Medidata Solutions, Inc.
Form 10-Q
November 10, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2010

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)

Delaware **(State or other jurisdiction of** **incorporation or organization)**	**13-4066508** **(I.R.S. Employer** **Identification No.)**
79 Fifth Avenue, 8th Floor **New York, New York** **(Address of principal executive offices)**	**10003** **(Zip Code)**

(212) 918-1800

(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. x Yes ¨ No

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 x (Do not check if a smaller reporting company)	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 x No

As of November 4, 2010, the registrant had 23,810,771 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, 2010

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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, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 18,425	$ 39,449
Marketable securities	70,647	36,566
Accounts receivable, net of allowance for doubtful accounts of $305 and $197, respectively	21,868	18,887
Prepaid commission expense	2,846	3,045
Prepaid expenses and other current assets	5,957	3,566
Deferred income taxes	139	139
Total current assets	119,882	101,652
Restricted cash	532	532
Marketable securities long term		13,072
Furniture, fixtures and equipment, net	11,288	12,960
Goodwill	9,799	9,799
Intangible assets, net	3,309	4,404
Other assets	1,167	990
Total assets	$ 145,977	$ 143,409
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,884	$ 3,073
Accrued payroll and other compensation	9,202	10,837
Accrued expenses and other	6,554	7,543
Deferred revenue	72,632	69,842
Capital lease obligations	956	2,735
Total current liabilities	91,228	94,030
Noncurrent liabilities:		
Deferred revenue, less current portion	17,763	27,868
Capital lease obligations, less current portion	175	781
Other long-term liabilities	813	498
Total noncurrent liabilities	18,751	29,147
Total liabilities	109,979	123,177
Commitments and contingencies		
Stockholders equity:		

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, 23,835 and 22,900 shares issued; 23,797 and 22,895 shares outstanding, respectively	238	229
Additional paid-in capital	120,150	113,674
Treasury stock, 38 and 5 shares, respectively	(474)	(69)
Accumulated other comprehensive loss	(53)	(246)
Accumulated deficit	(83,863)	(93,356)
Total stockholders equity	35,998	20,232
Total liabilities and stockholders equity	$ 145,977	$ 143,409

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

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MEDIDATA SOLUTIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(Amounts in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenues				
Application services	$ 34,522	$ 25,957	$ 96,414	$ 74,145
Professional services	6,580	9,260	22,643	28,702
Total revenues	41,102	35,217	119,057	102,847
Cost of revenues(1)(2)				
Application services	6,738	6,006	19,132	17,521
Professional services	6,470	6,458	19,471	19,910
Total cost of revenues	13,208	12,464	38,603	37,431
Gross profit	27,894	22,753	80,454	65,416
Operating costs and expenses:				
Research and development(1)	6,450	5,608	19,464	16,894
Sales and marketing(1)(2)	7,493	6,709	22,913	20,167
General and administrative(1)	7,905	7,814	24,679	22,672
Total operating costs and expenses	21,848	20,131	67,056	59,733
Operating income	6,046	2,622	13,398	5,683
Interest and other income (expense):				
Interest expense	(48)	(908)	(195)	(1,747)
Interest income	95	10	288	73
Other income (expense), net	25	44	158	36
Total interest and other income (expense), net	72	(854)	251	(1,638)
Income before income taxes	6,118	1,768	13,649	4,045
Provision for income taxes	1,454	219	4,156	602
Net income	$ 4,664	$ 1,549	$ 9,493	$ 3,443
Earnings per share:				
Basic	$ 0.20	$ 0.07	$ 0.41	$ 0.26
Diluted	$ 0.20	$ 0.06	$ 0.40	$ 0.17
Weighted average common shares outstanding:				
Basic	23,019	22,364	22,878	12,318
Diluted	23,856	23,846	23,738	19,693

(1)Stock-based compensation expense included in cost of revenues and operating costs and expenses is as follows:

Cost of revenues	$ 240	$ 124	$ 525	$ 280

Research and development	150	129	378	397
Sales and marketing	398	376	1,060	844
General and administrative	1,059	876	2,692	1,907
Total stock-based compensation	$ 1,847	$ 1,505	$ 4,655	$ 3,428

(2)Amortization expense of intangible assets included in cost of revenues and operating costs and expenses is as follows:

Cost of revenues	$ 277	$ 421	$ 831	$ 1,262
Sales and marketing	88	36	264	108
Total amortization of intangible assets	$ 365	$ 457	$ 1,095	$ 1,370

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

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MEDIDATA SOLUTIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(Amounts in thousands)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Cash flows from operating activities:		
Net income	$ 9,493	$ 3,443
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,045	7,810
Stock-based compensation	4,655	3,428
Amortization of discounts or premiums on marketable securities	887	
Excess tax benefit associated with equity awards	(827)	
Deferred income taxes	44	42
Amortization of debt issuance costs	42	420
Changes in operating assets and liabilities:		
Accounts receivable	(2,981)	5,632
Prepaid commission expense	199	60
Prepaid expenses and other current assets	(2,391)	(212)
Other assets	2	(54)
Accounts payable	(57)	(885)
Accrued payroll and other compensation	(1,635)	766
Accrued expenses and other	153	632
Deferred revenue	(7,315)	2,618
Other long-term liabilities	71	7
Net cash provided by operating activities	7,385	23,707
Cash flows from investing activities:		
Purchases of furniture, fixtures and equipment	(5,609)	(3,442)
Purchases of available-for-sale securities	(65,169)	
Proceeds from sale of available-for-sale securities	43,363	
Decrease in restricted cash		13
Net cash used in investing activities	(27,415)	(3,429)
Cash flows from financing activities:		
Proceeds from exercise of stock options	1,003	20
Excess tax benefit associated with equity awards	827	
Repayment of obligations under capital leases	(2,385)	(3,658)
Acquisition of treasury stock	(405)	
Payment of debt issuance costs	(21)	
Proceeds from initial public offering, net of underwriting discounts and commissions		82,026
Payment of costs associated with initial public offering		(4,288)
Payment of preferred stock accumulated accrued dividends		(2,282)
Repayment of debt obligation		(15,000)
Net cash (used in) provided by financing activities	(981)	56,818

Net (decrease) increase in cash and cash equivalents	(21,011)	77,096
Effect of exchange rate changes on cash and cash equivalents	(13)	20
Cash and cash equivalents Beginning of period	39,449	9,784
Cash and cash equivalents End of period	$ 18,425	$ 86,900

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

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MEDIDATA SOLUTIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED (Unaudited)

(Amounts in thousands)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 147	$ 1,320
Income taxes	$ 2,745	$ 739
Noncash activities:		
Furniture, fixtures and equipment acquired through capital lease obligations	$	$ 1,186
Furniture, fixtures and equipment acquired but not yet paid for at period-end	$ 812	$ 222
Accrued costs associated with initial public offering	$	$ 4
Conversion of convertible redeemable preferred stock to common stock	$	$ 11,206
Accretion of preferred stock issuance costs	$	$ 21

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) based clinical technology solutions that enhance the efficiency of its customers clinical development processes and optimize their research and development investments. The Company s solutions allow its customers to achieve clinical results by streamlining the design, planning and management of key aspects of the clinical development process, including protocol development, contract research organization negotiation, investigator contracting, the capture and management of clinical trial data and the analysis and reporting of that data on a worldwide basis.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Except to the extent updated or described below, the Company s significant accounting policies as of September 30, 2010 are substantially the same as those at December 31, 2009, which are included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on March 15, 2010.

Basis of Presentation The accompanying interim condensed consolidated balance sheets as of September 30, 2010 and December 31, 2009, the condensed consolidated statements of operations for the three and nine months ended September 30, 2010 and 2009, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2010 and 2009 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, 2009 included in the Company s Annual Report on Form 10-K filed with the SEC on March 15, 2010.

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, 2010, results of its operations for the three and nine months ended September 30, 2010 and 2009 and cash flows for the nine months ended September 30, 2010 and 2009. The results of operations for the three and nine months ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010.

Income Taxes The Company uses the asset and liability method of accounting for income taxes, as prescribed by Financial Accounting Standards Board (FASB) Accounting Standards Codification (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.

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.

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MEDIDATA SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)

Segment Information As defined by ASC 280, *Segment Reporting*, the Company operates as a single segment, as management makes operating decisions and assesses performance based on one single operating unit. The Company recorded revenues for the three and nine months ended September 30, 2010 and 2009 in the following geographic areas, based on the country in which revenues were generated (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenues:				
United States of America	$ 26,102	$ 23,007	$ 74,931	$ 68,675
Japan	4,424	3,831	13,267	10,859
United Kingdom	3,564	3,089	10,506	8,668
Switzerland	2,188	1,496	6,807	4,749
Other	4,824	3,794	13,546	9,896
Total	$ 41,102	$ 35,217	$ 119,057	$ 102,847

The following table summarizes long-term assets by geographic area as of September 30, 2010 and December 31, 2009 (in thousands):

	September 30, 2010	December 31, 2009
Long-term assets:		
United States of America	$ 24,490	$ 39,895
United Kingdom	839	976
Japan	766	886
Total	$ 26,095	$ 41,757

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 Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income	$ 4,664	$ 1,549	$ 9,493	$ 3,443
Foreign currency translation adjustment	218	(18)	103	191
Net unrealized gain on marketable securities	46		90	
Total comprehensive income	$ 4,928	$ 1,531	$ 9,686	$ 3,634

Recently Issued Accounting Pronouncements 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 (a) eliminate the separation criterion that requires entities to establish objective and reliable evidence of fair value for undelivered elements; (b) establish a selling price hierarchy to help entities allocate arrangement consideration to the separate units of account; (c) eliminate the residual allocation method which will be replaced by the relative selling price allocation method for all arrangements; and (d) significantly expand the disclosure requirements. ASU No. 2009-13 is effective for new or materially modified arrangements in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. If early adoption is elected and the period of adoption is not the beginning of the fiscal year, retrospective application from the beginning of the fiscal year of adoption and additional disclosure are required. The Company expects to adopt ASU No. 2009-13 prospectively beginning on January 1, 2011 and is currently evaluating the impact, if any, of these provisions of ASU No. 2009-13 on its consolidated financial statements.

MEDIDATA SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)

In October 2009, the FASB also 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. The effective date for ASU No. 2009-14 is consistent with ASU No. 2009-13 as stated above. The Company expects to adopt ASU No. 2009-14 prospectively and concurrently with ASU No. 2009-13 beginning on January 1, 2011. The Company is currently evaluating the impact, if any, of these provisions of ASU No. 2009-14 on its consolidated financial statements.

In January 2010, the FASB issued ASU No. 2010-06, *Improving Disclosure about Fair Value Measurement*. ASU No. 2010-06 amends ASC 820-10, *Fair Value Measurements and Disclosures*, to add new requirements for disclosure about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. ASU No. 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements, which are effective for interim and annual reporting periods beginning after December 15, 2010. The Company adopted ASU No. 2010-06 on January 1, 2010 and the adoption did not have a material impact on its 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, and will be applied prospectively. 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 this ASU No. 2010-13 is not expected to have a material impact on the Company s 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 substantially consist of investment in money market funds. Marketable securities, in which we classify as available-for-sale securities, primarily consist of high quality commercial paper, corporate bonds, U.S. government obligations and bank certificates of deposit. 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. The following table provides the Company s marketable securities by security type as of September 30, 2010 and December 31, 2009 (in thousands):

	As of September 30, 2010			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Commercial paper and corporate bonds	$ 37,136	$ 35	$ (6)	$ 37,165
U.S. Treasury and U.S. government agency debt securities	31,207	25		31,232
Bank certificates of deposit	2,250			2,250

Total	$ 70,593	$ 60	$ (6)	$ 70,647

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MEDIDATA SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)

	As of December 31, 2009			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Commercial paper and corporate bonds	$ 33,374	$ 17	$ (49)	$ 33,342
U.S. Treasury and U.S. government agency debt securities	9,599		(4)	9,595
Bank certificates of deposit	6,701			6,701
Total	$ 49,674	$ 17	$ (53)	$ 49,638

Contractual maturities of the Company s marketable securities as of September 30, 2010 and December 31, 2009 are summarized as follows (in thousands):

	As of September 30, 2010		As of December 31, 2009	
	Cost	Estimated Fair Value	Cost	Estimated Fair Value
Due in one year or less	$ 70,593	$ 70,647	$ 36,550	$ 36,566
Due after one through five years			13,124	13,072
Total	$ 70,593	$ 70,647	$ 49,674	$ 49,638

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, 2010 and December 31, 2009 (in thousands):

	In Loss Position for Less than 12 Months			
	As of September 30, 2010		As of December 31, 2009	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Commercial paper and corporate bonds	$ 8,386	$ (6)	$ 15,341	$ (49)
U.S. Treasury and U.S. government agency debt securities			9,595	(4)
Total	$ 8,386	$ (6)	$ 24,936	$ (53)

None of the Company s marketable securities has been in a continuous unrealized loss position for more than twelve months as of September 30, 2010 and December 31, 2009.

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MEDIDATA SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)

At September 30, 2010, 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, 2010 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, 2010.

The Company began to invest in marketable securities in October 2009. During the three and nine months ended September 30, 2010, the Company recorded an insignificant amount of net realized gains 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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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, 2010 and December 31, 2009 are summarized as follows (in thousands):

	As of September 30, 2010			As of December 31, 2009		
	Fair Value Measurement Using			Fair Value Measurement Using		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Money market funds	$ 8,867	$	$ 8,867	$ 27,114	$	$ 27,114
Total cash equivalents	8,867		8,867	27,114		27,114
Commercial paper and corporate bonds		37,165	37,165		33,342	33,342
U.S. Treasury and U.S. government agency debt securities	15,061	16,171	31,232	5,995	3,600	9,595
Bank certificates of deposit		2,250	2,250		6,701	6,701
Total marketable securities	15,061	55,586	70,647	5,995	43,643	49,638
Total financial assets	$ 23,928	$ 55,586	$ 79,514	$ 33,109	$ 43,643	$ 76,752

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 bank certificates of deposit 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 and U.S. government agency debt 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, 2010, there were no transfers of financial assets between Level 1 and Level 2.

The carrying amount of accounts receivable, accounts payable and accrued liabilities approximate fair value because of the short maturity of these instruments.

4. GOODWILL AND INTANGIBLE ASSETS

There was no change in the carrying amount of goodwill during the first nine months of 2010.

Intangible assets are summarized as follows (in thousands):

	As of September 30, 2010			As of December 31, 2009	
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Accumulated Amortization	Net Carrying Amount
Acquired technology	$ 2,400	$ (1,220)	$ 1,180	$ (860)	$ 1,540
Database	1,900	(966)	934	(681)	1,219
Customer relationships	1,600	(488)	1,112	(224)	1,376
Customer contracts	1,600	(1,517)	83	(1,331)	269
Total	$ 7,500	$ (4,191)	$ 3,309	$ (3,096)	$ 4,404

MEDIDATA SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)

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

Remainder of year ending December 31, 2010	$ 364
Years ending December 31,	
2011	1,377
2012	1,308
2013	260
2014	

5. DEBT

The Company has a $10.0 million revolving line of credit (Revolving Credit Line) under its senior secured credit facility (Credit Facility) that matures in September 2013. In June 2010, the Company entered into the second loan modification agreement (Second Modification) with the lender. Pursuant to the terms of the Second Modification, the Credit Facility was amended to:

reduce fees payable by the Company on its $10.0 million Revolving Credit Line under the Credit Facility by (a) eliminating the 2.25% margin on prime rate borrowings and (b) decreasing the undrawn revolving credit line fee from 0.500% of the average undrawn balance to an annual rate of 0.375% of the average undrawn balance;

provide the Company with an option to borrow under the Revolving Credit Line at an interest rate based on the U.S. London Interbank Offer Rate (LIBOR) plus a margin of 2.5%;

simplify the Company s financial reporting procedures by eliminating monthly financial reporting obligations and amending certain reporting procedures; and

replace the Company s prior financial covenants with a simplified adjusted quick ratio covenant of 2.00:1.00 as defined in the Second Modification and provide that in the event that the Company has less than $10.0 million of cash or cash equivalents in accounts with the lender in excess of the Company s borrowings under the Credit Facility, the Company would also be required to satisfy a minimum trailing-two-quarter cash flow covenant, commencing at $3 million for the period ended June 30, 2010 and increasing each quarter by $1 million up to $6 million for the quarter ended March 31, 2011 and thereafter.

Since the Second Modification did not amend the total amount of the $10.0 million revolving line of credit nor change the remaining term, the Company concluded that the borrowing capacity remained unchanged after the amendment. As a result, the $21 thousand of new debt issuance costs incurred from the Second Modification has been deferred and amortized together with the existing unamortized debt issuance costs over the remaining term of the Credit Facility in accordance with ASC 470-50-40-21. As of September 30, 2010, the remaining unamortized balance was approximately $0.2 million and is classified in other assets on the accompanying condensed consolidated balance sheet.

Except for the $0.2 million reduction of the available amount due to a standby letter of credit issued in connection with the office lease executed under the Credit Facility in July 2009, the Revolving Credit Line remains undrawn. As of September 30, 2010, approximately $9.8 million of the Revolving Credit Line was still available for future borrowings.

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MEDIDATA SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)

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, 2010 and 2009, the components of stock-based compensation expense were summarized in the following table (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Stock options	$ 1,076	$ 1,146	$ 3,042	$ 3,035
Restricted stock awards	771	359	1,613	393
Total stock-based compensation	$ 1,847	$ 1,505	$ 4,655	$ 3,428

During the three months ended September 30, 2010, the Company did not grant any stock options nor restricted stock awards. 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:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Expected volatility		62%	60%	63%
Expected life		6 years	6 years	6 years
Risk-free interest rate		2.81%	2.47%	2.53%
Dividend yield				

The following table summarizes the activity under the stock option plans as of September 30, 2010, and changes during the nine months then ended (in thousands, except per share data):

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at January 1, 2010	2,813	$ 8.85		
Granted	337	15.35		
Exercised	(388)	2.58		
Forfeited	(22)	15.10		
Expired	(33)	19.50		
Outstanding at September 30, 2010	2,707	$ 10.38	6.61	$ 24,096
Exercisable at September 30, 2010	1,732	$ 7.75	5.48	$ 19,977

Vested and expected to vest at September 30, 2010	2,666	$ 10.31	6.57	$ 23,936

The weighted-average grant-date fair value of stock options granted during the three months ended September 30, 2010 and 2009 was none and $10.01, respectively, and the nine months ended September 30, 2010 and 2009 was $8.75 and $8.59, respectively. The total intrinsic value of stock options exercised during the three months ended September 30, 2010 and 2009 was $1.0 million and $0.2 million, respectively, and the nine months ended September 30, 2010 and 2009 was $5.1 million and $0.3 million, respectively.

The following table summarizes the status of the Company s nonvested restricted stock awards as of September 30, 2010, and changes during the nine months then ended (in thousands, except per share data):

	Number of Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2010	286	$ 14.02
Granted	548	15.35
Vested	(80)	14.02
Forfeited	(9)	14.93
Nonvested at September 30, 2010	745	$ 14.99

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MEDIDATA SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)

As of September 30, 2010, there was a total of $18.8 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 2.5 years for stock options and 3.3 years for restricted stock awards. The total fair value of shares vested during the three months ended September 30, 2010 and 2009 was $1.3 million and $1.0 million, respectively, and the nine months ended September 30, 2010 and 2009 was $4.3 million and $3.3 million, respectively.

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, 2010 and 2009 are shown in the following table (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Numerator				
Numerator for basic earnings per share:				
Net income	$ 4,664	$ 1,549	$ 9,493	$ 3,443
Preferred stock dividends and accretion				(243)
Net income available to common stockholders	4,664	1,549	9,493	3,200
Numerator for diluted earnings per share:				
Effect of dilutive preferred stock				243
Net income available to common stockholders with assumed conversion	$ 4,664	$ 1,549	$ 9,493	$ 3,443
Denominator				
Denominator for basic earnings per share:				
Weighted average common shares outstanding	23,019	22,364	22,878	12,318
Denominator for diluted earnings per share:				
Dilutive potential common shares:				
Preferred stock				5,977
Stock options	745	1,420	781	1,381
Restricted stock awards	92	62	79	17
Weighted average common shares outstanding with assumed conversion	23,856	23,846	23,738	19,693
Basic earnings per share	$ 0.20	$ 0.07	$ 0.41	$ 0.26

Diluted earnings per share	$ 0.20	$ 0.06	$ 0.40	$ 0.17
Total number of anti-dilutive shares of stock options and nonvested stock excluded from calculation of diluted earnings per share	1,228	1,236	1,138	1,017

8. INCOME TAXES

The Company s effective tax rate for the three and nine months ended September 30, 2010 was approximately 24% and 30%, respectively. During the third quarter of 2010, the Company s estimated annual effective tax rate declined from approximately 36% to 30%. This decline primarily resulted from the recent extension of the tax law

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MEDIDATA SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)

allowing for higher bonus tax-based depreciation on current year capital expenditures and higher overall projected pre-tax income for 2010. In addition, these changes resulted in an offsetting reduction in the valuation allowance which further reduced the annual effective tax rate. The annual effective tax rate of 30% differs from the federal statutory rate of 34% primarily due to the full valuation allowance against the majority of domestic net deferred tax assets, foreign tax rate differential, stock-based compensation and state and local income taxes. For the three and nine months ended September 30, 2009, the Company s income tax expense consisted primarily of foreign income taxes imposed on its foreign subsidiaries in the United Kingdom and Japan. The Company s domestic income tax was fully covered by its U.S. federal and state net operating loss carryforwards prior to December 2009.

In assessing the realizability of deferred tax assets, 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. To date, a significant piece of objective negative evidence evaluated has been the cumulative losses incurred over the three year period ended December 31, 2009. Such objective evidence limits the ability to consider other subjective evidence such as the Company s projections for future growth. Based on this evaluation, as of December 31, 2009 and as updated through September 30, 2010, 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 estimates of future taxable income during the carryforward period change or if objective negative evidence in the form of cumulative losses is no longer present and additional weight may be given to subjective evidence such as the Company s projections for growth.

In addition to the Company s initial calculation of the amount of net operating loss carryforwards subject to limitation under Section 382 of the Internal Revenue Code in December 2009, the Internal Revenue Code also allows for an increase in the annual limitation for the five years following an ownership change. Alternatively, such an increase may be determined by treating the ownership change as a deemed sale of assets as defined under Section 338 of the Internal Revenue Code (Section 338). The Company is currently in the process of completing the evaluation required to elect Section 338 treatment which, among other items, requires an independent third party valuation of the Company. Upon the completion of such evaluation, if the Company decides to elect Section 338 treatment, it could have a significant impact on the Company s income tax expense and amount of valuation allowance maintained on its net deferred tax assets.

The Company had approximately $0.2 million of gross unrecognized tax benefits as of December 31, 2009. In July 2010, the Company filed the amended tax returns with the state of Texas along with the tax payment, including interest and penalties, of approximately $0.2 million. As a result, the entire balance of unrecognized tax benefits has been removed.

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, 2010 nor December 31, 2009. The Claimant also filed patent infringement lawsuits against two of the Company s customers. See Indemnification below for additional information.

MEDIDATA SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)

In 2006, a former employee of the Company made a claim seeking compensation of approximately $1.6 million in relation to a wrongful dismissal lawsuit. Subsequently, the claim was reduced to approximately $1.4 million as of December 31, 2008. The court rendered its decision in January 2009, which awarded approximately $0.1 million to the plaintiff. The plaintiff filed a notice of appeal in September 2009, which remains pending. The Company will continue to vigorously defend this claim until it is ultimately resolved. The Company had accrued approximately $0.6 million and $0.7 million which was included in accrued payroll and other compensation on the accompanying condensed consolidated balance sheets as of September 30, 2010 and December 31, 2009, respectively. Since this accrual is denominated in the same functional currency as the claim in Euros, its balance is subject to change due to foreign currency adjustment.

Indemnification In 2008, two customers requested the Company to indemnify them in connection with patent infringement lawsuits filed by the Claimant who also filed a lawsuit against the Company in June 2009 as discussed above. The Company agreed to defend and indemnify one of these customers with respect to the allegations, claims, and defenses relating to its use of the Company s software. As the estimated indemnification obligation concerning this claim was determined to be probable and could be reasonably estimated, the Company had accrued $0.5 million which was included in accrued expenses and other on the accompanying condensed consolidated balance sheet as of December 31, 2009. In March 2010, the Company reached a final agreement with this customer and paid a settlement amount of $0.5 million to fully settle this indemnification obligation. To date, no claims have been asserted against the second customer with respect to its use of the Company s products.

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, 2009 filed with the Securities and Exchange Commission, or SEC, on March 15, 2010.

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, 2009.

Overview

We are a leading global provider of software-as-a-service, or SaaS, based clinical technology solutions that enhance the efficiency of our customers clinical development processes and optimize their research and development investments. 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 protocol development, contract research organization, or CRO, negotiation, investigator contracting, the capture and management of clinical trial data and the analysis and reporting of that data on a worldwide basis.

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 Medidata Rave 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 customer growth, customer retention rate, revenues from lost customers, geographic contribution, and backlog.

Our customer base has grown from 50 at January 1, 2007 to 204 at September 30, 2010. 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 number of sales generated through our CRO relationships. Our customer retention rate was 91.9% and 93.2% for the nine months ended September 30, 2010 and 2009, respectively. We calculate customer retention based upon the number of customers that existed both at the beginning and end of the relevant period. Traditionally, we maintain a high percentage of customer retention and hence the revenue impact from lost customers is insignificant to our total revenues. Revenues from lost customers for the nine months ended September 30, 2010 and 2009 accounted for 1.2% and 0.5%, 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. 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 24% and 21% of total revenues for the three months ended September 30, 2010 and 2009, respectively, and approximately 24% and 21% of total revenues for the nine months ended September 30, 2010 and 2009, respectively. Revenues generated from customers in Asia represented approximately 12% of total revenues for each of the three months ended September 30, 2010 and 2009, and approximately 13% and 12% of total revenues for the nine months ended September 30, 2010 and 2009, 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, 2010, we had full year backlog of approximately $132 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, 2010 is approximately $41 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.

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 for both 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 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.

Our professional services provide our customers with reliable, repeatable and cost-effective implementation and training in the use of our application services. Professional services revenues have represented a significant portion of overall revenues to date. 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 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 outside service provider costs, data center and networking expenses and allocated overhead. We allocate overhead such as depreciation and amortization expense, rent and utilities to all departments based on relative headcount. As such, a portion of general overhead expenses are reflected in cost of revenues. The costs associated with providing professional services are recognized as such costs are incurred and are significantly higher as a percentage of revenue than the costs associated with delivering our application services due to the labor costs associated with providing professional services. 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, 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 remain relatively constant.

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 will decline slightly as a percentage of total revenues.

General and Administrative. General and administrative expenses consist primarily of personnel and related expenses for executive, legal, quality assurance, finance and human resources, 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 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.

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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. 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 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. To date, a significant piece of objective negative evidence evaluated has been the cumulative losses incurred over the three year period ended December 31, 2009. Such objective evidence limits the ability to consider other subjective evidence such as our projections for future growth. Based on this evaluation, as of December 31, 2009 and as updated through September 30, 2010, 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 estimates of future taxable income during the carryforward period change or if objective negative evidence in the form of cumulative losses is no longer present and additional weight may be given to subjective evidence such as our projections for growth.

Moreover, in 2009, 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. While the value of our available federal net operating loss carryforwards was not materially impacted by Section 382, it will take a longer period of time to utilize these federal net operating loss carryforwards to offset any of our future taxable income. Due to this Section 382 limitation, as well as the temporary suspension of net operating loss carryforward utilization in the State of California and income taxes incurred in other state and local jurisdictions, we incurred domestic income tax expense beginning in the fourth quarter of 2009.

In addition to our initial calculation of the amount of net operating loss carryforwards subject to limitation under Section 382, the Internal Revenue Code also allows for an increase in the annual limitation for the five years following an ownership change. Alternatively, such an increase may be determined by treating the ownership change as a deemed sale of assets as defined under Section 338 of the Internal Revenue Code, or Section 338. We are currently in the process of completing the evaluation required to elect Section 338 treatment which, among other items, requires an independent third party valuation of the company. Upon the completion of such evaluation, if we decide to elect Section 338 treatment, it could have a significant impact on our income tax expense and amount of valuation allowance maintained on our net deferred tax assets.

Overall, excluding any potential impact associated with utilization of net operating loss carryforwards resulting from a Section 338 election, we expect our income tax expense to increase in absolute dollars and as a percentage of our operating income as we become more profitable domestically and our 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, descriptions of which are included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009. There have been no material changes to our critical accounting policies since December 31, 2009.

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Results of Operations

We recognize revenues from applications 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, when we sell application services and professional services in a combined arrangement, which is our typical practice, we recognize revenues from professional services ratably over the term of the arrangement, rather than as the professional services are delivered, which varies throughout the arrangement term. Accordingly, a significant portion of the revenues for professional services performed in any reporting period will be deferred to future periods. 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 reporting period 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.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenues:				
Application services	84.0%	73.7%	81.0%	72.1%
Professional services	16.0%	26.3%	19.0%	27.9%
Total revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues:				
Application services	16.4%	17.1%	16.1%	17.0%
Professional services	15.7%	18.3%	16.4%	19.4%
Total cost of revenues	32.1%	35.4%	32.5%	36.4%
Gross profit	67.9%	64.6%	67.5%	63.6%
Operating costs and expenses:				
Research and development	15.7%	15.9%	16.3%	16.4%
Sales and marketing	18.2%	19.1%	19.2%	19.6%
General and administrative	19.2%	22.2%	20.7%	22.0%
Total operating costs and expenses	53.1%	57.2%	56.2%	58.0%
Operating income	14.8%	7.4%	11.3%	5.6%

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Three Months Ended September 30, 2010 Compared with Three Months Ended September 30, 2009

Revenues

	Three Months Ended September 30,					
	2010		2009		Change	
	Amount	% of Revenues	Amount	% of Revenues	Amount	%
	(Amount in thousands)					
Revenues:						
Application services	$ 34,522	84.0%	$ 25,957	73.7%	$ 8,565	33.0%
Professional services	6,580	16.0%	9,260	26.3%	(2,680)	(28.9)%
Total revenues	$ 41,102	100.0%	$ 35,217	100.0%	$ 5,885	16.7%

Total revenues. Total revenues increased $5.9 million, or 16.7%, to $41.1 million for the three months ended September 30, 2010 from $35.2 million for the same period in 2009. The increase in revenues was primarily due to a $8.6 million increase in revenues from application services, partially offset by a $2.7 million decrease in revenues from professional services. At the start of the third quarter of 2010, we had approximately $75 million of 2010 remaining backlog. As of September 30, 2010, the total 2010 remaining backlog was approximately $41 million.

Application services revenues. Revenues from application services increased $8.6 million, or 33.0%, to $34.5 million for the three months ended September 30, 2010 from $25.9 million for the same period in 2009. The majority of the increase in application services revenues was derived from increased activity in our existing large 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 third quarter of 2010, we added 13 customers to reach the total of 204 customers as of September 30, 2010. Revenues from new customers accounted for 29.1% of the total increase in application services revenues. We also continued to benefit from the revenue stream recognized from our multi-study arrangements, which increased by 36.7% compared with the prior period. Revenues also expanded significantly from customers based in Europe compared with the prior period, while revenues from customers based in Asia and North America grew at a steady rate. Revenues from customers based in Europe grew 39.7%, whereas revenues from customers based in Asia and North America grew 31.9% and 31.0%, respectively.

Professional services revenues. Revenues from professional services decreased $2.7 million, or 28.9%, to $6.6 million for the three months ended September 30, 2010 from $9.3 million for the same period in 2009. Our professional services continue to represent a smaller portion of total revenues as our strategy has been to enable our customers to implement studies on their own or through CROs, rather than incurring additional follow-on costs. Consistent with the prior quarter, this has contributed to lower professional services revenues compared with the prior year. An additional factor contributing to the decline was an update to the estimated fair value utilized to determine the value of our professional services revenues.

Cost of Revenues

	Three Months Ended September 30,					
	2010		2009		Change	
	Amount	% of Revenues	Amount	% of Revenues	Amount	%
	(Amount in thousands)					
Cost of revenues:						
Application services	$ 6,738	16.4%	$ 6,006	17.1%	$ 732	12.2%
Professional services	6,470	15.7%	6,458	18.3%	12	0.2%
Total cost of revenues	$ 13,208	32.1%	$ 12,464	35.4%	$ 744	6.0%

Total cost of revenues. Total cost of revenues increased $0.7 million, or 6.0%, to $13.2 million for the three months ended September 30, 2010 from $12.5 million for the same period in 2009.

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Cost of application services revenues. Cost of application services revenues increased $0.7 million, or 12.2%, to $6.7 million for the three months ended September 30, 2010 from $6.0 million for the same period in 2009. The increase was principally due to an increase in personnel-related costs. We continued to increase staffing levels in our Houston data center to support our growth in business.

Cost of professional services revenues. Cost of professional services remained relatively constant at approximately $6.5 million for the three months ended September 30, 2010 as compared with the same period in 2009. We continued our effort to manage overall personnel-related costs carefully and reduce our reliance on outside consultants. These cost savings were offset by certain slightly higher miscellaneous costs, such as office and travel-related expenses.

Operating Costs and Expenses

	Three Months Ended September 30,					
	2010		2009		Change	
	Amount	% of Revenues	Amount	% of Revenues	Amount	%
	(Amount in thousands)					
Operating costs and expenses:						
Research and development	$ 6,450	15.7%	$ 5,608	15.9%	$ 842	15.0%
Sales and marketing	7,493	18.2%	6,709	19.1%	784	11.7%
General and administrative	7,905	19.2%	7,814	22.2%	91	1.2%
Total operating costs and expenses	$ 21,848	53.1%	$ 20,131	57.2%	$ 1,717	8.5%

Total operating costs and expenses. Total operating costs and expenses increased $1.7 million, or 8.5%, to $21.8 million for the three months ended September 30, 2010 from $20.1 million for the same period in 2009. Costs increased in research and development and sales and marketing while general and administrative remains relatively constant.

Research and development expenses. Research and development expenses increased $0.8 million, or 15.0%, to $6.4 million for the three months ended September 30, 2010 from $5.6 million for the same period in 2009. The increase was primarily due to an increase in personnel-related costs of $0.5 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.

Sales and marketing expenses. Sales and marketing expenses increased $0.8 million, or 11.7%, to $7.5 million for the three months ended September 30, 2010 from $6.7 million for the same period in 2009. The increase was primarily due to higher personnel-related costs of $0.5 million, as we expanded our sales team to support our continuing growth in sales. The increase was also driven by higher travel costs incurred by members of our sales team as a result of increased domestic and international sales efforts.

General and administrative expenses. General and administrative expenses increased $0.1 million, or 1.2%, to $7.9 million for the three months ended September 30, 2010 from $7.8 million for the same period in 2009. The increase was impacted by a higher depreciation and amortization expense resulting from the purchases of certain technology equipment at the end of 2009 and increased costs associated with certain software licenses and maintenance renewals in the current year.

Income Tax Expense

Income tax expense increased $1.2 million to $1.4 million for the three months ended September 30, 2010 from $0.2 million for the same period in 2009. This increase was primarily driven by higher domestic income taxes incurred in 2010 which resulted from our inability to fully utilize our federal net operating loss carryforwards due to a limitation as defined by Section 382. Our effective tax rate for the three months ended September 30, 2010 was approximately 24%, reflecting the impact of the decline in our estimated annual effective tax rate from approximately 36% to 30%. The decline in our estimated annual effective tax rate resulted from the recent extension of the tax law allowing for higher bonus tax-based depreciation on current year capital expenditures and higher overall projected pre-tax income for 2010. In addition, these changes resulted in an offsetting reduction in our valuation allowance which further reduced our annual effective tax rate.

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For the three months ended September 30, 2009, our total income tax expense primarily consisted of foreign income taxes imposed on our foreign subsidiaries in the United Kingdom and Japan. Our foreign income taxes increased by $0.1 million for the three months ended September 30, 2010 as compared with the same period in 2009, primarily due to the impact of the return to provision adjustments.

Nine Months Ended September 30, 2010 Compared with Nine Months Ended September 30, 2009

Revenues

	Nine Months Ended June 30, 2010		2009		Change	
	Amount	% of Revenues	Amount	% of Revenues	Amount	%
	(Amount in thousands)					
Revenues:						
Application services	$ 96,414	81.0%	$ 74,145	72.1%	$ 22,269	30.0%
Professional services	22,643	19.0%	28,702	27.9%	(6,059)	(21.1)%
Total revenues	$ 119,057	100.0%	$ 102,847	100.0%	$ 16,210	15.8%

Total revenues. Total revenues increased $16.2 million, or 15.8%, to $119.0 million for the nine months ended September 30, 2010 from $102.8 million for the same period in 2009. The increase in revenues was primarily due to a $22.3 million increase in revenues from application services, partially offset by a $6.1 million decrease in revenues from professional services. At the start of 2010, we had approximately $132 million of full year backlog. As of September 30, 2010, the total 2010 remaining backlog was approximately $41 million.

Application services revenues. Revenues from application services increased $22.3 million, or 30.0%, to $96.4 million for the nine months ended September 30, 2010 from $74.1 million for the same period in 2009. The majority of the increase in application services revenues was derived from increased activity in our existing large 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. We increased the number of customers to 204 compared with 157 a year ago and carried on our success in adding new midmarket customers. Revenues from new customers accounted for 18.8% of the total increase in application services revenues. We also continued to benefit from the revenue stream recognized from our multi-study arrangements, which increased by 39.1% compared with the prior period. Revenues also expanded significantly from international customers compared with the prior period, while revenues from domestic customers grew at a steady rate. Revenues from customers based in Europe and Asia grew 47.1% and 40.7%, respectively, whereas revenues from customers based in North America grew 22.9%.

Professional services revenues. Revenues from professional services decreased $6.1 million, or 21.1%, to $22.6 million for the nine months ended September 30, 2010 from $28.7 million for the same period in 2009. Our professional services continue to represent a smaller portion of total revenues as our strategy has been to enable our customers to implement studies on their own or through CROs, rather than incurring additional follow-on costs. This has contributed to lower professional services revenues compared with the prior year. An additional factor contributing to the decline was an update to the estimated fair value utilized to determine the value of our professional services revenues.

Cost of Revenues

	Nine Months Ended September 30, 2010		2009		Change	
	Amount	% of Revenues	Amount	% of Revenues	Amount	%
	(Amount in thousands)					
Cost of revenues:						
Application services	$ 19,132	16.1%	$ 17,521	17.0%	$ 1,611	9.2%
Professional services	19,471	16.4%	19,910	19.4%	(439)	(2.2)%

Total cost of revenues	$ 38,603	32.5%	$ 37,431	36.4%	$ 1,172	3.1%

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Total cost of revenues. Total cost of revenues increased $1.2 million, or 3.1%, to $38.6 million for the nine months ended September 30, 2010 from $37.4 million for the same period in 2009.

Cost of application services revenues. Cost of application services revenues increased $1.6 million, or 9.2%, to $19.1 million for the nine months ended September 30, 2010 from $17.5 million for the same period in 2009. The increase was principally due to an increase in personnel-related costs. We continued to increase staffing levels in our Houston data center to support our growth in business.

Cost of professional services revenues. Cost of professional services decreased $0.4 million, or 2.2%, to $19.5 million for the nine months ended September 30, 2010 from $19.9 million for the same period in 2009. The decrease was primarily due to lower consulting-related costs and personnel-related costs. The decrease was associated with our continuing effort to reduce our reliance on outside consultants and maintain the utilization level of our existing staff.

Operating Costs and Expenses

	Nine Months Ended September 30,					
	2010		2009		Change	
	Amount	% of Revenues	Amount	% of Revenues	Amount	%
	(Amount in thousands)					
Operating costs and expenses:						
Research and development	$ 19,464	16.3%	$ 16,894	16.4%	$ 2,570	15.2%
Sales and marketing	22,913	19.2%	20,167	19.6%	2,746	13.6%
General and administrative	24,679	20.7%	22,672	22.0%	2,007	8.9%
Total operating costs and expenses	$ 67,056	56.2%	$ 59,733	58.0%	$ 7,323	12.3%

Total operating costs and expenses. Total operating costs and expenses increased $7.3 million, or 12.3%, to $67.0 million for the nine months ended September 30, 2010 from $59.7 million for the same period in 2009. Costs increased across the board in each department.

Research and development expenses. Research and development expenses increased $2.6 million, or 15.2%, to $19.5 million for the nine months ended September 30, 2010 from $16.9 million for the same period in 2009. The increase was primarily due to an increase in personnel-related costs of $1.8 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 a higher depreciation and amortization expense of $0.4 million due to higher capital expenditure spending.

Sales and marketing expenses. Sales and marketing expenses increased $2.7 million, or 13.6%, to $22.9 million for the nine months ended September 30, 2010 from $20.2 million for the same period in 2009. The increase was primarily due to higher personnel-related costs of $1.7 million, as we expanded our sales team to support our continuing growth in sales. The increase was also driven by higher travel costs of $0.3 million incurred by members of our sales team as a result of increased domestic and international sales efforts. The increase was also due to higher overall marketing costs to support the launch of several new products and existing product upgrades in 2010.

General and administrative expenses. General and administrative expenses increased $2.0 million, or 8.9%, to $24.6 million for the nine months ended September 30, 2010 from $22.6 million for the same period in 2009. The increase was primarily due to an increase in personnel-related costs of $0.9 million, professional fees of $0.7 million and technology-related costs of $0.7 million, partially offset by a lower foreign exchange loss of $0.3 million. The increase in personnel-related costs was primarily due to higher stock-based compensation costs resulting from a full nine months impact in 2010 from our equity awards granted in June 2009, as well as the additional costs associated with our annual equity awards granted in May 2010. The increase also was attributable to higher staffing levels in order to manage our increased administrative workload and other additional costs incurred as a public company. The increase in professional fees was primarily due to higher legal fees incurred in association with certain of our litigation and indemnification obligation matters, as well as additional professional fees incurred as a result of being a public company since June 2009. The increase was also impacted by a higher depreciation and amortization expense resulting from the purchases of certain technology equipment at the end of 2009 and increased costs associated with certain software licenses and maintenance renewals in the current year.

Income Tax Expense

Income tax expense increased $3.6 million to $4.2 million for the nine months ended September 30, 2010 from $0.6 million for the same period in 2009. The increase was primarily driven by higher domestic income taxes incurred in 2010 which resulted from our inability to fully utilize our federal net operating loss carryforwards due to a limitation as defined by Section 382. Our effective tax rate for the nine months ended September 30, 2010 was approximately 30%.

For the nine months ended September 30, 2009, our total income tax expense primarily consisted of foreign income taxes imposed on our foreign subsidiaries in the United Kingdom and Japan. Our foreign income taxes increased by $0.2 million for the nine months ended September 30, 2010 as compared with the same period in 2009, primarily due to the impact of the return to provision adjustments and higher pre-tax income in the current year.

Liquidity and Capital Resources

Our principal sources of liquidity were cash, cash equivalents and marketable securities of $89.1 million at September 30, 2010 and December 31, 2009. Cash and cash equivalents decreased $21.0 million during the first nine months of 2010 primarily due to the net purchases of marketable securities and the funding of capital expenditures. 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, in which we classify as available-for-sale securities, primarily consist of high quality commercial paper, corporate bonds, U.S. government debt obligations and bank certificates of deposit. 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.

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 $0.2 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 July 2009, the revolving line of credit remains undrawn. As of September 30, 2010, approximately $9.8 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, 2010, the effective interest rate for our senior secured credit facility, as amended, was 2.75%, if borrowing under the U.S. London Interbank Offer Rate, or LIBOR, option. See Revolving Line of Credit section below for a summary of the second loan modification to our senior secured credit facility.

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 2010, we expect to make approximately $3 million in capital expenditures, primarily to enhance the stability and increase the capacity in our Houston data center. We expect to acquire our capital equipment through purchases as opposed to capital lease arrangements.

Revolving Line of Credit

In June 2010, we entered into the second loan modification agreement with the lender to amend our existing senior secured credit facility. Pursuant to the terms of the second loan modification agreement, our senior secured credit facility was amended to:

- reduce fees payable by us on our $10.0 million revolving line of credit under the senior secured credit facility by (a) eliminating the 2.25% margin on prime rate borrowings and (b) decreasing the undrawn revolving credit line fee from 0.500% of the average undrawn balance to an annual rate of 0.375% of the average undrawn balance;

- provide us with an option to borrow under the revolving line of credit at an interest rate based on the LIBOR, plus a margin of 2.5%;

simplify our financial reporting procedures by eliminating monthly financial reporting obligations and amending certain reporting procedures; and

replace our prior financial covenants with a simplified adjusted quick ratio covenant of 2.00:1.00 as defined in the second loan modification agreement and provide that in the event that we have less than $10.0 million of cash or cash equivalents in accounts with the lender in excess of our borrowings under the senior secured credit facility, we would also be required to satisfy a minimum trailing-two-quarter cash flow covenant, commencing at $3 million for the period ended June 30, 2010 and increasing each quarter by $1 million up to $6 million for the quarter ended March 31, 2011 and thereafter.

Cash Flows

Cash Flows Provided By Operating Activities

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 provided by operating activities during the nine months ended September 30, 2009 were $23.7 million, which consisted primarily of a net income of $3.4 million, non-cash adjustments of depreciation and amortization of $7.8 million and stock-based compensation of $3.4 million, a decrease in accounts receivable of $5.6 million, and an increase in deferred revenue of $2.6 million. The decrease in accounts receivable was due to strong customer collection activity. Deferred revenue was impacted by a $5.0 million customer payment, provided in accordance with the underlying contractual agreement, made in advance of the full delivery of services required to begin revenue recognition.

Cash Flows Used In Investing Activities

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 investing activities during the nine months ended September 30, 2009 were related to the $3.4 million of purchases of furniture, fixtures and equipment. We also acquired $1.2 million of equipment through capital lease arrangements.

Cash Flows Used In or Provided by Financing Activities

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.

Cash flows provided by financing activities during the nine months ended September 30, 2009 were $56.8 million, which was primarily due to $82.0 million of proceeds from the IPO, net of underwriting discounts and commissions. It was partially offset by a $15.0 million repayment of the term loan under our credit facility, $4.3 million of costs associated with our IPO, $3.6 million of capital lease principal payments and $2.3 million of preferred stock dividend payments.

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Contractual Obligations, Commitments and Contingencies

In March 2010, we entered into a lease amendment to renew and expand our office in Edison, New Jersey. Pursuant to the amended lease agreement, the renewed lease has a term of five years which will commence when the expansion space is ready for occupancy, which is estimated in January 2011. We will continue to occupy the existing space during the interim period until the expansion space is ready. The expansion will provide us an additional 10,536 rentable square feet of office space. The total amount of obligations is approximately $3.6 million over the term of this amended lease agreement, including the interim period.

Other than stated above, there was no material change in our contractual obligations during the first nine months of 2010.

In 2006, one of our former employees made a claim seeking compensation of approximately $1.6 million in relation to a wrongful dismissal lawsuit. Subsequently, the claim was reduced to approximately $1.4 million as of December 31, 2008. The court rendered its decision in January 2009, which awarded approximately $0.1 million to the plaintiff. The plaintiff filed a timely notice of appeal in September 2009, which remains pending. We will continue to vigorously defend this claim until it is ultimately resolved. We have an accrual of approximately $0.6 million and $0.7 million as of September 30, 2010 and December 31, 2009, respectively, in association with this claim. Since this accrual is denominated in the same functional currency as the claim in Euros, its balance is subject to change due to foreign currency adjustment.

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, 2009 nor December 31, 2009. The claimant also filed patent infringement lawsuits against two of our customers as discussed below.

In 2008, two customers requested us to indemnify them in connection with patent infringement lawsuits filed by the claimant who also filed a lawsuit against us in June 2009 as discussed above. We agreed to defend and indemnify one of these customers with respect to the allegations, claims, and defenses relating to its use of our software. As the estimated indemnification obligation concerning this claim was determined to be probable and could be reasonably estimated, we had accrued $0.5 million which was included in our consolidated balance sheet as of December 31, 2009. In March 2010, we reached a final agreement with this customer and paid a settlement amount of $0.5 million to fully settle this indemnification obligation. To date, no claims have been asserted against the second customer with respect to its use of Medidata s products.

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.

Effects of Recently Issued Accounting Standards

In October 2009, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, No. 2009-13, *Multiple-Deliverable Revenue Arrangements*. ASU No. 2009-13 amends the current guidance on arrangements with multiple deliverables under Accounting Standards Codification, or ASC, 605-25, *Revenue*

Recognition Multiple-Element Arrangements, to (a) eliminate the separation criterion that requires entities to establish objective and reliable evidence of fair value for undelivered elements; (b) establish a selling price hierarchy to help entities allocate arrangement consideration to the separate units of account; (c) eliminate the residual allocation method which will be replaced by the relative selling price allocation method for all arrangements; and (d) significantly expand the disclosure requirements. ASU No. 2009-13 is effective for new or materially modified arrangements in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. If early adoption is elected and the period of adoption is not the beginning of the fiscal year, retrospective application from the beginning of the fiscal year of adoption and additional disclosure are required. Retrospective application for all prior periods presented in the financial statements is also permitted, but not required. We expect to adopt ASU No. 2009-13 prospectively beginning on January 1, 2011 and are currently evaluating the impact, if any, of these provisions of ASU No. 2009-13 on our consolidated financial statements.

In October 2009, the FASB also 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. The effective date for ASU No. 2009-14 is consistent with ASU No. 2009-13 as stated above. We expect to adopt ASU No. 2009-14 prospectively and concurrently with ASU No. 2009-13 beginning on January 1, 2011. We are currently evaluating the impact, if any, of these provisions of ASU No. 2009-14 on our consolidated financial statements.

In January 2010, the FASB issued ASU No. 2010-06, *Improving Disclosure about Fair Value Measurement*. ASU No. 2010-06 amends ASC 820-10, *Fair Value Measurements and Disclosures*, to add new requirements for disclosure about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. ASU No. 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements, which are effective for interim and annual reporting periods beginning after December 15, 2010. We adopted ASU No. 2010-06 on January 1, 2010 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, and will be applied prospectively. 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 is not expected to have a material impact 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.

Off-Balance Sheet Arrangements

As of September 30, 2010, we did 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.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Sensitivity

We had unrestricted cash and cash equivalents totaling $18.4 million at September 30, 2010. Our cash equivalents are invested in money market funds, the fair value of which is not materially affected by fluctuations in interest rates. We also had investment in marketable securities, in which we classify as available-for-sale securities, totaling $70.6 million at September 30, 2010. 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 bank certificates of deposit. 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, 2010, 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 which 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, 2010.

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, Swiss Franc 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 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.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of September 30, 2010, 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, 2010.

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, 2009 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, 2009. 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. A portion of the remaining net proceeds from our IPO has been invested into 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 granted 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.

A summary of our repurchases of shares of our common stock for the three months ended September 30, 2010 was as follows:

	Total Number of Shares Purchased(1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased under the Plans or Programs
July 1 July 31, 2010		$		

August 1 August 31, 2010	4,406		16.74
September 1 September 30, 2010			
Total	4,406	$	16.74

(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.

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/ BRUCE D. DALZIEL
Bruce D. Dalziel

Chief Financial Officer

(Principal financial officer and duly

authorized to sign on behalf of the registrant)

Date: November 10, 2010

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EXHIBIT INDEX

Exhibit No.	Description
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.

* Filed herewith.