40)   |
| 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 | 1,547,615                      | 1,680,505   | 1,721,305   |

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**Table of Contents****17. Segment Information**

The Company operates in one business segment: the eClinical solutions business.

*Enterprise-Wide Disclosures*

*Geographic Information*

| <b>Year Ended December 31,</b>         | <b>United States</b> | <b>Germany</b> | <b>Total</b>   |
|--|----------------------|----------------|----------------|
| Revenue from external customers:       |                      |                |                |
| 2008                                   | \$ 8,826,060         | \$             | \$ 8,826,060   |
| 2007                                   | 10,561,868           |                | 10,561,868     |
| 2006                                   | 17,690,336           |                | 17,690,336     |
| Net income (loss):                     |                      |                |                |
| 2008                                   | \$(14,800,200)       | \$(1,996,405)  | \$(16,796,605) |
| 2007                                   | (6,216,583)          | (4,636,920)    | (10,853,503)   |
| 2006                                   | 340,921              | (4,831,331)    | (4,490,410)    |
| Long-lived assets, net at December 31, |                      |                |                |
| 2008                                   | \$ 785,549           | \$             | \$ 785,549     |
| 2007                                   | 14,770,246           | 141,124        | 14,911,370     |

*Major Customers*

The following sets forth the percentage of revenue generated by customers who accounted for more than 10% of the Company's revenue during each of the periods presented:

| <b>Customer</b>           | <b>2008</b> | <b>2007</b> | <b>2006</b> |
|---------------------------|-------------|-------------|-------------|
| Otsuka Research Institute | *           | 15%         | 44%         |
| Gilead Sciences, Inc.     | 18%         | 14%         | *           |
| Allergan, Inc.            | *           | 12%         | *           |
| Seattle Genetics, Inc.    | 15%         | *           | *           |

\* Less than 10% of revenue.

**18. Restricted Cash**

The Company's wholly owned subsidiary, DATATRAK Deutschland GmbH ( Deutschland GmbH ), was 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 Deutschland GmbH to maintain a restricted cash balance of 59,000 Euros with the bank. In 2008, Deutschland GmbH closed its office in Germany. In addition, Deutschland GmbH defaulted on its office lease agreement and the German landlord exercised its claim on the restricted cash reserve. Therefore, the Company wrote off the restricted cash balance of 59,000 Euros in 2008. Long-term restricted cash balances were \$0 at December 31, 2008 and \$87,000 at December 31, 2007.

Effective January 31, 2009, DATATRAK, Inc., a wholly owned subsidiary of the Company, terminated its non-exclusive Marketing Service Agreement ( Agreement ) with DATATRAK Deutschland GmbH ( Deutschland GmbH ) and DATATRAK Inc. As of December 31, 2008, Deutschland GmbH recorded accrued expenses for lease and other obligations incurred through January 31, 2009 totaling \$218,000. As a result of the termination of the Agreement, Deutschland GmbH was required under applicable German law to file a petition for voluntary bankruptcy in the German courts and has on hand \$218,000, designated as restricted cash, to fund these liabilities as of December 31, 2008.

**Table of Contents****19. Quarterly Data (Unaudited)**

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

|                                     | <b>Year Ended December 31, 2008</b> |                           |                          |                           |
|-------------------------------------|-------------------------------------|---------------------------|--------------------------|---------------------------|
|                                     | <b>First<br/>Quarter</b>            | <b>Second<br/>Quarter</b> | <b>Third<br/>Quarter</b> | <b>Fourth<br/>Quarter</b> |
| Revenue                             | \$ 2,088                            | \$ 2,249                  | \$ 2,367                 | \$2,122                   |
| Gross profit                        | 1,155                               | 1,350                     | 1,799                    | 1,689                     |
| Loss from operations (1)            | (2,225)                             | (15,572)                  | (1,567)                  | (109)                     |
| Net income (loss) (2)               | (2,233)                             | (16,000)                  | (1,599)                  | 3,035                     |
| Basic net income (loss) per share   | (0.16)                              | (1.17)                    | (0.12)                   | 0.22                      |
| Diluted net income (loss) per share | (0.16)                              | (1.17)                    | (0.12)                   | 0.22                      |

(1) Second quarter loss from operations included a \$12.8 million impairment loss.

(2) Fourth quarter net income included a \$3.0 million reversal of the ClickFind debt obligation.

During the first, second, third and fourth quarters of 2008, the Company recorded charges of \$26,000, \$579,000, \$47,000 and \$123,000, respectively for severance benefits due to terminated employees. These charges were primarily related to staff reductions of 26 employees.

|                            | <b>Year Ended December 31, 2007</b> |                           |                          |                           |
|----------------------------|-------------------------------------|---------------------------|--------------------------|---------------------------|
|                            | <b>First<br/>Quarter</b>            | <b>Second<br/>Quarter</b> | <b>Third<br/>Quarter</b> | <b>Fourth<br/>Quarter</b> |
| Revenue                    | \$ 3,542                            | \$ 3,065                  | \$ 2,116                 | \$ 1,839                  |
| Gross profit               | 2,205                               | 1,845                     | 1,055                    | 874                       |
| Loss from operations       | (1,840)                             | (2,999)                   | (3,497)                  | (2,632)                   |
| Net loss                   | (1,895)                             | (2,966)                   | (3,506)                  | (2,487)                   |
| Basic net loss per share   | (0.16)                              | (0.22)                    | (0.26)                   | (0.18)                    |
| Diluted net loss per share | (0.16)                              | (0.22)                    | (0.26)                   | (0.18)                    |

During the second, third and fourth quarters of 2007, the Company recorded charges of \$337,000, \$386,000 and \$192,000, respectively for severance benefits due to terminated employees. These charges were related to staff reductions of 45 employees.

**20. 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. In July 2007, the Company settled its litigation related to Datasci s

patent infringement claim with no liability against the Company.

**21. Subsequent Event**

In January of 2009 we announced the retirement of our Chief Executive Officer, Dr. Jeffrey A. Green. The Company will record a severance charge of approximately \$463,000 in the first quarter of 2009 related to Dr. Green's retirement which is expected to be paid over a two-year period.

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**Table of Contents****Exhibit Index**

| <b>Exhibit No.</b> | <b>Description</b>   | <b>Page</b> |
|--------------------|--|-------------|
| 2.1                | Agreement and Plan of Merger among DATATRAK International, Inc., CF Merger Sub, Inc., ClickFind, Inc., each of the shareholders of ClickFind, Inc and Jim Bob Ward, dated February 13, 2006                    | (10)        |
| 3.1                | Sixth Amended and Restated Articles of Incorporation   | (1)         |
| 3.2                | Third Amended and Restated Code of Regulations   | (2)         |
| 3.3                | Amendment to the Third Amended and Restated Code of Regulations  | (2)         |
| 3.4                | Amendment to the Third Amended and Restated Code of Regulations  | (1)         |
| 3.5                | Amendment to the Third Amended and Restated Code of Regulations  | (15)        |
| 4.1                | Specimen Certificate of the Company's Common Shares, without par value   | (5)         |
| 4.3                | Registration Rights Agreement among DATATRAK International, Inc. and the Cash and Securities Recipients, dated February 13, 2006   | (10)        |
| 4.4                | Rights Agreement, dated September 5, 2007, by and among the Company and National City Bank, as Rights Agent, which includes the Form of Rights Certificate as Exhibit A and the summary of Rights as Exhibit B | (14)        |
| 4.6                | Form of Warrant, dated March 19, 2007  | (13)        |
| 10.1               | Amended and Restated 1996 Outside Directors' Stock Option Plan*  | (4)         |
| 10.2               | Amendment No. 1 to the Amended and Restated 1996 Outside Directors' Stock Option Plan*   | (2)         |
| 10.3               | Amendment No. 2 to the Amended and Restated 1996 Outside Directors' Stock Option Plan*   | (2)         |
| 10.4               | Amendment to the Amended and Restated 1996 Outside Directors' Stock Option Plan*   | (2)         |
| 10.5               | DATATRAK International, Inc. 2005 Omnibus Equity Plan*   | (9)         |
| 10.6               | Amendment No. 1 to the DATATRAK International, Inc. 2005 Omnibus Equity Plan*  | (15)        |
| 10.7               | Amendment No. 2 to the DATATRAK International, Inc. 2005 Omnibus Equity Plan*  | (16)        |
| 10.8               | Amended and Restated 1996 Key Employees' and Consultants Stock Option Plan*  | (4)         |
| 10.9               | Amendment No. 1 to the Amended and Restated 1996 Key Employees' and Consultants Stock Option Plan*   | (2)         |
| 10.10              | Amendment No. 2 to the Amended and Restated 1996 Key Employees' and Consultants Stock Option Plan*   | (2)         |

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|       |  |      |
|-------|--|------|
| 10.11 | Amendment No. 3 to the Amended and Restated 1996 Key Employees and Consultants Stock Option Plan*      | (2)  |
| 10.12 | Amendment to the Amended and Restated 1996 Key Employees and Consultants Stock Option Plan*            | (2)  |
| 10.13 | Amended and Restated Outside Director Stock Option Plan*   | (8)  |
| 10.14 | Form of Indemnification Agreement*   | (3)  |
| 10.15 | Employment Agreement between the Company and Jeffrey A. Green, dated February 5, 2001*                 | (11) |
| 10.16 | Employment Agreement between the Company and Raymond J. Merk, dated April 14, 2008*                    | (17) |
| 10.17 | Employment Agreement between the Company and G. Matthew Delaney, dated June 16, 2008*                  | (15) |
| 10.18 | Separation Agreement and Release of Claims between the Company and Terry C. Black, dated July 7, 2008* | (18) |

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**Table of Contents**

| <b>Exhibit No.</b> | <b>Description</b>   | <b>Page</b>       |
|--------------------|--|-------------------|
| 10.19              | Separation Agreement and Release of Claims between the Company and Jeffrey A. Green, dated January 20, 2009*                   | (19)              |
| 10.20              | Form of Non-Qualified Stock Option Agreement for Employees   | (16)              |
| 10.21              | Employment Agreement between the Company and Jim Bob Ward, dated February 13, 2006*  | (10)              |
| 10.22              | Amendment to Employment Agreement between the Company and Jim Bob Ward, dated December 17, 2008 *                              | Filed<br>herewith |
| 10.23              | DATATRAK International, Inc. Retirement Savings Plan*  | (6)               |
| 10.24              | Limited Software License Agreement between DATATRAK International, Inc. and Jim Bob Ward, dated February 13, 2006              | (10)              |
| 10.25              | Security Agreement with KeyBank National Association and related Demand Master Promissory Note, each dated August 31, 2006     | (12)              |
| 10.26              | Securities Purchase Agreement by and among the Company and the Purchasers named on Schedule A(3) thereto, dated March 16, 2007 | (13)              |
| 14.1               | Code of Business Conduct and Ethics  | (12)              |
| 14.2               | Financial Code of Ethics   | (7)               |
| 21.1               | Subsidiaries of the Company  |                   |
| 23.1               | Consent of Ernst & Young LLP   | (20)              |
| 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  |                   |

\* Management compensatory plan or arrangement.

(1) Incorporated herein by reference to the Company's Form

10-Q for the  
quarter ended  
June 30, 2003  
(File  
No. 000-20699).

(2) Incorporated  
herein by  
reference to the  
Company's Form  
10-K for the year  
ended  
December 31,  
2002 (File  
No. 000-20699).

(3) Incorporated  
herein by  
reference to the  
Company's Form  
S-1 Registration  
Statement filed  
on March 8,  
1996, as  
amended by  
Amendment  
No. 1 filed on  
May 10, 1996  
and as amended  
by Amendment  
No. 2 filed on  
June 10, 1996  
(File  
No. 333-2140).

(4) Incorporated  
herein by  
reference to the  
Company's Form  
S-8 Registration  
Statement filed  
on November 13,  
1996 (File  
No. 333-16061).

(5) Incorporated  
herein by  
reference to the  
Company's Form  
10-K for the year  
ended

December 31,  
2004 (File  
No. 000-20699).

(6) Incorporated  
herein by  
reference to the  
Company's Form  
S-8 Registration  
Statement filed  
on April 30,  
1997 (File  
No. 333-26251).

(7) Incorporated  
herein by  
reference to the  
Company's Form  
10-K for the year  
ended  
December 31,  
2003 (File  
No. 000-20699).

(8) Incorporated  
herein by  
reference to the  
Company's Form  
10-Q for the  
quarter ended  
June 30, 2004  
(File  
No. 000-20699).

(9) Incorporated  
herein by  
reference to the  
Company's  
current report on  
Form 8-K dated  
July 22, 2005  
(File  
No. 000-20699).

(10) Incorporated  
herein by  
reference to the  
Company's  
current report on  
Form 8-K dated  
February 13

2006 (File  
No. 000-20699).

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(11) Incorporated herein by reference to the Company's Form 10-K for the year ended December 31, 2005 (File No. 000-20699).

(12) Incorporated herein by reference to the Company's Form 10-K for the year ended December 31, 2006 (File No. 000-20699).

(13) Incorporated herein by reference to the Company's current report on Form 8-K dated March 20, 2007 (File No. 000-20699).

(14) Incorporated herein by reference to the Company's current report on Form 8-K dated September 11, 2007 (File No. 000-20699).

(15) Incorporated herein by reference to the Company's Form 10-Q for the quarter ended June 30, 2008 (File No. 000-20699).

- (16) Incorporated herein by reference to the Company's Form 10-Q for the quarter ended September 30, 2008 (File No. 000-20699).
- (17) Incorporated herein by reference to the Company's Form 10-Q for the quarter ended March 31, 2008 (File No. 000-20699).
- (18) Incorporated herein by reference to the Company's Form 8-K dated July 10, 2008 (File No. 000-20699).
- (19) Incorporated herein by reference to the Company's Form 8-K dated January 20, 2009 (File No. 000-20699).
- (20) Consent of Independent Registered Public Accounting Firm