

Medidata Solutions, Inc.  
Form 10-Q  
November 08, 2011  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**FORM 10-Q**

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended September 30, 2011

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: 001-34387

**Medidata Solutions, Inc.**

(Exact name of registrant as specified in its charter)

|                                                                                                                |                                                              |
|----------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------|
| <b>Delaware</b><br>(State or other jurisdiction of<br>incorporation or organization)                           | <b>13-4066508</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>79 Fifth Avenue, 8th Floor</b><br><br><b>New York, New York</b><br>(Address of principal executive offices) | <b>10003</b><br>(Zip Code)                                   |
| <b>(212) 918-1800</b><br>(Registrant's telephone number, including area code)                                  |                                                              |

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

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ☒ Yes ☐ No

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 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 Rule 12b-2 of the Exchange Act). ☐ Yes ☒ No

As of November 1, 2011, the registrant had 24,780,126 shares of common stock outstanding.

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**MEDIDATA SOLUTIONS, INC.**

**QUARTERLY REPORT ON FORM 10-Q**

**For the quarterly period ended September 30, 2011**

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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)**  
**MEDIDATA SOLUTIONS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)**

(Amounts in thousands, except per share data)

|                                                                                              | September 30,<br>2011 | December 31,<br>2010 |
|----------------------------------------------------------------------------------------------|-----------------------|----------------------|
| <b>ASSETS</b>                                                                                |                       |                      |
| Current assets:                                                                              |                       |                      |
| Cash and cash equivalents                                                                    | \$ 26,049             | \$ 16,025            |
| Marketable securities                                                                        | 76,646                | 69,473               |
| Accounts receivable, net of allowance for doubtful accounts of \$750 and \$308, respectively | 19,456                | 34,268               |
| Prepaid commission expense                                                                   | 1,798                 | 3,087                |
| Prepaid expenses and other current assets                                                    | 6,064                 | 6,297                |
| Deferred income taxes                                                                        | 3,901                 | 3,731                |
| Total current assets                                                                         | 133,914               | 132,881              |
| Restricted cash                                                                              | 388                   | 532                  |
| Furniture, fixtures and equipment, net                                                       | 8,955                 | 10,993               |
| Goodwill                                                                                     | 15,360                | 9,799                |
| Intangible assets, net                                                                       | 3,889                 | 2,945                |
| Other assets                                                                                 | 3,028                 | 795                  |
| Total assets                                                                                 | \$ 165,534            | \$ 157,945           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                  |                       |                      |
| Current liabilities:                                                                         |                       |                      |
| Accounts payable                                                                             | \$ 2,483              | \$ 2,797             |
| Accrued payroll and other compensation                                                       | 8,612                 | 11,520               |
| Accrued expenses and other                                                                   | 3,866                 | 4,058                |
| Deferred revenue                                                                             | 51,554                | 63,228               |
| Capital lease obligations                                                                    | 173                   | 712                  |
| Total current liabilities                                                                    | 66,688                | 82,315               |
| Noncurrent liabilities:                                                                      |                       |                      |
| Deferred revenue, less current portion                                                       | 14,066                | 20,540               |
| Deferred tax liabilities                                                                     | 3,904                 | 3,418                |
| Capital lease obligations, less current portion                                              | 2                     | 68                   |
| Other long-term liabilities                                                                  | 2,254                 | 478                  |
| Total noncurrent liabilities                                                                 | 20,226                | 24,504               |
| Total liabilities                                                                            | 86,914                | 106,819              |
| Commitments and contingencies                                                                |                       |                      |
| Stockholders' equity:                                                                        |                       |                      |

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|                                                                                                                                                          |                   |                   |
|----------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|-------------------|
| Preferred stock, par value \$0.01 per share; 5,000 shares authorized, none issued and outstanding                                                        |                   |                   |
| Common stock, par value \$0.01 per share; 100,000 shares authorized, 24,915 and 24,141 shares issued; 24,766 and 24,089 shares outstanding, respectively |                   |                   |
|                                                                                                                                                          | 249               | 241               |
| Additional paid-in capital                                                                                                                               | 130,682           | 122,015           |
| Treasury stock, 149 and 52 shares, respectively                                                                                                          | (2,186)           | (474)             |
| Accumulated other comprehensive loss                                                                                                                     | (251)             | (117)             |
| Accumulated deficit                                                                                                                                      | (49,874)          | (70,539)          |
| <b>Total stockholders' equity</b>                                                                                                                        | <b>78,620</b>     | <b>51,126</b>     |
| <b>Total liabilities and stockholders' equity</b>                                                                                                        | <b>\$ 165,534</b> | <b>\$ 157,945</b> |

The accompanying notes are an integral part of the condensed consolidated financial statements.

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**Table of Contents****MEDIDATA SOLUTIONS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**

(Amounts in thousands, except per share data)

|                                                                                                                   | <b>Three Months Ended<br/>September 30,</b> |                 | <b>Nine Months Ended<br/>September 30,</b> |                 |
|-------------------------------------------------------------------------------------------------------------------|---------------------------------------------|-----------------|--------------------------------------------|-----------------|
|                                                                                                                   | <b>2011</b>                                 | <b>2010</b>     | <b>2011</b>                                | <b>2010</b>     |
| <b>Revenues</b>                                                                                                   |                                             |                 |                                            |                 |
| Application services                                                                                              | \$ 35,940                                   | \$ 34,522       | \$ 108,372                                 | \$ 96,414       |
| Professional services                                                                                             | 10,365                                      | 6,580           | 28,892                                     | 22,643          |
| <b>Total revenues</b>                                                                                             | <b>46,305</b>                               | <b>41,102</b>   | <b>137,264</b>                             | <b>119,057</b>  |
| <b>Cost of revenues(1)(2)</b>                                                                                     |                                             |                 |                                            |                 |
| Application services                                                                                              | 7,279                                       | 6,738           | 21,471                                     | 19,132          |
| Professional services                                                                                             | 6,224                                       | 6,470           | 18,476                                     | 19,471          |
| <b>Total cost of revenues</b>                                                                                     | <b>13,503</b>                               | <b>13,208</b>   | <b>39,947</b>                              | <b>38,603</b>   |
| <b>Gross profit</b>                                                                                               | <b>32,802</b>                               | <b>27,894</b>   | <b>97,317</b>                              | <b>80,454</b>   |
| <b>Operating costs and expenses:</b>                                                                              |                                             |                 |                                            |                 |
| Research and development(1)                                                                                       | 7,306                                       | 6,450           | 21,511                                     | 19,464          |
| Sales and marketing(1)(2)                                                                                         | 8,788                                       | 7,493           | 26,519                                     | 22,913          |
| General and administrative(1)                                                                                     | 9,140                                       | 7,905           | 27,522                                     | 24,679          |
| <b>Total operating costs and expenses</b>                                                                         | <b>25,234</b>                               | <b>21,848</b>   | <b>75,552</b>                              | <b>67,056</b>   |
| <b>Operating income</b>                                                                                           | <b>7,568</b>                                | <b>6,046</b>    | <b>21,765</b>                              | <b>13,398</b>   |
| <b>Interest and other income (expense):</b>                                                                       |                                             |                 |                                            |                 |
| Interest expense                                                                                                  | (30)                                        | (48)            | (97)                                       | (195)           |
| Interest income                                                                                                   | 64                                          | 95              | 227                                        | 288             |
| Other income, net                                                                                                 | 244                                         | 25              | 242                                        | 158             |
| <b>Total interest and other income, net</b>                                                                       | <b>278</b>                                  | <b>72</b>       | <b>372</b>                                 | <b>251</b>      |
| <b>Income before income taxes</b>                                                                                 | <b>7,846</b>                                | <b>6,118</b>    | <b>22,137</b>                              | <b>13,649</b>   |
| <b>Provision for income taxes</b>                                                                                 | <b>364</b>                                  | <b>1,454</b>    | <b>1,472</b>                               | <b>4,156</b>    |
| <b>Net income</b>                                                                                                 | <b>\$ 7,482</b>                             | <b>\$ 4,664</b> | <b>\$ 20,665</b>                           | <b>\$ 9,493</b> |
| <b>Earnings per share:</b>                                                                                        |                                             |                 |                                            |                 |
| Basic                                                                                                             | \$ 0.32                                     | \$ 0.20         | \$ 0.88                                    | \$ 0.41         |
| Diluted                                                                                                           | \$ 0.31                                     | \$ 0.20         | \$ 0.84                                    | \$ 0.40         |
| <b>Weighted average common shares outstanding:</b>                                                                |                                             |                 |                                            |                 |
| Basic                                                                                                             | 23,752                                      | 23,019          | 23,579                                     | 22,878          |
| Diluted                                                                                                           | 24,491                                      | 23,856          | 24,683                                     | 23,738          |
| (1) Stock-based compensation expense included in cost of revenues and operating costs and expenses is as follows: |                                             |                 |                                            |                 |
| Cost of revenues                                                                                                  | \$ 361                                      | \$ 240          | \$ 922                                     | \$ 525          |
| Research and development                                                                                          | 226                                         | 150             | 523                                        | 378             |
| Sales and marketing                                                                                               | 553                                         | 398             | 1,464                                      | 1,060           |

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|                                                                                                                            |          |          |          |          |
|----------------------------------------------------------------------------------------------------------------------------|----------|----------|----------|----------|
| General and administrative                                                                                                 | 1,297    | 1,059    | 3,564    | 2,692    |
| Total stock-based compensation                                                                                             | \$ 2,437 | \$ 1,847 | \$ 6,473 | \$ 4,655 |
| (2) Amortization expense of intangible assets included in cost of revenues and operating costs and expenses is as follows: |          |          |          |          |
| Cost of revenues                                                                                                           | \$ 318   | \$ 277   | \$ 770   | \$ 831   |
| Sales and marketing                                                                                                        | 126      | 88       | 374      | 264      |
| Total amortization of intangible assets                                                                                    | \$ 444   | \$ 365   | \$ 1,144 | \$ 1,095 |

The accompanying notes are an integral part of the condensed consolidated financial statements.

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**Table of Contents****MEDIDATA SOLUTIONS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

(Amounts in thousands)

|                                                                                   | <b>Nine Months Ended<br/>September 30,</b> |             |
|-----------------------------------------------------------------------------------|--------------------------------------------|-------------|
|                                                                                   | <b>2011</b>                                | <b>2010</b> |
| Cash flows from operating activities:                                             |                                            |             |
| Net income                                                                        | \$ 20,665                                  | \$ 9,493    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                            |             |
| Depreciation and amortization                                                     | 5,902                                      | 7,045       |
| Stock-based compensation                                                          | 6,473                                      | 4,655       |
| Amortization of discounts or premiums on marketable securities                    | 944                                        | 887         |
| Deferred income taxes                                                             | (113)                                      | 44          |
| Amortization of debt issuance costs                                               | 45                                         | 42          |
| Excess tax benefit associated with equity awards                                  |                                            | (827)       |
| Changes in operating assets and liabilities:                                      |                                            |             |
| Accounts receivable                                                               | 14,949                                     | (2,981)     |
| Prepaid commission expense                                                        | 785                                        | 199         |
| Prepaid expenses and other current assets                                         | 318                                        | (2,391)     |
| Other assets                                                                      | (509)                                      | 2           |
| Accounts payable                                                                  | (251)                                      | (57)        |
| Accrued payroll and other compensation                                            | (2,920)                                    | (1,635)     |
| Accrued expenses and other                                                        | (26)                                       | 153         |
| Deferred revenue                                                                  | (19,963)                                   | (7,315)     |
| Other long-term liabilities                                                       | (43)                                       | 71          |
| Net cash provided by operating activities                                         | 26,256                                     | 7,385       |
| Cash flows from investing activities:                                             |                                            |             |
| Purchases of furniture, fixtures and equipment                                    | (2,896)                                    | (5,609)     |
| Purchases of available-for-sale securities                                        | (93,918)                                   | (65,169)    |
| Proceeds from sale of available-for-sale securities                               | 85,712                                     | 43,363      |
| Acquisition of business, net of cash acquired                                     | (5,166)                                    |             |
| Decrease in restricted cash                                                       | 144                                        |             |
| Net cash used in investing activities                                             | (16,124)                                   | (27,415)    |
| Cash flows from financing activities:                                             |                                            |             |
| Proceeds from exercise of stock options                                           | 2,202                                      | 1,003       |
| Excess tax benefit associated with equity awards                                  |                                            | 827         |
| Repayment of obligations under capital leases                                     | (605)                                      | (2,385)     |
| Acquisition of treasury stock                                                     | (1,712)                                    | (405)       |
| Payment of debt issuance costs                                                    |                                            | (21)        |
| Net cash used in financing activities                                             | (115)                                      | (981)       |
| Net increase (decrease) in cash and cash equivalents                              | 10,017                                     | (21,011)    |
| Effect of exchange rate changes on cash and cash equivalents                      | 7                                          | (13)        |
| Cash and cash equivalents Beginning of period                                     | 16,025                                     | 39,449      |
| Cash and cash equivalents End of period                                           | \$ 26,049                                  | \$ 18,425   |

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### Supplemental disclosures of cash flow information:

#### Cash paid during the period for:

|          |    |    |    |     |
|----------|----|----|----|-----|
| Interest | \$ | 40 | \$ | 147 |
|----------|----|----|----|-----|

|              |    |       |    |       |
|--------------|----|-------|----|-------|
| Income taxes | \$ | 1,524 | \$ | 2,745 |
|--------------|----|-------|----|-------|

#### Noncash activities:

|                                                                               |    |     |    |     |
|-------------------------------------------------------------------------------|----|-----|----|-----|
| Furniture, fixtures and equipment acquired but not yet paid for at period-end | \$ | 214 | \$ | 812 |
|-------------------------------------------------------------------------------|----|-----|----|-----|

|                                                                                 |    |       |    |  |
|---------------------------------------------------------------------------------|----|-------|----|--|
| Contingent consideration associated with acquisition of business, at fair value | \$ | 1,819 | \$ |  |
|---------------------------------------------------------------------------------|----|-------|----|--|

The accompanying notes are an integral part of the condensed consolidated financial statements.

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### **MEDIDATA SOLUTIONS, INC.**

#### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

##### **1. ORGANIZATION**

Medidata Solutions, Inc. ( Medidata or the Company ) provides software-as-a-service ( SaaS ) clinical technology solutions that enhance the efficiency of its customers' clinical development processes. The Company's solutions allow its customers to optimize clinical development efforts by streamlining the design, planning and management of key aspects of the clinical development process, including study and protocol design, trial planning and budgeting, site negotiation, clinical portal, trial management, randomization and trial supply management, clinical data capture and management, safety events capture, medical coding and business analytics.

##### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Except to the extent updated or described below, the Company's significant accounting policies as of September 30, 2011 are the same as those at December 31, 2010, which are included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission ( SEC ) on March 16, 2011.

**Basis of Presentation** The accompanying interim condensed consolidated balance sheets as of September 30, 2011 and December 31, 2010, the condensed consolidated statements of operations for the three and nine months ended September 30, 2011 and 2010, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2011 and 2010 are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) and applicable rules and regulations of the SEC for interim financial reporting. Accordingly, certain information and footnote disclosures have been condensed or omitted pursuant to SEC rules that would ordinarily be required by GAAP for complete financial statements. These unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes thereto for the fiscal year ended December 31, 2010 included in the Company's Annual Report on Form 10-K filed with the SEC on March 16, 2011.

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, reflect all adjustments consisting of normal recurring accruals considered necessary to present fairly the Company's financial position as of September 30, 2011, results of its operations for the three and nine months ended September 30, 2011 and 2010 and cash flows for the nine months ended September 30, 2011 and 2010. The results of operations for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

**Revenue Recognition** The Company derives its revenues from the sale of application services and the rendering of professional services. The Company recognizes revenue when all of the following conditions are satisfied: (1) persuasive evidence of an arrangement exists; (2) service has been delivered to the customer; (3) amount of the fees to be paid by the customer is fixed or determinable; and (4) collection of the fees is reasonably assured or probable.

##### ***Application Services***

The Company typically enters into multi-study and single-study arrangements that include the sale of software licenses that provide the customer the right to use the software, as well as hosting and other support services, to be provided over a specified term. Multi-study arrangements grant the customer the right to manage a predetermined number of clinical trials simultaneously for a term typically ranging from three to five years. Single-study arrangements allow customers to use the Company's technology on a per clinical trial basis.

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### **MEDIDATA SOLUTIONS, INC.**

#### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)**

The Company provides its software as a service and recognizes revenues in accordance with Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) 605-10-S99, *Revenue Recognition SEC Materials*. Revenues from application service arrangements are recognized ratably over the term of the arrangement, beginning with the commencement of the arrangement term, which correlates with the activation of the hosting services, assuming all other revenue recognition criteria are met. The term of the arrangement includes optional renewal periods, if such renewal periods are likely to be exercised.

Revenue for multi-study arrangements and several of the Company's trial planning software solutions where the customer has the ability to self host, or the customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty and it is feasible for the customer to either run the software on its own hardware or contract with another unrelated party to host the software, is recognized in accordance with ASC 985-605, *Software Revenue Recognition*.

#### ***Professional Services***

The Company also provides a range of professional services that its customers have the ability to utilize on an as-needed basis. These services generally include training, implementation, interface creation, trial configuration, data testing, reporting, procedure documentation and other customer-specific services. Professional services do not result in significant alterations to the underlying software.

In certain situations, when professional services are sold separate and apart from application services, they are recognized as services are rendered or using a proportional performance method based on services performed for fixed fee professional services.

#### ***Multiple-Element Arrangements***

The Company may also enter into arrangements to provide a combination of its offerings of application services and professional services.

In October 2009, the FASB issued Accounting Standards Update ( ASU ) No. 2009-13, *Multiple Deliverable Revenue Arrangements*. ASU No. 2009-13 amends the current guidance on arrangements with multiple deliverables under ASC 605-25, *Revenue Recognition Multiple-Element Arrangements*, to:

eliminate the separation criterion that requires entities to establish objective and reliable evidence of fair value for undelivered elements;

eliminate the residual allocation method which will be replaced by the relative selling price allocation method for all arrangements; and

establish a selling price hierarchy to help entities allocate arrangement consideration to the separate units of account. The selling price hierarchy is defined as follows:

Vendor-specific objective evidence ( VSOE ) the price charged for a deliverable when it is sold separately.

Third-party evidence ( TPE ) the price of the vendor's or any competitor's largely interchangeable products or services in standalone sales to similarly situated customers.

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Estimated selling price ( ESP ) the price best estimated by the vendor and at which the vendor would transact if the deliverable would have been sold by the vendor regularly on a standalone basis.

The Company adopted ASU No. 2009-13 on January 1, 2011. As a result, the revenues for the majority of the Company's multiple-element arrangements entered into or materially modified in 2011 are recognized in accordance with the provisions under ASU No. 2009-13.

To qualify as a separate unit of accounting under ASU No. 2009-13, the delivered item must have value to the customer on a standalone basis. The significant deliverables under the Company's multiple-element arrangements are application services and professional services.

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### **MEDIDATA SOLUTIONS, INC.**

#### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)**

The Company determined that the application services have standalone value as such services are often sold separately without professional services. Since the Company provides SaaS application services, the service components, including license, hosting and support, are combined and accounted for as a separate unit of accounting. The Company uses ESP to determine the selling pricing for application services when sold in multiple-element arrangements, as the Company does not have VSOE for these application services and TPE is not a practical alternative due to differences in features and functionality as compared with other companies' offerings.

The Company also determined that the professional services have standalone value because those services are sold separately by other vendors. The Company uses ESP to determine the selling price for professional services when sold in multiple-element arrangements, as the Company does not have sufficient reliable pricing data to establish VSOE and TPE is not a practical alternative due to the incompatibility of its services with other vendors.

The Company determines its single-point ESP for application services and professional services as follows:

**Application services** – the Company has developed an internal pricing tool that provides price quotes for application services configurations. Any new and potential customer application service arrangements must be priced through the utilization of the Company's internal pricing tool. The Company has established an internal committee to monitor compliance and evaluate pricing data on a periodic basis. This evaluation includes the review of actual historical pricing data, market conditions consideration and the review of pricing strategies and practices. Any necessary pricing modification made to the internal pricing tool is supported by the result of such evaluation. Accordingly, the Company's ESP for application services is obtained from this internal pricing tool.

**Professional services** – the Company evaluates internal historic professional services pricing data to determine average pricing rates by type of professional services rendered. These averages are utilized to determine ESP for professional services, and are reviewed and updated at least annually.

The Company believes the effect of changes in either the selling price, or the method, or assumptions used to determine ESP for application services and professional services will not have significant effect on the allocation of the arrangement consideration as the ESP for the above deliverables are based on historic pricing data.

For multiple-element arrangements entered into or materially modified in 2011, the Company allocates the arrangement consideration based on their related ESP. Revenues for deliverables under application services are recognized ratably over the term of the arrangement, beginning with the commencement of the arrangement term, which correlates with the activation of the hosting services, assuming all other revenue recognition criteria are met. The majority of the Company's professional services under multiple-element arrangements are fixed fee. Therefore, revenues for deliverables under professional services are recognized using a proportional performance method as services are rendered.

For multiple-element arrangements entered into prior to 2011, the Company accounts for these arrangements as a combined single unit of accounting, which include application services and professional services, and the related revenues are recognized ratably beginning with the commencement of the arrangement term, assuming all other remaining revenue recognition criteria are met. Revenues for any deliverables included in multiple-element arrangements that are within the scope of ASC 985-605 will continue to be recognized under such accounting standards.

The change in accounting policy in connection with the adoption of ASU No. 2009-13 accelerates the timing of professional services revenue recognition in multiple-element arrangements. For multiple-element arrangements entered into in 2011, the Company recognizes professional services revenues as rendered, subject to the proportional performance methodology, as a separate unit of accounting. For multiple-element arrangements entered into prior to 2011 but materially modified in the current year, the Company recognizes professional services revenues as rendered (based upon the proportional performance method) starting from the date of the modification, and any deferred professional services revenue, as previously required under the former accounting policy, is evaluated and potentially recognized as revenues based upon the

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completion of detailed review of the total consideration provided in the modified arrangement. See Deferred Revenue below for additional information. Finally, the change in accounting policy impacts application services revenue recognition in multiple-element arrangements to the extent

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### **MEDIDATA SOLUTIONS, INC.**

#### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)**

that the start of revenue recognition for application services is not dependent upon the delivery of professional services, which was a requirement under the Company's former single unit of accounting revenue recognition policy for multiple-element arrangements.

For the three and nine months ended September 30, 2011, the total revenues recognized for multiple-element arrangements entered into or materially modified in 2011 was \$11.4 million and \$23.2 million, respectively. The total amount of revenues that would have been recognized for the three and nine months ended September 30, 2011 if the same arrangements were accounted for under the pre-amended ASC 605-25 was \$6.8 million and \$10.3 million, respectively. During the three months ended September 30, 2011, the Company did not accelerate any deferred revenue related to multiple-element arrangements materially modified in 2011 as required per the adoption of ASU No. 2009-13. During the nine months ended September 30, 2011, the Company accelerated \$6.0 million related to such arrangements.

For multiple-element arrangements entered into prior to 2011, management's estimate of fair value for professional services is used to derive a reasonable approximation for presenting application services and professional services separately in its consolidated financial statements.

#### ***Deferred Revenue***

Deferred revenue consists of billings or payments received in advance of revenue recognition and is recognized as the revenue recognition criteria are met. Amounts that have been invoiced are initially recorded in accounts receivable and deferred revenue. The Company invoices its customers in accordance with the terms of the underlying contract, usually in installments in advance of the related service period. Accordingly, the deferred revenue balance does not represent the total contract value of outstanding arrangements. Payment terms are net 30 to 45 days. Deferred revenue that will be recognized during the subsequent 12-month period is recorded as current deferred revenue and the remaining portion as non-current deferred revenue.

In some instances, customers elect to renew their application services arrangements prior to the original termination date of the arrangement. The renewed application services agreement provides support for in-process clinical trials, and includes the right to use the software for initial clinical studies. As such, the unrecognized portion of the deferred revenue associated with the initial arrangement is aggregated with the consideration received upon renewal and recognized as revenues over the renewed term of the application services arrangements.

In connection with the adoption of ASU No. 2009-13 on January 1, 2011, the recognizable portion of any remaining deferred revenue associated with multiple-element arrangements that are materially modified in 2011 is calculated based on an allocation of the total arrangement consideration (which includes the consideration of the modified arrangement plus the remaining balance of deferred revenue), to the remaining deliverables on the basis of their relative selling price. If the total arrangement consideration exceeds the sum of the total selling prices for the remaining deliverables, the surplus is recognized as revenues in the period of modification. If the total arrangement consideration does not exceed the sum of the total selling prices for the remaining deliverables, the shortfall is considered a discount and allocated to the remaining deliverables utilizing a relative-selling price method.

***Income Taxes*** The Company uses the asset and liability method of accounting for income taxes, as prescribed by ASC 740, *Income Taxes*, which recognizes deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

In addition, the Company follows ASC 740-10 for the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the consolidated financial statements. Under ASC 740-10, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position.

**Table of Contents****MEDIDATA SOLUTIONS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)**

For the provision for income taxes at interim periods, the Company follows ASC 740-270, *Income Taxes - Interim Reporting*, and has developed an estimate of the annual effective tax rate based upon the facts and circumstances known at the time. The Company's effective tax rate is based on expected income, statutory rates and permanent differences applicable to the Company in the various jurisdictions in which the Company operates.

**Segment Information** As defined by ASC 280, *Segment Reporting*, the Company operates as a single segment, as the chief operating decision maker makes operating decisions and assesses performance based on one single operating unit. The Company recorded revenues in the following geographic areas, based on the country in which revenues were generated and greater than five percent of the total revenues for the three and nine months ended September 30, 2011 and 2010 (in thousands):

|                          | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|--------------------------|-------------------------------------|-----------|------------------------------------|------------|
|                          | 2011                                | 2010      | 2011                               | 2010       |
| Revenues:                |                                     |           |                                    |            |
| United States of America | \$ 30,377                           | \$ 26,102 | \$ 87,554                          | \$ 74,931  |
| Japan                    | 6,167                               | 4,424     | 17,947                             | 13,267     |
| United Kingdom           | 1,866                               | 3,564     | 9,809                              | 10,506     |
| Switzerland              | 2,390                               | 2,188     | 7,881                              | 6,807      |
| Other                    | 5,505                               | 4,824     | 14,073                             | 13,546     |
| Total                    | \$ 46,305                           | \$ 41,102 | \$ 137,264                         | \$ 119,057 |

The following table summarizes long-term assets by geographic area as of September 30, 2011 and December 31, 2010 (in thousands):

|                          | September 30,<br>2011 | December 31,<br>2010 |
|--------------------------|-----------------------|----------------------|
| Long-term assets:        |                       |                      |
| United States of America | \$ 22,997             | \$ 23,580            |
| United Kingdom           | 8,046                 | 809                  |
| Japan                    | 577                   | 675                  |
| Total                    | \$ 31,620             | \$ 25,064            |

**Comprehensive Income** ASC 220, *Comprehensive Income*, established standards for reporting and displaying comprehensive income into its components (revenues, expenses, gains and losses) in a full set of general-purpose financial statements. The Company's other comprehensive income components result from foreign currency translation adjustments, as well as unrealized holding gains and losses for investments in available-for-sale securities. The following table sets forth the calculation of comprehensive income (in thousands):

|            | Three Months<br>Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|------------|----------------------------------------|----------|------------------------------------|----------|
|            | 2011                                   | 2010     | 2011                               | 2010     |
| Net income | \$ 7,482                               | \$ 4,664 | \$ 20,665                          | \$ 9,493 |

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|                                                     |       |     |      |     |
|-----------------------------------------------------|-------|-----|------|-----|
| Foreign currency translation adjustment             | (158) | 218 | (45) | 103 |
| Net unrealized (loss) gain on marketable securities | (51)  | 46  | (89) | 90  |

|                            |          |          |           |          |
|----------------------------|----------|----------|-----------|----------|
| Total comprehensive income | \$ 7,273 | \$ 4,928 | \$ 20,531 | \$ 9,686 |
|----------------------------|----------|----------|-----------|----------|

**Recently Issued Accounting Pronouncements** In October 2009, the FASB issued ASU No. 2009-14, *Certain Revenue Arrangements that Include Software Elements*. ASU No. 2009-14 amends the scoping guidance for software arrangements under ASC 985-605, *Software Revenue Recognition*, to exclude tangible products that contain software elements and nonsoftware elements that function together to interdependently deliver the product's essential functionality. Such tangible products being excluded from ASU No. 2009-14 will instead fall under the scope of ASU No. 2009-13. The FASB also provided several considerations and examples for entities applying this guidance. ASU No. 2009-14 is effective for new or materially modified arrangements in fiscal years beginning on or after June 15, 2010. The Company adopted ASU No. 2009-14 prospectively and concurrently with ASU No. 2009-13 on January 1, 2011 and the adoption did not have a material impact on its consolidated financial statements.

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### **MEDIDATA SOLUTIONS, INC.**

#### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)**

In April 2010, the FASB issued ASU No. 2010-13, *Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades*, which amends ASC 718, *Compensation - Stock Compensation*, to clarify that a share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades must not be considered a market, performance, or service condition. Therefore, an entity should not classify such an award as a liability if it otherwise qualifies for classification in equity. ASU No. 2010-13 is effective for interim and annual periods beginning on or after December 15, 2010. The Company adopted ASU No. 2010-13 on January 1, 2011. All of the Company's stock-based awards granted to its international employees were classified as equity awards in accordance with its current accounting policy, which is consistent with the accounting treatment contained in this ASU No. 2010-13. Therefore, the adoption of ASU No. 2010-13 did not have a material impact on the Company's consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The amendments in this ASU generally represent clarification of ASC 820-10, *Fair Value Measurements and Disclosures*, but also include instances where a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements has changed. This ASU is the result of joint efforts by the FASB and International Accounting Standards Board to develop a single, converged fair value framework and guidance with respect to how to measure fair value and what disclosures to provide about fair value measurements. ASU No. 2011-04 is effective for interim and annual periods beginning after December 15, 2011. The adoption of ASU No. 2011-04 is not expected to have a material impact on the Company's consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income*, which removes the presentation options contained in ASC 220, *Comprehensive Income*, and requires entities to report components of comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements. Under the two-statement approach, the first statement would include components of net income, which is consistent with the format of statement of operations used today, and the second statement would include components of other comprehensive income. ASU No. 2011-05 is effective for interim and annual periods beginning after December 15, 2011 and must be applied retrospectively for all periods presented in the financial statements. Early adoption is permitted. The adoption of ASU No. 2011-05 is not expected to have a material impact on the Company's consolidated financial statements other than merely a change in its presentation.

In September 2011, the FASB issued ASU No. 2011-08, *Testing Goodwill for Impairment*, which simplifies how entities test goodwill for impairment. ASU No. 2011-08 permits an entity to assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. ASU No. 2011-08 is effective for interim and annual reporting periods beginning after December 15, 2011, with early adoption permitted. The Company is currently evaluating the impact, if any, of the provisions of ASU No. 2011-08 on its consolidated financial statements.

### **3. MARKETABLE SECURITIES AND FAIR VALUE**

The Company manages its cash equivalents and marketable securities as a single investment portfolio that is intended to be available to meet the Company's current cash requirements. Cash equivalents consist of investments in money market funds, and certain U.S. government debt obligations and commercial paper with maturities of less than three months. Marketable securities, which the Company classifies as available-for-sale securities, primarily consist of high quality commercial paper, corporate bonds, U.S. government debt obligations and foreign government fixed income securities. All of our marketable securities have remaining effective maturities of twelve months or less from the balance sheet date; therefore, they are classified as short-term on the consolidated balance sheet. The Company's investment policy for this portfolio generally requires investments in marketable securities with less than one year to maturity. The following table provides the Company's marketable securities by security type as of September 30, 2011 and December 31, 2010 (in thousands):

As of September 30, 2011

Cost

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|                                                          |           | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Estimated<br/>Fair<br/>Value</b> |
|----------------------------------------------------------|-----------|---------------------------------------|----------------------------------------|-------------------------------------|
| Commercial paper and corporate bonds                     | \$ 57,057 | \$                                    | \$ (61)                                | \$ 56,996                           |
| U.S. Treasury and U.S. government agency debt securities | 17,139    | 6                                     | (2)                                    | 17,143                              |
| Foreign government fixed income securities               | 2,507     |                                       |                                        | 2,507                               |
| Total                                                    | \$ 76,703 | \$ 6                                  | \$ (63)                                | \$ 76,646                           |

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**Table of Contents****MEDIDATA SOLUTIONS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)**

|                                                          | Cost      | As of December 31, 2010      |                               | Estimated<br>Fair<br>Value |
|----------------------------------------------------------|-----------|------------------------------|-------------------------------|----------------------------|
|                                                          |           | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |                            |
| Commercial paper and corporate bonds                     | \$ 44,324 | \$ 27                        | \$ (3)                        | \$ 44,348                  |
| U.S. Treasury and U.S. government agency debt securities | 22,569    | 11                           |                               | 22,580                     |
| Foreign government fixed income securities               | 2,548     |                              | (3)                           | 2,545                      |
| Total                                                    | \$ 69,441 | \$ 38                        | \$ (6)                        | \$ 69,473                  |

Contractual maturities of the Company's marketable securities as of September 30, 2011 and December 31, 2010 are summarized as follows (in thousands):

|                                  | As of September 30, 2011 |                            | As of December 31, 2010 |                            |
|----------------------------------|--------------------------|----------------------------|-------------------------|----------------------------|
|                                  | Cost                     | Estimated<br>Fair<br>Value | Cost                    | Estimated<br>Fair<br>Value |
| Due in one year or less          | \$ 76,703                | \$ 76,646                  | \$ 69,441               | \$ 69,473                  |
| Due after one through five years |                          |                            |                         |                            |
| Total                            | \$ 76,703                | \$ 76,646                  | \$ 69,441               | \$ 69,473                  |

The following table provides the fair market value and the gross unrealized losses of the Company's marketable securities with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by security type as of September 30, 2011 and December 31, 2010 (in thousands):

|                                                          | In Loss Position for Less than 12 Months |                               |                         |                               |
|----------------------------------------------------------|------------------------------------------|-------------------------------|-------------------------|-------------------------------|
|                                                          | As of September 30, 2011                 |                               | As of December 31, 2010 |                               |
|                                                          | Fair<br>Value                            | Gross<br>Unrealized<br>Losses | Fair<br>Value           | Gross<br>Unrealized<br>Losses |
| Commercial paper and corporate bonds                     | \$ 34,511                                | \$ (61)                       | \$ 5,713                | \$ (3)                        |
| U.S. Treasury and U.S. government agency debt securities | 6,598                                    | (2)                           |                         |                               |
| Foreign government fixed income securities               |                                          |                               | 2,545                   | (3)                           |
| Total                                                    | \$ 41,109                                | \$ (63)                       | \$ 8,258                | \$ (6)                        |

None of the Company's marketable securities has been in a continuous unrealized loss position for more than twelve months as of September 30, 2011 and December 31, 2010.

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### **MEDIDATA SOLUTIONS, INC.**

#### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)**

At September 30, 2011, the Company had an insignificant gross unrealized loss primarily due to a decrease in the fair value of certain corporate bond securities. The Company regularly reviews its investment portfolio to identify and evaluate investments that have indications of possible impairment. Factors considered in determining whether a loss is temporary include:

the length of time and extent to which fair value has been lower than the cost basis;

the financial condition, credit quality and near-term prospects of the investee; and

whether it is more likely than not that the Company will be required to sell the security prior to recovery.

As the Company has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Company has determined that the gross unrealized losses on such investments at September 30, 2011 are temporary in nature. Accordingly, the Company did not consider that its investments in marketable securities were other-than-temporarily impaired as of September 30, 2011.

During the three and nine months ended September 30, 2011, the Company recorded an insignificant amount of net realized gains and losses from the sale of marketable securities.

ASC 820-10, *Fair Value Measurements and Disclosures*, establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value and enhances disclosure requirements for fair value measurements. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under ASC 820-10 are described as follows:

Level 1      Unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2      Other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, include:

quoted prices for similar assets or liabilities in active markets;

quoted prices for identical or similar assets or liabilities in markets that are not active;

inputs other than quoted prices that are observable for the asset or liability;

inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3      Unobservable inputs to the valuation methodology and significant to the fair value measurement for the asset or liability.

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**Table of Contents****MEDIDATA SOLUTIONS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)**

Financial assets (excluding cash balances) measured at fair value on a recurring basis as of September 30, 2011 and December 31, 2010 are summarized as follows (in thousands):

|                                                          | As of September 30, 2011        |           |           | As of December 31, 2010         |           |           |
|----------------------------------------------------------|---------------------------------|-----------|-----------|---------------------------------|-----------|-----------|
|                                                          | Fair Value<br>Measurement Using |           |           | Fair Value<br>Measurement Using |           |           |
|                                                          | Level 1                         | Level 2   | Total     | Level 1                         | Level 2   | Total     |
| Money market funds                                       | \$ 5,866                        |           | \$ 5,866  | \$ 4,556                        |           | \$ 4,556  |
| Commercial paper                                         |                                 | 2,499     | 2,499     |                                 | 3,899     | 3,899     |
| U.S. government agency debt securities                   |                                 | 2,000     | 2,000     |                                 |           |           |
| Total cash equivalents                                   | 5,866                           | 4,499     | 10,365    | 4,556                           | 3,899     | 8,455     |
| Commercial paper and corporate bonds                     |                                 | 56,996    | 56,996    |                                 | 44,348    | 44,348    |
| U.S. Treasury and U.S. government agency debt securities | 7,524                           | 9,619     | 17,143    | 13,051                          | 9,529     | 22,580    |
| Foreign government fixed income securities               |                                 | 2,507     | 2,507     |                                 | 2,545     | 2,545     |
| Total marketable securities                              | 7,524                           | 69,122    | 76,646    | 13,051                          | 56,422    | 69,473    |
| Total financial assets                                   | \$ 13,390                       | \$ 73,621 | \$ 87,011 | \$ 17,607                       | \$ 60,321 | \$ 77,928 |

The Company's financial assets that are measured at fair value on a recurring basis are generally classified within Level 1 or Level 2 of the fair value hierarchy. Investments in money market funds and U.S. Treasury debt securities have been classified as Level 1 since these securities are valued based upon \$1.00 net asset value per share or unadjusted quoted prices in active markets. Investments in commercial paper, corporate bonds, U.S. government agency debt securities and foreign government fixed income securities have been classified as Level 2 since these securities are valued based on quoted prices in less active markets or significant inputs which are directly or indirectly observable. The valuation techniques used to measure the fair values of corporate bonds, U.S. government agency debt securities and foreign government fixed income securities were derived from the inputs of market prices from multiple sources at each reporting period. The fair value was then determined based on a consensus price or a weighted average price for each security. For the remaining financial assets classified as Level 2, substantially all of the securities had a short maturity within one year with high credit ratings. Therefore, the valuation techniques used to measure the fair values were primarily derived from accretion of purchase price to its face value over the term of maturity or quoted market prices for similar instruments if available. During the nine months ended September 30, 2011 and 2010, there were no transfers of financial assets between Level 1 and Level 2.

The carrying amounts of all other current financial assets and current financial liabilities reflected in the consolidated balance sheets approximate fair value due to their short-term nature. Except for the contingent consideration associated with the acquisition as discussed in Note 4, the Company does not have non-financial assets or liabilities that have been measured at fair value on a nonrecurring basis as of September 30, 2011 and December 31, 2010.

**4. ACQUISITION**

On July 1, 2011, the Company completed its acquisition of Clinical Force Limited ( "Clinical Force" ), a UK-based provider of SaaS clinical trial management systems ( "CTMS" ). With this acquisition, the Company expanded its service offerings to include a clinical trial management solution, which enables customers to reduce the financial and operational management burden of clinical trials, streamline clinical processes and increase visibility to timely information that enhances governance and decision making.

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The Company combined Clinical Force into its single operating segment. The Company's results of operations for the three and nine months ended September 30, 2011 include the operations of Clinical Force since the date of acquisition. The Company does not consider this acquisition significant to its condensed consolidated results of operations and therefore the related pro forma information related to revenues and earnings has not been presented. Revenues and earnings related to Clinical Force for the three and nine months ended September 30, 2011 were insignificant.

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**Table of Contents****MEDIDATA SOLUTIONS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)**

The Company acquired all outstanding shares of Clinical Force and the acquisition was accounted for using the purchase method of accounting. The purchase price was allocated to the assets purchased and liabilities assumed based upon their estimated fair values at the date of the acquisition. The purchase price consisted of cash consideration of \$5.2 million paid by the Company at closing, plus additional performance-based earn out payments of up to \$2.6 million. Of the cash payment at closing, \$4.4 million was paid to the sellers at the closing date and \$0.8 million was held in an escrow account and will be released on the first anniversary of the acquisition pursuant to the terms of the purchase agreement. Of the earn-out payments, the maximum payable amount of \$1.7 million will be cash and up to \$0.9 million will be paid in the form of promissory notes to be issued to certain sellers by the Company. The earn-out payments are contingent upon the achievement of future billing targets for the CTMS application and will be calculated over three measuring periods beginning at December 31, 2011 and continuing for each of the next two calendar years thereafter.

This contingent consideration associated with the earn-out payments had an estimated fair value of \$1.8 million as of the acquisition date and was recorded in other long-term liabilities on the Company's consolidated financial statements. The fair value of the contingent consideration was estimated by applying the income approach. That measure is based on significant inputs that are not observable in the market, which ASC 820-10 refers to as Level 3 inputs. The significant inputs in the Level 3 measurement not supported by market activity included the Company's probability assessments of expected future cash flows related to its acquisition of Clinical Force during the earn-out payments measurement period, appropriately discounted considering the uncertainties associated with the obligation, and calculated in accordance with the terms of the purchase agreement. Any subsequent changes in the fair value of the contingent consideration will be reflected in earnings.

The purchase price excludes acquisition costs of \$0.3 million, which were expensed in general and administrative expenses as incurred.

The following table sets forth the components of the purchase price (in thousands).

|                                        |                 |
|----------------------------------------|-----------------|
| Cash payment                           | \$ 5,200        |
| Contingent consideration at fair value | 1,819           |
| <b>Total purchase price</b>            | <b>\$ 7,019</b> |

The Company paid a premium over the fair value of the net tangible and identified intangible assets acquired for a number of reasons, including the following:

A CTMS offering will strategically enhance the Company's comprehensive SaaS platform, furthering the Company's mission to help its customers optimize clinical trials from concept to conclusion.

The acquisition will enable the Company to provide its existing customers with a SaaS CTMS solution that eliminates the time, cost, and complexity of implementation associated with other non-SaaS CTMS software.

The value inherent in these elements does not meet the definition of an intangible asset under ASC 805, *Business Combinations*, and is therefore reflected as goodwill.

In connection with this acquisition, the Company acquired intangible assets of \$2.1 million and assumed net liabilities of \$0.8 million, resulting in recognition of goodwill of \$5.7 million, none of which is tax deductible.



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In connection with the allocation of the purchase price to the assets acquired and liabilities assumed, we identified certain intangible assets with determinable lives. The following table presents the acquired intangible assets, their estimated fair values derived using an income approach (in thousands), and weighted average lives.

|                           | <b>Acquisition Date Fair<br/>Value</b> | <b>Weighted Average<br/>Useful Lives (years)</b> |
|---------------------------|----------------------------------------|--------------------------------------------------|
| Developed/core technology | \$ 1,680                               | 4                                                |
| Customer relationships    | 460                                    | 6                                                |
|                           | <b>\$ 2,140</b>                        |                                                  |

The estimates of fair values for the assets acquired and liabilities assumed for the Clinical Force acquisition were based upon preliminary calculations and valuations. The estimates and assumptions used are subject to change as the Company obtains additional information for its estimates during the respective measurement periods (up to one year from the acquisition date). The primary areas of those estimates that are not yet finalized related to certain tangible assets and liabilities acquired, identifiable intangible assets, and income taxes.

**5. GOODWILL AND INTANGIBLE ASSETS**

The changes in the carrying amount of goodwill for the nine months ended September 30, 2011, are as follows (in thousands).

|                                          |           |
|------------------------------------------|-----------|
| Balance as of January 1, 2011            | \$ 9,799  |
| Additions related to acquisition         | 5,695     |
| Foreign currency translation adjustments | (134)     |
| Balance as of September 30, 2011         | \$ 15,360 |

**Table of Contents****MEDIDATA SOLUTIONS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)**

Intangible assets are summarized as follows (in thousands):

|                        | As of September 30, 2011 |              |          | As of December 31, 2010 |              |          |
|------------------------|--------------------------|--------------|----------|-------------------------|--------------|----------|
|                        | Gross                    |              | Net      | Gross                   |              | Net      |
|                        | Carrying                 | Accumulated  | Carrying | Carrying                | Accumulated  | Carrying |
|                        | Amount                   | Amortization | Amount   | Amount                  | Amortization | Amount   |
| Acquired technology    | \$ 4,039                 | \$ (1,802)   | \$ 2,237 | \$ 2,400                | \$ (1,340)   | \$ 1,060 |
| Database               | 1,900                    | (1,346)      | 554      | 1,900                   | (1,060)      | 840      |
| Customer relationships | 2,049                    | (951)        | 1,098    | 1,600                   | (576)        | 1,024    |
| Customer contracts     | 1,600                    | (1,600)      |          | 1,600                   | (1,579)      | 21       |
| Total                  | \$ 9,588                 | \$ (5,699)   | \$ 3,889 | \$ 7,500                | \$ (4,555)   | \$ 2,945 |

Annual amortization for the next five years is expected to be as follows (in thousands):

|                                            |        |
|--------------------------------------------|--------|
| Remainder of year ending December 31, 2011 | \$ 443 |
| Years ending December 31,                  |        |
| 2012                                       | 1,785  |
| 2013                                       | 804    |
| 2014                                       | 522    |
| 2015                                       | 272    |
| 2016                                       | 45     |

**6. STOCK-BASED COMPENSATION**

The Company accounts for the stock-based compensation in accordance with ASC 718, *Compensation - Stock Compensation*. For the three and nine months ended September 30, 2011 and 2010, the components of stock-based compensation expense were summarized in the following table (in thousands):

|                                | Three Months  |               | Nine Months   |               |
|--------------------------------|---------------|---------------|---------------|---------------|
|                                | Ended         | Ended         | Ended         | Ended         |
|                                | September 30, | September 30, | September 30, | September 30, |
|                                | 2011          | 2010          | 2011          | 2010          |
| Stock options                  | \$ 1,092      | \$ 1,076      | \$ 3,205      | \$ 3,042      |
| Restricted stock awards        | 1,345         | 771           | 3,268         | 1,613         |
| Total stock-based compensation | \$ 2,437      | \$ 1,847      | \$ 6,473      | \$ 4,655      |

**Table of Contents****MEDIDATA SOLUTIONS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)**

The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes pricing model with the following weighted-average assumptions:

|                         | <b>Three Months</b> |             | <b>Nine Months Ended</b> |             |
|-------------------------|---------------------|-------------|--------------------------|-------------|
|                         | <b>Ended</b>        |             | <b>September 30,</b>     |             |
|                         | <b>2011</b>         | <b>2010</b> | <b>2011</b>              | <b>2010</b> |
| Expected volatility     | 51%                 |             | 50%                      | 60%         |
| Expected life           | 6 years             |             | 6 years                  | 6 years     |
| Risk-free interest rate | 1.39%               |             | 1.85%                    | 2.47%       |
| Dividend yield          |                     |             |                          |             |

The following table summarizes the activity under the stock option plans as of September 30, 2011, and changes during the nine months then ended (in thousands, except per share data):

|                                                   | <b>Number of</b> | <b>Weighted-</b> | <b>Weighted-</b>   | <b>Aggregate</b> |
|---------------------------------------------------|------------------|------------------|--------------------|------------------|
|                                                   | <b>Shares</b>    | <b>Average</b>   | <b>Remaining</b>   | <b>Intrinsic</b> |
|                                                   |                  | <b>Exercise</b>  | <b>Contractual</b> | <b>Value</b>     |
|                                                   |                  | <b>Price</b>     | <b>Term</b>        |                  |
|                                                   |                  |                  | <b>(years)</b>     |                  |
| Outstanding at January 1, 2011                    | 2,384            | \$ 11.33         |                    |                  |
| Granted                                           | 397              | 21.83            |                    |                  |
| Exercised                                         | (295)            | 7.47             |                    |                  |
| Forfeited                                         | (24)             | 19.26            |                    |                  |
| Expired                                           | (21)             | 16.16            |                    |                  |
| Outstanding at September 30, 2011                 | 2,441            | \$ 13.38         | 6.76               | \$ 10,308        |
| Exercisable at September 30, 2011                 | 1,574            | \$ 10.85         | 5.69               | \$ 9,601         |
| Vested and expected to vest at September 30, 2011 | 2,392            | \$ 13.27         | 6.71               | \$ 10,281        |

The weighted-average grant-date fair value of stock options granted during the three months ended September 30, 2011 and 2010 was \$9.19 and none, respectively. The weighted-average grant-date fair value of stock options granted during the nine months ended September 30, 2011 and 2010 was \$10.78 and \$8.75, respectively. The total intrinsic value of stock options exercised during the three months ended September 30, 2011 and 2010 was \$1.1 million and \$1.0 million, respectively. The total intrinsic value of stock options exercised during the nine months ended September 30, 2011 and 2010 was \$4.7 million and \$5.1 million, respectively.

The following table summarizes the status of the Company's nonvested restricted stock awards as of September 30, 2011, and changes during the nine months then ended (in thousands, except per share data):

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|                                 | Number of<br>Shares | Weighted-<br>Average<br>Grant-Date<br>Fair Value |
|---------------------------------|---------------------|--------------------------------------------------|
| Nonvested at January 1, 2011    | 731                 | \$ 14.99                                         |
| Granted                         | 479                 | 23.22                                            |
| Vested                          | (213)               | 14.89                                            |
| Forfeited                       | (20)                | 16.98                                            |
| Nonvested at September 30, 2011 | 977                 | \$ 19.01                                         |

As of September 30, 2011, there was a total of \$25.0 million of unrecognized compensation cost related to all non-vested stock-based compensation awards granted, as recorded in accordance with ASC 718. This cost is expected to be recognized over a weighted-average remaining period of 2.7 years for stock options and 3.1 years for restricted stock awards. The total fair value of shares vested during each of the three month periods ended September 30, 2011 and 2010 was \$1.3 million. The total fair value of shares vested during the nine months ended September 30, 2011 and 2010 was \$8.1 million and \$4.3 million, respectively.

**Table of Contents****MEDIDATA SOLUTIONS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)****7. EARNINGS PER SHARE**

The Company follows ASC 260, *Earnings Per Share*, in calculating earnings per share. Basic earnings per share is calculated by dividing net income available to common stockholders by the weighted-average number of shares outstanding during the period. Diluted earnings per share includes the determinants of basic net income per share and, in addition, gives effect to the potential dilution that would occur if securities or other contracts to issue common stock are exercised, vested or converted into common stock unless they are anti-dilutive.

A reconciliation of the numerators and denominators of basic earnings per share and diluted earnings per share for the three and nine months ended September 30, 2011 and 2010 are shown in the following table (in thousands, except per share data):

|                                                                                                                                   | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|-----------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                                                                                                                                   | <b>2011</b>                                 | <b>2010</b> | <b>2011</b>                                | <b>2010</b> |
| <b>Numerator</b>                                                                                                                  |                                             |             |                                            |             |
| Net income                                                                                                                        | \$ 7,482                                    | \$ 4,664    | \$ 20,665                                  | \$ 9,493    |
| <b>Denominator</b>                                                                                                                |                                             |             |                                            |             |
| Denominator for basic earnings per share:                                                                                         |                                             |             |                                            |             |
| Weighted average common shares outstanding                                                                                        | 23,752                                      | 23,019      | 23,579                                     | 22,878      |
| Denominator for diluted earnings per share:                                                                                       |                                             |             |                                            |             |
| Dilutive potential common shares:                                                                                                 |                                             |             |                                            |             |
| Stock options                                                                                                                     | 610                                         | 745         | 822                                        | 781         |
| Restricted stock awards                                                                                                           | 129                                         | 92          | 282                                        | 79          |
| Weighted average common shares outstanding with assumed conversion                                                                | 24,491                                      | 23,856      | 24,683                                     | 23,738      |
| Basic earnings per share                                                                                                          | \$ 0.32                                     | \$ 0.20     | \$ 0.88                                    | \$ 0.41     |
| Diluted earnings per share                                                                                                        | \$ 0.31                                     | \$ 0.20     | \$ 0.84                                    | \$ 0.40     |
| Total number of anti-dilutive shares of stock options and nonvested stock excluded from calculation of diluted earnings per share | 1,635                                       | 1,228       | 347                                        | 1,138       |

**8. INCOME TAXES**

In developing the estimate of the annual effective tax rate for the provision for income taxes for the three and nine months ended September 30, 2011, the Company expects its federal taxable income to be fully offset by its federal net operating loss carryforwards based on the Company's increased Section 382 limitation resulting from a tax analysis completed in the fourth quarter of 2010. As a result, the Company's effective tax rate for the three and nine months ended September 30, 2011 was approximately 5% and 7%, respectively.

In assessing the realizability of deferred tax assets, including the net operating loss carryforwards, the Company assesses the available positive and negative evidence to estimate if sufficient future taxable income will be generated to utilize its existing deferred tax assets. A significant piece of objective negative evidence evaluated has been the Company's history of operating losses since its inception and continuing through 2008. While 2009 and 2010 have resulted in profitability, the existence of and the history of such negative evidence limits the Company's ability to consider other subjective evidence such as the Company's projections for future growth. Based on this evaluation, as of September 30, 2011, the Company has provided a valuation allowance against the majority of its domestic net deferred tax assets as their future utilization remains uncertain at this time. The amount of the deferred tax asset considered realizable, however, could be adjusted if forecasts of future taxable income during the carryforward period are ultimately achieved and the Company continues to be profitable.



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### **MEDIDATA SOLUTIONS, INC.**

### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)**

#### **9. COMMITMENTS AND CONTINGENCIES**

**Legal Matters** The Company is subject to legal proceedings and claims which have arisen in the ordinary course of business. The Company records an estimated liability for these matters when an adverse outcome is considered to be probable and can be reasonably estimated.

In 2006, it was claimed that certain applications offered to the Company's customers potentially infringed on intellectual property rights held by a third party (the Claimant). As a result of negotiations with the Claimant, the Company entered into a license and settlement agreement in June 2007, pursuant to which the Company licensed the intellectual property held by the Claimant for use in its future sales to customers and settled all past infringement claims. The Company paid a settlement amount of \$2.2 million to the Claimant in 2007. In June 2009, the Claimant initiated a lawsuit against the Company claiming breach of contract. The complaint includes allegations that the Company has failed to pay unspecified royalties relating to sales of the Company's products. The Company believes that the allegations in this lawsuit are without merit. The Company filed an answer in July 2009, denying all material allegations and asserting numerous affirmative defenses. The Company also asserted counterclaims for a declaratory judgment that no royalties are owed with respect to sales of the Company's products, as well as a counterclaim for Claimant's breach of the license and settlement agreement. The parties are nearing completion of pre-trial discovery activities. A trial date has not yet been scheduled. Since the probable outcome and the future economic impact of this litigation on the Company remain uncertain, the Company is unable to develop an estimate of its potential liability, if any, as it relates to this litigation. As a result, the Company did not record a liability as of September 30, 2011 nor December 31, 2010.

On March 4, 2011, DataTrak International, Inc. (DataTrak) filed a complaint for alleged patent infringement against the Company in DataTrak International v. Medidata Solutions, C.A. No. 1:11-cv-00458 in the U.S. District Court for the Northern District of Ohio. The complaint asserts infringement of U.S. Patent No. 7,464,087, which claims a method and system for unifying data from a variety of sources and seeks unspecified damages and injunctive relief. DataTrak formally served the Company with the complaint on June 6, 2011. The initial complaint did not provide any details concerning the alleged infringement; however, DataTrak amended the complaint in July 2011 and named Medidata Rave as an allegedly infringing product. In July 2011, the Company filed its answer to the amended complaint and filed counterclaims seeking a declaratory judgment of non-infringement and a finding that the patent at issue is invalid. The Company intends to defend itself against DataTrak's claims, and to pursue the Company's counterclaims, vigorously. On October 28, 2011, the Company filed a reexamination request in the U.S. Patent and Trademark Office seeking to invalidate and/or narrow all of the claims of the asserted patent. On the same day, the Company filed a motion to stay this litigation in view of the reexamination request. The court has not yet entered an order on this motion. The probability of a favorable or unfavorable outcome to the Company is unknown and a range of loss, if any, cannot be estimated at this time. As a result, no accrual has been recorded by the Company associated with this litigation.

**Contractual Warranties** The Company typically provides contractual warranties to its customers covering its product and services. To date, any refunds provided to customers have been immaterial.

**Change in Control Agreements** In January 2009, the Company entered into change in control agreements with its chief executive officer and certain other executive officers. These agreements provide for payments to be made to such officers upon involuntary termination of their employment by the Company without cause or by such officers for good reason as defined in the agreements, within a two-year period following a change in control. The agreements provide that, upon a qualifying termination event, such officers will be entitled to (a) a severance payment equal to the officer's base salary plus target bonus amount; (b) continuation of health benefits for 12 months; (c) immediate vesting of any remaining unvested equity awards; and (d) a tax gross up payment under Section 280G of the Internal Revenue Code sufficient to reimburse the officer for 50% of any excise tax payable as a result of any termination payments following a change in control, if applicable.

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### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or Exchange Act. Forward-looking statements reflect our current estimates, expectations and projections about our future results, performance, prospects and opportunities. Forward-looking statements include, among other things, the information concerning our possible future results of operations, business and growth strategies, financing plans, expectations that regulatory developments or other matters will not have a material adverse effect on our business or financial condition, our competitive position and the effects of competition, the projected growth of the industry in which we operate, the benefits and synergies to be obtained from our completed and any future acquisitions, and statements of management's goals and objectives, and other similar expressions concerning matters that are not historical facts. Words such as may, should, could, would, predicts, potential, continue, expects, anticipates, future, intends, plans, believes, estimates, appears, projects and similar expressions, as well as statements in the future tense, identify forward-looking statements. Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, such performance or results will be achieved. Forward-looking information is based on information available at the time and/or management's good faith belief with respect to future events, and is subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements. Important factors that could cause such differences include, but are not limited to the factors discussed under the Risk Factors section included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 filed with the Securities and Exchange Commission, or SEC, on March 16, 2011.*

*The following is a discussion and analysis of our financial condition and results of operations and should be read together with our condensed consolidated financial statements and related notes to condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q and our audited consolidated financial statements and related notes to audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.*

### **Overview**

We are a leading global provider of software-as-a-service, or SaaS, clinical technology solutions that enhance the efficiency and timeliness of our customers' clinical development processes. Our solutions allow our customers to achieve clinical results more efficiently and effectively by streamlining the design, planning and management of key aspects of the clinical development process, including study and protocol design, trial planning and budgeting, site negotiation, clinical portal, trial management, randomization and trial supply management, clinical data capture and management, safety events capture, medical coding and business analytics.

The demand for electronic clinical solutions, such as those provided by us, has been driven by the increasing complexity and cost associated with paper-based trials and inefficiencies with early generation electronic data capture, or EDC, solutions. Paper-based trials may delay the clinical development process, impair data quality and prevent real-time decision making, while traditional EDC solutions have faced challenges with integration, site requirements, customization and scalability.

We have grown our revenues significantly since inception by expanding our customer base, increasing penetration with existing customers, enhancing our products and services and growing our indirect channel. In order to achieve and sustain our growth objectives, we have and will continue to invest in key areas, including: new personnel, particularly in direct domestic and international sales activities; resources to support our product development, including product functionality and platform; marketing programs to build brand awareness; and infrastructure to support growth.

We derive a majority of our application services revenues through multi-study arrangements for a pre-determined number of studies. We also offer our application services on a single-study basis that allows customers to use our solution for a limited number of studies or to evaluate it prior to committing to multi-study arrangements. We invest heavily in training our customers, their investigators and other third parties to configure clinical trials independently. We believe this knowledge transfer accelerates customer adoption of our solutions.

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We use a number of metrics to evaluate and manage our business. These metrics include revenue growth, customer growth, customer retention rate, revenues from lost customers, geographic contribution, and backlog.

Our customer base has grown from 92 at January 1, 2008 to 261 at September 30, 2011, 18 of which were acquired through the acquisition of Clinical Force Limited, or Clinical Force on July 1, 2011. Our relationships with some of these customers include multiple divisions and business units at various domestic and international locations. We generate revenues from sales to new customers as well as sales and renewals from our existing customers. Our global direct sales organization represents our primary source of sales, with an increasing volume of sales generated through our CRO relationships. Our customer retention rate was 94.1% and 91.9% for the nine months ended September 30, 2011 and 2010, respectively. We calculate customer retention based upon the number of customers that existed both at the beginning and end of the relevant period. Revenues from lost customers for the nine months ended September 30, 2011 and 2010 accounted for 4.2% and 1.2%, respectively, of total prior year revenues. To calculate the impact of customers lost during the period, we consider the revenues recognized from lost customers during the most recent prior fiscal year as a percentage of total company revenues from the same period. Traditionally, we maintain a high percentage of customer retention and hence the revenue impact from lost customers is insignificant to our total revenues. Our revenues from lost customers for the nine months ended September 30, 2011 was impacted by a contract termination which resulted in a one-time acceleration of revenue recognition in the fourth quarter of 2010. We believe revenues from lost customers coupled with customer retention rate give the best sense of volume and scale of customer loss and retention. Our presentation of customer retention and revenues from lost customers may differ from other companies in our industry.

We manage our business as one reportable segment. Historically, we have generated most of our revenues from sales to customers located in the United States. However, revenues generated from customers located in Europe and Asia (including Australia) represent a significant portion of overall revenues. Revenues generated from customers located in Europe represented approximately 20% and 24% of total revenues for the three months ended September 30, 2011 and 2010, respectively, and approximately 21% and 24% of total revenues for the nine months ended September 30, 2011 and 2010, respectively. Revenues generated from customers in Asia represented approximately 14% and 12% of total revenues for the three months ended September 30, 2011 and 2010, respectively, and approximately 14% and 13% of total revenues for the nine months ended September 30, 2011 and 2010, respectively. We expect sales from customers in Europe and Asia to continue to represent a significant portion of total sales as we continue to serve existing and new customers in these markets.

Our backlog is primarily associated with application services and represents the total future contract value of outstanding, multi-study and single-study arrangements, billed and unbilled, at a point in time. Thus, our backlog includes deferred revenue. Revenue generated in any given period is a function of revenue recognized from the beginning of period backlog, contract renewals, and new customer contracts. For this reason, backlog at the beginning of any period is not necessarily indicative of long-term future performance. We monitor as an annual metric the amount of revenues expected to be recognized from backlog over the current fiscal year, or full year backlog. As of January 1, 2011, we had full year backlog of approximately \$135 million. We also track, quarterly, the remaining amount of revenue to be recognized from backlog in the current year, or remaining backlog, which as of September 30, 2011 is approximately \$39 million. Our presentation of backlog may differ from other companies in our industry.

We consider the global adoption of clinical development technologies to be essential to our future growth. Our future growth will also depend on our ability to sustain the high levels of customer satisfaction and our ability to increase sales to existing customers. In addition, the market for our products is often characterized by rapid technological change and evolving regulatory standards. Our future growth is dependent on the successful development and introduction of new products and enhancements. To address these challenges, we will continue to expand our direct and indirect sales channels in domestic and international markets, pursue research and development as well as acquisition opportunities to expand and enhance our product offerings, expand our marketing efforts, and drive customer adoption through our knowledge transfer professional services offerings. Our success in these areas will depend upon our abilities to execute on our operational plans, interpret and respond to customer and regulatory requirements, and retain key staff.

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### **Acquisition of Clinical Force**

On July 1, 2011, we completed an acquisition of Clinical Force, a provider of SaaS clinical trial management systems, or CTMS. With this acquisition, we expanded our service offerings to include a clinical trial management solution, which enables our customers to reduce the financial and operational management burden of clinical trials, streamline clinical processes and increase visibility to timely information that enhances governance and decision making. The total consideration is expected to be \$7.0 million consisting of a cash payment of \$5.2 million paid at the closing date, plus additional performance-based earn-out payments of up to \$2.6 million which have an estimated fair value of \$1.8 million as of the acquisition date. Our results of operations for the three and nine months ended September 30, 2011 include the operations of Clinical Force since the date of acquisition. We have combined Clinical Force into our single operating segment.

### **Sources of Revenues**

We derive revenues from application services and professional services. Application services consist of multi-study or single-study arrangements, which give our customers the right to use our software solutions, hosting and site support, as well as clinical trial planning software solutions, which enable our customers to effectively manage their trial planning. Professional services consist of assisting our customers and partners with the design, workflow, implementation and management of their clinical trials.

Our application services are principally provided through multi-study arrangements, which grant customers the right to manage up to a predetermined number of clinical trials for a term generally ranging from three to five years, as well as single-study arrangements that allow customers to use application services for an individual study and/or to evaluate our application services prior to committing to multi-study arrangements. Many of our customers have migrated from single-study arrangements to multi-study arrangements and multi-study arrangements represent the majority of our application services revenues. We also offer other applications that improve efficiencies for clinical trials from concept to conclusion.

Our professional services provide our customers with reliable, repeatable and cost-effective implementation and training in the use of our application services. We also offer consulting services to advise customers on ways to optimize their clinical development process from trial concept to conclusion. Professional services revenues have represented a smaller portion of overall revenues in recent years. We expect professional services revenues to decline as a percentage of total revenues as our customers and partners become more adept at the management and configuration of our technology for their clinical trials as part of our knowledge transfer efforts.

### **Cost of Revenues**

Cost of revenues consists primarily of costs related to hosting, maintaining and supporting our application suite and delivering our professional services and support. These costs include salaries, benefits, bonuses and stock-based compensation for our data center and professional services staff. Cost of revenues also includes costs associated with our data center, including networking and related depreciation expense; as well as outside service provider costs, amortization expense and general overhead. We allocate general overhead, such as applicable shared rent and utilities, to cost of revenues based on relative headcount. The costs associated with providing professional services are recognized as such costs are incurred. Over the long term, we believe that cost of revenues as a percentage of total revenues will decrease.

### **Operating Costs and Expenses**

**Research and Development.** Research and development expenses consist primarily of personnel and related expenses for our research and development staff, including salaries, benefits, bonuses and stock-based compensation, the cost of certain third-party service providers and allocated overhead. We have focused our research and development efforts on expanding the functionality and ease of use of our applications. We expect research and development costs to increase in absolute dollars in the future as we intend to release new features and functionality designed to maximize the efficiency and effectiveness of the clinical development process for our customers. Over the long term, we believe that research and development expenses as a percentage of total revenues will decline slightly.

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**Sales and Marketing.** Sales and marketing expenses consist primarily of personnel and related expenses for our sales and marketing staff, including salaries, benefits, bonuses and stock-based compensation, commissions, travel costs, and marketing and promotional events, corporate communications, advertising, other brand building and product marketing expenses and allocated overhead. Our sales and marketing expenses have increased in absolute dollars primarily due to our ongoing substantial investments in customer acquisition. We expect sales and marketing expenses to increase in absolute dollars. Over the long term, we believe that sales and marketing expenses as a percentage of total revenues will decline slightly.

**General and Administrative.** General and administrative expenses consist primarily of personnel and related expenses for executive, legal, regulatory, finance and human resource departments, including salaries, benefits, bonuses and stock-based compensation, professional fees, insurance premiums, allocated overhead and other corporate expenses. On an ongoing basis, we expect general and administrative expenses to increase modestly in absolute dollars as we continue to add administrative personnel and incur additional professional fees and other expenses resulting from continued growth and the compliance requirements of operating as a public company. Over the long term, we believe that general and administrative expenses as a percentage of total revenues will decrease.

## **Income Tax Expense**

Prior to 2009, income tax expense consisted primarily of foreign income taxes imposed on our foreign subsidiaries in the United Kingdom and Japan. Due to the cumulative impact of our initial public offering, or IPO, in June 2009, coupled with our secondary offering in December 2009, an ownership change as defined by Section 382 of the Internal Revenue Code, or Section 382, occurred in early December 2009. As a result, utilization of our federal net operating loss carryforwards are subject to an annual limitation under Section 382. During the fourth quarter of 2010, we completed a tax analysis which enabled us to increase our Section 382 limitation. Pursuant to the Internal Revenue Service guidance, we are entitled to an increase in Section 382 limitation by assuming a deemed sale of assets, which is calculated based on a valuation of all of our assets and liabilities. Based upon the completion of such valuation, we were able to increase our Section 382 limitation by an additional \$17 million to the total of \$31 million. As a result, our federal taxable income is expected to be fully offset by our federal net operating loss carryforwards. In addition, beginning in 2009, we have been subject to state income taxes for certain jurisdictions where we do not have net operating loss carryforwards to apply against our taxable income and due to temporary suspension of net operating loss carryforward utilization in California.

We have U.S. federal and state net operating loss carryforwards available to offset future taxable income which do not fully expire until 2028. We do not realize an income tax benefit for the majority of our net operating loss carryforwards and other domestic net deferred tax assets in our financial statements as we have yet to determine that it is more likely than not that our future taxable income will be sufficient to utilize these tax benefits.

In assessing the realizability of our deferred tax assets, including the net operating loss carryforwards, we assess the available positive and negative evidence to estimate if sufficient future taxable income will be generated to utilize our existing deferred tax assets. A significant piece of objective negative evidence evaluated has been our history of operating losses since our inception and continuing through 2008. While 2009 and 2010 have resulted in profitability, the existence of and the history of such negative evidence limits our ability to consider other subjective evidence such as our projections for future growth. Based on this evaluation, as of September 30, 2011, we have provided a valuation allowance against the majority of our domestic net deferred tax assets as their future utilization remains uncertain at this time. The amount of the deferred tax asset considered realizable, however, could be adjusted if forecasts of future taxable income during the carryforward period are ultimately achieved and we continue to be profitable.

With the increase in our Section 382 limitation, we expect that it will take a shorter period of time than previously estimated to fully utilize our federal net operating loss carryforwards. We expect to continue to achieve profitability during the remainder of the current year and expect to continue to be profitable in the next fiscal year. We continue to evaluate the future realization of our deferred tax assets based on expectations of future taxable income. Depending on our continued ability to achieve expected levels of profitability, we may have sufficient evidence to conclude that it is more likely than not that we will be able to recognize the value of our deferred tax assets, in whole or in part, during the remainder of 2011. The reversal of the valuation allowance will likely result in

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recognizing a significant income tax benefit in our consolidated statement of operations. In addition, we expect our overall income tax expense to increase in absolute dollars due to state and local income taxes, as well as foreign income taxes as our income from international operations continue to grow.

### **Critical Accounting Policies**

Our condensed consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. Our critical accounting policies, including the assumptions and judgments underlying them, require the application of significant judgment in the preparation of our financial statements, and as a result they are subject to a greater degree of uncertainty. In applying these policies, we use our judgment to determine the appropriate assumptions to be used in calculating estimates that affect the reported amounts of assets, liabilities, revenues and expenses. Estimates and assumptions are based on historical experience and on various other factors that are believed to be reasonable under the circumstances. Accordingly, actual results could differ from those estimates. Our critical accounting policies consist of revenue recognition, stock-based compensation, goodwill and intangibles and income taxes. Except to the extent updated or described below, our critical accounting policies as of September 30, 2011 are the same as those at December 31, 2010, which are included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

### ***Revenue Recognition***

We derive our revenues from the sale of application services and the rendering of professional services. We recognize revenues when all of the following conditions are satisfied:

persuasive evidence of an arrangement exists;

service has been delivered to the customer;

amount of the fees to be paid by the customer is fixed or determinable; and

collection of the fees is reasonably assured or probable.

### ***Application Services***

We typically enter into multi-study and single-study arrangements that include the sale of software licenses that provide our customers the right to use our software, as well as hosting and other support services, to be provided over a specified term. We recognize revenues ratably over the term of the arrangement, beginning with the commencement of the arrangement term, which correlates with the activation of the hosting services, assuming all other revenue recognition criteria are met. The term of the arrangement includes optional renewal periods if such renewal periods are likely to be exercised.

### ***Professional Services***

We also provide a range of professional services that our customers have the ability to utilize on an as-needed basis. These services generally include training, implementation, interface creation, trial configuration, data testing, reporting, procedure documentation and other customer-specific services. Professional services do not result in significant alterations to our underlying software.

In certain situations, when professional services are sold separate and apart from application services, they are recognized as services are rendered or using a proportional performance method based on services performed for fixed fee professional services.

### ***Multiple-Element Arrangements***

We may also enter into arrangements to provide a combination of our offerings of application services and professional services. Our professional services are typically sold together with application services as a component of a single-study or multi-study arrangement.

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On January 1, 2011, we adopted Accounting Standards Update, or ASU, No. 2009-13, *Multiple Deliverable Revenue Arrangements*, which amends current guidance on arrangements with multiple deliverables under Accounting Standards Codification, or ASC, 605-25, *Revenue Recognition - Multiple-Element Arrangements*. As a result, the revenues for the majority of our multiple-element arrangements entered into or materially modified in 2011 are recognized in accordance with the provisions under ASU No. 2009-13.

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To qualify as a separate unit of accounting under ASU No. 2009-13, the delivered item must have value to the customer on a standalone basis. The significant deliverables under our multiple-element arrangements are application services and professional services.

We determined that the application services have standalone value as such services are often sold separately without professional services. Since we provide SaaS application services, the service components, including license, hosting and support, are combined and accounted for as a separate unit of accounting. We use estimated selling price, or ESP, to determine the selling pricing for application services when sold in multiple-element arrangements, as we do not have, vendor-specific objective evidence, or VSOE, for these application services and third-party evidence, or TPE, is not a practical alternative due to differences in features and functionality as compared with other companies' offerings.

We also determined that the professional services have standalone value because those services are sold separately by other vendors. We use ESP to determine the selling price for professional services when sold in multiple-element arrangements, as we do not have sufficient reliable pricing data to establish VSOE and TPE is not a practical alternative due to the incompatibility of our services with other vendors.

We determine our single-point ESP for application services and professional services as follows:

**Application services** we have developed an internal pricing tool that provides price quotes for application services configurations. Any new and potential customer application service arrangements must be priced through the utilization of our internal pricing tool. We have established an internal committee to monitor compliance and evaluate pricing data on a periodic basis. This evaluation includes the review of historical pricing data, market conditions consideration and the review of pricing strategies and practices. Any necessary pricing modification made to the internal pricing tool is supported by the result of such evaluation. Accordingly, our ESP for application services is obtained from this internal pricing tool.

**Professional services** we evaluate internal historic professional services pricing data to determine average pricing rates by type of professional services rendered. These averages are utilized to determine ESP for professional services, and are reviewed and updated at least annually.

We believe the effect of changes in either the selling price, or the method, or assumptions used to determine ESP for application services and professional services will not have significant effect on the allocation of the arrangement consideration as the ESP for the above deliverables are based on historic pricing data.

For multiple-element arrangements entered into or materially modified in 2011, we allocate the arrangement consideration based on their related ESP. Revenues for deliverables under application services are recognized ratably over the term of the arrangement, beginning with the commencement of the arrangement term, which correlates with the activation of the hosting services, assuming all other revenue recognition criteria are met. The majority of our professional services under multiple-element arrangements are fixed fee. Therefore, revenues for deliverables under professional services are recognized using a proportional performance method as services are rendered.

For multiple-element arrangements entered into prior to 2011, we account for these arrangements as a combined single unit of accounting, which include application services and professional services, and the related revenues are recognized ratably beginning with the commencement of the arrangement term, assuming all other remaining revenue recognition criteria are met. Revenues for any deliverables included in multiple-element arrangements that are within the scope of ASC 985-605, *Software Revenue Recognition*, will continue to be recognized under such accounting standards.

In addition, for multiple-element arrangements entered into prior to 2011, management's estimate of fair value for professional services is used to derive a reasonable approximation for presenting application services and professional services separately in our consolidated financial statements.

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### ***Deferred Revenue***

Deferred revenue consists of billings or payments received in advance of revenue recognition and is recognized as the revenue recognition criteria are met. Amounts that have been invoiced are initially recorded in accounts receivable and deferred revenue. We invoice our customers in accordance with the terms of the underlying contract, usually in installments in advance of the related service period. Accordingly, the deferred revenue balance does not represent the total contract value of outstanding arrangements. Payment terms are net 30 to 45 days. Deferred revenue that will be recognized during the subsequent 12-month period is recorded as current deferred revenue and the remaining portion as non-current deferred revenue.

In some instances, customers elect to renew their application services arrangements prior to the original termination date of the arrangement. The renewed application services agreement provides support for in-process clinical trials, and includes the right to use the software for initial clinical studies. As such, the unrecognized portion of the deferred revenue associated with the initial arrangement is aggregated with the consideration received upon renewal and recognized as revenues over the renewed term of the application services arrangements.

In connection with our adoption of ASU 2009-13 on January 1, 2011, the recognizable portion of any remaining deferred revenue associated with multiple-element arrangements that are materially modified in 2011 is calculated based on an allocation of the total arrangement consideration (which includes the consideration of the modified arrangement plus the remaining balance of deferred revenue), to the remaining deliverables on the basis of their relative selling price. If the total arrangement consideration exceeds the sum of the total selling prices for the remaining deliverables, the surplus is recognized as revenues in the period of modification. If the total arrangement consideration does not exceed the sum of the total selling prices for the remaining deliverables, the shortfall is considered a discount and allocated to the remaining deliverables utilizing a relative-selling price method.

### **Results of Operations**

We recognize revenues from application services arrangements ratably over the terms of these arrangements. As a result, a substantial majority of our application services revenues in each quarter are generated from arrangements entered into during prior periods. Consequently, an increase or a decrease in new application services arrangements in any one quarter may not significantly affect our results of operations in that quarter.

Additionally, prior to 2011, when we sold application services and professional services in a multiple-element arrangement, which is our typical practice, we recognized revenues from professional services ratably over the term of the arrangement, rather than as the professional services were delivered, which varied throughout the arrangement term. Accordingly, a significant portion of the revenues for professional services performed in any reporting period had been deferred to future periods. In connection with our adoption of ASU No. 2009-13 on January 1, 2011 as noted in our critical accounting policies, we recognize revenues from professional services as delivered for any multiple-element arrangements entered into or materially modified in 2011. Regardless of revenue recognition, we recognize expenses related to our professional services in the period in which the expenses are incurred.

As a result, our professional services revenues and gross margin for any past or future reporting period associated with the multiple-element arrangements entered into prior to January 1, 2011 may not be reflective of the professional services delivered during that reporting period or of the current business trends with respect to our professional services.

Our results of operations for the three and nine months ended September 30, 2011 include the operations of Clinical Force since the date of acquisition, July 1, 2011. The operations of Clinical Force did not have a significant impact on our results of operations. For the three months ended September 30, 2011, we recognized \$0.2 million of revenues, and incurred \$0.2 million and \$0.3 million of cost of revenues and operating costs and expenses, respectively.

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The following table sets forth our consolidated results of operations as a percentage of total revenues for the periods shown:

|                                    | Three Months<br>Ended<br>September 30,<br>2011 |        | Nine Months<br>Ended<br>September 30,<br>2011 |        |
|------------------------------------|------------------------------------------------|--------|-----------------------------------------------|--------|
| Revenues:                          |                                                |        |                                               |        |
| Application services               | 77.6%                                          | 84.0%  | 79.0%                                         | 81.0%  |
| Professional services              | 22.4%                                          | 16.0%  | 21.0%                                         | 19.0%  |
| Total revenues                     | 100.0%                                         | 100.0% | 100.0%                                        | 100.0% |
| Cost of revenues:                  |                                                |        |                                               |        |
| Application services               | 15.7%                                          | 16.4%  | 15.6%                                         | 16.1%  |
| Professional services              | 13.4%                                          | 15.7%  | 13.5%                                         | 16.4%  |
| Total cost of revenues             | 29.1%                                          | 32.1%  | 29.1%                                         | 32.5%  |
| Gross profit                       | 70.9%                                          | 67.9%  | 70.9%                                         | 67.5%  |
| Operating costs and expenses:      |                                                |        |                                               |        |
| Research and development           | 15.8%                                          | 15.7%  | 15.7%                                         | 16.3%  |
| Sales and marketing                | 19.0%                                          | 18.2%  | 19.3%                                         | 19.2%  |
| General and administrative         | 19.7%                                          | 19.2%  | 20.1%                                         | 20.7%  |
| Total operating costs and expenses | 54.5%                                          | 53.1%  | 55.1%                                         | 56.2%  |
| Operating income                   | 16.4%                                          | 14.8%  | 15.8%                                         | 11.3%  |

*Three Months Ended September 30, 2011 Compared with Three Months Ended September 30, 2010*

### Revenues

|                       | 2011      |                  | Three Months Ended September 30,<br>2010 |                  | Change   |       |
|-----------------------|-----------|------------------|------------------------------------------|------------------|----------|-------|
|                       | Amount    | % of<br>Revenues | Amount                                   | % of<br>Revenues | Amount   | %     |
| (Amount in thousands) |           |                  |                                          |                  |          |       |
| Revenues:             |           |                  |                                          |                  |          |       |
| Application services  | \$ 35,940 | 77.6%            | \$ 34,522                                | 84.0%            | \$ 1,418 | 4.1%  |
| Professional services | 10,365    | 22.4%            | 6,580                                    | 16.0%            | 3,785    | 57.5% |
| Total revenues        | \$ 46,305 | 100.0%           | \$ 41,102                                | 100.0%           | \$ 5,203 | 12.7% |

*Total revenues.* Total revenues increased \$5.2 million, or 12.7%, to \$46.3 million for the three months ended September 30, 2011 from \$41.1 million for the same period in 2010. The increase in revenues was primarily due to a \$1.4 million increase in revenues from application services and a \$3.8 million increase in revenues from professional services. At the start of the third quarter of 2011, we had approximately \$74 million of 2011 remaining backlog. As of September 30, 2011, the total 2011 remaining backlog was approximately \$39 million.

*Application services revenues.* Revenues from application services increased \$1.4 million, or 4.1%, to \$36.0 million for the three months ended September 30, 2011 from \$34.5 million for the same period in 2010. The majority of the increase in application services revenues was derived from the revenue from new customers. We also benefited from increased product uptake and cross-selling to existing customers, as well as new

customer additions.

*Professional services revenues.* Revenues from professional services increased \$3.8 million, or 57.5%, to \$10.4 million for the three months ended September 30, 2011 from \$6.6 million for the same period in 2010. As a result of our adoption of ASU No. 2009-13, professional services revenues in multiple-element arrangements entered into in 2011 are recognized on a more accelerated, as-delivered basis, as compared with the revenues recognized ratably over the term of the arrangements in the prior period.

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**Table of Contents****Cost of Revenues**

|                        | 2011      |               | Three Months Ended September 30, 2010 |               | Change |        |
|------------------------|-----------|---------------|---------------------------------------|---------------|--------|--------|
|                        | Amount    | % of Revenues | Amount                                | % of Revenues | Amount | %      |
| (Amount in thousands)  |           |               |                                       |               |        |        |
| Cost of revenues:      |           |               |                                       |               |        |        |
| Application services   | \$ 7,279  | 15.7%         | \$ 6,738                              | 16.4%         | \$ 541 | 8.0%   |
| Professional services  | 6,224     | 13.4%         | 6,470                                 | 15.7%         | (246)  | (3.8)% |
| Total cost of revenues | \$ 13,503 | 29.1%         | \$ 13,208                             | 32.1%         | \$ 295 | 2.2%   |

*Total cost of revenues.* Total cost of revenues increased \$0.3 million, or 2.2%, to \$13.5 million for the three months ended September 30, 2011 from \$13.2 million for the same period in 2010.

*Cost of application services revenues.* Cost of application services revenues increased \$0.5 million, or 8.0%, to \$7.3 million for the three months ended September 30, 2011 from \$6.7 million for the same period in 2010. The increase was primarily due to an increase in personnel-related costs. We continued to increase staffing levels to support our growth in business.

*Cost of professional services revenues.* Cost of professional services revenues decreased \$0.2 million, or 3.8%, to \$6.2 million for the three months ended September 30, 2011 from \$6.5 million for the same period in 2010. The decrease was primarily driven by lower personnel-related costs resulting from a decline in headcount due to our effort to increase the utilization of professional services staff.

**Operating Costs and Expenses**

|                                    | 2011      |               | Three Months Ended September 30, 2010 |               | Change   |       |
|------------------------------------|-----------|---------------|---------------------------------------|---------------|----------|-------|
|                                    | Amount    | % of Revenues | Amount                                | % of Revenues | Amount   | %     |
| (Amount in thousands)              |           |               |                                       |               |          |       |
| Operating costs and expenses:      |           |               |                                       |               |          |       |
| Research and development           | \$ 7,306  | 15.8%         | \$ 6,450                              | 15.7%         | \$ 856   | 13.3% |
| Sales and marketing                | 8,788     | 19.0%         | 7,493                                 | 18.2%         | 1,295    | 17.3% |
| General and administrative         | 9,140     | 19.7%         | 7,905                                 | 19.2%         | 1,235    | 15.6% |
| Total operating costs and expenses | \$ 25,234 | 54.5%         | \$ 21,848                             | 53.1%         | \$ 3,386 | 15.5% |

*Total operating costs and expenses.* Total operating costs and expenses increased \$3.4 million, or 15.5%, to \$25.2 million for the three months ended September 30, 2011 from \$21.8 million for the same period in 2010. Costs increased in each department with the larger increases in sales and marketing and general and administrative expenses.

*Research and development expenses.* Research and development expenses increased \$0.9 million, or 13.3%, to \$7.3 million for the three months ended September 30, 2011 from \$6.4 million for the same period in 2010. The increase was primarily due to an increase in personnel-related costs, which was attributable to our increase in staffing levels in order to support our strategy to continue to enhance and broaden our products offerings. The increase was also due to an increase in technology-related expenses to support our overall growth in research and development.

*Sales and marketing expenses.* Sales and marketing expenses increased \$1.3 million, or 17.3%, to \$8.8 million for the three months ended September 30, 2011 from \$7.5 million for the same period in 2010. The increase was primarily due to higher personnel-related costs, attributable to our sales team expansion in order to support our continuing growth in sales. The increase in personnel-related costs was also attributable to a higher stock-based compensation expense primarily due to new awards granted in 2011. The overall increase was also driven by higher travel costs and conference expenses as a result of increased sales and marketing efforts and higher recruiting expenses driven by the increase in

headcount.

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*General and administrative expenses.* General and administrative expenses increased \$1.2 million, or 15.6%, to \$9.1 million for the three months ended September 30, 2011 from \$7.9 million for the same period in 2010. The increase was primarily due to an increase in professional fees and personnel-related costs. The increased professional fees were driven by legal fees associated with our ongoing litigation matters and higher accounting fees. The increase in personnel-related costs primarily resulted from a higher stock-based compensation expense largely due to new awards granted in 2011.

**Income Tax Expense**

Income tax expense decreased \$1.0 million to \$0.4 million for the three months ended September 30, 2011 from \$1.4 million for the same period in 2010. This decrease was primarily due to our ability to fully utilize our federal net operating loss carryforwards to offset federal taxable income as a result of the increased Section 382 limitation based upon our tax analysis completed in the fourth quarter of 2010. Our income tax expense for the three months ended September 30, 2011 was also impacted by a \$0.3 million tax benefit resulting from the federal return to provision adjustment. Our foreign income taxes were fairly consistent for the three months ended September 30, 2011 as compared with the same period in 2010.

**Nine Months Ended September 30, 2011 Compared with Nine Months Ended September 30, 2010****Revenues**

|                       | 2011       |               | Nine Months Ended September 30, 2010 |               | Change    |       |
|-----------------------|------------|---------------|--------------------------------------|---------------|-----------|-------|
|                       | Amount     | % of Revenues | Amount                               | % of Revenues | Amount    | %     |
| (Amount in thousands) |            |               |                                      |               |           |       |
| Revenues:             |            |               |                                      |               |           |       |
| Application services  | \$ 108,372 | 79.0%         | \$ 96,414                            | 81.0%         | \$ 11,958 | 12.4% |
| Professional services | 28,892     | 21.0%         | 22,643                               | 19.0%         | 6,249     | 27.6% |
| Total revenues        | \$ 137,264 | 100.0%        | \$ 119,057                           | 100.0%        | \$ 18,207 | 15.3% |

*Total revenues.* Total revenues increased \$18.2 million, or 15.3%, to \$137.3 million for the nine months September 30, 2011 from \$119.0 million for the same period in 2010. The increase in revenues was primarily due to a \$12.0 million increase in revenues from application services and a \$6.2 million increase in revenues from professional services. At the start of 2011, we had approximately \$135 million of 2011 full year backlog. As of September 30, 2011, the total 2011 remaining backlog was approximately \$39 million.

*Application services revenues.* Revenues from application services increased \$12.0 million, or 12.4%, to \$108.4 million for the nine months ended September 30, 2011 from \$96.4 million for the same period in 2010. The majority of the increase in application services revenues was derived from increased activity in our existing large and midmarket customers, primarily resulting from new studies and renewals. We also benefited from increased product uptake and cross-selling to existing customers, as well as new customer additions. During the first nine months of 2011, we added 61 customers, including 18 customers acquired as a result of the acquisition of Clinical Force, to reach a total of 261 customers as of September 30, 2011. Revenues from new customers accounted for 32% of the total increase in application services revenues. Revenues also expanded significantly from customers based in Asia and North America, which grew 35% and 11%, respectively, whereas revenues from customers based in Europe grew slightly as compared with the prior period. As a result of our adoption of ASU No. 2009-13, our application services revenues also benefitted from a \$2.5 million one-time revenue acceleration primarily associated with two customer contract renewals.

*Professional services revenues.* Revenues from professional services increased \$6.2 million, or 27.6%, to \$28.9 million for the nine months ended September 30, 2011 from \$22.6 million for the same period in 2010. Professional services revenues benefitted from a \$3.5 million one-time revenue acceleration associated with two customer contract renewals as required per the adoption of ASU No. 2009-13. Excluding this impact, our professional services revenues increased as compared with the prior period. The increase was primarily driven by the timing of revenue recognition, as our professional service revenues in multiple-element arrangements entered



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into in 2011 are recognized on a more accelerated, as-delivered basis, following our adoption of ASU No. 2009-13. This increase was partially offset by the current period decline in the estimated fair value utilized to determine the value of our professional services associated with our multiple-element arrangements entered into prior to 2011.

**Cost of Revenues**

|                        | Nine Months Ended September 30, |          |           |          |          |        |
|------------------------|---------------------------------|----------|-----------|----------|----------|--------|
|                        | 2011                            |          | 2010      |          | Change   |        |
|                        | Amount                          | % of     | Amount    | % of     | Amount   | %      |
|                        |                                 | Revenues |           | Revenues |          |        |
| (Amount in thousands)  |                                 |          |           |          |          |        |
| Cost of revenues:      |                                 |          |           |          |          |        |
| Application services   | \$ 21,471                       | 15.6%    | \$ 19,132 | 16.1%    | \$ 2,339 | 12.2%  |
| Professional services  | 18,476                          | 13.5%    | 19,471    | 16.4%    | (995)    | (5.1)% |
| Total cost of revenues | \$ 39,947                       | 29.1%    | \$ 38,603 | 32.5%    | \$ 1,344 | 3.5%   |

*Total cost of revenues.* Total cost of revenues increased \$1.3 million, or 3.5%, to \$39.9 million for the nine months ended September 30, 2011 from \$38.6 million for the same period in 2010.

*Cost of application services revenues.* Cost of application services revenues increased \$2.3 million, or 12.2%, to \$21.5 million for the nine months ended September 30, 2011 from \$19.1 million for the same period in 2010. The increase was principally due to an increase in personnel-related costs. We continued to increase staffing levels to support our growth in business.

*Cost of professional services revenues.* Cost of professional services decreased \$1.0 million, or 5.1%, to \$18.5 million for the nine months ended September 30, 2011 from \$19.5 million for the same period in 2010. The decrease was primarily driven by lower personnel-related costs and allocated general overhead costs resulting from a decline in headcount due to our effort to increase the utilization of professional services staff.

**Operating Costs and Expenses**

|                                    | Nine Months Ended September 30, |          |           |          |          |       |
|------------------------------------|---------------------------------|----------|-----------|----------|----------|-------|
|                                    | 2011                            |          | 2010      |          | Change   |       |
|                                    | Amount                          | % of     | Amount    | % of     | Amount   | %     |
|                                    |                                 | Revenues |           | Revenues |          |       |
| (Amount in thousands)              |                                 |          |           |          |          |       |
| Operating costs and expenses:      |                                 |          |           |          |          |       |
| Research and development           | \$ 21,511                       | 15.7%    | \$ 19,464 | 16.3%    | \$ 2,047 | 10.5% |
| Sales and marketing                | 26,519                          | 19.3%    | 22,913    | 19.2%    | 3,606    | 15.7% |
| General and administrative         | 27,522                          | 20.1%    | 24,679    | 20.7%    | 2,843    | 11.5% |
| Total operating costs and expenses | \$ 75,552                       | 55.1%    | \$ 67,056 | 56.2%    | \$ 8,496 | 12.7% |

*Total operating costs and expenses.* Total operating costs and expenses increased \$8.5 million, or 12.7%, to \$75.6 million for the nine months ended September 30, 2011 from \$67.0 million for the same period in 2010. Costs increased in each department with the largest percentage increase in sales and marketing.

*Research and development expenses.* Research and development expenses increased \$2.0 million, or 10.5%, to \$21.5 million for the nine months ended September 30, 2011 from \$19.5 million for the same period in 2010. The increase was primarily due to an increase in personnel-related costs of \$1.5 million, which was attributable to our increase in staffing levels in order to support our strategy to continue to enhance and broaden our products offerings. The increase was also due to an increase in technology-related expenses of \$0.8 million to support our overall growth in research and development.



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*Sales and marketing expenses.* Sales and marketing expenses increased \$3.6 million, or 15.7%, to \$26.5 million for the nine months ended September 30, 2011 from \$22.9 million for the same period in 2010. The increase was primarily due to higher personnel-related costs of \$3.1 million, attributable to our sales team expansion in order to support our continuing growth in sales. The increase in personnel-related costs was also attributable to a higher commission expense driven by our sales growth and a higher stock-based compensation expense. The overall increase was also driven by higher travel costs and conference expenses as a result of increased sales and marketing efforts and higher recruiting costs driven by the increase in headcount.

*General and administrative expenses.* General and administrative expenses increased \$2.9 million, or 11.5%, to \$27.5 million for the nine months ended September 30, 2011 from \$24.6 million for the same period in 2010. The increase was primarily due to an increase in personnel-related costs of \$1.4 million and professional fees of \$1.2 million. The increase in personnel-related costs was primarily resulted from a higher stock-based compensation expense resulting from a full nine months impact in 2011 from our equity awards granted in May 2010, as well as additional costs associated with our equity awards granted in May 2011. The increased professional fees were driven by higher accounting fees, and certain legal fees incurred for our acquisition of Clinical Force and associated with our ongoing litigation matters.

### ***Income Tax Expense***

Income tax expense decreased \$2.7 million to \$1.5 million for the nine months ended September 30, 2011 from \$4.2 million for the same period in 2010. This decrease was primarily due to our ability to fully utilize our federal net operating loss carryforwards to offset federal taxable income as a result of the increased Section 382 limitation based upon our tax analysis completed in the fourth quarter of 2010. Our foreign income taxes were fairly consistent for the nine months ended September 30, 2011 as compared with the same period in 2010.

### ***Liquidity and Capital Resources***

Our principal sources of liquidity were cash, cash equivalents and marketable securities of \$102.7 million at September 30, 2011 and \$85.5 million at December 31, 2010. Cash and cash equivalents increased \$10.0 million during the first nine months of 2011 primarily due to our strong sales activities and collection from our accounts receivable, partially offset by net purchases of marketable securities and the cash consideration paid for the acquisition of Clinical Force at closing. We manage our cash equivalents and marketable securities as a single investment portfolio that is intended to be available to meet our current cash requirements. Cash equivalents substantially consist of investment in money market funds. Marketable securities, which we classify as available-for-sale securities, primarily consist of high quality commercial paper, corporate bonds, U.S. government debt obligations and foreign government fixed income securities. Marketable securities with remaining effective maturities of twelve months or less from the balance sheet date are classified as short-term; otherwise, they are classified as long-term on the consolidated balance sheet. Our investment policy for this investment portfolio generally requires investments in securities with less than one year to maturity.

We have a \$10.0 million revolving line of credit under our senior secured credit facility, as amended, that matures in September 2013. Except for the \$0.1 million reduction of the available amount due to a standby letter of credit issued in connection with the office lease executed under our credit agreement in March 2011, the revolving line of credit remains undrawn. As of September 30, 2011, approximately \$9.9 million of the revolving line of credit was still available for future borrowings. Due to the structure of the credit agreement, any future borrowings under the revolving line of credit will be classified as a current liability. As of September 30, 2011, the effective interest rate for our senior secured credit facility, as amended, was 2.74%, if borrowing under the U.S. London Interbank Offer Rate, or LIBOR, option. We are in compliance with all covenants under our senior secured credit facility, as amended, as of September 30, 2011.

We believe that our cash flows from operations, existing cash and cash equivalents and highly liquid marketable securities and our availability under our existing revolving line of credit will be sufficient to satisfy the anticipated cash requirements associated with our existing operations for the foreseeable future. For the remainder of 2011, we expect to make approximately \$3 to 4 million in capital expenditures, primarily to enhance our infrastructure and increase the capacity in our Houston data center, as well as to enhance our computer equipment across various corporate functions. We expect to acquire our capital equipment through purchases as opposed to capital lease arrangements.

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### ***Cash Flows***

#### ***Cash Flows Provided By Operating Activities***

Cash flows provided by operating activities during the nine months ended September 30, 2011 were \$26.3 million, which consisted primarily of a net income of \$20.7 million, non-cash adjustments of stock-based compensation of \$6.5 million and depreciation and amortization of \$5.9 million, a decrease in accounts receivable of \$14.9 million, partially offset by a decrease in deferred revenue of \$20.0 million. The change in working capital was impacted by the fluctuation within accounts receivable and deferred revenue, which was primarily due to strong customer collections, the timing of billings, the associated revenue recognition and the decline in large upfront payments received from our customers. Some of our larger customers changed to more periodic payment terms upon their contracts renewals which is consistent with our expectation as our SaaS business model continues to evolve.

Cash flows provided by operating activities during the nine months ended September 30, 2010 were \$7.4 million, which consisted primarily of a net income of \$9.5 million, non-cash adjustments of depreciation and amortization of \$7.0 million and stock-based compensation of \$4.6 million, partially offset by a decrease in deferred revenue of \$7.3 million and an increase in accounts receivable of \$3.0 million. The decrease in operating cash flows was primarily due to a decline in large upfront payments received from our customers, as some of our larger customers changed to more periodic payment terms upon their contract renewals. This trend is consistent with our expectation as our SaaS business model continues to evolve.

#### ***Cash Flows Used In Investing Activities***

Cash flows used in investing activities during the nine months ended September 30, 2011 were \$16.1 million, which was related to the \$93.9 million purchases of marketable securities, the \$5.2 million of cash consideration paid for the acquisition of Clinical Force, and the \$2.9 million purchases of furniture, fixtures and equipment, partially offset by the \$85.7 million proceeds from the sale and maturity of marketable securities and a \$0.1 million decrease in our restricted cash. For the nine months ended September 30, 2011, we did not acquire any equipment through capital lease arrangements.

Cash flows used in investing activities during the nine months ended September 30, 2010 were \$27.4 million, which was related to the \$65.2 million purchases of marketable securities and the \$5.6 million purchases of furniture, fixtures and equipment, partially offset by the \$43.4 million in proceeds from the maturity of marketable securities. For the nine months ended September 30, 2010, we did not acquire any equipment through capital lease arrangements.

#### ***Cash Flows Used In Financing Activities***

Cash flows used in financing activities during the nine months ended September 30, 2011 were \$0.1 million, which was primarily due to \$1.7 million relating to the acquisition of treasury stock in connection with the vesting of restricted stock awards and \$0.6 million of capital lease principal payments, partially offset by \$2.2 million of proceeds from stock options exercise.

Cash flows used in financing activities during the nine months ended September 30, 2010 were \$1.0 million, which was primarily due to \$2.4 million of capital lease principal payments and \$0.4 million relating to the acquisition of treasury stock in connection with the vesting of restricted stock awards activities, partially offset by \$1.0 million of proceeds from stock options exercise and \$0.8 million of excess tax benefit realized from stock options exercise and restricted stock awards vesting.

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### ***Contractual Obligations, Commitments and Contingencies***

In March 2011, we entered into a lease amendment to renew and expand our office in Conshohocken, Pennsylvania. Pursuant to the amended lease agreement, the renewed lease has a term of five years which will expire in June 2016. The expansion will provide us a total office space of 10,297 rentable square feet. The total amount of obligations is approximately \$1.3 million over the term of this amended lease agreement.

In April 2011, we entered into a lease modification to extend the term of our office lease in New York, New York. Pursuant to the modified lease agreement, the term of the lease will be extended from March 2012 to September 2013. The total amount of obligations is approximately \$1.1 million over the extended term.

In July 2011, we completed an acquisition of Clinical Force. Pursuant to the terms of the purchase agreement, the total consideration includes earn-out payments of up to \$2.6 million. Of the maximum payable amount, \$1.7 million will be cash and up to \$0.9 million will be paid in the form of promissory notes to be issued to certain sellers by us. The earn-out payments are contingent upon the achievement of future billing targets for the CTMS application and will be calculated over three measuring periods beginning at December 31, 2011 and continuing for each of the next two calendar years thereafter.

Other than stated above, there was no material change in our contractual obligations during the first nine months of 2011.

In 2006, it was claimed that certain applications offered to our customers potentially infringed on intellectual property rights held by a third party. As a result of negotiations with the claimant, we entered into a license and settlement agreement in June 2007, pursuant to which we licensed the intellectual property held by the claimant for use in our future sales to customers and settled all past infringement claims. We paid a settlement amount of \$2.2 million to the claimant in 2007. In June 2009, the claimant initiated a lawsuit against us claiming breach of contract. The complaint includes allegations that we have failed to pay unspecified royalties relating to sales of our products. We believe that the allegations in this lawsuit are without merit. We filed an answer in July 2009, denying all material allegations and asserting affirmative defenses. We also asserted counterclaims for a declaratory judgment that no royalties are owed with respect to sales of our products, as well as a counterclaim for claimant's breach of the license and settlement agreement. The parties are nearing completion of pre-trial discovery activities. A trial date has not yet been scheduled. Since the probable outcome and the future economic impact of this litigation on us remain uncertain, we are unable to develop an estimate of our potential liability, if any, as it relates to this litigation. As a result, we did not record a liability as of September 30, 2011 nor December 31, 2010.

In January 2009, we entered into agreements with certain of our executive officers that provide them with certain benefits upon the termination of their employment following a change of control in our company. The agreements provide that, upon a qualifying event, such officers will be entitled to (a) a severance payment equal to the officer's base salary plus target bonus amount; (b) continuation of health benefits for 12 months; (c) immediate vesting of any remaining unvested equity awards; and (d) a tax gross up payment under Section 280G of the Internal Revenue Code sufficient to reimburse the officer for 50% of any excise tax payable as a result of any termination payments following a change in control, if applicable.

On March 4, 2011, DataTrak International, Inc., or DataTrak, filed a complaint for alleged patent infringement against us in DataTrak International v. Medidata Solutions, C.A. No. 1:11-cv-00458 in the U.S. District Court for the Northern District of Ohio. The complaint asserts infringement of U.S. Patent No. 7,464,087, which claims a method and system for unifying data from a variety of sources and seeks unspecified damages and injunctive relief. DataTrak formally served us with the complaint on June 6, 2011. The initial complaint did not provide any details concerning the alleged infringement; however, DataTrak amended the complaint in July 2011 and named Medidata Rave as an allegedly infringing product. In July 2011, we filed our answer to the amended complaint as well as counterclaims seeking a declaratory judgment of non-infringement and a finding that patent at issue is invalid. We intend to defend against DataTrak's claims, and to pursue our counterclaims, vigorously. On October 28, 2011, we filed a reexamination request in the U.S. Patent and Trademark Office seeking to invalidate and/or narrow all of the claims of the asserted patent. On the same day, we filed a motion to stay this litigation in view of the reexamination report. The court has not yet entered an order on this motion. The probability of a favorable or unfavorable outcome to us is unknown and a range of loss, if any, cannot be estimated at this time. As a result, no accrual has been recorded by us associated with this litigation.

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### **Effects of Recently Issued Accounting Standards**

In October 2009, the Financial Accounting Standards Board, or FASB issued ASU No. 2009-14, *Certain Revenue Arrangements that Include Software Elements*. ASU No. 2009-14 amends the scoping guidance for software arrangements under ASC 985-605, *Software Revenue Recognition*, to exclude tangible products that contain software elements and nonsoftware elements that function together to interdependently deliver the product's essential functionality. Such tangible products being excluded from ASU No. 2009-14 will instead fall under the scope of ASU No. 2009-13. The FASB also provided several considerations and examples for entities applying this guidance. ASU No. 2009-14 is effective for new or materially modified arrangements in fiscal years beginning on or after June 15, 2010. We adopted ASU No. 2009-14 prospectively and concurrently with ASU No. 2009-13 on January 1, 2011 and the adoption did not have a material impact on our consolidated financial statements.

In April 2010, the FASB issued ASU No. 2010-13, *Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades*, which amends ASC 718, *Compensation - Stock Compensation*, to clarify that a share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades must not be considered a market, performance, or service condition. Therefore, an entity should not classify such an award as a liability if it otherwise qualifies for classification in equity. ASU No. 2010-13 is effective for interim and annual periods beginning on or after December 15, 2010. We adopted ASU No. 2010-13 on January 1, 2011. All of our stock-based awards granted to our international employees were classified as equity awards in accordance with our current accounting policy, which is consistent with the accounting treatment contained in this ASU No. 2010-13. Therefore, the adoption of this ASU No. 2010-13 did not have a material impact on our consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The amendments in this ASU generally represent clarification of ASC 820-10, *Fair Value Measurements and Disclosures*, but also include instances where a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements has changed. This ASU is the result of joint efforts by the FASB and International Accounting Standards Board to develop a single, converged fair value framework and guidance with respect to how to measure fair value and what disclosures to provide about fair value measurements. ASU No. 2011-04 is effective for interim and annual periods beginning after December 15, 2011. The adoption of this ASU No. 2011-04 is not expected to have a material impact on our consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income*, which removes the presentation options contained in ASC 220, *Comprehensive Income*, and requires entities to report components of comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements. Under the two-statement approach, the first statement would include components of net income, which is consistent with the format of statement of operations used today, and the second statement would include components of other comprehensive income. ASU No. 2011-05 is effective for interim and annual periods beginning after December 15, 2011 and must be applied retrospectively for all periods presented in the financial statements. Early adoption is permitted. The adoption of this ASU No. 2011-05 is not expected to have a material impact on our consolidated financial statements other than merely a change in its presentation.

In September 2011, the FASB issued ASU No. 2011-08, *Testing Goodwill for Impairment*, which simplifies how entities test goodwill for impairment. ASU No. 2011-08 permits an entity to assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. ASU No. 2011-08 is effective for interim and annual reporting periods beginning after December 15, 2011, with early adoption permitted. We are currently evaluating the impact, if any, of the provisions of ASU No. 2011-08 on our consolidated financial statements.

### **Dividends**

We currently expect to retain any future earnings for use in the operation and expansion of our business and do not anticipate paying any cash dividends on our common stock.

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

We do not have any relationships with unconsolidated entities of financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Other than our operating leases for office space and computer equipment, we do not engage in off-balance sheet financing arrangements.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

#### ***Interest Rate Sensitivity***

We had unrestricted cash and cash equivalents totaling \$26.0 million at September 30, 2011. Our cash equivalents are invested in money market funds and certain U.S. government obligations and commercial paper with maturities of less than three months, the fair value of which is not materially affected by fluctuations in interest rates. We also had investment in marketable securities, which we classify as available-for-sale securities, totaling \$76.6 million at September 30, 2011. Substantially all of our marketable securities are fixed income securities, which primarily consist of high quality commercial paper, corporate bonds, U.S. government debt obligations and foreign government fixed income securities. The unrestricted cash and cash equivalents as well as marketable securities are held for working capital purposes. We manage our cash equivalents and marketable securities as a single investment portfolio that is intended to be available to meet our current cash requirements. We do not enter into investments for trading or speculative purposes. Due to the short-term nature and high credit ratings of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. Declines in interest rates, however, would reduce future investment income.

We have a floating rate revolving line of credit under our senior secured credit facility, as amended, which is currently undrawn. Accordingly, we will be exposed to fluctuations in interest rates if such revolving line of credit is drawn. Assuming the maximum available amount of our revolving line of credit was drawn as of September 30, 2011, each hundred basis point change in prime rate or LIBOR would result in a change in interest expense by an average of approximately \$0.1 million annually.

#### ***Exchange Rate Sensitivity***

We have two separate exposures to currency fluctuation risk: subsidiaries outside the United States which use a foreign currency as their functional currency that are translated into U.S. dollars for consolidation; and non-U.S. dollar invoiced revenues.

Changes in foreign exchange rates for our subsidiaries that use a foreign currency as their functional currency are translated into U.S. dollars and result in cumulative translation adjustments, which are included in accumulated other comprehensive income (loss). We have translation exposure to various foreign currencies, including the Euro, British Pound Sterling and Japanese Yen. The potential loss resulting from a hypothetical 10% adverse change in quoted foreign currency exchange rates amounts to \$0.4 million as of September 30, 2011.

We generally invoice our customers in U.S. dollars. However, we invoice a portion of customers in foreign currencies, the majority of which is denominated in Euro and Canadian dollars. As such, the fluctuations in such currencies could impact our operating results.

#### ***Impact of Inflation***

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we might not be able to offset these higher costs fully through price increases. Our inability or failure to do so could harm our business, operating results and financial condition.

#### ***Fair Value of Financial Instruments***

ASC 825-10, *Financial Instruments*, requires disclosure about fair value of financial instruments. The carrying amounts of our financial instruments, which consist of cash and cash equivalents, receivables, accounts payable and accrued liabilities, approximate fair value because of the short maturity of these instruments. Fair values of



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marketable securities are based on unadjusted quoted market prices or pricing models using current market data that are observable either directly or indirectly. All methods of assessing fair value result in a general approximation of value, and such value may never actually be realized.

### **Item 4. Controls and Procedures**

#### ***Evaluation of Disclosure Controls and Procedures***

As of September 30, 2011, an evaluation was performed with the participation of our Disclosure Committee and our management, including the Chief Executive Officer, or CEO, and the Chief Financial Officer, or CFO, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures are also designed to ensure that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Based upon such evaluation, our CEO and CFO have concluded that our disclosure controls and procedures were effective as of September 30, 2011.

#### ***Changes in Internal Control over Financial Reporting***

There were no changes in our internal control over financial reporting, during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

See Note 9, Commitments and Contingencies – Legal Matters, to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for a description of current legal proceedings.

**Item 1A. Risk Factors**

We operate in a rapidly changing environment that involves a number of risks, some of which are beyond our control. The risks described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 are those which we believe are the material risks we face. There have been no material changes in our risk factors since our Annual Report on Form 10-K for the fiscal year ended December 31, 2010. Any of those disclosed risk factors or additional risks and uncertainties not presently known to us, or that we currently deem immaterial, could have a material adverse effect on our business, financial condition and results of operations.

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

Not applicable.

**Use of Proceeds from our IPO**

In July 2009, we used a portion of the net proceeds from our IPO in June 2009 to prepay the entire outstanding indebtedness of the term loan under our credit facility. The total payoff amount of \$14.7 million included the outstanding principal balance of \$14.3 million, as well as accrued interest and termination fees of \$0.4 million.

In addition, we also used a portion of the net proceeds from our IPO to acquire Clinical Force in July 2011. The total consideration was cash payment of \$5.2 million paid at closing and earn-out payments of up to \$2.6 million. The earn-out payments are contingent upon the achievement of future billing targets for the CTMS application and will be payable in three annual installments beginning at December 31, 2011.

The remaining net proceeds from our IPO have been invested in high quality marketable securities. We plan to use these remaining net proceeds for working capital and other general corporate purposes.

**Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

From time to time, we grant restricted stock awards to our employees pursuant to the terms of our 2009 Long-Term Incentive Plan, or 2009 Plan. Under the provisions of our 2009 Plan, the plan participants are allowed to cover their income tax withholding obligation through net shares upon the vesting of their restricted shares. On the date of vesting of restricted shares, we determine the number of vested shares to be withheld based on their fair value at closing price of our common stock on the vesting date, which equals to the amount of plan participants' income tax withholding obligation.

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A summary of our repurchases of shares of our common stock for the three months ended September 30, 2011 was as follows:

|             |                    |                                                    |                                             | <b>Total<br/>Number<br/>of<br/>Shares<br/>Purchased as<br/>Part of<br/>Publicly<br/>Announced<br/>Plans or<br/>Programs</b> | <b>Maximum<br/>Number of<br/>Shares that<br/>May Yet be<br/>Purchased<br/>under the<br/>Plans<br/>or<br/>Programs</b> |
|-------------|--------------------|----------------------------------------------------|---------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------|
|             |                    | <b>Total Number<br/>of Shares<br/>Purchased(1)</b> | <b>Average<br/>Price Paid<br/>per Share</b> |                                                                                                                             |                                                                                                                       |
| July 1      | July 31, 2011      |                                                    | \$                                          |                                                                                                                             |                                                                                                                       |
| August 1    | August 31, 2011    | 5,528                                              | 15.90                                       |                                                                                                                             |                                                                                                                       |
| September 1 | September 30, 2011 |                                                    |                                             |                                                                                                                             |                                                                                                                       |
| Total       |                    | 5,528                                              | \$ 15.90                                    |                                                                                                                             |                                                                                                                       |

- (1) Represents the number of shares acquired as payment by employees of applicable statutory minimum withholding taxes owed upon vesting of restricted stock granted under our 2009 Plan.

**Item 3. Defaults Upon Senior Securities**  
None.

**Item 4. [Removed and Reserved]**

**Item 5. Other Information**  
None.

**Item 6. Exhibits**  
The information required by this Item 6 is set forth on the exhibit index that follows the signature page of this report.

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**Signature**

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

**MEDIDATA SOLUTIONS, INC.**

By: /s/ CORY DOUGLAS  
Cory Douglas

*Chief Financial Officer (Principal Financial and  
Chief Accounting Officer)*

Date: November 8, 2011

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**EXHIBIT INDEX**

| <b>Exhibit No.</b> | <b>Description</b>                                                                                       |
|--------------------|----------------------------------------------------------------------------------------------------------|
| 31.1*              | Certification of CEO pursuant to Rule 13a-14(a) or Rule 15d-14(a) under the Exchange Act.                |
| 31.2*              | Certification of CFO pursuant to Rule 13a-14(a) or Rule 15d-14(a) under the Exchange Act.                |
| 32.1*              | Certification of CEO pursuant to Rules 13a-14(b) or 15d-14(b) under the Exchange Act and 18 U.S.C. 1350. |
| 32.2**             | Certification of CFO pursuant to Rules 13a-14(b) or 15d-14(b) under the Exchange Act and 18 U.S.C. 1350. |
| 101.INS***         | XBRL Instance Document                                                                                   |
| 101.SCH***         | XBRL Taxonomy Extension Schema Document                                                                  |
| 101.CAL***         | XBRL Taxonomy Extension Calculation Linkbase Document                                                    |
| 101.LAB***         | XBRL Taxonomy Extension Label Linkbase Document                                                          |
| 101.PRE***         | XBRL Taxonomy Extension Presentation Linkbase Document                                                   |

\* Filed herewith.

\*\* Furnished herewith.

\*\*\* In accordance with Rule 406T of Regulation S-T, the information in Exhibit 101 is furnished and deemed not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Exchange Act of 1934, and otherwise is not subject to liability under these sections and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.