SUPPORTSOFT INC
Form 10-K
March 16, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the Fiscal Year Ended December 31, 2006

OR

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

For the Transition Period from to

Commission File No. 000-30901

SUPPORTSOFT, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**94-3282005** (I.R.S. Employer Identification No.)
1900 Seaport Boulevard, 3rd Floor, Redwood City, CA (Address of Registrant s Principal Executive Offices)	**94063** (Zip Code)

Registrant s telephone number including area code: **(650) 556-9440**

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

Title of each class	**Name of each exchange on which registered**
Common Stock, $.0001 par value	The NASDAQ Stock Market LLC

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

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

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

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

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

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

Large accelerated filer o   Accelerated filer x   Non-accelerated filer o

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

The aggregate market value of the registrant s common stock, $.0001 par value, held by non-affiliates of the registrant was approximately $144,440,648 based upon the closing price of $3.94 per share as of June 30, 2006. Shares of common stock held by each executive officer, director, and stockholders known by the registrant to own 10% or more of the outstanding stock based on Schedule 13G filings and other information known to us, have been excluded since such persons may be deemed affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 8, 2007, there were 45,486,342 shares of the registrant s common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III, Items 10 (as to directors, section 16(a) beneficial ownership and audit committee and audit committee financial expert), 11, 12 (as to beneficial ownership), 13 and 14 incorporate by reference information from the registrant s definitive proxy statement (the Proxy Statement) to be mailed to stockholders in connection with the solicitations of proxies for its 2007 annual meeting of stockholders scheduled to be held on May 23, 2007. Except as expressly incorporated by reference, the registrant s Proxy Statement shall not be deemed to be part of this report.

SUPPORTSOFT, INC.

FORM 10-K

FOR FISCAL YEAR ENDED DECEMBER 31, 2006

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FORWARD-LOOKING STATEMENTS

The statements contained in this Report on Form 10-K that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements regarding our expectations, beliefs, intentions or strategies regarding the future. Words such as anticipates, expects, intends, plans, believes, seeks, estimates and similar expressions identify such forward-looking statements. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those indicated in the forward-looking statements. These are statements that relate to future periods and include, but are not limited to, statements relating to anticipated features and benefits of our current products and services and those that we intend to offer in the future; anticipated customer demand for features and benefits provided by our products and services; the impact on our business from our new consumer technology support initiative; our industry and trends, such as the changing competitive landscape as a result of growing complexity in technologies; our strategy and components of our strategy, including our intentions to expand internationally and the potential international market opportunities for our solutions, to strengthen our indirect channels, our plan to establish new strategic relationships and our product development and service offering strategies and future plans; our anticipated competition with respect to our consumer offering; the development of our professional services organization; our strategic alliances and distribution relationships; expected results, cash flows and expenses, including those related to sales and marketing, research and development and general and administrative; expected revenue and sources of revenue; anticipated mix of revenue; expected impact, if any, of legal proceedings; expected seasonality in our business; the adequacy of liquidity and capital resources; the growth in business and operations; and the effect of recent accounting pronouncements. Factors that could cause actual results to differ materially from those predicted, include but are not limited to, our dependence on a small number of relatively large orders, our ability to attract and retain customers for existing and new services and to achieve adoption and acceptance of our products and services, the ability of our products and service offerings to achieve market penetration, our ability to use or integrate third-party technologies and to expand infrastructure to meet the demand for our services, our ability to expand internationally, our ability to attract and retain key employees, our ability to control expenses, the success of our strategic relationships, lack of renewals or payments for license agreements, the impact of international conflict and continued economic downturns in either domestic or foreign markets and the resulting changes in the amount of technology spending by customers and prospects, the effects of ongoing litigation, the rapid pace of technological change and the strength of competitive offerings and our ability to address our material weakness in our internal control over financial reporting. Additional factors, which could cause actual results to differ materially, include those set forth in the following discussion, and, in particular, the risks discussed in Item 1A, Risk Factors. These forward-looking statements speak only as of the date hereof. Unless required by law, we undertake no obligation to update publicly any forward-looking statements.

PART I

ITEM 1. BUSINESS.

Overview

SupportSoft is a leading provider of software and services that automate the resolution of technology problems. Our solutions reduce technology support costs, improve customer satisfaction and enable new revenue streams for organizations worldwide. We recently expanded our offerings and now provide technology support directly to consumers.

Our corporate customers are digital service providers (telecommunications and cable companies) and corporate IT departments. Digital service providers use our products to automate the installation, activation and verification of broadband services, to reduce the cost and improve the quality of support for customers, to enable the remote management of devices located at customer premises, and to provide value-added services to consumers. Corporate IT departments and managed service providers (IT outsourcing firms) use our software to improve the cost-effectiveness and efficiency of their support through an integrated portfolio of proactive service, self service and assisted service capabilities.

In the second half of 2006, we announced a new offering to address the consumer technology support market. This offering is an extension of our traditional business and relies upon our products, technology and expertise in technology problem resolution. The new offering provides computer problem resolution for consumers over the phone and the Internet. We offer our consumer technology support services through www.support.com and through consumer-facing companies such as PC manufacturers and digital service providers.

Industry Background

Technology has become a fundamental part of everyday life. Devices such as personal computers, cellular phones, personal digital assistants, digital cameras and home networks, and digital services such as high speed data, video over DSL (IPTV) and voice over Internet Protocol (VoIP), are increasingly common. As technology has become more prevalent, technology problems, whether with individual devices or systems incorporating multiple devices, have proliferated. As a result, we believe the need for efficient and effective technology support, both inside and outside the workplace, has become pressing.

For digital service providers, the availability of high speed data, IPTV and VoIP services, often refered to as triple play, has changed the competitive dynamics worldwide. We expect these dynamics to change further and grow in complexity as wireless services grow in popularity and triple play evolves to multi-play. The change in the competitive landscape that triple play has wrought causes digital service providers to offer a broader and more complex range of services. With these services has come a growing number of technology problems for subscribers, which we believe digital service providers must address efficiently and effectively to succeed in the marketplace.

Inside the enterprise, corporate IT departments are tasked with managing, supporting and servicing an expanding array of technologies used by employees. This challenge, combined with a redefinition of the workplace to include the office, the home and any point between, has made keeping the enterprise secure from virus attacks, maintaining business critical applications and responding to end-user requests for assistance an increasingly difficult and expensive task.

The traditional approach that organizations have embraced to address these challenges relies upon call centers and help desks resolving problems in a largely manual fashion. This approach to meeting technology support needs has been ineffective for many organizations, given its costly and time-intensive nature. This approach has also been inadequate for consumers, who require an increasing amount of assistance to manage the technology that now pervades their lives.

Strategy

SupportSoft is a leading provider of support automation solutions, supplying companies worldwide with technology designed to facilitate the identification, diagnosis and resolution of technology-related problems. Our strategy includes the following initiatives:

Enter Consumer Technology Support Market

Based on our own research and the success of early market entrants, we believe there is an opportunity to provide fee-based technology support to consumers. We also believe that our products, technology and expertise in technology problem resolution equip us well to participate in this market. To capitalize on this opportunity, we are offering technology support to consumers over the phone and the Internet through www.support.com. We are also offering hosted consumer technology solutions through consumer-facing partners such as PC manufacturers and digital service providers.

Expand Internationally

Historically, our presence in international markets has been limited, and we believe we have an opportunity to expand our international business. We believe the digital service provider market overseas represents a growth opportunity for us. We also believe that there are opportunities for our solutions in corporate IT departments overseas that we have not previously addressed. We have recently expanded our sales efforts internationally to address these international opportunities.

Strengthen Indirect Channels to Market

We are seeking to strengthen and expand relationships with key hardware and services companies who provide complementary products or services. We have established relationships with a number of consumer premises equipment (CPE) manufacturers and managed service providers. We plan to enhance existing relationships and establish new ones to broaden our routes to market.

Deliver Packaged Solutions

We have traditionally offered comprehensive solutions with extensive feature sets. While these solutions can provide substantial value, they also require significant implementation effort. In our next generation of products and services, we are tailoring our offerings to include targeted solutions with shorter implementation cycles designed to achieve accelerated return on investment. We believe these packaged offerings can expand the addressable market for our solutions.

Enhance Digital Service Provider Solutions

The triple play of high speed data, IPTV and VoIP services is changing the dynamics of the digital service market worldwide. We believe that service providers are looking for proven solutions which can enable them to deal with the complexities of installation, activation, verification, management and on-going support of these services for new and existing subscribers. We are enhancing our existing products and developing new products to help digital service providers address a number of the key challenges related to supporting these new services. These products are being designed to provide value to both established firms and emerging providers.

Enhance Solutions for Corporate IT Departments

As corporate IT departments and managed service providers face the ever increasing complexities of supporting remote and mobile workforces with a wide variety of new technologies, our proven solutions can both reduce cost and improve effectiveness through automation. We are enhancing our existing products and developing new products to help corporate IT departments and managed service providers address a number of key challenges. These products are being designed to provide value to enterprises of many sizes.

Products

For corporate customers, we offer a number of products suitable for both digital service providers and corportate IT departments. We also offer certain products targeted specifically at digital service providers. We have recently introduced solutions for the consumer technology support market that build upon our established offerings.

Products that are suitable for both for digital service providers and corporate IT departments include the following:

Desktop Agent. The SupportSoft agent is a desktop application that identifies, diagnoses and corrects potential problems prior to their impact on a user. Additionally, should a user need to call a customer service representative or help desk analyst, the SupportSoft agent provides permission-based tools for speeding the call by transferring system level information to the analyst electronically. For digital service providers, this product can diagnose and resolve connectivity and email issues as well as other common problems that are faced by high-speed data subscribers. For corporate IT departments, this product also supports the proactive resolution of problems through the delivery of updates to desktops.

Self-Service Suite. Self-Service Suite is an integrated set of products designed to bring together knowledge automation capabilities and service request management capabilities to support users who require web-based answers to technology-related issues, automated fixes to technology problems, or the ability to submit requests for assistance. The Self-Service Suite includes the SupportSoft Knowledge Center and RequestAssist products described below.

Intelligent Assistance Suite. Intelligent Assistance Suite is an integrated set of products designed to provide technical support representatives with a full set of capabilities to speed problem resolution. The Intelligent Assistance Suite includes the SupportSoft Knowledge Center, AnalystAssist, RemoteAssist, LiveAssist and EmailAssist products described below.

Knowledge Center. Knowledge Center is designed to automate the real-time creation, publication and management of knowledge-based content for technology problem resolution. Users can benefit from Knowledge Center solutions through their ability to quickly access personalized, self-service answers online, including access to automated one-click-fixes. Analysts can benefit from Knowledge Center software through functionality that allows them to access a rich repository of knowledge to speed problem resolution, including both structured and unstructured data. Knowledge Center content can be used to create consumer or employee facing self-service portals and/or call center or help desk facing content.

RequestAssist. RequestAssist is designed to manage the complete lifecycle of request management, from identification through resolution. A Web-based interface lets end-users quickly create, submit or check the status of typical requests and incidents. RequestAssist incorporates capabilities to support rules-based escalation of requests to the appropriate analysts, as well as automated notification of such escalations via the Web or email.

RemoteAssist. RemoteAssist is designed to enable analysts to remotely take control of a user s computer to speed problem resolution. By remotely managing and controlling a device, an analyst can diagnose problems in detail. This may include identifying whether the problem is at the application, hardware or operating system level, determining the necessary action to resolve the problem and implementing the resolution. No complex software installation or re-boot of the computer is typically required and a complete audit trail of all remote sessions is retained to expedite resolution should the problem be encountered again.

LiveAssist. LiveAssist is designed to provide call center organizations and IT help desks with a full set of chat capabilities. LiveAssist allows users and analysts to communicate directly with each other with a scalable, real-time chat solution enhanced by Web-push capabilities and access to relevant content.

EmailAssist. EmailAssist is designed to provide call center organizations and IT help desks with tools to support e-mail support channels. EmailAssist enables analysts to create e-mail responses faster by leveraging standard content and also manages the escalation of e-mail created tickets.

AnalystAssist. AnalystAssist is designed to provide call center organizations and IT help desks with a comprehensive set of diagnostic and problem resolution tools to solve technical problems remotely, without requiring on-site support. AnalystAssist also provides analysts with full visibility into the diagnostic tests performed, the tools used and the solutions provided to resolve the problem. AnalystAssist can be used by analysts during chat sessions using our LiveAssist product and during telephone sessions as well as in combination with our RemoteAssist product.

Products targeted specifically at digital service providers include:

SmartAccess. SmartAccess is designed to automatically determine if a subscriber s computing system qualifies for a broadband connection and, if so, enable self-installation of high-speed data service while providing a platform for the qualification, notification, installation, management and support of additional services. SmartAccess automates these front-end processes to enable auto-provisioning of services.

ServiceGateway. ServiceGateway is designed to automate CPE configuration activities, such as firmware upgrades. ServiceGateway also enables analysts to take remote control of CPE devices, such as routers or gateways, to diagnose and solve problems on a one-to-one basis.

ServiceVerify. ServiceVerify is designed to enable digital service providers to automatically verify the successful installation, activation and ongoing operations of high-speed data, IPTV and VoIP services. ServiceVerify provides tools and service information to the service technician and dispatcher as well as the analyst. ServiceVerify can help technicians determine that the work has been performed correctly and the customer has access to all the services ordered before the technician leaves the job. ServiceVerify also provides analyst tools designed to rapidly diagnose and resolve problems when a customer calls with a service-related problem.

Service Automation Suite for Video. Developed in conjunction with Scientific-Atlanta (a Cisco company), Service Automation Suite for Video can improve the way broadband cable service providers deliver high quality video services to their customers and enhance the consumer experience for digital cable delivery, while enabling customer-facing personnel such as installers, dispatchers and analysts to more effectively and efficiently uncover and resolve customer issues and problems.

Under the brand name of support.com, we currently offer technology support services directly to consumers. We offer these services through our outsourced North American Solution Center, currently staffed with 25 solutions engineers. These technical support professionals provide services over the telephone and the Internet, using our software solutions to identify, diagnose and resolve problems. Key features of our consumer technology support services are the following: (1) our services are provided remotely, with technical experts available over the phone and the internet rather than through in-home or in-store appointments; (2) our services leverage our proprietary technology which is protected by eight patents; and (3) our services leverage our extensive knowledgebase of solving technology problems for digital service providers and corporate IT departments. Service offerings on support.com include:

Comprehensive Problem Resolution. Our Comprehensive Problem Resolution service is designed to assist consumers with a wide range of computer-related problems. Our solutions engineers use our technology to remotely identify, diagnose and resolve technical problems and to answer questions that customers have about their computers and related devices.

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System Tune-Up. Our System Tune-Up service is designed to enhance the performance of computers. Our agents use our technology to remotely perform various tasks such as optimizing computer settings, removing unnecessary programs and content, and re-organizing and compacting computer hard disk contents. This results in faster computer processes including computer start-up and shut-down, loading of programs and internet browsing as well as increased disk space.

Virus and Spyware Removal. Our Virus and Spyware Removal service is designed to eradicate malicious software that may impact computer performance and threaten the consumer s data. Our agents use technology to remotely scan, identify and remove viruses and spyware and offer suggestions for continued protection.

Security Audit. Our Security Audit service is designed to protect a computer from hackers and malicious software. Our agents use our technology to remotely perform various tasks such as configuring Internet firewalls, closing security holes in the operating system, and verifying that antivirus and anti-spyware software is installed and current.

Windows Vista Upgrade Assessment. Our Windows Vista Upgrade Assessment service is designed to help determine if a computer can be upgraded to Microsoft Windows Vista as well as to recommend the most appropriate version of the new operating system. In addition, our agents can answer customer questions about Windows Vista.

Digital Camera Training and Setup. Our Digital Camera Training and Setup service is designed to help consumers connect, manage and share digital photos. Our agents assist consumers with installing and configuring digital camera, photo management and photo editing software. Our agents also train consumers how to transfer digital photos from the camera to the computer, share pictures over the Internet and obtain prints from online photo processing services.

MP3 Player Training and Setup. Our MP3 Player Training and Setup service helps consumers learn how to transfer, download and organize digital music and audio books. Our agents assist consumers with installing and configuring software to connect an MP3 player to a computer, download music from an Internet music site, copy music from a CD to a computer, and organize music.

In addition to providing services through support.com, we also license technology solutions to partners for their use in providing services to consumers. These consumer technology solutions are delivered to partners on a hosted basis for use by the partner s call center agents. System Tune-Up is currently available for license and the Virus and Spyware Removal service is expected to be available for license in the second quarter of 2007.

Technology

Our software provides self-healing capabilities designed to identify, diagnose and correct potential problems prior to their impact on the user. If a user does require assistance, our products are designed to provide an integrated approach to escalating the problem to either self-service web-based portals or to analysts who use our products to deliver the appropriate resolution to the problem. Many of our products have been architected to function on a common software platform which is based on a set of patented technologies.

Our technology is designed to enable our products to be extended and easily adapt to, and integrate with, varying software environments. Our solutions support a high degree of scalability using industry standard web server infrastructure and datacenter practices such as load balancing, clustering and data partitioning. Our products are web-based and provide similar functionality on a variety of web servers, application servers, operating systems and databases. The product architecture has been used in implementations that scale to several million endpoints. Common services such as user and group management, user-based security, user interface navigation, database access, extensible markup language handling, reporting and integration are shared by many of our products, allowing for faster product development.

Sales and Marketing

We maintain a worldwide sales organization to reach digital service providers and corporate IT departments. Our sales organization is managed geographically in three regions: the Americas; Europe, the Middle East and Africa; and Asia/Pacific. Within regions, some sales representatives sell specifically to digital service providers, some to corporate IT departments, and some to both.

The marketing organization works closely with the sales organization to create programs which build awareness of our solutions. The marketing organization uses a wide range of programs to build market awareness, including relationships with industry analysts, direct mail and relationship marketing programs, business and trade press tours, and participation in industry-specific trade shows. The marketing organization also creates collateral for the sales process.

For our consumer offerings, our customer acquisition program is currently focused on online marketing, primarily search, banners and viral programs, and terrestrial radio, as well as public relations activities. We expect to expand our marketing activities as our consumer offering evolves. We have a consumer business development organization that establishes and manages relationships with partners through whom we make our consumer offerings available.

Customers

Representative digital service providers who have purchased our products and services include: Belgacom, BellSouth, Bharti, Casema, Carphone Warehouse (Talk Talk), Charter, Comcast, Cox, Essent Kabelcom, FastWeb, KPN, Ono, Portugal Telecom, TDC Kabel, TDC Solutions, TDC Switzerland, TeliaSonera, Time Warner Cable, UPC Broadband, Verizon, and other service providers worldwide. Representative companies that have licensed SupportSoft software for corporate IT operations and customer support requirements include: ADP, Bank of America, BT, Kimberly-Clark, Lockheed Martin, Marriott, Northrop Grumman, Sony Electronics, Symantec, Thomson Financial and Trend Micro. Representative managed service providers that have purchased our products to provide outsourced services to enterprises include: CGI, CSC, CompuCom, EDS and IBM.

Alliances

We establish alliances with other companies to expand the reach of our sales and marketing efforts. We incorporate products from other companies, such as search engines, where we believe they will enhance the functionality of our products.

We work closely with CPE manufacturers and maintain an interoperability laboratory to test their hardware products against standards developed by the DSL Forum. Certain of these firms resell our products to digital service providers.

We have formed relationships with managed service providers that represent a customer base as well as a delivery option for our products. We have developed relationships with managed service providers, including CGI, CSC, CompuCom, EDS and IBM to address customer demand for outsourced IT services.

We have formed relationships with consumer facing companies in order to expand the reach of our consumer offerings. We have relationships with a large personal computer manufacturer and a European digital service provider in which such firms use our System Tune-Up solution to provide computer performance enhancement services to consumers. We have also established referral and affiliate programs which provide fees to third parties referring consumers to support.com.

Global Services

Our Global Services organization provides best practice solutions tailored to support our customers in maximizing value from our products. Our services capabilities are divided into five core areas with the goal of guiding the customer through a successful deployment:

- *Project Planning and Management.* Builds comprehensive project plans in coordination with customers and partners with a goal of ensuring that budget, timeline and quality objectives are achieved.

- *Design and Implementation.* Provides architectural solution design, product integration and deployment services.

- *Education*. Trains customers and alliance partners in the design, implementation and support of our products.

- *Customer Support*. Responds to design, feature and deployment questions. We use our own software to provide an Internet support portal, titled ExpertExchange, in providing support to our customers. Under our standard maintenance contracts, our customers also receive generally available patches, enhancements and updates to the products they have purchased.

- *Strategic Services.* Educates customers on best practices for supporting and servicing users and moving from traditional support processes to more automated approaches.

Research and Development

We devote a substantial portion of our resources to developing new and enhanced versions of our support automation software, conducting product testing and improving our core technologies. Fundamental to our research and development strategy are rapid product development cycles, continuous improvement and customer feedback. We have created customer advisory councils with representatives from our customers to formalize this input. We use our own products in providing support to both corporate customers and consumers, thereby gaining real-time knowledge and experience with our own products.

Research and development expense was $9.2 million in 2006, $11.2 million in 2005, and $9.7 million in 2004.

Intellectual Property

As of December 31, 2006, we had eight patents in the United States. We also hold patents in China, Singapore and Israel and have a number of patent applications pending in other foreign jurisdictions. We may or may not seek additional patents in the future. We do not know if our current patent applications or any future patent application will result in a patent being issued with the scope of the claims we seek, if at all. Also, we do not know whether any patents we have or may receive will be challenged or invalidated. It is difficult to monitor unauthorized use of technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States, and our competitors may develop technology that competes with ours but nevertheless does not infringe our intellectual property rights.

We maintain a number of trademarks and service marks associated with our business.

We rely on a combination of copyright, trade secret, trademark and contractual protection to establish and protect our proprietary rights that are not protected by patent. We also enter into confidentiality agreements with our employees and consultants involved in product development. We routinely require our employees, customers and potential business partners to enter into confidentiality agreements before we will disclose any sensitive aspects of our business. Also, we require employees to agree to assign and surrender to us any proprietary information, inventions or other intellectual property they generate or come to possess while employed by us. These precautions may not prevent misappropriation or infringement of our intellectual property.

Competition

We compete in markets that are highly competitive, subject to rapid change and significantly affected by new product introductions and other market activities of industry participants. Although we do not believe there is one principal competitor for all aspects of our offerings, we do compete with a number of other vendors.

Companies we encounter in competing for corporate customers include a broad range of publicly-traded and privately-held companies. In our digital service provider business, we compete with Motive, NGB, Fine Point Technologies, 2Wire, Alcatel, Motorola and Siemens. In our corporate IT business, our principal competition comes from companies such as ATG, BMC, CA, eGain, Hewlett Packard, Talisma, Kana, Knova and RightNow. In addition, we expect that internally developed applications will continue to be a significant source of competition in the foreseeable future. We believe that the principal competitive factors for our corporate offerings include the following:

- Breadth and depth of product functionality;
- Demonstrated customer success and return on investment;
- Scalability of platform and integrated architecture;
- Quality, performance and reputation of solutions;
- Pricing;
- Implementation services and support; and
- Product innovation.

We believe that we presently compete favorably with respect to each of these factors. However, the markets for our products are still rapidly evolving, and we may not be able to compete successfully against current and potential competitors. Our ability to expand our business will depend on our ability to maintain our technological advantage, introduce timely enhanced products to meet growing support needs, deliver on-going value to our customers and scale our business. Our potential competitors may have longer operating histories, significantly greater financial, technical and other resources, stronger strategic alliances or greater name recognition than we have. Competition in our markets could reduce our market share or require us to reduce the price of products and services, which could harm our business, financial condition and operating results.

As we enter the market for consumer technology support, we expect to compete against a set of competitors different than the competitors against whom we have historically competed, including retailers offering on-site technology support services, companies offering online technology support services and companies offering local technology support services. Principal competitive factors in this market include breadth and depth of service offerings; quality of the consumer experience; pricing; brand recognition; and relationships with industry participants. Certain of our competitors in this market have longer operating histories, significantly greater financial, technical and other resources, stronger strategic alliances or greater name recognition than we have.

Employees

As of December 31, 2006, we had 278 full-time employees and 34 contractors for total full-time equivalent headcount of 312. None of our employees are covered by collective bargaining agreements. We believe our relations with our employees are good.

Executive Officers

Our executive officers and their ages as of March 10, 2007 are:

Name	Age	Position
Josh Pickus	45	President and Chief Executive Officer
Ken Owyang	43	Chief Financial Officer, and Senior Vice President of Finance and Administration
Michael Sayer	55	Senior Vice President of Worldwide Sales
Robert Barnum	45	Senior Vice President of Global Services

Josh Pickus. Mr. Pickus has served as President, Chief Executive Officer and as a director of SupportSoft since April 2006. Mr. Pickus served as Senior Vice President and General Manager of the Clarity Division of Computer Associates, Inc., an IT management software company, from August 2005 until April 2006. From November 1999 until August 2005, Mr. Pickus held various executive positions at Niku Corporation, an IT governance software company, including President and Chief Executive Officer from November 2002 until August 2005, Chief Financial Officer from April 2001 to October 2002, and President of Vertical Markets from November 1999 to March 2001. Mr. Pickus holds a Bachelor of Arts from Princeton University and a Juris Doctor from University of Chicago School of Law.

Ken Owyang. Mr. Owyang has served as Chief Financial Officer and Senior Vice President of Finance and Administration since March 2006. Mr. Owyang served as Interim Chief Financial Officer from January to March 2006, and as Vice President of Finance of SupportSoft from November 2004 to January 2006. Mr. Owyang provided consulting services to SupportSoft from April 2004 to November 2004. From May 2003 until April 2004, he was an independent financial consultant to private and public companies. From November 1997 until February 2002, Mr. Owyang was employed by Marimba, Inc, an enterprise software company, initially as Controller and then as Chief Financial Officer beginning in June 2000. Mr. Owyang holds a B.A. in Business Administration and Accounting from San Francisco State University.

Michael Sayer. Mr. Sayer has served as Senior Vice President of Worldwide Sales of SupportSoft since May 2006. Mr. Sayer served as Vice President of Worldwide Sales of the Clarity Division of Computer Associates, Inc., an IT management software company, from August 2005 until April 2006. From August 2003 until August 2005, Mr. Sayer was Executive Vice President of Worldwide Sales of Niku Corporation, an IT governance software company. From November 1999 to April 2003, Mr. Sayer served as the Chief Executive Officer of Hipbone Corporation, a venture-backed startup company. Earlier in his career, Mr. Sayer established Remedy Corporation s European sales operations. Mr. Sayer holds a Bachelor of Science in Industrial Engineering from the University of Herfordshire in the United Kingdom.

Robert Barnum. Mr. Barnum has served as Senior Vice President of Global Services of SupportSoft since August 2006. From April 1997 until December 2005, Mr. Barnum held various professional services leadership positions at Oracle Corporation (formerly PeopleSoft, Inc.) including Vice President of North American Solutions Centers from April 2003 to December 2005. Mr. Barnum holds a B.S. in Management Information Systems from the University of Nevada, Las Vegas and an M.B.A. in International Business from San Francisco State University.

Other Key Employees

Other key employee as of March 10, 2007 are:

Anthony Rodio. Mr. Rodio has served as Chief Marketing Officer and Senior Vice President since September 2006. Mr. Rodio was Vice President of Product Management at SideStep, Inc., a private vertical search company in the travel space, from June 2005 to August 2006. From April 2004 to March of 2005, Mr. Rodio was Vice President of Marketing at StubHub, Inc., a secondary ticketing company that was recently acquired by eBay. From January 2001 to April 2004, Mr. Rodio served as Senior Director Brand and Communications of the MSN division of Microsoft. Earlier in his career, Mr. Rodio held marketing positions at Amazon.com Inc. and Procter & Gamble. Mr. Rodio holds a Bachelor of Science from the University of Oregon, a Master of Science from Portland State University and a Master of Business Administration from the Olin School of Business at Washington University in St. Louis.

Richard Mandeberg. Mr. Mandeberg has served as Senior Vice President of Consumer Business Development since December of 2006. From September 2005 to December of 2006, Mr. Mandeberg was Executive Director of Market Development at Seagate Technology s Consumer Branded Division. From January 2003 until September 2005, Mr. Mandeberg held various executive positions including Chief Executive Officer at Mirra Inc., a consumer storage appliance product company, before its acquisition by Seagate. Prior to Mirra, Mr. Mandeberg was Chief Executive Officer of IQ Commerce, an online marketing and consumer services software company. Mr. Mandeberg holds a Bachelor of Arts degree in Film and Computer Imaging from the University of Michigan.

David Temlak. Mr. Temlak has served as Senior Vice President of Customer Service at SupportSoft since November 2006. Mr. Temlak served as Senior Vice President of Customer Care at Time Warner Cable, a large cable operator, from January 2002 until November 2006. From August 1998 until January 2002, Mr. Temlak held various positions at Road Runner, a broadband internet service provider, including Vice President and Group Vice President of Customer Care. Mr. Temlak holds a Bachelor of Science degree in Electrical Engineering from Northeastern University.

Rich Matta. Mr. Matta has served as Vice President of Engineering since November 2005 and has been with us since November 2000 in various engineering and product management capacities. Mr. Matta holds a B.A. in Economics from Pomona College.

Mark Williams. Mr. Williams has served as Vice President of Customer Support since July 2006. Between May 2005 and July 2006, Mr. Williams served as IT Director. From April 2002 to May 2005, Mr. Williams served as Director of Consolidated Support overseeing the internal IT and Customer Support organizations. Mr. Williams also served as IT Director from December 1999 until April 2002. Mr. Williams holds a Bachelor of Science in Cognitive Science from the University of California, San Diego.

Cadir B. Lee. Mr. Lee co-founded SupportSoft. He has served in various leadership positions since our incorporation in December 1997, including most recently as our Chief Technology Officer. Mr. Lee holds a Bachelor of Science in biological sciences and a Bachelor of Arts in music from Stanford University.

SEC Filings and Other Available Information

We were incorporated in Delaware in December, 1997. We file reports with the Securities and Exchange Commission (SEC), including without limitation annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. The public may read and copy any materials we file with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at (202) 551-8090. In addition, we are an electronic filer. The SEC maintains an Internet site that contains reports, proxy and

information statements, and other information regarding issuers, including us, that file electronically with the SEC at the website address located at http://www.sec.gov.

Our telephone number is 650-556-9440 and our website address is http://www.supportsoft.com. The information contained in our website does not form any part of this Annual Report on Form 10-K. However, we make available free of charge through our website our Annual Report on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file this material with, or furnish it to, the SEC. In addition, we also make available on http://www.supportsoft.com/investors our Code of Ethics and Business Conduct for Employees, Officers and Directors. This Code is also available in print without charge to any person who requests it by writing to:

SupportSoft, Inc.
Investor Relations
1900 Seaport Boulevard, 3rd Floor
Redwood City, CA 94063

www.supportsoft.com

ITEM 1A. RISK FACTORS.

Investing in our securities involves a high degree of risk. In addition to the other information contained in this report, you should consider the following risk factors before investing in our securities.

We were not profitable in 2006 and will continue to sustain a loss in the foreseeable future.

We were not profitable in 2006. In addition, we intend to make significant investments in support of our business in 2007 and we expect to sustain a loss in 2007 and possibly subsequent periods. If we fail to achieve such revenue growth as a result of these additional investments or if such revenue growth does not result in our achieving profitability, the market price of our common stock will likely decline. A sustained period of losses would also result in an increased usage cash to fund our operating activities and a corresponding reduction in our cash balance.

Our quarterly results have in the past, and may in the future, fluctuate significantly.

Our quarterly revenue and operating results have in the past and may in the future fluctuate from quarter to quarter. As a result, we believe that quarter-to-quarter and year-to-year comparisons of our revenue and operating results are not necessarily meaningful, and that these comparisons may not be accurate indicators of future performance.

Several factors that have contributed or may in the future contribute to fluctuations in our operating results include:

- demand for our software and services;
- size and timing of customer orders and our ability to recognize revenue in a given quarter;
- our reliance on a small number of customers for a substantial portion of our revenue;
- the price and mix of products and services we or our competitors offer;
- our ability to attract and retain customers;
- the rate of expansion of our new consumer offerings and our investments therein;
- the amount and timing of operating costs and capital expenditures in our business;
- seasonal trends resulting from corporate spending patterns;

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- the exercise of judgment by our management in making accounting decisions in accordance with our accounting policies; and

- general economic conditions and their effect on our operations.

In prior years, we licensed a significant portion of our software on a term basis in which revenue was recognized ratably over the length of the agreement with the customer. In recent periods, however, we typically have licensed our software on a perpetual basis in which we recognize the license revenue up front, assuming all criteria for revenue recognition have been met. As we have shifted to a perpetual licensing model, we have become dependent on a few customer contracts with up-front license revenue for a substantial portion of our revenue in any one quarter. In addition, a significant portion of our total revenue each quarter comes from a number of orders received in the last month of a quarter. In previous quarters, we failed to close expected perpetual licenses with up-front revenue resulting in a revenue shortfall. If in future quarters we fail to close orders expected to be completed by the end of a quarter, particularly if these orders are for perpetual licenses with up-front revenue, our quarterly results would suffer and the market price of our common stock would likely decline. We are seeking to introduce transaction structures that involve ratable revenue recognition, but these types of transactions do not yet account for a material portion of our revenue.

Our inability to meet future financial performance targets that we announce or that are published by research analysts could cause the market price of our common stock to decline.

From time to time, we provide guidance related to our future financial performance. In addition, financial analysts publish their own expectations of our future financial performance. Because our quarterly revenue and our operating results fluctuate, future financial performance is difficult to predict. In the past, we have failed to meet our guidance. Future downward adjustments of our guidance or the failure to meet our guidance or the expectations of research analysts would cause the market price of our common stock to decline.

Management s ability to accurately predict performance is affected in large part by a significant portion of our total revenue being dependent upon the closing of new large customer orders. In addition, our guidance is based in part upon the expectation of new product sales and services offerings with which we have a limited history. In the event we fail to achieve projected revenue levels in any quarter, we will be unable to reduce our expenses for that quarter in a corresponding fashion, and our results will not meet our guidance or the expectations of securities analysts or investors, which would cause the market price of our common stock to decline.

The trading market for our common stock relies in part on the research and reports that industry or financial analysts publish about us or our business. We do not control these analysts. If one or more of the analysts who currently cover us downgrade our stock, our stock price would likely decline rapidly. Furthermore, if one or more of these analysts cease coverage of us, we could lose visibility in the market, which in turn could cause our stock price to decline.

Because a small number of customers have historically accounted for and may in future periods account for substantial portions of our revenue, our revenue could decline because of delays or losses of specific customer orders.

A small number of customers have historically accounted for, and may in future periods account for, substantial portions of our revenue. For the quarter ended December 31, 2006, one customer accounted for 13% of our total revenue for the quarter. Transaction structures that involve ratable revenue recognition and our consumer offerings, which typically involve payment on a per transaction basis, could reduce our dependence on large transactions with a small number of customers. However, in the near term, we are likely to continue to derive a significant portion of our revenue from large transactions with a limited number of customers. Therefore, our revenue could decline because of the loss or delay of a single customer order. Additionally, we may not obtain new customers. The failure to obtain significant new customers, particularly customers that purchase perpetual licenses with up-front payments, the loss or delay of significant customer orders or the failure of existing customers to pay ongoing fees when due would harm our operating results.

Our sales cycle is lengthy and if revenue forecasted for a particular quarter is not realized in that quarter, significant expenses incurred may not be offset by corresponding revenue.

Our sales cycle for our software typically ranges from three to nine months or more and may vary substantially from customer to customer. The purchase of our products and services for corporate customers generally involves a significant commitment of capital and other resources by a customer. This commitment often requires significant technical review, assessment of competitive products and approval at a number of management levels within a customer s organization. In addition, in the wake of the Sarbanes-Oxley Act of 2002, companies have enhanced their approval processes, making sales more difficult or protracted. While our customers are evaluating our products and services, we may incur substantial sales and marketing expenses and spend significant management effort to complete these sales. Any delay in completing sales in a particular quarter or the failure to complete a sale after expending resources during the sales cycle could cause our operating results to suffer.

Our recently announced consumer technology support initiative will increase operating expenses without any assurance of yielding increased revenue.

We have announced a plan to extend our business by providing consumer technology support services. In addition to continuing to offer our software to corporate customers, we are offering technology support to consumers. We may not be able to offer these new services successfully. We have limited experience in reaching or serving consumers directly or in managing call centers. As a result, we expect to use significant cash and incur increased operating expenses to support this new initiative, including costs of our outsourced call centers, promotional costs associated with reaching consumers and costs of obtaining personnel with the necessary consumer expertise. These investments may not yield increased revenue to offset these expenses. Furthermore, this new business initiative, if not favorably received by consumers, could damage the reputation of our corporate enterprise business as well as strain our management, financial and operational resources necessary to maintain our corporate business. The lack of market acceptance of such efforts or our inability to generate satisfactory revenue from such expanded services would have a material adverse effect on our business, prospects, financial condition and operating results.

Our future product and service offerings may not achieve market acceptance.

If we fail to develop enhanced versions of our software in a timely manner or to provide products and services that achieve rapid and broad market acceptance, we may not maintain or expand our market share. We may fail to identify new product and service opportunities for our current market or new markets that we enter in the future. In addition, our existing products may become obsolete if we fail to introduce new products or product enhancements that meet new customer demands, support new standards or integrate with new or upgraded versions of packaged applications or operating systems. We have limited control over factors that affect market acceptance of our product and services, including:

- the willingness of companies to transition to automated solutions; and
- customer preferences for competitors solutions or other technologies.

If our existing customers do not renew maintenance contracts or purchase additional products and services, our operating results could suffer.

Historically, we have derived, and expect to continue to derive, a significant portion of our total revenue from existing customers who purchase additional products and services and renew maintenance contracts. Our customers may not renew maintenance contracts or purchase additional products and services. In addition, as we introduce new products, our current customers may not require or desire the functionality of our new products and may not ultimately purchase these products. If our customers do not renew maintenance contracts or do not purchase additional products and services, our operating results would suffer.

We are seeking to increase our international revenues and if our revenue from this effort does not exceed the expense of establishing and maintaining international operations, our business could suffer.

We are seeking to increase our international revenues. For the years ended December 31, 2004, 2005, and 2006, international revenue was 11%, 21% and 23% of total revenue, respectively. We have limited experience in international operations and may not be able to compete effectively in international markets or effectively manage our operations in various countries. If we do not generate enough revenue from international operations to offset the expense of these operations, our operating results could suffer. Risks we face in conducting business internationally include:

- costs of staffing and managing international operations;
- smaller customers with less ability to pay United States rates for software and services;
- difficulty in reaching geographically dispersed customers;
- differing technology standards and legal considerations;
- longer sales cycles;
- dependence on local vendors and consultants;
- difficulties in staffing and managing international operations, including the difficulty in managing a geographically dispersed workforce in compliance with diverse local laws and customs;
- potential adverse tax consequences;
- changes in currency exchange rates and controls;
- difficulties in maintaining effective internal control over financial reporting as a result of a geographically-dispersed workforce and customers;
- longer collection cycles for accounts receivable; and
- the effects of external events such as terrorist acts and any related conflicts or similar events worldwide.

Our operating results will suffer if we do not expand and manage our professional services organization effectively.

Clients that license our software typically engage our professional services organization to assist with installation and implementation of our software and related consulting services. Revenue from professional services represented a substantial portion of our total revenue for the year ended December 31, 2006. We plan to further increase the number of professional services personnel, especially internationally, to meet customer needs. We may not be able to recruit the professional services personnel we need or retain our current professional services personnel because competition for qualified professional services personnel is intense. New professional services personnel will require training and education and take time to reach full productivity.

In addition, we cannot be certain that our professional services business will operate in a profitable manner. We have generally billed our customers for professional services on a time and material basis, using an agreed upon daily rate. However, customers have increasingly requested various contract

structures, including milestone-based contracts and contracts for a fixed total fee. If unanticipated factors in a project are encountered and the contract structure prevents us from billing additional amounts, we may be subject to monetary penalties, and the profitably of our professional services business would suffer. Furthermore, an estimated loss on a contract is generally required to be recorded in the period in which a loss becomes evident. Recording a loss on a services contract could have a material adverse effect on our operating results for the period in which the loss was recorded.

Our failure to establish and expand third-party alliances would harm our ability to sell our software and provide our services.

We have alliances with third parties that are important to our business. Our existing relationships include those with hardware vendors and managed service providers who provide outsourced support to corporate customers. If these relationships fail, we may need to devote substantially more resources to the sales and marketing of our products and services than we would otherwise, and our efforts may not be as effective. For example, companies that provide outsourced support and services often have extensive relationships with our existing and potential customers and significant input in the purchase decisions of these customers. In addition, we may establish relationships with third party resellers and other sales partners as we expand internationally. Our failure to maintain existing relationships, or to establish new relationships with key third parties, could significantly harm our ability to sell our products and services. In addition, our competitors may have strong alliances with other companies, including hardware providers, which could impact our ability to obtain greater market share, participate in deals where hardware and software are sold together, or require us to reduce the price of products and services, which could harm our business, prospects, financial condition and operating results.

Our consumer offerings require us to establish and maintain relationships with third parties who will direct consumers to us and provide technology support services to consumers based on our technology, as well as with third parties to whom we outsource our call center services. Failure to establish or maintain these relationships on acceptable terms or at all could materially and adversely affect the success of this initiative.

We may engage in investments or acquisitions or other strategic matters that could divert management attention and prove difficult to integrate with our business.

We may engage in acquisitions of other companies, products or technologies or in other strategic initiatives. If we fail to integrate successfully any future acquisitions, the operating results of the combined company could decline. The process of integrating businesses, technologies, services or products may result in unforeseen operating difficulties and expenditures. Acquisitions involve a number of other potential risks to our business, including the following:

- unanticipated costs and liabilities and unforeseen accounting charges or fluctuations;
- delays and difficulties in delivery of products and services from the combined company;
- failure to integrate management information systems, personnel, research and development, marketing, sales and support operations;
- loss of key employees;
- diversion of management s attention from other business concerns and disruption of our ongoing business;
- difficulty in maintaining controls and procedures;
- uncertainty on the part of our existing customers about our ability to operate on a combined basis;
- loss of customers;

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- loss of alliance partners;
- failure to realize the potential financial or strategic benefits of the acquisition; and
- failure to successfully further develop the combined technology, resulting in the impairment of amounts recorded as goodwill or other intangible assets.

We must compete successfully in the market for software and services that resolve technology problems or our business will suffer.

We compete in markets that are highly competitive, subject to rapid change and significantly affected by new product introductions and other market activities of industry participants. We compete with a number of companies in the market for automated delivery of support and service automation and other vendors who may offer products or services with features that compete with specific elements of our software products and services. In addition, our customers and potential customers have developed or may develop internally similar software systems.

The markets for our products are still rapidly evolving, and we may not be able to compete successfully against current and potential competitors. Our ability to expand our business will depend on our ability to maintain our technological advantage, introduce timely enhanced products to meet growing support needs, deliver on-going value to our customers and scale our business. Our potential competitors may have longer operating histories, significantly greater financial, technical and other resources, stronger strategic alliances or greater name recognition than we have. Competition in our markets could reduce our market share or require us to reduce the price of products and services, which could harm our business, financial condition and operating results.

As we further enter the market for consumer technology support, we expect to compete against a set of competitors different than the competitors against whom we have historically competed, including electronics retailers offering on-site technology support services, companies offering online technology support services and companies offering local technology support services. Certain of these anticipated competitors have longer operating histories, significantly greater financial, technical and other resources, stronger strategic alliances or greater name recognition than we have.

The loss of key personnel and the integration of new management may affect our ability to achieve our business goals.

Our success depends on the skills, experience and performance of our senior management, engineering, sales, marketing and other key personnel. The loss of the services of any of our executive officers or other key personnel at the Senior Vice President or Vice President level, could harm our business and our ability to achieve our business goals. In addition, many members of senior management have been appointed within the last year. Our success will depend to a significant extent on the ability of these executives to function effectively in their new roles and to work together successfully. If these executives do not function and work together successfully or if we lose the services of one or more of our executives or key employees, our business could be harmed.

Our exposure to the credit risks of our customers and resellers could adversely affect our operating results and financial condition.

To sell to some of our customers, we may be required to take risks of uncollectible accounts. We may be exposed to similar risks relating to third party resellers and other sales partners, as we intend to increasingly utilize such parties as we expand into new geographic regions. Additionally, as we have expanded our business internationally, we have experienced longer payment terms and collection cycles from customers outside the United States. While we monitor these situations carefully and attempt to take appropriate measures to protect ourselves by recognizing revenue upon collection of accounts from customers we deem to have credit risks and upon sell-through by resellers, it is possible that we may have to write down or write off doubtful accounts. Such write-downs or write-offs would negatively affect our operating results for the period in which they occur, and, if large, could have a material adverse effect on our operating results and financial condition.

Our products depend on and work with products containing complex software, and if our products fail to perform properly due to errors in the software, we may need to devote resources to correct the errors or compensate for losses from these errors and our reputation could be harmed.

Our products depend on complex software, both internally developed and licensed from third parties. Also, our customers may use our products with other companies products, which may also contain complex software. Complex software often contains errors and may not perform properly. These errors could result in:

- delays in product shipments;
- unexpected expenses and diversion of resources to identify the source of errors or to correct errors, whether or not the error is later determined to be related to our software;
- damage to our reputation;
- lost sales;
- contractual penalties, demands, claims and litigation and related defense costs; and
- warranty claims.

In our consumer offerings, we generally use our own products to diagnose and resolve consumer technology problems. If our products fail to perform well in this environment, our consumer offerings would suffer and may not be successful.

Our software may not operate with the hardware and software platforms that are used by our customers now or in the future, and, as a result, our business and operating results may suffer.

We currently serve a customer base with a wide variety of constantly changing hardware, software and networking platforms. If we fail to release versions of our software that are compatible with operating systems, software applications or hardware devices used by our customers, our business and operating results would suffer. Our future success also depends on the continuing ability of our products to inter-operate with multiple platforms and packaged applications used by our customer base and on our management of software being developed by third parties for our customers or for use with our products.

We rely on third-party technologies and our inability to use or integrate third-party technologies could delay product or service development.

We intend to continue to license technologies from third parties, including applications used in our research and development activities and technologies such as third-party search engine technology, which are integrated into our products and services. Our inability to obtain or integrate any of these technologies with our own products could delay product and service development until equivalent compatible technology can be identified, licensed and integrated. These technologies may not continue to be available to us on commercially reasonable terms or at all. We may fail to successfully integrate any licensed technology into our products or services, which would harm our business and operating results. Third-party licenses also expose us to increased risks that include:

- risks of product malfunction after new technology is integrated;
- the diversion of resources from the development of our own proprietary technology; and

- our inability to generate revenue from new technology sufficient to offset associated acquisition and maintenance costs.

Our system security is important to our customers and we may need to spend significant resources to protect against or correct problems caused by security breaches.

A fundamental requirement for online communications, transactions and support is the secure transmission of confidential information. Third parties may attempt to breach our security or that of our customers. We may be liable to our customers for any breach in security and any breach could harm our business and reputation. Also, computers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays or loss of data. We recently released a security advisory and a patch for a remote code execution vulnerability in several of our ActiveX components. We may be required to expend significant capital and other resources to further protect against security breaches or to correct problems caused by any breach.

Our reported results of operations will continue to be materially and adversely affected by our adoption of SFAS 123R.

Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), became effective in our first quarter of 2006, and has resulted in our recognition of substantial compensation expense relating to our employee stock options and employee stock purchase plans. Historically, we generally have not recognized in our statement of operations any compensation expense related to stock option grants we issue under our stock option plans or the discounts we provide under our employee stock purchase plans. Under the new rules, we are required to measure the compensation expense related to employee stock awards on a fair value basis, which leads to substantial additional compensation expense and a material adverse effect on our reported results of operations.

If we are unable to successfully address the material weakness in our disclosure controls and procedures or otherwise maintain effective disclosure controls and procedures, including our internal control over financial reporting, our ability to report our financial results on a timely and accurate basis may be adversely affected.

We have evaluated our disclosure controls and procedures as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as well as our internal control over financial reporting as required by Section 404 of the Sarbanes-Oxley Act of 2002. Our independent registered public accounting firm has performed a similar evaluation of our internal control over financial reporting. Effective controls are necessary for us to provide reliable financial reports and effectively prevent fraud. If we cannot provide reliable financial reports or prevent fraud, our operating results would be harmed. For the period ended December 31, 2006, we concluded that we had a material weakness in our internal control over financial reporting, as further described in Item 8, Report of Management on Internal Control over Financial Reporting. Our independent registered public accounting firm reached the same conclusion. We are implementing corrective actions, which we believe will remediate this material weakness. However, we cannot be certain that these measures will remediate the material weakness we have identified or, if we are successful in remediating this material weakness, whether we will be able to maintain adequate controls over our financial processes and reporting in the future. If these actions are not successful in addressing this material weakness, our ability to report our financial results on a timely and accurate basis may be adversely affected. In addition, if we cannot establish effective internal control over financial reporting and disclosure controls and procedures, investors may lose confidence in our reported financial information, which could cause the market price of our common stock to decline.

We have recorded long-lived assets, and our results of operations would be adversely affected if their value becomes impaired.

Goodwill and identifiable intangible assets were recorded in part due to our acquisition of substantially all of the assets of Core Networks Incorporated in September 2004. We also have certain intangible assets with an indefinite life. We assess the impairment of goodwill and indefinite life intangible assets annually or more often if events or changes in circumstances indicate that the carrying value may not be recoverable. We assess the impairment of acquired product rights and other finite life intangible assets whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. An impairment loss would be recognized when the sum of the discounted future net cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Such impairment loss would be measured as the difference between the carrying amount of the asset and its fair value. Material differences may result in write-downs of net long-lived and intangible assets, which would cause our operating results to suffer.

Failure to resolve pending securities claims and other lawsuits may lead to continued costs and expenses and divert management s attention from our business, which could cause our revenue and our stock price to decline.

Securities class action lawsuits were filed against us in November 2001 and again in December 2004. In addition, a derivative stockholder lawsuit was filed against us in December 2005. Should these lawsuits linger for a long period of time, whether ultimately resolved in our favor or not, or further lawsuits be filed against us, coverage limits of our insurance or our ability to pay such amounts may not be adequate to cover the fees and expenses and any ultimate resolution associated with such litigation. The size of these payments, if any, individually or in the aggregate, could seriously impair our cash reserves and financial condition. The continued defense of these lawsuits also could result in diversion of our management s time and attention away from business operations, which could cause our financial results to decline. A failure to resolve definitively current or future material litigation in which we are involved or in which we may become involved in the future, regardless of the merits of the respective cases, could also cast doubt as to our prospects in the eyes of customers, potential customers and investors, which could cause our revenue and stock price to decline.

Privacy concerns and laws or other domestic or foreign regulations may reduce the effectiveness of our solutions or harm our reputation and cause us to lose customers.

Our software contains features which allow our customers to control, monitor or collect information from computers running the software. Federal, state and foreign government bodies and agencies, however, have adopted or are considering adopting laws and regulations regarding the collection, use and disclosure of personal information obtained from consumers and individuals. Liability for violation of, costs of compliance with, and other burdens imposed by such laws and regulations may limit the use and adoption of our solutions and reduce overall demand for them. Even the perception of privacy concerns, whether or not valid, may inhibit adoption of our solutions. In addition, we may face claims about invasion of privacy or inappropriate disclosure, use or loss of this information. Any imposition of liability could harm our reputation, cause us to lose customers and cause our operating results to suffer.

We may not obtain sufficient patent protection, which could harm our competitive position, increase our expenses and harm our business.

Our success and ability to compete depend to a significant degree upon the protection of our software and other proprietary technology. It is possible that:

- our pending patent applications may not be issued;
- competitors may independently develop similar technologies or design around any of our patents;

- patents issued to us may not be broad enough to protect our proprietary rights; and

- our issued patents could be successfully challenged.

We rely upon patents, trademarks, copyrights and trade secrets to protect our proprietary rights and if these rights are not sufficiently protected, it could harm our ability to compete and to generate revenue.

We rely on a combination of laws, such as patents, copyright, trademark and trade secret laws, and contractual restrictions, such as confidentiality agreements and licenses, to establish and protect our proprietary rights. Our ability to compete and grow our business could suffer if these rights are not adequately protected. Our proprietary rights may not be adequately protected because:

- laws and contractual restrictions may not adequately prevent misappropriation of our technologies or deter others from developing similar technologies; and

- policing unauthorized use of our products and trademarks is difficult, expensive and time-consuming, and we may be unable to determine the existence or extent of this unauthorized use.

Also, the laws of other countries in which we market our products may offer little or no protection of our proprietary technologies. Reverse engineering, unauthorized copying or other misappropriation of our proprietary technologies could enable third parties to benefit from our technologies without paying us for them, which would harm our competitive position and market share.

We may face intellectual property infringement claims that could be costly to defend and result in our loss of significant rights.

Other parties may assert intellectual property infringement claims against us or our customers and our products may infringe the intellectual property rights of third parties. For example, our products may infringe issued patents that may relate to our products. In addition, as is increasingly common in the software industry, we may be confronted with the aggressive enforcement of patents by companies whose primary business activity is to acquire patents for the purpose of offensively asserting them against other companies. Intellectual property litigation is expensive and time-consuming and could divert management s attention from our business. If there is a successful claim of infringement, we may be required to develop non-infringing technology or enter into royalty or license agreements, which may not be available on acceptable terms, if at all. Our failure to develop non-infringing technologies or license proprietary rights on a timely basis would harm our business.

If the growth of demand for digital services does not continue, our ability to increase our revenue could suffer.

Our ability to increase our revenue will depend in part on increased demand for digital services. If this demand does not grow as rapidly or to the extent we anticipate, our business could suffer. The growth of digital services is uncertain and will depend in particular upon the availability, at a reasonable price, of such digital services, the building of infrastructure to support such services, the availability of competitive products, and the reliability of such services.

We may experience a decrease in market demand due to uncertain economic conditions in the United States and in international markets, which has been further exacerbated by the concerns of terrorism, war and social and political instability.

The United States and international economies have in the past experienced periods of slow economic growth and this could occur again. In addition, terrorist attacks in the United States and turmoil in certain overseas regions have increased uncertainty and may exacerbate a decline in economic conditions, both domestically and internationally. If the economy declines as a result of economic, political and social turmoil, or if there are further terrorist attacks in the United States or elsewhere, we may experience decreases in the demand for our products and services, which would harm our operating results.

We may be required to change our business practices if there are changes in accounting regulations and related interpretations and policies.

Accounting standards groups and regulators are actively re-examining various accounting policies, guidelines and interpretations related to revenue recognition, income taxes, investments in equity securities, facilities consolidation, accounting for acquisitions, allowance for doubtful accounts and other financial reporting matters. These standards groups and regulators could promulgate interpretations and guidance that could result in material and potentially adverse changes to our business practices and accounting policies.

New rules and regulations for public companies have increased and may continue to increase our administrative costs.

The Sarbanes-Oxley Act of 2002, as well as new rules subsequently implemented by the Securities and Exchange Commission and the Nasdaq Global Select Market, has required changes in corporate governance practices of public companies. These rules and regulations are increasing our legal and financial compliance costs, and making some activities more time-consuming and costly. These rules and regulations make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These new rules and regulations could also make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our audit committee, and qualified executive officers.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

Not applicable.

ITEM 2. PROPERTIES.

In the fourth quarter of 2006, we signed a lease for our new corporate headquarters facility with approximately 37,400 square feet at 1900 Seaport Boulevard, 3rd Floor, Redwood City, California. We are currently transitioning our headquarters from 575 Broadway in Redwood City, California, where our lease for approximately 23,600 square feet expires in May 2007. The new corporate headquarters lease expires in July, 2012. We believe the new facilities are adequate and suitable for our business requirements.

ITEM 3. LEGAL PROCEEDINGS.

Between December 2004 and January 2005, several purported securities class action suits were filed in the United States District Court for the Northern District of California against us, our former Chief Executive Officer, Radha R. Basu, and our former Chief Financial Officer, Brian M. Beattie. These actions were consolidated on March 22, 2005 as *In re SupportSoft, Inc. Securities Litigation,* Civil Action No.: c 04-5222 SI. The consolidated complaint alleges generally violations of certain federal securities laws and seeks unspecified damages on behalf of a class of purchasers of our common stock between January 20, 2004 and October 1, 2004. Plaintiffs allege, among other things, that defendants made false and misleading statements concerning our business and guidance for the third quarter 2004, purportedly violating Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. On June 1, 2006, this action was certified to proceed as a class action on behalf of all persons and entities who purchased or otherwise acquired the securities of the Company from January 29, 2004 to October 1, 2004 and who were allegedly damaged thereby. The case is currently in discovery. A trial date has been set for October 29, 2007. Defendants intend to vigorously defend themselves against the consolidated lawsuit. While we cannot predict with certainty the outcome of the litigation, we believe that we have meritorious defenses to such claims.

In December 2005, a purported derivative stockholder complaint was filed in the Superior Court of the State of California for the County of San Mateo captioned *White v. Vase et al.*, No. Civ. 451677. This complaint pursues claims derivatively and on behalf of the Company as a nominal defendant against certain of our directors and former directors: Radha R. Basu, Manuel Diaz, Kevin C. Eichler, Edward S. Russell and James Thanos. The derivative complaint alleges, among other things, that the director-defendants harmed us by making or permitting us to make false and misleading statements between January 20, 2004 and October 1, 2004 concerning our business and guidance for the third quarter 2004 and by purportedly exposing us to liability for securities fraud in violation of their fiduciary duties. On October 4, 2006, the court denied the defendants demurrer to the plaintiffs first amended complaint. The defendants answered this complaint on November 6, 2006. The case is currently in discovery. While we cannot predict with certainty the outcome of the litigation, we believe we have meritorious defenses to such claims.

In November 2001, a class action lawsuit was filed against us and two of our officers in the United States District Court for the Southern District of New York. The lawsuit alleged that our registration statement and prospectus dated July 18, 2000 for the issuance and initial public offering of 4,250,000 shares of our common stock contained material misrepresentations and/or omissions related to alleged inflated commissions received by the underwriters of the offering. The defendants named in the lawsuit are SupportSoft, Radha Basu, Brian Beattie, Credit Suisse First Boston Corporation, Bear, Stearns & Co. Inc. and FleetBoston Robertson Stephens Inc. The lawsuit seeks unspecified damages as well as interest, fees and costs. Similar complaints have been filed against 55 underwriters and more than 300 other companies and other individual officers and directors of those companies. All of the complaints against the underwriters, issuers and individuals have been consolidated for pre-trial purposes before U.S. District Court Judge Scheindlin of the Southern District of New York. On June 26, 2003, the plaintiffs announced that a proposed settlement between the issuer defendants and their directors and officers had been reached. Under the proposed settlement, which is subject to court approval, our insurance carrier would be responsible for any payments other than attorneys fees prior to June 1, 2003. A final settlement approval hearing on the proposed issuer settlement was held on April 24, 2006. The district court took the matter under submission and has not yet ruled. Meanwhile the consolidated case against the underwriters has proceeded. On October 13, 2004, the district court certified a class. On December 5, 2006, however, the Second Circuit reversed, holding that a class could not be certified. The Second Circuit s holding, while directly affecting only the underwriters, raises some doubt as to whether the proposed issuer settlement will be approved in its present form. On January 5, 2007, plaintiffs petitioned the Second Circuit for rehearing of the Second Circuit s decision. On January 24, 2007, the Second Circuit asked the underwriter defendants to respond to the petition by February 7, 2007. On February 7, 2007, the underwriters filed their response. While we cannot predict with certainty the outcome of the litigation or whether the settlement will be approved, we believe that the claims against us and our officers are without merit.

We are also subject to other routine legal proceedings, as well as demands, claims and threatened litigation that arise in the normal course of our business. The ultimate outcome of any litigation is uncertain, and either unfavorable or favorable outcomes could have a material negative impact. Regardless of outcome, litigation can have an adverse impact on SupportSoft because of defense costs, diversion of management resources and other factors.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matters were submitted to a vote of security holders during the fourth quarter of the year ended December 31, 2006.

PART II

ITEM 5. MARKET FOR THE REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Market of Common Stock

Our common stock has been traded publicly on the Nasdaq Global Select Market under the symbol SPRT since July 19, 2000. Before July 19, 2000, there was no public market for our common stock. The following table sets forth the highest and lowest sale price of our common stock for the quarters indicated:

	Low	High
Fiscal Year 2005:		
First Quarter	$ 5.06	$ 6.70
Second Quarter	$ 4.50	$ 5.70
Third Quarter	$ 4.78	$ 6.17
Fourth Quarter	$ 3.93	$ 5.12
Fiscal Year 2006:		
First Quarter	$ 3.99	$ 4.80
Second Quarter	$ 3.60	$ 4.77
Third Quarter	$ 3.31	$ 4.39
Fourth Quarter	$ 4.14	$ 6.05

Holders of Record

As of March 8, 2007, there were approximately 180 holders of record of our common stock (not including beneficial holders of stock held in street name).

Dividend Policy

We have not declared or paid any cash dividends on our capital stock since our inception and do not expect to do so in the foreseeable future. We currently anticipate that all future earnings, if any, generated from operations will be retained by us to develop and expand our business. Any future determination with respect to the payment of dividends will be at the discretion of the Board of Directors and will depend upon, among other things, our operating results, financial condition and capital requirements, the terms of then-existing indebtedness, general business conditions and such other factors as the Board of Directors deems relevant.

Securities Authorized for Issuance Under Equity Compensation Plans

Information regarding the securities authorized for issuance under our equity compensation plans can be found under Item 12 of Part III of this Report.

Stock Price Performance Graph

The following graph illustrates a comparison of the cumulative total stockholder return (change in stock price plus reinvested dividends) of the Company s Common Stock and the CRSP Total Return Index for the Nasdaq U.S. Stocks (the Nasdaq Composite Index) and Nasdaq Computer and Data Processing Services Index from December 31, 2001 through December 29, 2006. The graph assumes that $100 was invested on December 29, 2001 in us, the Nasdaq Composite Index and the Nasdaq Computer and Data Processing Services Index and that all dividends were reinvested. No cash dividends have been declared or paid on the Company s Common Stock. The Company s Common Stock has been traded on the Nasdaq Global Select Market since July 19, 2000. The comparisons in the table are required by the Securities and Exchange Commission and are not intended to forecast or be indicative of possible future performance of the Company s Common Stock.

COMPARISON OF CUMULATIVE TOTAL RETURN AMONG
SUPPORTSOFT, INC.,
THE NASDAQ COMPOSITE INDEX, AND
THE NASDAQ COMPUTER AND DATA PROCESSING SERVICES INDEX

CUMULATIVE TOTAL RETURN AT PERIOD END

	12/31/01	12/31/02	12/31/03	12/31/04	12/30/05	12/31/06
SupportSoft, Inc.	$ 100.00	$ 62.84	$ 209.89	$ 106.22	$ 67.30	$ 87.40
Nasdaq Composite Index	$ 100.00	$ 69.13	$ 103.36	$ 112.49	$ 114.88	$ 126.21
Nasdaq Computer & Data Processing Services Index	$ 100.00	$ 68.93	$ 90.84	$ 100.15	$ 103.55	$ 116.26

The information presented above in the stock performance graph shall not be deemed to be soliciting material or to be filed with the Commission or subject to Regulation 14A or 14C, except to the extent that we subsequently specifically request that such information be treated as soliciting material or specifically incorporate it by reference into a filing under the Securities Act or Exchange Act.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA.

The information set forth below is not necessarily indicative of results of future operations and should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes included in Items 7 and 8 of Part II of this Report.

	Years Ended December 31, 2006	2005	2004	2003	2002
	(in thousands, except per share data)				
Consolidated Statements of Operations Data:					
Revenue:					
License fees	$ 16,415	$ 32,737	$ 37,923	$ 40,885	$ 31,260
Maintenance	15,672	14,317	11,002	5,757	3,038
Services	12,941	14,877	11,692	6,629	6,862
Total revenue	45,028	61,931	60,617	53,271	41,160
Costs and expenses:					
Cost of license fees	499	555	295	369	289
Cost of maintenance(1)	1,225	988	418	400	(1)
Cost of services	13,599	13,128	9,592	6,446	5,883
Amortization of intangible assets	1,090	1,090	363		1,580
Research and development	9,247	11,185	9,746	9,199	8,834
Sales and marketing	23,336	25,159	23,965	22,038	22,464
General and administrative	10,163	8,618	6,454	5,405	5,637
In-process research and development			1,618		
Amortization of deferred compensation					578
Total costs and expenses	59,159	60,723	52,451	43,857	45,265
Income (loss) from operations	(14,131)	1,208	8,166	9,414	(4,105)
Interest income and other, net	6,383	3,619	2,298	502	640
Income (loss) before income taxes	(7,748)	4,827	10,464	9,916	(3,465)
Provision for income taxes	(487)	(402)	(310)	(496)	(177)
Net income (loss)	(8,235)	4,425	10,154	9,420	(3,642)
Basic net income (loss) per share	$ (0.19)	$ 0.10	$ 0.24	$ 0.27	$ (0.11)
Shares used in computing basic net income (loss) per share	44,113	43,032	42,355	34,682	32,486
Diluted net income (loss) per share	$ (0.19)	$ 0.10	$ 0.22	$ 0.25	$ (0.11)
Shares used in computing diluted net income (loss) per share	44,113	44,519	45,590	38,048	32,486

	December 31, 2006	2005	2004	2003	2002
	(in thousands)				
Consolidated Balance Sheet Data:					
Cash, cash equivalents and marketable securities	$ 119,891	$ 120,663	$ 120,341	$ 121,414	$ 30,615
Working capital	118,238	119,807	113,320	114,089	23,918
Total assets	152,605	156,249	150,205	139,044	42,160
Long-term obligations	411	1,111	2,210	1,478	67
Accumulated deficit	(69,190)	(60,955)	(65,380)	(75,534)	(84,954)
Total stockholders equity	132,503	134,394	127,857	114,006	23,147

(1) The cost of maintenance was recorded separately beginning in 2003. In 2002, the cost of maintenance was included in cost of services.

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

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this Form 10-K. The following discussion includes forward-looking statements. Please refer to our cautionary statement on page 3 related to forward-looking statements and our risks and uncertainties listed under Item 1A of this report.

Overview

SupportSoft is a leading provider of software and services that automate the resolution of technology problems. Our solutions reduce technology support costs, improve customer satisfaction and enable new revenue streams for organizations worldwide. We recently expanded our offerings and now provide technology support directly to consumers.

Our corporate customers are digital service providers (telecommunications and cable companies) and corporate IT departments. Digital service providers use our products to automate the installation, activation and verification of broadband services, to reduce the cost and improve the quality of support for customers, to enable the remote management of devices located at customer premises, and to provide value-added services to consumers. Corporate IT departments and managed service providers (IT outsourcing firms) use our software to improve the cost-effectiveness and efficiency of their support through an integrated portfolio of proactive service, self service and assisted service capabilities.

In the second half of 2006, we announced a new offering to address the consumer technology support market. This offering is an extension of our traditional business and relies upon our products, technology and expertise in technology problem resolution. The new offering provides computer problem resolution for consumers over the phone and the Internet. We offer our consumer technology support services through www.support.com and through consumer-facing companies such as PC manufacturers and digital service providers.

Through December of 2006, our revenue has consisted entirely of software license fees and fees for maintenance, consulting, hosting and training services. In recent years, we have licensed our software to customers predominately on a perpetual basis in which we recognize the license revenue up front, assuming all criteria for revenue recognition under the applicable accounting rules have been met. Maintenance fees relating to perpetual software licenses result in ratable revenue over the period of the maintenance term, which is generally one year. Consulting and training revenues are generally recognized as the services are performed or in accordance with predefined project milestones. Hosting fees are recognized ratably over the term of the hosting arrangement.

License revenue and total revenue grew in each of the three quarters following the first quarter of 2006, resulting in license revenue of $16.4 million and total revenue of $45.0 million for the year ended December 31, 2006. Despite the sequential quarterly increases in license revenue in the last three quarters of 2006, we have experienced a trend of decreasing annual license revenue over the last three fiscal years. License revenue has decreased due to closing fewer large licensing transactions with corporate customers, particularly U.S.-based digital service providers. To address the trend of decreasing annual revenue, we have made and are planning to make a number of changes in the business. We have hired new senior leadership, including a new Chief Executive Officer, Senior Vice President of Worldwide Sales, Senior Vice President of Global Services, Chief Marketing Officer, Senior Vice President of Customer Service and Senior Vice President of Consumer Business Development. We have also hired new regional sales leadership for the North America, EMEA and Asia/Pacific regions and made substantial changes in our sales force and sales compensation plans. We have expanded our sales and marketing efforts internationally and with channel partners and increased the size of our professional services organization.

We have also begun the development of packaged product and service offerings capable of delivering return on investment in shorter time frames. Finally, we have entered the consumer technology support market with our support.com and consumer technology solutions offerings.

We do not expect immediate returns from our initiatives but believe they can create sustainable revenue growth over time. Although we intend to leverage many of our existing resources, we are making significant incremental investments in support of these initiatives, including investments to operate our outsourced call center, to promote our consumer offerings, to expand our professional services organization and to increase visibility of our enterprise offerings. We expect that these additional investments will precede any material revenue increase from our new business initiatives. As a result, we currently expect to incur a net loss in each quarter, at least through 2007. We expect that our net loss in each quarter, as well as for the full year in 2007, will significantly exceed the net losses we incurred during fiscal 2006.

Based upon our recent history, we expect to experience downward revenue seasonality between the fourth and first quarters. Consequently, we expect revenues for the first quarter of 2007 to be significantly lower than revenue recorded in the fourth quarter of 2006. This seasonal revenue decline, coupled with the incremental investments noted above will likely result in a significantly larger net loss in the first quarter of 2007 as compared with the fourth quarter of 2006. Furthermore, as of the filing date of this Form 10-K, we are in the sales and negotiation process with several companies for the purchase of our products and services. Ultimate closure of these transactions prior to March 31, 2007 will have a significant influence on whether or not we meet expectations for revenue in the first quarter of 2007.

We intend the following discussion of our financial condition and results of operations that follows to provide information that will assist in understanding our financial statements, the changes in certain key items in those financial statements from year to year, and the primary factors that accounted for those changes, as well as how certain accounting principles, policies and estimates affect our financial statements.

Critical Accounting Policies and Estimates

In preparing our consolidated financial statements in conformity with accounting principles generally accepted in the United States, we make assumptions, judgments and estimates that can have a significant impact on our net revenue, and operating results, as well as on the value of certain assets and liabilities on our consolidated balance sheet. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. On a regular basis we evaluate our assumptions, judgments and estimates and make changes accordingly. We believe that the assumptions, judgments and estimates involved in the accounting for revenue recognition, allowance for doubtful accounts, accounting for income taxes, accounting for goodwill and other intangible assets, and stock-based compensation have the greatest potential impact on our consolidated financial statements, so we consider these to be our critical accounting policies. We discuss below the critical accounting estimates associated with these policies. For further information on the critical accounting policies, see Note 1 of our Notes to Consolidated Financial Statements.

Revenue Recognition

We recognize revenue in accordance with generally accepted accounting principles that have been prescribed for the software industry. Revenue recognition requirements in the software industry are very complex and are subject to change. Our revenue recognition policy is one of our critical accounting policies because revenue is a key component of our results of operations and is based on complex rules which require us to make judgments. In applying our revenue recognition policy we must determine which portions of our revenue are recognized currently and which portions must be deferred. In order to determine current and deferred revenue, we make estimates with regard to the expected amount of future services to be performed and the appropriate fair value for those services. We also make judgments as to whether future services are essential to the functionality of other elements of the software arrangement. We do not record revenue on sales transactions when the collection of cash is in doubt at the time of sale. Rather, revenue is recognized from these transactions as cash is collected. The determination of collectibility requires significant judgment.

Allowances for Doubtful Accounts

We make judgments as to our ability to collect outstanding receivables and provide allowances for the portion of receivables when collection becomes doubtful. Provisions are made based upon a specific review of all significant outstanding invoices. For those invoices not specifically provided for, provisions are recorded at differing rates, based upon the age of the receivable. In determining these percentages, we analyze our historical collection experience and current payment trends. If the historical data we use to calculate the allowance for doubtful accounts does not reflect the future ability to collect outstanding receivables, additional provisions for doubtful accounts may be needed and the future results of operations could be materially affected.

Accounting for Income Taxes

We are required to estimate our income taxes in each of the tax jurisdictions in which we operate. This process involves management s estimation of our actual current tax exposures together with an assessment of temporary differences determined based on the difference between the financial statement and tax basis of certain items. These differences result in net deferred tax assets and liabilities, which are included within the consolidated balance sheet. We must then assess the likelihood that the deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or adjust this allowance in a period, we must include a tax expense or benefit within the tax provision in the statements of operations.

Accounting for Goodwill and Other Intangible Assets

At December 31, 2006, goodwill was $9.8 million, and net identifiable intangible assets were $3.2 million. We assess the impairment of goodwill and indefinite life intangible assets annually or more often if events or changes in circumstances, indicate that the carrying value may not be recoverable. We assess potential impairment at the entity level because we have only one reporting unit. An impairment loss would be recognized if the fair value of the Company is less than the carrying value of the Company s net assets on the date of the evaluation. We assess the impairment of finite life identifiable intangible assets whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. An impairment loss would be recognized when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Such impairment loss would be measured as the difference between the carrying amount of the asset and its fair value. The estimate of cash flow is based upon, among other things, certain assumptions about expected future operating performance and an appropriate discount rate determined by our management. Our estimates of discounted cash flows may differ from actual cash flows due to, among other things, economic conditions, changes to the business model or changes in operating performance. If we made different estimates, material differences may result in write-downs of net long-lived and intangible assets, which would be reflected by charges to our operating results for any period presented. At September 30, 2006, management concluded its annual evaluation for impairment of goodwill and no impairment was recognized.

Stock-based compensation

We account for stock-based compensation in accordance with the provisions of SFAS 123R. We adopted SFAS 123R using the modified prospective transition method which requires the application of the accounting standard starting from January 1, 2006. Under the fair value recognition provisions of SFAS 123R, stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized as expense ratably over the requisite service period of the award. We estimate the fair value of stock-based awards on the grant date using the Black-Scholes-Merton option-pricing model. Determining the appropriate fair value model and calculating the fair value of stock-based awards requires judgment, including estimating stock price volatility, forfeiture rates and expected life. If any of these assumptions used in the option-pricing models changes significantly, stock-based compensation may differ materially in the future from that recorded in the accompanying financial statements.

Results of Operations

The following table presents certain consolidated statements of operations data for the periods indicated as a percentage of total revenue.

	Years Ended December 31, 2006	2005	2004
Revenue:			
License fees	36 %	53 %	63 %
Maintenance	35	23	18
Services	29	24	19
Total revenue	100	100	100
Costs and expenses:			
Cost of license fees	1	1	0
Cost of maintenance	3	2	1
Cost of services	30	21	15
Amortization of intangible assets	2	2	1
Research and development	20	18	16
Sales and marketing	52	40	40
General and administrative	23	14	11
In-process research and development	0	0	3
Amortization of deferred compensation	0	0	0
Total costs and expenses	131	98	87
Income (loss) from operations	(31)	2	13
Interest income and other, net	14	6	4
Income (loss) before income taxes	(17)	8	17
Provision for income taxes	(1)	(1)	0
Net income (loss)	(18)%	7 %	17 %

Years Ended December 31, 2006, 2005, and 2004

Revenue ($ in thousands)

	2006	% Change 2005 to 2006	2005	% Change 2004 to 2005	2004
License fees	$ 16,415	(50)%	$ 32,737	(14)%	$ 37,923
Maintenance	15,672	9 %	14,317	30 %	11,002
Services	12,941	(13)%	14,877	27 %	11,692
Total revenue	$ 45,028	(27)%	$ 61,931	2 %	$ 60,617

Total Revenue. Total revenue decreased by 27% in 2006 as compared to 2005 and increased by 2% in 2005 as compared to 2004. Each of the components of total revenue is discussed in more detail below.

License revenue. License revenue is comprised of fees for term and perpetual licenses of our software. Perpetual license revenue is recognized using the residual method described in SOP 98-9 for arrangements in which licenses are sold with multiple elements. We allocate revenues on these licenses based upon the fair value of each undelivered element including undelivered maintenance, consulting and training. The determination of fair value is based upon vendor specific objective evidence (VSOE). VSOE for maintenance is based upon separate renewals of maintenance from customers. VSOE for consulting or training is based upon separate sales of these services to customers. Assuming all other revenue recognition criteria are met, the difference between the total arrangement fee and the amount deferred for each undelivered element is recognized as license revenue. Revenue from license fees was $16.4 million in 2006, $32.7 million in 2005, and $37.9 million in 2004. License fees decreased by approximately $16.3 million, or 50%, in 2006 from 2005 and $5.2 million, or 14%, in 2005 from 2004. The decreases in license revenue from 2005 to 2006 and from 2004 to 2005 were primarily due to fewer large license transactions from our corporate customers. For example, in 2006, we had three customers that contributed greater than $1.0 million in license revenue for the year as compared with eight customers in 2005.

Maintenance revenue. Maintenance revenue is comprised primarily of revenue from post-contract technical support services which includes software product updates. Maintenance revenue is recognized ratably over the term of the maintenance period, which is generally one year.

Maintenance revenue was $15.7 million in 2006, $14.3 million in 2005 and $11.0 million in 2004. Maintenance revenue increased by approximately $1.4 million, or 9%, in 2006 from 2005, and $3.3 million, or 30%, in 2005 from 2004. The increases in maintenance revenue were due to new license customers who generally purchase maintenance in connection with their purchase of our software products and more customers who have licensed our products on a perpetual basis versus a term basis. Generally, under a perpetual license arrangement, maintenance services are sold separately and, therefore, maintenance revenue is recognized as a separate component of total revenue. Under a term license arrangement, maintenance services are bundled and not sold separately and, therefore, included with license revenue because we do not have VSOE of fair value to determine fair value of maintenance for a term-based license.

Services revenue. Services revenue is primarily comprised of revenue from professional services, such as consulting, training and fees for hosting services. Services revenue is generally recognized as the services are performed.

Services revenue was $12.9 million in 2006, $14.9 million in 2005, and $11.7 million in 2004. Services revenue decreased by approximately $1.9 million, or 13%, in 2006 from 2005 and increased by approximately $3.2 million, or 27%, in 2005 from 2004. The decrease in services revenue in 2006 from 2005 was due mainly to lower services revenue from a single customer who ordered approximately $1.5 million less consulting services in 2006, as compared to 2005. The increase in services revenue in 2005 from 2004 was mainly due to performing implementation projects in connection with the growth of our customer base.

Revenue Mix. The components of revenue by type, expressed as a percentage of total revenue were:

	Year Ended December 31, 2006	2005	2004
Perpetual license revenue	32 %	48 %	47 %
Term license revenue	4 %	5 %	16 %
Maintenance revenue	35 %	23 %	18 %
Services revenue	29 %	24 %	19 %
Total revenue	100 %	100 %	100 %

We currently anticipate that license revenue will comprise approximately 30% to 40% of total revenue over the next 12 months, with services and maintenance revenue comprising the balance. We expect that revenue from perpetual licensing arrangements will comprise almost all of our license revenue and term license revenue will represent a small percentage of our license revenue over the next 12 months. Therefore, our future revenue will depend upon sales of perpetual licenses, generally with up-front license revenue recognition, resulting in less predictability of future operating results.

The year over year decreases in term license revenue, which is recognized ratably over the duration of the agreement, are largely related to new customers who have purchased perpetual licenses and existing customers who initially licensed our software on a term license basis choosing, at or near the end of the initial term, to renew their licenses on a perpetual license basis.

For the years ended December 31, 2006 and 2005, no customers accounted for 10% or more of our total revenue. For the year ended December 31, 2004, two customers accounted for 13% and 10%, respectively, of our total revenue.

Revenue from customers outside the United States accounted for approximately 23%, 21% and 11% of our total revenue in 2006, 2005 and 2004, respectively. Although the percentage of revenue we recognize in the future from international customers will vary from period to period, we are expanding our international sales and marketing activities and we currently anticipate that revenue from international customers will increase as a percentage of revenue over the next 12 months.

Cost of license fees, maintenance, services and the amortization of intangible assets

($ in thousands)

	2006	% Change 2005 to 2006	2005	% Change 2004 to 2005	2004
Cost of license fees	$ 499	(10)%	$ 555	88 %	$ 295
Cost of maintenance	1,225	24 %	988	136 %	418
Cost of services	13,599	4 %	13,128	37 %	9,592
Amortization of intangible assets	1,090	0 %	1,090	200 %	363
Total cost of revenues	$ 16,413	4 %	$ 15,761	48 %	$ 10,668

Cost of license fees. Cost of license fees consists primarily of third-party royalty fees under license arrangements for technology embedded into or sold with our products and represented approximately 1% or less of total revenue in each year. Cost of license fees was $499,000 in 2006, $555,000 in 2005, and $295,000 in 2004. Cost of license fees in 2006 was generally in line with 2005 and increased $260,000, or 88%, in 2005 from 2004. The increase in cost of license fees in 2005 from 2004 was due primarily to royalties for a third-party product that was resold with our products during 2005, which we did not sell in 2004.

Cost of maintenance. Cost of maintenance consists primarily of compensation costs, travel costs, related overhead expenses for customer support personnel. Cost of maintenance was $1.2 million in 2006, $1.0 million in 2005, and $418,000 in 2004. Cost of maintenance increased by $237,000, or 24%, in 2006 from 2005 and $570,000, or 136%, in 2005 from 2004. The year over year increases in cost of maintenance were due primarily to increases in salary and related employees costs and travel expenses as a result of an increase in the number of customer support personnel.

Cost of services. Cost of services consists primarily of compensation costs, travel costs, related overhead expenses for professional services personnel and costs from third parties for subcontracted consulting services. Cost of services revenue was $13.6 million in 2006, $13.1 million in 2005, and $9.6 million in 2004. Cost of services revenue increased by $471,000, or 4%, in 2006 from 2005, and $3.5 million, or 37%, in 2005 from 2004. The year over year increases in cost of service revenue were due primarily to increases in salary and related employees costs and travel expenses as a result of an increase in the number of professional services personnel. Included in cost of services for the year ended December 31, 2006 was $379,000 of stock-based compensation expense. There were no comparable expenses in the prior years, because we adopted the provisions of SFAS 123R effective January 1, 2006. We plan to hire additional professional services personnel in 2007 and therefore expect cost of services to increase over 2006. Cost of services also includes the third-party costs for our outsourced call center and other costs to support our consumer technology support offering that was launched in January 2007. Although such costs were not a significant portion of cost of services in 2006, we expect a substantial increase in these costs for 2007.

Amortization of intangible assets. There is no change in amortization of intangible assets in 2006 from 2005. Amortization of intangible assets increased approximately $727,000, or 200%, in 2005 from 2004. The increase in amortization of intangible assets in 2005 from 2004 was due primarily to the acquisition of substantially all of the assets of Core Networks which was effective September 2, 2004. Consequently, 2006 and 2005 include a full twelve months of amortization, compared with only four months of amortization in 2004.

Operating expenses

($ in thousands)

	2006	% Change 2005 to 2006	2005	% Change 2004 to 2005	2004
Research and development	$ 9,247	(17)%	$ 11,185	15 %	$ 9,746
Sales and marketing	23,336	(7)%	25,159	5 %	23,965
General and administrative	10,163	18 %	8,618	34 %	6,454
In-process research & development		N/A		(100)%	1,618
Total operating expenses	$ 42,746	(5)%	$ 44,962	8 %	$ 41,783

Research and development. Research and development costs are expensed as incurred. Research and development expense consists primarily of compensation costs, third-party consulting expenses and related overhead costs for research and development personnel. Research and development expense was $9.2 million in 2006, $11.2 million in 2005, and $9.7 million in 2004. Research and development expense decreased approximately $1.9 million, or 17%, in 2006 from 2005. The decrease in research and development expense in 2006 from 2005 was due primarily to a workforce reduction in the third quarter of 2006 designed to align staffing with our new initiatives. The increase in research and development expense of $1.4 million, or 15%, in 2005 from 2004 was primarily due to additional headcount and related expenses resulting from the acquisition of Core Networks in September 2004. Twenty three employees were added to our research and development organization from the acquisition of Core Networks. Included in research and development expense for the year ended December 31, 2006 was $422,000 of stock-based

compensation expense. There were no comparable expenses in the prior years, because we adopted the provisions of SFAS 123R effective January 1, 2006. We believe the decrease in research and development expense from 2005 to 2006 was temporary because we expect to grow our research and development expense in 2007.

Sales and marketing. Sales and marketing expense consists primarily of compensation costs, including salaries, sales commissions and related overhead costs for sales and marketing personnel; expenses for lead generation activities; and promotional expenses, including public relations, advertising and marketing events. Sales and marketing expense was $23.3 million in 2006, $25.2 million in 2005, and $24.0 million in 2004. Sales and marketing expense decreased by $1.8 million, or 7%, in 2006 from 2005 due primarily to a reduction in commission expenses as a result of lower revenue in 2006 and a workforce reduction during the third quarter of 2006 designed to align staffing with our new initiatives. The increase in sales and marketing expense of $1.2 million, or 5%, in 2005 from 2004 was primarily due to increased headcount and related compensation and travel expenses throughout the year, and international marketing events in 2005. Included in sales and marketing expense for the year ended December 31, 2006 was $899,000 of stock-based compensation expense. There were no comparable expenses in the prior years, because we adopted the provisions of SFAS 123R effective January 1, 2006. In 2007 we expect to substantially increase our sales and marketing expenses to continue to develop and promote our consumer technology support offering and to fund other marketing and selling initiatives that we believe are essential to creating sustainable revenue growth.

General and administrative. General and administrative expense consists primarily of compensation costs and related overhead costs for administrative personnel and professional fees for legal, accounting and other professional services. General and administrative expense was $10.2 million in 2006, $8.6 million in 2005, and $6.5 million in 2004. General and administrative expense increased approximately $1.5 million, or 18%, in 2006 from 2005 and $2.2 million, or 34%, in 2005 from 2004. Included in general and administrative expense for the year ended December 31, 2006 was $1,638,000 of stock-based compensation expense. There were no comparable expenses in the prior years, because we adopted the provisions of SFAS 123R effective January 1, 2006. The increase from 2004 to 2005 in general and administrative expense were primarily due to increases in salaries, consulting expenses and legal fees related to the defense of the class action lawsuit.

In-process research and development. In-process research and development expense was zero in 2006 and 2005 and $1.6 million in 2004. The in-process research and development expense was a one-time expense related to our acquisition of substantially all of the assets of Core Networks on September 2, 2004.

Interest income and other, net

($ in thousands)

	2006	% Change 2005 to 2006	2005	% Change 2004 to 2005	2004
Interest income and other, net	$ 6,383	76 %	$ 3,619	57 %	$ 2,298

Interest income and other, net. Interest income and other, net was $6.4 million in 2006, $3.6 million in 2005, and $2.3 million in 2004. Interest income and other, net increased approximately $2.8 million, or 76%, in 2006 from 2005 and increased by $1.3 million, or 57%, in 2005 from 2004. The increases in interest income and other, net in 2006 from 2005 and in 2005 from 2004 were primarily due to higher interest rates earned on our invested cash and marketable securities.

Provision for income taxes

($ in thousands)

	2006	2005	2004
Income (loss) before income taxes	$ (7,748)	$ 4,827	$ 10,464
Provision for income taxes	(487)	(402)	(310)
Net Income (loss)	$ (8,235)	$ 4,425	$ 10,154

Provision for income taxes. In 2006, 2005, and 2004, we recorded income tax provisions of $487,000, $402,000, and $310,000, respectively. These tax provisions are based on estimates of current taxes due in foreign jurisdictions for income and withholding taxes. The 2006, 2005 and 2004 tax provisions varied from the expected tax provision at the U.S. federal statutory rate primarily due to benefits from stock option deductions for which stock-based compensation was not previously benefited and the net reversal of timing differences, offset by nondeductible expenses.

Liquidity and Capital Resources

Operating Activities

Net cash generated by (used in) operating activities was $(3.0) million in 2006, $(844,000) in 2005, and $14.5 million in 2004. Amounts included in net income (loss), which do not require the use of cash, primarily include the depreciation of fixed assets, stock-based compensation expense, amortization of intangible assets, and in-process research and development. The sum of these items totaled $5.4 million, $2.2 million, and $2.9 million in 2006, 2005 and 2004, respectively. Net cash used in operating activities during 2006 was the result of the net loss of $(8.2) million, a decrease in deferred revenue of $1.4 million, a decrease in accounts payable of $700,000, a decrease in accrued compensation of $556,000, and an increase in prepaid expenses and other current assets of $443,000 partially offset by a decrease in accounts receivable of $2.3 million and an increase in other accrued liabilities of $605,000. Net cash used in operating activities during 2005 was a result of net income of $4.4 million, an increase in accounts receivable of $7.8 million, an increase of $177,000 in other long-term assets, and a decrease in deferred revenues of $1.6 million offset by a decrease in prepaid expenses and other current assets of $1.1 million, an increase in accounts payable of $686,000, an increase in other accrued liabilities and other long-term liabilities of $520,000. Net cash generated by operating activities during 2004 was the result of net income of $10.2 million, a decrease in accounts receivable of $3.0 million, a decrease in prepaid expenses and other current assets of $291,000, a decrease in other long-term assets of $195,000, an increase in accrued compensation of $904,000 and an increase in other accrued liabilities of $726,000, offset by a decrease in deferred revenue of $4.3 million and accounts payable of $83,000.

Our accounts receivable and deferred revenue balances fluctuate from period to period and are primarily dependent on (i) the timing of the closure of our license agreements, especially larger agreements concluded late in the period, (ii) the related invoicing and payment provisions under those contracts, (iii) the timing of maintenance renewals and related invoicing, and (iv) collections.

Accounts receivable decreased to $15.1 million at December 31, 2006 from $17.4 million at December 31, 2005. There were two customers with balances greater than $1.0 million at December 31, 2006. These two customers accounted for approximately $3.6 million in the aggregate, or 24% of net accounts receivable. The balances for these two customers resulted primarily from invoices raised in December 2006. By comparison, the higher accounts receivable balance at December 31, 2005 was due primarily to several large license and maintenance renewal invoices raised in December 2005 for six customers. These six customers each had accounts receivable balances greater than $1.0 million and together accounted for approximately $11.1 million, or 63% of net accounts receivable at December 31, 2005. As of December 31, 2004, there were only two customers with balances greater than $1.0 million.

These two customers accounted for approximately $4.9 million in the aggregate, or 51% of net accounts receivable.

Total deferred revenue decreased to $13.6 million at December 31, 2006 from $15.0 million at December 31, 2005 due primarily to lower deferred maintenance revenue. Customers typically purchase maintenance contracts when they purchase our products. Therefore, the decrease in deferred maintenance revenue is consistent with the lower level of license revenue in 2006 as compared to 2005. Total deferred revenue decreased to $16.7 million at December 31, 2004 from $20.9 million at December 31, 2003. The decrease in total deferred revenue was primarily due to a decrease in deferred license revenue from term-based arrangements, partially offset by an increase in deferred maintenance revenue, as our business has transitioned to more perpetual-based arrangements from term-based arrangements.

In 2007, we expect to make substantial investments in support of business initiatives that we believe are essential to creating long term revenue growth. We expect that these investments will precede any material revenue from our new business initiatives. We therefore expect to use a significantly higher level of cash from operations in 2007 than in 2006.

Investing Activities

Net cash provided by (used in) investing activities was $(8.0) million in 2006, $5.5 million in 2005, and $(24.2) million in 2004. Net cash used in investing activities in 2006 was primarily due to the purchase of $92.4 million in marketable securities and to a lesser extent the purchase of $964,000 in property and equipment offset by the sale and maturity of $85.3 million in marketable securities. Net cash provided by investing activities in 2005 was primarily due to sales and maturities of $98.0 million of marketable securities largely offset by the purchase of $91.5 million of marketable securities and the purchase of $963,000 of property and equipment. Net cash used in investing activities in 2004 was also primarily due to the purchase of $94.0 million in marketable securities, payments for a business acquisition of $17.6 million and to a lesser extent the purchase of $791,000 in property and equipment offset by the sale and maturity of $88.3 million in marketable securities. In 2007, we expect our capital expenditures to be significantly higher than historical levels due primarily to the build out of our new headquarters office under a lease that was entered into in November 2006. See Note 5 to the Consolidated Financial Statements.

Financing Activities

Net cash generated by financing activities was $3.1 million for 2006, $2.1 million for 2005, and $4.0 million for 2004. In 2006, cash generated by financing activities was primarily due to the exercise of employee stock options and the purchase of common stock under the employee stock purchase plan of $3.1 million. In 2005, net cash generated by financing activities was primarily due to the exercise of employee stock options and the purchase of common stock under the employee stock purchase plan of $3.1 million, offset by $0.9 million of common stock repurchases by the Company. In 2004, net cash generated by financing activities of $4.0 million was primarily due to the exercise of employee stock options and the purchase of common stock under the employee stock purchase plan.

Commitments

The following summarizes our contractual obligations at December 31, 2006 and the effect these contractual obligations are expected to have on our liquidity and cash flows in future periods (in thousands).

	Payments Due By Period			
	Total	**1 Year or Less**	**1 3 Years**	**After 3 Years**
Operating leases	$ 5,777	$ 1,557	$ 1,988	$ 2,232

These obligations are for noncancelable operating leases which relate primarily to the lease of our headquarters office in Redwood City, California and international offices to carry out sales, marketing, research and development, and services operations.

Working Capital and Capital Expenditure Requirements

At December 31, 2006, we had stockholders equity of $132.5 million and working capital of $118.2 million. Included as a reduction to working capital is short-term deferred revenue of $13.4 million, which will not require settlement in cash, but will be recognized as revenue in the future. We believe that our existing cash balances will be sufficient to meet our working capital and capital expenditure requirements for at least the next 12 months.

If we require additional capital resources to grow our business internally or to acquire complementary technologies and businesses at any time in the future, we may seek to sell additional equity or debt securities. The sale of additional equity or debt securities could result in more dilution to our stockholders. Financing arrangements may not be available to us, or may not be available in amounts or on terms acceptable to us.

As noted above, we plan to make substantial investments in our business during 2007, including but not limited to such areas as (i) cost of services, (ii) sales and marketing, (iii) research and development, and (iv) capital expenditures. We believe these investments and others are essential to creating sustainable growth in our business in the future. Because these investments will likely precede any associated revenues, we expect our working capital to decrease in the near term.

Recent Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109*. FIN No. 48 clarifies the accounting for uncertainty in income taxes by creating a framework for how companies should recognize, measure, present, and disclose in their financial statements uncertain tax positions that they have taken or expect to take in a tax return. FIN No. 48 is effective for fiscal years beginning after December 15, 2006 and is required to be adopted by the Company beginning in the first quarter of fiscal 2007. We are currently evaluating the impact of FIN No. 48 on our results of operations and financial position.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements,* which defines fair value, provides a framework for measuring fair value, and expands the disclosures required for fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require fair value measurements; it does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by the Company beginning in the first quarter of fiscal 2008. Although the Company will continue to evaluate the application of SFAS No. 157, management does not currently believe adoption will have a material impact on the Company s results of operations or financial position.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* . SFAS No. 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS No. 159 is effective for the Company beginning in the first quarter of fiscal year 2008, although earlier adoption is permitted. The Company is currently evaluating the impact of adopting SFAS No. 159 on its consolidated financial statements.

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

Our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. As most sales are currently made in U.S. dollars, a strengthening of the dollar could make our products less competitive in foreign markets.

As of December 31, 2006, we held $15.4 million in cash and cash equivalents consisting of highly liquid investments having original maturity dates of no more than 90 days. A decline in interest rates over time would reduce our interest income from our highly liquid marketable securities. Based upon our balance of cash and cash equivalents, a decrease in interest rates of 100 basis points would cause a corresponding decrease in our annual interest income of approximately $154,000. Due to the nature of our highly liquid cash equivalents, a change in interest rates would not materially change the fair market value of our cash and cash equivalents.

As of December 31, 2006, we held $104.5 million in marketable securities, which consisted primarily of money market funds held by large institutions in the U.S. and commercial paper. Our marketable securities were primarily invested in corporate bonds, government debt securities maturing in less than eighteen months and auction-rate securities resetting in less than ninety days. The weighted average interest rate of our portfolio was approximately 4.14% at December 31, 2006. A decline in interest rates over time would reduce our interest income from our marketable securities. A decrease in interest rates of 100 basis points would cause a corresponding decrease in our annual interest income of approximately $1.0 million. Due to the nature of our highly liquid cash equivalents, a change in interest rates would not materially change the fair market value of our marketable securities.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

SUPPORTSOFT, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of
SupportSoft, Inc.

We have audited the accompanying consolidated balance sheets of SupportSoft, Inc. as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of SupportSoft, Inc. at December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, in 2006, SupportSoft, Inc. changed its method of accounting for share-based payments in accordance with guidance provided in Statement of Financial Accounting Standards No. 123(R), Share-Based Payment.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of SupportSoft, Inc. s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 12, 2007 expressed an unqualified opinion on management s assessment and an adverse opinion on the effectiveness of internal control over financial reporting.

/s/ Ernst & Young LLP

San Jose, California
March 12, 2007

SUPPORTSOFT, INC.

CONSOLIDATED BALANCE SHEETS
(in thousands except share and per share data)

	December 31, 2006	2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 15,369	$ 23,342
Marketable securities	104,522	97,321
Accounts receivable, less allowance of $373 and $296 at December 31, 2006 and 2005, respectively	15,144	17,437
Prepaid expenses and other current assets	2,894	2,451
Total current assets	137,929	140,551
Property and equipment, net	937	1,211
Goodwill	9,792	9,792
Intangible assets, net	3,155	3,994
Other assets	792	701
Total assets	$ 152,605	$ 156,249
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 331	$ 1,030
Accrued compensation	2,112	2,669
Other accrued liabilities	3,813	2,985
Deferred revenue, less long-term portion	13,435	14,060
Total current liabilities	19,691	20,744
Deferred revenue long-term portion	178	969
Other long-term liabilities	233	142
Commitments and contingencies		
Stockholders equity:		
Preferred stock; par value $0.0001, 5,000,000 shares authorized, no shares issued or outstanding at December 31, 2006 and 2005		
Common stock; par value $0.0001, 150,000,000 shares authorized, 44,587,720 issued and outstanding at December 31, 2006 and 43,627,075 issued and outstanding at December 31, 2005	4	4
Additional paid-in capital	202,440	195,990
Accumulated other comprehensive loss	(751)	(645)
Accumulated deficit	(69,190)	(60,955)
Total stockholders equity	132,503	134,394
Total liabilities and stockholders equity	$ 152,605	$ 156,249

See accompanying notes.

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SUPPORTSOFT, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands except per share data)

	Years Ended December 31, 2006	2005	2004
Revenue:			
License fees	$ 16,415	$ 32,737	$ 37,923
Maintenance	15,672	14,317	11,002
Services	12,941	14,877	11,692
Total revenue	45,028	61,931	60,617
Costs and expenses:			
Cost of license fees	499	555	295
Cost of maintenance	1,225	988	418
Cost of services	13,599	13,128	9,592
Amortization of intangible assets	1,090	1,090	363
Research and development	9,247	11,185	9,746
Sales and marketing	23,336	25,159	23,965
General and administrative	10,163	8,618	6,454
In-process research and development			1,618
Total costs and expenses	59,159	60,723	52,451
Income (loss) from operations	(14,131)	1,208	8,166
Interest income and other, net	6,383	3,619	2,298
Income (loss) before income taxes	(7,748)	4,827	10,464
Provision for income taxes	(487)	(402)	(310)
Net income (loss)	$ (8,235)	$ 4,425	$ 10,154
Basic net income (loss) per share	$ (0.19)	$ 0.10	$ 0.24
Shares used in computing basic net income (loss) per share	44,113	43,032	42,355
Diluted net income (loss) per share	$ (0.19)	$ 0.10	$ 0.22
Shares used in computing diluted net income (loss) per share	44,113	44,519	45,590

See accompanying notes.

SUPPORTSOFT, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
(in thousands, except share data)

	Common Stock Shares	Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders Equity
Balances at December 31, 2003	41,744,260	$ 4	$ 189,693	$ (157)	$ (75,534)	$ 114,006
Components of comprehensive income:						
Net income					10,154	10,154
Unrealized loss on investments				(265)		(265)
Foreign currency translation adjustment				(196)		(196)
Comprehensive income						9,693
Compensation expense related to stock options			183			183
Issuance of common stock upon exercise of stock options for cash	766,027		2,954			2,954
Issuance of common stock under employee stock purchase plan	165,241		1,021			1,021
Balances at December 31, 2004	42,675,528	$ 4	$ 193,851	$ (618)	$ (65,380)	$ 127,857
Components of comprehensive income:						
Net income					4,425	4,425
Unrealized gain on investments				152		152
Foreign currency translation adjustment				(179)		(179)
Comprehensive income						4,398
Issuance of common stock upon exercise of stock options for cash	959,016		2,162			2,162
Issuance of common stock under employee stock purchase plan	185,129		899			899
Repurchase of common stock	(192,598)		(922)			(922)
Balances at December 31, 2005	43,627,075	$ 4	$ 195,990	$ (645)	$ (60,955)	$ 134,394
Components of comprehensive income:						
Net loss					(8,235)	(8,235)
Unrealized gain on investments				63		63
Foreign currency translation adjustment				(169)		(169)
Comprehensive loss						(8,341)
Stock-based compensation expense			3,338			3,338
Issuance of common stock upon exercise of stock options for cash	807,967		2,600			2,600
Issuance of common stock under employee stock purchase plan	152,678		512			512
Balances at December 31, 2006	44,587,720	$ 4	$ 202,440	$ (751)	$ (69,190)	$ 132,503

See accompanying notes.

SUPPORTSOFT, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended December 31, 2006	2005	2004
Operating activities:			
Net income (loss)	$ (8,235)	$ 4,425	$ 10,154
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation	988	1,099	766
Stock-based compensation expenses	3,338		183
Amortization of intangible assets	1,090	1,090	363
In-process research and development			1,618
Changes in assets and liabilities:			
Accounts receivable, net	2,293	(7,843)	2,985
Prepaid expenses and other current assets	(443)	1,072	291
Other assets	(91)	(177)	195
Accounts payable	(700)	686	(83)
Accrued compensation	(556)	(87)	904
Other accrued liabilities	828	378	726
Other long-term liabilities	91	142	
Deferred revenue	(1,416)	(1,612)	(4,281)
Other	(223)	(17)	673
Net cash provided by (used in) operating activities	(3,036)	(844)	14,494
Investing activities:			
Purchases of property and equipment	(964)	(963)	(791)
Payment for business acquisition, net of cash acquired			(17,562)
Purchases of marketable securities	(92,351)	(91,493)	(94,079)
Sales and maturities of marketable securities	85,266	97,994	88,264
Net cash provided by (used in) investing activities	(8,049)	5,538	(24,168)
Financing activities:			
Proceeds from issuances of common stock	3,112	3,061	3,975
Repurchase of common stock		(922)	
Net cash provided by financing activities	3,112	2,139	3,975
Net increase (decrease) in cash and cash equivalents	(7,973)	6,833	(5,699)
Cash and cash equivalents at beginning of period	23,342	16,509	22,208
Cash and cash equivalents at end of period	$ 15,369	$ 23,342	$ 16,509
Supplemental schedule of cash flow information:			
Income taxes paid	$ 294	$ 293	$ 247

See accompanying notes.

SUPPORTSOFT, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Organization and Summary of Significant Accounting Policies

Nature of Operations

SupportSoft, Inc. (SupportSoft, the Company, We or Our), was incorporated in the state of Delaware on December 3, 1997. We are a leading provider of software and services that automate the resolution of technology problems. Our solutions reduce technology support costs, improve customer satisfaction and enable new revenue streams for organizations worldwide. We recently expanded our offerings and now provides technology support directly to consumers.

Our headquarters is located in Redwood City, California and we maintain offices in several other cities in the United States. We have international operations in several countries around the world.

Basis of Presentation

The consolidated financial statements include the accounts of SupportSoft and its wholly-owned subsidiaries. SupportSoft has export sales from the United States and has operations in India, Canada, Europe and the Asia/Pacific region. All significant intercompany transactions and balances have been eliminated.

Acquisition

On September 2, 2004, the Company acquired substantially all the assets and certain liabilities of Core Networks Incorporated (Core Networks). The acquisition was accounted for as a purchase and the operating results have been included in our consolidated financial statements since the date of acquisition.

Foreign Currency Translation

Assets and liabilities of SupportSoft s wholly-owned foreign subsidiaries are translated from their respective functional currencies at exchange rates in effect at the balance sheet date, and revenues and expenses are translated at average exchange rates prevailing during the year. Any material resulting translation adjustments are reflected as a separate component of stockholders equity in accumulated other comprehensive income or loss. Realized foreign currency transaction gains and losses were not material during the years ending December 31, 2006, 2005, and 2004.

Use of Estimates and Reclassifications

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and the accompanying notes. Actual results could differ materially from these estimates. The Company has made certain reclassifications to conform to current year s presentation.

Concentrations of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash equivalents, marketable securities and trade accounts receivable. Our investment portfolio is diversified and consists of investment grade securities. Our investment policy limits the amount of credit risk exposure to any one issuer and in any one country except the United States. We are exposed to credit

SUPPORTSOFT, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1. Organization and Summary of Significant Accounting Policies (Continued)

risks in the event of default by the issuers to the extent of the amount recorded on the balance sheet. The credit risk in our trade accounts receivable is substantially mitigated by our credit evaluation process, reasonably short collection terms and because the Company sells its products primarily to large organizations in diversified industries.

Trade Accounts Receivable and Allowance for Doubtful Accounts

Trade accounts receivable are recorded at the invoiced amount. We perform evaluations of our customers financial condition and generally do not require collateral. We make judgments as to our ability to collect outstanding receivables and provide allowances for the portion of receivables when collection becomes doubtful. Provisions are made based upon a specific review of all significant outstanding invoices. For those invoices not specifically provided for, provisions are recorded at differing rates, based upon the age of the receivable. In determining these percentages, we analyze our historical collection experience and current payment trends. If the historical data we use to calculate the allowance for doubtful accounts does not reflect the future ability to collect outstanding receivables, additional provisions for doubtful accounts may be needed and the future results of operations could be materially affected.

The following table summarizes the allowance for doubtful accounts as of December 31, 2006, 2005 and 2004 (in thousands):

	Balance at Beginning of Period	Charged/ (Recovery) to Costs and Expenses	Write-offs	Balance at End of Period
Allowance for doubtful accounts:				
Year ended December 31, 2004	$ 735	$ (134)	$ (154)	$ 447
Year ended December 31, 2005	447	209	(360)	296
Year ended December 31, 2006	296	185	(108)	373

The following table lists customers representing greater than 10% of total account receivable, net as of December 31, 2006 and 2005:

	% of Total Accounts Receivable, Net Years Ended December 31, 2006	2005
Customer A	15 %	20 %
Customer B		20 %

Included in accounts receivable and deferred revenue at December 31, 2006 is approximately $1.0 million related to advance maintenance billings for customers who have elected to renew their maintenance contracts.

SUPPORTSOFT, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1. Organization and Summary of Significant Accounting Policies (Continued)

Cash, Cash Equivalents and Marketable Securities

SupportSoft considers all liquid instruments with an original maturity at the date of purchase of ninety days or less to be cash equivalents. Cash equivalents and marketable securities consist primarily of money market funds, commercial paper, auction rate securities, corporate bonds and notes and treasury bills issued by the United States government and its agencies. Our cash equivalents and marketable securities are classified as available-for-sale, and are reported at fair value with unrealized gains and losses included in accumulated other comprehensive income within stockholders equity on the consolidated balance sheets. Realized gains and losses and declines in value judged to be other than temporary on available-for-sale securities are included in other income (expense), net in the consolidated statements of operations. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity, both of which are included in interest income. SupportSoft recorded net unrealized losses on available-for-sale securities of $54,000 and $117,000 as of December 31, 2006 and 2005, respectively. Realized gains and losses are recorded using the specific identification method and were immaterial during the years ending December 31, 2006, 2005, and 2004.

We monitor our investments for impairment on a quarterly basis and determine whether a decline in fair value is other-than-temporary by considering factors such as current economic and market conditions, the credit rating of the security s issuer, the length of time an investment s fair value has been below our carrying value, and our ability and intent to hold investments to maturity. If an investment s decline in fair value is deemed to be other-than-temporary, we reduce its carrying value to its estimated fair value, as determined based on quoted market prices or liquidation values. Declines in value judged to be other-than-temporary, if any, are recorded in operations as incurred.

The following is a summary of available-for-sale securities (in thousands):

	For the Year Ended December 31, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash	$ 2,372	$	$	$ 2,372
Money market fund	22			22
Commercial paper	35,390		(30)	35,360
Federal agencies	2,000		(1)	1,999
Corporate bonds	31,511		(23)	31,488
Auction rate securities	48,650			48,650
	$ 119,945	$	$ (54)	$ 119,891
Classified as:				
Cash and cash equivalents	$ 15,372	$	$ (3)	$ 15,369
Marketable securities	104,573		(51)	104,522
	$ 119,945	$	$ (54)	$ 119,891

SUPPORTSOFT, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1. Organization and Summary of Significant Accounting Policies (Continued)

	For the Year Ended December 31, 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash	$ 8,257	$	$	$ 8,257
Money market fund	625			625
Commercial paper	16,725		(3)	16,722
Federal agencies	1,000			1,000
Corporate bonds	22,773		(114)	22,659
Auction rate securities	71,400			71,400
	$ 120,780	$	$ (117)	$ 120,663
Classified as:				
Cash and cash equivalents	$ 23,345	$	$ (3)	$ 23,342
Marketable securities	97,435		(114)	97,321
	$ 120,780	$	$ (117)	$ 120,663

The following table summarizes the estimated fair value of our available-for-sale debt securities held in marketable securities classified by the stated maturity date of the security (in thousands):

	December 31,	
	2006	2005
Due within one year	$ 51,103	$ 56,371
Due within two years	4,769	
Due within three years		
Due after three years	48,650	40,950
	$ 104,522	$ 97,321

Although SupportSoft s investment portfolio in auction rate securities includes investments maturing after 3 years, these investments are highly liquid and typically reset between 28 and 90 days and are therefore classified in marketable securities.

Property and Equipment

Property and equipment is stated at cost, less accumulated depreciation which is determined using the straight-line method over the estimated useful lives of 2 years for computer equipment and software, 3 years for furniture and fixtures, and the shorter of the estimated useful lives or the lease term for leasehold improvements.

Goodwill

Goodwill resulted from the Company s acquisition of Core Networks on September 2, 2004. The Company applies the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangibles Assets*, which prohibits the amortization of goodwill.

SUPPORTSOFT, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1. Organization and Summary of Significant Accounting Policies (Continued)

We assess the impairment of goodwill annually or more often if events or changes in circumstances indicate that the carrying value may not be recoverable. An impairment loss would be recognized when the sum of the discounted future net cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Such impairment loss would be measured as the difference between the carrying amount of the asset and its fair value. The estimate of cash flows is based upon, among other things, certain assumptions about expected future operating performance and an appropriate discount rate determined by our management. Our estimates of discounted cash flows may differ from actual cash flows due to, among other things, economic conditions, changes to the business model or changes in operating performance. If we made different estimates, material differences may result in write-down of net long-lived and intangible assets, which would be reflected by charges to our operating results for any period presented. At September 30, 2006, we concluded our annual evaluation for impairment of goodwill and no impairment was recognized. We will continue to test for impairment during the third quarter of each year, or earlier if indicators of impairment exist.

Intangible Assets

The Company records purchased intangible assets at fair value. The original cost is amortized on a straight-line basis over the estimated useful life of each asset. We assess the impairment of intangible assets whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. We perform an annual review to determine if the carrying value of the intangible asset is impaired, unless events or circumstances indicate a potential impairment exists in which case a review is performed more often. The review considers facts and circumstance, either internal or external, which indicate that the carrying value of the asset cannot be recovered. If and when indicators of impairment exist, SupportSoft assesses the need to record an impairment loss, by comparing the undiscounted net cash flows associated with related assets or group of assets over their remaining lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets.

As of December 31, 2006, intangible assets, in the amount of $2.9 million, net of amortization, consist of customer relationships, developed and core technology, which are amortized over an estimated useful lives of 5 years. Included in intangible assets, in the aggregate amount of $250,000, is the cost of obtaining a toll-free telephone number which does not have a finite useful life.

Revenue Recognition

We recognize revenue in accordance with the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, Software Revenue Recognition, as amended by SOP 98-4 and SOP 98-9. License revenue is recognized when all of the following criteria are met:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred;
- Collection is considered probable; and

SUPPORTSOFT, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1. Organization and Summary of Significant Accounting Policies (Continued)

- The fees are fixed or determinable.

SupportSoft considers all arrangements with payment terms longer than 90 days, not to be fixed or determinable. If the fee is determined not to be fixed or determinable, revenue is recognized as payments become due from the customer.

License revenue is comprised of fees for perpetual and term licenses of our software. Perpetual license revenue is recognized using the residual method, in compliance with SOP 98-9 for arrangements in which licenses are sold with multiple elements. We allocate revenues on these licenses based upon the fair value of each undelivered element including undelivered maintenance, consulting and training. The determination of fair value is based upon vendor specific objective evidence (VSOE). VSOE for maintenance is based upon separate renewals of maintenance from customers. VSOE for consulting or training is based upon separate sales of these services to customers. Assuming all other revenue recognition criteria are met, the difference between the total arrangement fee and the amount deferred for each undelivered element is recognized as license revenue. In perpetual arrangements that include contractual obligations such as rights to unspecified future products, license revenue is recognized ratably over the contract period.

Term licenses are sold with maintenance for which SupportSoft does not have VSOE to determine fair value for maintenance fees. As a result, license revenue for term licenses is recognized ratably over the duration of the agreement. License revenue in the accompanying financial statements includes maintenance for term licenses. We do not allocate maintenance revenue from term licenses to maintenance revenue, as we do not believe there is an allocation methodology that provides a meaningful and supportable allocation between license and maintenance revenues. Services revenue associated with the term licenses are recognized ratably over the period associated with the initial payment, generally one year.

We provide resellers with the right to sublicense our software to end user customers. Generally, we recognize revenue from our arrangements with resellers when we receive persuasive evidence that the reseller has actually sublicensed the software to a named end user (sell-through), assuming all other criteria for revenue recognition have been met. The forms of sell-through acceptable to us include one or more of the following: i) a copy of the agreement or license between the reseller and the end user, ii) a purchase order from the end user to the reseller, iii) a written communication from the reseller specifically identifying the end user, or iv) delivery made directly by SupportSoft to the end user. Whether the license revenue is then recognized immediately or ratably depends upon the terms of the arrangements with the reseller regarding the sublicense (i.e. perpetual license or term license). If a reseller is not deemed creditworthy, revenue otherwise recognizable is deferred until cash is received. When licensing arrangements with resellers include guaranteed minimum amounts due, revenue is recognized ratably over the term of the arrangement commencing when payments are made or become due.

Maintenance revenue is primarily comprised of revenue from post-contract technical support services, which includes software product updates. Maintenance revenue is recognized ratably over the term of the maintenance period, which is generally one year. We invoice customers who elect to renew their maintenance agreements. An equal amount is recorded as accounts receivable and deferred revenue.

Services revenue is primarily comprised of revenue from professional services such as consulting, training and hosting fees. Arrangements are evaluated to determine whether those services are essential to

SUPPORTSOFT, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1. Organization and Summary of Significant Accounting Policies (Continued)

the functionality of other elements of the arrangement. In the event services are considered essential to the functionality of other elements of the arrangement, revenue under the arrangement is recognized using contract accounting. Non-essential consulting and training revenues are generally recognized as the services are performed or project milestones are accepted by the customer. When non-essential services are bundled in a term licensing arrangement, revenue from the services is recognized ratably over the period associated with the initial payment, generally one year.

In connection with licensing arrangements we may also provide hosting of our own software, a service for which SupportSoft does not have VSOE currently. If hosting services are sold with perpetual licenses, license revenue is recognized ratably over the term of the hosting contract. Hosting revenue is also recognized ratably over the duration of the hosting contract. Consulting services sold in conjunction with arrangements that include licenses and hosting services are recognized ratably over the duration of the hosting term.

Research and Development

Research and development expenditures are charged to operations as incurred. Statement of Financial Accounting Standards No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed*, requires the capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based on SupportSoft s product development process, technological feasibility is established upon the completion of a working model. Costs incurred by SupportSoft between the completion of the working model and the point at which the product is ready for general release have been insignificant. Accordingly, SupportSoft has charged all such costs to research and development expense in the accompanying statements of operations. SupportSoft did not incur any cost related to software developed or for software obtained for internal use as defined in SOP 98-1.

Sales Commissions

Sales commissions are the incremental costs that are directly associated with non-cancelable contracts with customers and consist of commissions paid to the Company s sales personnel. If the customer contract is a perpetual license, the commission expense attributable to the license fees are recorded in the month license revenue is recognized. For term licenses and other ratable license arrangements, sales commissions are deferred and amortized over the non-cancelable terms of the related customer contracts, which are typically 12 to 36 months. The sales commissions, which are paid in the month following the time an order is consummated or when customer payment is received, are a direct and incremental cost of the revenue arrangements. The deferred commission amounts are recoverable through the future revenue streams under the non-cancelable customer contracts. Commissions payments made to sales personnel are non-refundable unless amounts due from a customer are determined to be uncollectible in which cash commissions paid are generally recoverable by the Company.

Advertising Costs

Advertising costs are recorded as sales and marketing expense in the period in which they are incurred. Advertising expense was $725,000, $224,000, and $357,000 for the years ended December 31, 2006, 2005, and 2004, respectively.

SUPPORTSOFT, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1. Organization and Summary of Significant Accounting Policies (Continued)

Net Income (Loss) Per Share

Basic and diluted net income (loss) per share are presented in conformity with the Financial Accounting Standards Board s (FASB) Statement of Financial Accounting Standards No. 128, *Earnings Per Share* (FAS 128), for all periods presented. Basic net income (loss) per share is computed using net income (loss) and the weighted average number of common shares outstanding during the reporting period. Diluted net income (loss) per share is computed using net income and the weighted average number of common shares outstanding, including the effect from the potential issuance of common stock such as stock issuable pursuant to the exercise of stock options using the treasury stock method when dilutive.

The following table sets forth the computation of basic and diluted net income (loss) per share (in thousands, except per share amounts):

	Year Ended December 31, 2006	2005	2004
Net income (loss)	$ (8,235)	$ 4,425	$ 10,154
Basic:			
Weighted-average shares of common stock outstanding	44,113	43,032	42,355
Shares used in computing basic net income per share	44,113	43,032	42,355
Basic net income (loss) per share	$ (0.19)	$ 0.10	$ 0.24
Diluted:			
Weighted-average shares of common stock outstanding	44,113	43,032	42,355
Add: Common equivalent shares outstanding		1,487	3,235
Shares used in computing diluted net income per share	44,113	44,519	45,590
Diluted net income (loss) per share	$ (0.19)	$ 0.10	$ 0.22

In 2006, SupportSoft has not included the effect from the potential issuance of common stock as a result of the exercise of stock options as the issuance of these shares would be anti-dilutive due to the net loss incurred in the current period.

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss relate entirely to accumulated foreign currency translation losses and unrealized losses on available-for-sale securities. Accumulated currency translation losses were $697,000 and $528,000 as of December 31, 2006 and 2005, respectively, and accumulated unrealized losses on available-for-sale securities were $54,000 and $117,000 as of December 31, 2006 and 2005, respectively.

Stock-Based Compensation

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, (SFAS 123R) which requires the measurement and recognition of compensation expense for all stock-based payment awards, including employee stock options and

SUPPORTSOFT, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1. Organization and Summary of Significant Accounting Policies (Continued)

employee stock purchases from employee stock purchase plan. Prior to January 1, 2006, the Company accounted for stock-based payments to employees using the intrinsic value method under APB Opinion No. 25, as permitted by SFAS 123R, and, as such, generally recognized no compensation cost for employee stock options or employees stock purchases.

SupportSoft elected the modified prospective transition method for adopting SFAS 123R which required the application of the accounting standard as of January 1, 2006, the first day of the Company s 2006 fiscal year. Under this transition method, compensation cost recognized includes the applicable amounts of: (a) compensation cost for all stock-based payments granted prior to, but not yet vested, as of December 31, 2005 based on the grant-date fair value estimated in accordance with the original provisions of SFAS 123R and previously presented in the pro-forma footnote disclosures, and (b) compensation cost of all stock-based payments granted subsequent to January 1, 2006 based on the grant-date fair value estimated in accordance with the new provisions of SFAS 123R. Prior periods have not been restated to reflect the impact of SFAS 123R.

Determining Fair Value

Valuation and Attribution Method: SupportSoft estimates the fair value of stock options granted using the *Black-Scholes option pricing model*. Stock options vest on a graded schedule; however the Company recognizes the expense on a straight-line basis over the requisite service period of the entire award, net of estimated forfeitures and subject to the minimum expense requirements of SFAS 123R. Compensation cost recognized is at least equal to the portion of the grant-date fair value of the award that is vested at that date.

Risk-free Interest Rate: The Company bases its risk-free interest rate upon the yield currently available on US Treasury zero coupon issues for the expected term of the employee stock options.

Expected Term: The Company s expected term represents the period that the Company s stock options are expected to be outstanding and is determined based on historical experience of similar stock options considering the contractual terms of the stock options, vesting schedules and expectations of future employee behavior.

Expected Volatility: The Company s expected volatility represents the amount by which the stock price is expected to fluctuate throughout the period that the stock option is outstanding. The Company bases its expected volatility on a weighted average calculation combining both historical and implied volatilities as it believes that this combination is more representative of future stock price trends than historical volatility alone. The implied volatility factor included in this computation is based upon traded options on the Company s stock.

Estimated Forfeitures: SFAS 123R requires that the stock option expense recognized be based on awards that are ultimately expected to vest, and therefore a forfeiture rate should be applied at the time of grant and revised, if necessary, in subsequent periods when actual forfeitures differ from those estimates. Prior to January 1, 2006, the Company accounted for forfeitures only as they occurred. Commencing in 2006, the Company has estimated its forfeitures based on historical experience.

Expected Dividend: The Company uses a dividend yield of zero, as it has never paid cash dividends and does not expect to pay dividends in the future.

SUPPORTSOFT, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1. Organization and Summary of Significant Accounting Policies (Continued)

The fair value of the Company s stock-based awards was estimated using the following assumptions for the years ended December 31, 2006, 2005 and 2004:

	Stock Option Plan			Employee Stock Purchase Plan		
	2006	2005	2004	2006	2005	2004
Risk-free interest rate	4.8 %	4.1 %	3.4 %	4.7 %	3.1 %	1.2 %
Expected term (in years)	3.9	4.0	4.0	0.5 to 2.0	0.5 to 2.0	0.5 to 2.0
Volatility	53.5 %	70.9 %	84.0 %	54.1 %	74.6 %	79.5 %
Estimated forfeitures	8.0 %	0 %	0 %	8.0 %	0 %	0 %
Expected dividend	0 %	0 %	0 %	0 %	0 %	0 %
Weighted average fair value	$ 2.01	$ 2.75	$ 4.48	$ 1.66	$ 2.83	$ 3.16

Tax Effects of Stock-Based Payments

On November 10, 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. SFAS-123R-3 *Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards* which provides for an alternative transition method to calculate the tax effects of stock-based compensation expense pursuant to SFAS 123R. We adopted the alternative transition method provided in the FASB Staff Position for calculating the tax effects of stock-based compensation pursuant to SFAS 123(R) in the fourth quarter of fiscal 2006. The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and Consolidated Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123(R). The adoption did not have a material impact on our results of operations and financial condition.

Stock Compensation Expense

The Company recorded the following stock-based compensation expense for the fiscal year ended December 31, 2006 (in thousands):

	Fiscal Year Ended December 31, 2006
Stock option compensation expense recognized in:	
Cost of services	$ 292
Research and development	316
Sales and marketing	774
General and administrative	1,572
	2,954
ESPP compensation expense recognized in:	
Cost of services	87
Research and development	106
Sales and marketing	125
General and administrative	66
	384
Stock-based compensation expense included in total costs and expenses	$ 3,338

SUPPORTSOFT, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 1. Organization and Summary of Significant Accounting Policies (Continued)

Included above was $238,000, of stock-based compensation expense related to the acceleration of the stock options awarded to the Company s former chief executive officer in connection with a transition agreement dated March 12, 2006. Pursuant to the terms of this agreement, provided the former CEO remained an employee of the Company, on the date the Board of Directors appointed a new CEO, all then outstanding and unvested options would be immediately vested. A new CEO was appointed on April 6, 2006 and vesting of 115,625 shares was accelerated.

There was no stock-based compensation expense recognized for the years ended December 31, 2005 and 2004.

As a result of adopting SFAS 123R, the Company s loss before income taxes and net loss for the year ended December 31, 2006 was $3.3 million higher than if it had continued to account for share-based compensation under APB 25. Basic and diluted loss per share for the year ended December 31, 2006 would have both been $0.08 lower if the Company had not adopted SFAS 123R.

No income tax benefit was realized from stock option exercises during the year ended December 31, 2006. In accordance with SFAS 123R, we present excess tax benefits from the exercise of stock options, if any, as cash flow from financing activities in the accompanying Consolidated Statements of Cash Flows.

The table below reflects the net income (loss) and net income (loss) per share for the year ended December 31, 2006. Pro-forma information required under SFAS 123R for periods prior to 2006 as if the Company has applied the fair value recognition provision under SFAS 123R is as follows:

	2006	2005	2004
Net income as reported for the prior period(1)	$ N/A	$ 4,425	$ 10,154
Stock-based compensation expense relating to:			
Stock options(2)	(2,953)	(20,540)	(8,478)
ESPP stock purchases(2)	(385)	(575)	(1,042)
Net income (loss), including the effect of stock-based compensation expense(3)	$ (8,235)	$ (16,690)	$ 634
Basic net income per share as reported for the prior period	N/A		

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Business Combinations (Continued)

basis. The following are the intangible assets acquired and their respective amortizable lives (dollars in thousands):

	Amount	Amortizable Life
Core technology	$ 4,154	5-7 years
Trade name	2,382	10 years
Customer relationships	11,181	17-25 years
Total intangible assets with finite lives	$ 17,717	

(iv) Other acquisitions in 2008

During 2008, we acquired the following assets and businesses for an aggregate purchase price of $50.6 million, in which we paid $49.0 million in cash, $1.8 million in direct acquisition costs, and accrued contingent consideration and milestone payments totaling $0.1 million. Upon settlement of certain milestones, we recognized a $0.2 million foreign currency exchange loss which was included in the aggregate purchase price.

Certain assets from Mochida Pharmaceutical Co., Ltd, or Mochida. As part of the acquisition of certain assets, Mochida transferred the exclusive distribution rights in Japan for certain Osteomark products (Acquired April 2008)

Privately-owned provider of care and health management services (Acquired July 2008)

Vision Biotech Pty Ltd, or Vision, located in Cape Town, South Africa, a privately-owned distributor of rapid diagnostic products predominantly to the South African marketplace (Acquired September 2008)

Global Diagnostics CC, or Global, located in Johannesburg, South Africa, a privately-owned contract manufacturer and distributor of high quality rapid diagnostic tests predominantly to the South African marketplace (Acquired September 2008)

DiaTeam Diagnostika und Arzneimittel Großhandel GmbH, or DiaTeam, located in Linz, Austria, a privately-owned distributor of high quality rapid diagnostic tests predominantly to the Austrian marketplace (Acquired September 2008)

Prodimol Biotecnologia S.A., or Prodimol, located in Brazil, a privately-owned distributor of high quality rapid diagnostic tests predominantly to the Brazilian marketplace (Acquired October 2008)

Ameditech, Inc., or Ameditech, located in San Diego, California, a leading manufacturer of high quality drugs of abuse diagnostic tests (Acquired December 2008)

A summary of the purchase price allocation for these acquisitions is as follows (in thousands):

Current assets	$ 10,960
Property, plant and equipment	770
Goodwill	15,623
Other non-current assets	67
Intangible assets	37,085
Total assets acquired	64,505

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Business Combinations (Continued)

Current liabilities	5,830
Non-current liabilities	8,033
Total liabilities assumed	13,863
Net assets acquired	50,642
Less:	
Acquisition costs	1,767
Realized foreign currency exchange loss	(179)
Accrued earned milestone and contingent consideration	57
Cash consideration	$ 48,997

Customer relationships are amortized based on patterns in which the economic benefits of customer relationships are expected to be utilized. Other finite-lived identifiable assets are amortized on a straight-line basis. The following are the intangible assets acquired and their respective amortizable lives (dollars in thousands):

	Amount	Amortizable Life
Core technology	$ 3,066	6-10 years
Trade names	2,690	10 years
Customer relationships	29,424	3.5-14 years
Non-compete agreements	1,063	2-5 years
Manufacturing know-how	842	5 years
Total intangible assets	$ 37,085	

Mochida, Vision, Global, DiaTeam, Prodimol and Ameditech are included in our professional diagnostics reporting unit and business segment; and our privately-owned health management acquisition is included in our health management reporting unit and business segment. Goodwill has been recognized in the Vision, Global, DiaTeam, Prodimol, Ameditech and our privately-owned health management business transactions and amounted to approximately $15.6 million. Goodwill related to these acquisitions, excluding Ameditech and the privately-owned health management acquisition, is not deductible for tax purposes.

(c) Acquisitions in 2007

(i) Acquisition of ParadigmHealth

On December 21, 2007, we acquired ParadigmHealth, Inc., or ParadigmHealth, a privately-owned leading provider of precise medical management to provide optimal health outcomes for acutely ill and clinically complex patients. The aggregate purchase price was $236.8 million, which consisted of $236.0 million in cash and $0.8 million for direct acquisition costs. The operating results of ParadigmHealth are included in our health management reporting unit and business segment.

A summary of the purchase price allocation for this acquisition is as follows (in thousands):

Current assets	$ 34,498
Property, plant and equipment	2,163
Goodwill	161,916
Intangible assets	61,449
Total assets acquired	260,026

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Business Combinations (Continued)

Current liabilities	1,094
Non-current liabilities	22,141
Total liabilities assumed	23,235
Net assets acquired	236,791
Less:	
Acquisition costs	844
Cash consideration	$ 235,947

We expect that substantially all of the amount allocated to goodwill will not be deductible for tax purposes.

Customer relationships are amortized based on patterns in which the economic benefits of customer relationships are expected to be utilized. Other finite-lived identifiable assets are amortized on a straight-line basis. The following are the intangible assets acquired and their respective amortizable lives (dollars in thousands):

	Amount	Amortizable Life
Core technology	$ 6,900	5-10 years
Trademarks	249	9 months
Software	5,100	8 years
Non-compete agreements	2,700	2 years
Customer relationships	46,500	6-21 years
Total intangible assets with finite lives	$ 61,449	

(ii) Acquisition of Redwood

On December 20, 2007, we acquired Redwood Toxicology Laboratories, Inc., or Redwood, a privately-owned drugs of abuse diagnostics and testing company. The aggregate purchase price was $53.8 million, which consisted of $53.3 million in cash and $0.5 million for direct acquisition costs. In addition, we assumed and paid debt of $47.7 million. The operating results of Redwood are included in our professional diagnostics reporting unit and business segment.

A summary of the purchase price allocation for this acquisition is as follows (in thousands):

Current assets	$ 11,234
Property, plant and equipment	5,653
Goodwill	37,296
Intangible assets	66,020
Other non-current assets	84
Total assets acquired	120,287
Current liabilities	2,947
Non-current liabilities	63,533
Total liabilities assumed	66,480
Net assets acquired	53,807
Less:	
Acquisition costs	546
Cash consideration	$ 53,261

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Business Combinations (Continued)

We expect that substantially all of the amount allocated to goodwill will not be deductible for tax purposes.

Customer relationships are amortized based on patterns in which the economic benefits of customer relationships are expected to be utilized. Other finite-lived identifiable assets are amortized on a straight-line basis. The following are the intangible assets acquired and their respective amortizable lives (dollars in thousands):

	Amount	Amortizable Life
Trademarks	$ 5,970	10 years
Non-compete agreements	2,800	2-5 years
Customer relationships	57,250	11-12.5 years
Total intangible assets with finite lives	$ 66,020	

(iii) Acquisition of Alere

On November 16, 2007, we acquired Alere Medical, Inc., or Alere Medical, a privately-held leading provider of care and health management services. The aggregate purchase price was $311.3 million, which consisted of $128.6 million in cash, common stock with an aggregate fair value of $161.1 million, $1.0 million for direct acquisition costs and $20.6 million of fair value associated with Alere Medical employee stock options which were exchanged as part of the transaction. The operating results of Alere Medical are included in our health management reporting unit and business segment.

With respect to Alere Medical, the terms of the acquisition agreement provided for contingent consideration payable to each Alere Medical stockholder who owned shares of our common stock or retained the option to purchase shares of our common stock on the six-month anniversary of the closing of the acquisition. The contingent consideration, payable in cash or stock at our election, was equal to the number of such shares of our common stock or options to purchase our common stock held on the six-month anniversary multiplied by the amount that $58.31 exceeded the greater of the average price of our common stock for the ten business days preceding the six-month anniversary date, or 75% of $58.31. Accordingly, based on the price of our common stock for the ten business days preceding the six-month anniversary of the closing of the acquisition, we issued approximately 0.1 million shares of our common stock on May 30, 2008 to the Alere Medical stockholders based on the remaining outstanding shares at that time. Payment of this contingent consideration did not impact the purchase price for this acquisition.

A summary of the purchase price allocation for this acquisition is as follows (dollars in thousands):

Current assets	$ 13,332
Property, plant and equipment	8,897
Goodwill	254,842

Intangible assets	55,500
Other non-current assets	5,523
Total assets acquired	338,094
Current liabilities	10,651
Non-current liabilities	16,157
Total liabilities assumed	26,808
Net assets acquired	311,286

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Business Combinations (Continued)

Less:	
Acquisition costs	959
Fair value of common stock issued (2,762,182 shares)	161,086
Fair value of stock options exchanged (380,894 options)	20,614
Cash consideration	$ 128,627

We expect that substantially all of the amount allocated to goodwill will not be deductible for tax purposes.

Customer relationships are amortized based on patterns in which the economic benefits of customer relationships are expected to be utilized. Other finite-lived identifiable assets are amortized on a straight-line basis. The following are the intangible assets acquired and their respective amortizable lives (dollars in thousands):

	Amount	Amortizable Life
Core technology	$ 6,100	3-6 years
Trademarks	1,500	10 years
Customer relationships	46,300	9 years
Non-compete agreements	1,600	0.5-1 year
Total intangible assets with finite lives	$ 55,500	

(iv) Acquisition of HemoSense

On November 6, 2007, we acquired HemoSense, Inc., or HemoSense, a publicly-traded developer and marketer of point-of-care testing products for therapeutic drug monitoring. The aggregate purchase price was $244.0 million, which consisted of common stock with an aggregate fair value of $226.4 million, $0.9 million for direct acquisition costs and $16.7 million of fair value associated with HemoSense employee stock options which were exchanged as part of the transaction. The operating results of HemoSense are included in our professional diagnostics reporting unit and business segment.

A summary of the purchase price allocation for this acquisition is as follows (dollars in thousands):

Current assets	$ 23,399
Property, plant and equipment	1,936
Goodwill	148,840
Intangible assets	100,670

Other non-current assets		232
Total assets acquired		275,077
Current liabilities		15,217
Non-current liabilities		15,811
Total liabilities assumed		31,028
Net assets acquired		244,049
Less:		
Acquisition costs		939
Fair value of common stock issued (3,691,369 shares)		226,415
Fair value of stock options exchanged (380,732 options)		16,695
Cash consideration	$	

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Business Combinations (Continued)

We expect that substantially all of the amount allocated to goodwill will not be deductible for tax purposes.

Customer relationships are amortized based on patterns in which the economic benefits of customer relationships are expected to be utilized. Other finite-lived identifiable assets are amortized on a straight-line basis. The following are the intangible assets acquired and their respective amortizable lives (dollars in thousands):

	Amount	Amortizable Life
Core technology	$ 24,130	1-10 years
Trademarks	7,100	10 years
Customer relationships	69,100	20 years
Non-compete agreements	300	1 year
Internally-developed software	40	10 years
Total intangible assets with finite lives	$ 100,670	

(v) Acquisition of Cholestech

On September 12, 2007, we acquired Cholestech Corporation, or Cholestech, a publicly-traded leading provider of diagnostic tools and information for immediate risk assessment and therapeutic monitoring of heart disease and inflammatory disorders. The aggregate purchase price was $354.7 million, which consisted of common stock with an aggregate fair value of $329.8 million, $4.6 million for direct acquisition costs and $20.3 million of fair value associated with the Cholestech employee stock options and restricted stock awards which were exchanged as part of the transaction. The operating results of Cholestech are included in our cardiology reporting unit of our professional diagnostics business segment.

A summary of the purchase price allocation for this acquisition is as follows (dollars in thousands):

Current assets	$ 83,377
Property, plant and equipment	6,643
Goodwill	140,395
Intangible assets	209,078
Other non-current assets	669
Total assets acquired	440,162
Current liabilities	17,434
Non-current liabilities	68,067

Total liabilities assumed		85,501
Net assets acquired		354,661
Less:		
Acquisition costs		4,556
Fair value of common stock issued (6,840,361 shares)		329,774
Fair value of stock options/awards exchanged (733,077 options/awards)		20,331
Cash consideration	$	

We expect that substantially all of the amount allocated to goodwill will not be deductible for tax purposes.

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Business Combinations (Continued)

Customer relationships are amortized based on patterns in which the economic benefits of customer relationships are expected to be utilized. Other finite-lived identifiable assets are amortized on a straight-line basis. The following are the intangible assets acquired and their respective amortizable lives (dollars in thousands):

	Amount	Amortizable Life
Core technology	$ 83,833	13 years
Trademarks	20,590	10 years
Customer relationships	99,060	26 years
License agreement	355	7 years
Non-compete agreements	5,040	1.5-2 years
Internally-developed software	200	7 years
Total intangible assets with finite lives	$ 209,078	

(vi) Acquisition of Biosite

On June 29, 2007, we completed our acquisition of Biosite Incorporated, or Biosite, a publicly-traded global medical diagnostic company utilizing a biotechnology approach to create products for the diagnosis of critical diseases and conditions. The aggregate purchase price was $1.8 billion, which consisted of $1.6 billion in cash, $68.9 million in estimated direct acquisition costs and $77.4 million of fair value associated with Biosite employee stock options which were exchanged as part of the transaction. In connection with our acquisition of Biosite, we also recorded $45.2 million of compensation expense associated with unvested stock options. The operating results of Biosite are included in our cardiology reporting unit of our professional diagnostics business segment.

A summary of the purchase price allocation for this acquisition is as follows (dollars in thousands):

Current assets	$ 325,804
Property, plant and equipment	145,144
Goodwill	784,623
Intangible assets	663,891
In-process research and development	169,000
Other non-current assets	102,343
Total assets acquired	2,190,805
Current liabilities	128,971
Non-current liabilities	272,510

Total liabilities assumed	401,481
Net assets acquired	1,789,324
Less:	
Acquisition costs	68,897
Cash settlement of vested stock options	51,503
Non-cash income tax benefits on stock options	2,574
Fair value of stock options exchanged (753,863 options)	25,879
Cash consideration	$ 1,640,471

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Business Combinations (Continued)

As part of the purchase price allocation, IPR&D projects have been valued at $169.0 million. These are projects that have not yet achieved technological feasibility as of the date of our acquisition of Biosite.

We expect that substantially all of the amount allocated to goodwill will not be deductible for tax purposes.

Customer relationships are amortized based on patterns in which the economic benefits of customer relationships are expected to be utilized. Other finite-lived identifiable assets are amortized on a straight-line basis. The following are the intangible assets acquired and their and respective amortizable lives (dollars in thousands):

	Amount	Amortizable Life
Core technology	$ 237,691	5-19.5 years
Trademarks	78,100	10.5 years
Customer relationships	348,100	1.5-22.5 years
Total intangible assets with finite lives	$ 663,891	

(vii) Acquisition of Instant

On March 12, 2007, we acquired 75% of the issued and outstanding capital stock of Instant Technologies, Inc., or Instant, a privately-owned distributor of rapid drugs of abuse diagnostic products used in the workplace, criminal justice and other testing markets. On December 28, 2007, we acquired the remaining 25% interest, bringing the aggregate purchase price to $60.8 million, which consisted of $38.9 million in cash, common stock with an aggregate fair value of $21.5 million and $0.3 million in direct acquisition costs. In addition, we assumed and paid debt of $4.9 million. The operating results of Instant are included in our professional diagnostics reporting unit and business segment.

A summary of the purchase price allocation for this acquisition is as follows (dollars in thousands):

Current assets	$ 9,012
Property, plant and equipment	141
Goodwill	43,321
Intangible assets	28,520
Total assets acquired	80,994
Current liabilities	4,273
Non-current liabilities	15,947

Total liabilities assumed	20,220
Net assets acquired	60,774
Less:	
Acquisition costs	348
Fair value of common stock issued (463,399 shares)	21,530
Cash consideration	$ 38,896

We expect that the amount allocated to goodwill will not be deductible for tax purposes.

Customer relationships are amortized based on patterns in which the economic benefits of customer relationships are expected to be utilized. Other finite-lived identifiable assets are amortized on a straight-line

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Business Combinations (Continued)

basis. The following are the intangible assets acquired and their respective amortizable lives (dollars in thousands):

	Amount	Amortizable Life
Trademarks	$ 3,170	5 years
Customer relationships	25,350	12 years
Total intangible assets with finite lives	$ 28,520	

(viii) Other acquisitions in 2007

During the year ended December 31, 2007, we acquired the following businesses for an aggregate purchase price of $184.9 million, in which we initially paid $116.0 million in cash, issued 1.0 million shares of our common stock with an aggregate fair value of $54.1 million, issued notes payable totaling $9.6 million, incurred $4.5 million in direct acquisition costs and accrued milestone payments totaling $0.3 million. Subsequently we repaid the $9.6 million notes payable initially issued. In addition, upon settlement of certain milestones, we recognized a $1.9 million foreign currency exchange gain which was included in the aggregate purchase price. The settlement of these milestones, in combination, with certain earn outs achieved and subsequently paid have resulted in net cash payments totaling $124.2 million.

Matritech, Inc., or Matritech, located in Newton, Massachusetts and Freiburg, Germany, a biotechnology company principally engaged in the development, manufacturing, marketing, distribution and licensing of cancer diagnostic technologies and products (Acquired December 2007)

Aska Diagnostic, Inc., or Aska, located in Tokyo, Japan, a distributor of professional diagnostics in Japan (Acquired December 2007)

90.91% share in Biosystems S.A., or Biosystems, located in Cali and Bogota, Colombia, a distributor of diagnostics tests, instruments and reagents throughout Colombia (Acquired December 2007). In October 2008, we acquired the remaining 9.09% interest in Biosystems

the assets of Akubio, a research company located in Cambridge, England (Acquired October 2007)

Bio-Stat Healthcare Group, or Bio-Stat, located in Cheshire, United Kingdom, a privately-owned distributor of core laboratory and point-of-care diagnostic testing products to the U.K. marketplace (Acquired October 2007)

Spectral Diagnostics Private Limited and its affiliate Source Diagnostics (India) Private Limited, or Spectral/Source, located in New Delhi and Shimla, India, distributes professional diagnostics in India (Acquired July 2007)

52.45% share in Diamics, Inc., or Diamics, located in Novato, California, a developer of molecular-based cancer screening and diagnostic systems (Acquired July 2007)

Quality Assured Services, Inc., or QAS, located in Orlando, Florida, a privately-owned provider of diagnostic home tests and services in the U.S. marketplace (Acquired June 2007)

Orange Medical, or Orange, located in Tilburg, The Netherlands, a manufacturer and marketer of rapid diagnostic products to the Benelux marketplace (Acquired May 2007)

Promesan S.r.l., or Promesan, located in Milan, Italy, a distributor of point-of-care diagnostic testing products to the Italian marketplace (Acquired January 2007)

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Business Combinations (Continued)

First Check Diagnostics LLC, or First Check, located in Lake Forrest, California, a privately-held diagnostics company in the field of home testing for drugs of abuse, including marijuana, cocaine, methamphetamines and opiates (Acquired January 2007)

the assets of Nihon Schering K.K., or NSKK, located in Japan, a diagnostic distribution business (Acquired January 2007)

Gabmed GmbH, or Gabmed, located in Nettetal, Germany, a distributor of point-of-care diagnostic testing products in the German marketplace (Acquired January 2007)

Med-Ox Chemicals Limited, or Med-Ox, located in Ottawa, Canada, a distributor of professional diagnostic testing products in the Canadian marketplace (Acquired January 2007)

A summary of the purchase price allocation for these acquisitions is as follows (in thousands):

Current assets	$ 38,518
Property, plant and equipment	4,145
Goodwill	110,556
Intangible assets	74,557
In-process research and development	4,826
Other non-current assets	183
Total assets acquired	232,785
Current liabilities	29,100
Non-current liabilities	18,786
Total liabilities assumed	47,886
Net assets acquired	184,899
Less:	
Acquisition costs	4,491
Realized foreign currency gain	1,879
Accrued earned milestones	194
Fair value of common stock issued (1,017,244 shares)	54,111
Cash consideration	$ 124,224

NSKK and Promesan are included in our professional and consumer diagnostics reporting units and business segments; Matritech, Aska, Biosystems, Bio-Stat, Akubio, Spectral/Source, Orange, Gabmed and Med-Ox are included in our professional diagnostics reporting unit and business segment; QAS is included in our health management reporting unit and business segment; and First Check is included in our consumer diagnostics reporting unit and business segment. Diamics is consolidated and included in our professional diagnostics reporting unit and business segment. Goodwill has been recognized in all transactions excluding NSKK and amounted to approximately $110.6 million. Goodwill related to these acquisitions, with the exception of Matritech and First Check, is not deductible for tax purposes.

Customer relationships are amortized based on patterns in which the economic benefits of customer relationships are expected to be utilized. Other finite-lived identifiable assets are amortized on a straight-line

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Business Combinations (Continued)

basis. The following are the intangible assets acquired and their respective amortizable lives (dollars in thousands):

	Amount	Amortizable Life
Core technology	$ 4,234	7.0-13.5 years
Supplier relationships	3,882	15 years
Trademarks	9,278	2-10 years
License agreements	920	15 years
Customer relationships	53,294	10-20 years
Non-compete agreements	801	3-4 years
Internally-developed software	1,910	7 years
Total intangible assets with finite lives	74,319	
Trademark	238	N/A
Total intangible assets with indefinite lives	238	
Total intangible assets	$ 74,557	

(d) Restructuring Plans Related to Business Combinations

In connection with several of our acquisitions, we initiated integration plans to consolidate and restructure certain functions and operations, including the relocation and termination of certain personnel of these acquired entities and the closure of certain of the acquired entities leased facilities. These costs have been recognized as liabilities assumed, in connection with the acquisition of these entities and are subject to potential adjustments as certain exit activities are confirmed or refined. The following table summarizes the liabilities established for exit activities related to these acquisitions (in thousands):

	Severance Related	Facility And Other	Total Exit Activities
Balance at December 31, 2006	$ 1,494	$ 789	$ 2,283
Acquisitions	19,823	1,327	21,150
Payments	(6,763)	(218)	(6,981)
Currency adjustments	25		25
Balance at December 31, 2007	14,579	1,898	16,477
Acquisitions	19,561	3,897	23,458

Payments	(23,407)	(854)	(24,261)
Currency adjustments	(385)	(15)	(400)
Balance at December 31, 2008	10,348	4,926	15,274
Adjustments to prior year acquisitions	203	5,317	5,520
Payments	(5,182)	(3,243)	(8,425)
Currency adjustments		2	2
Balance at December 31, 2009	$ 5,369	$ 7,002	$ 12,371

(i) 2008 Acquisitions

In connection with our acquisition of Matria, we implemented an integration plan to improve operating efficiencies and eliminate redundant costs resulting from the acquisition. The restructuring plan impacted all cost centers within the Matria organization, as activities were combined with our existing business operations.

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Business Combinations (Continued)

We recorded $20.2 million in exit costs, of which $15.4 million relates to change in control and severance costs to involuntarily terminate employees and $4.8 million related to facility exit costs. As of December 31, 2009, $5.8 million in exit costs remain unpaid. See Note 22 for additional restructuring charges related to the Matria facility exit costs, within the health management reporting unit.

In conjunction with our acquisition of Panbio, we formulated a restructuring plan to realize efficiencies and cost savings. In February 2008, we agreed upon a plan to close Panbio s facility located in Columbia, Maryland. The manufacturing operation at the Maryland-based facility has transferred to a third-party manufacturer, the sales of the products at this facility has transferred to our shared services center in Orlando, Florida and the distribution operations has transferred to our distribution facility in Freehold, New Jersey. We recorded $1.0 million in exit costs, including $0.8 million related to facility and other exit costs and $0.2 million related to severance costs to involuntarily terminate employees. As of December 31, 2009, $0.5 million in exit costs remain unpaid. See Note 22 for additional restructuring charges related to the Panbio facility closure and integration.

Although we believe our plan and estimated exit costs for our 2008 acquisitions are reasonable, actual spending for exit activities may differ from current estimated exit costs.

(ii) 2007 Acquisitions

In conjunction with our acquisition of Biosite, we implemented an integration plan to improve efficiencies and eliminate redundant costs resulting from the acquisition. The restructuring plan impacted all cost centers within the Biosite organization, as activities were combined with our existing business operations. Since the inception of the plan, we recorded $15.4 million in exit costs, of which $15.1 million relates to change in control and severance costs to involuntarily terminate employees and $0.3 million relates to facility and other exit costs. As of December 31, 2009, all exit costs have been paid.

During 2007, we formulated restructuring plans in connection with our acquisition of Cholestech, consistent with our acquisition strategy to realize operating efficiencies and cost savings. Additionally, in March 2008, we announced plans to close the Cholestech facility in Hayward, California. We are transitioning the manufacturing of the related products to our Biosite facility in San Diego, California and have transitioned the sales and distribution of the products to our shared services center in Orlando, Florida. Since inception of the plans, we recorded $9.2 million in exit costs, of which $6.5 million relates to executive change in control agreements and severance costs to involuntarily terminate employees and $2.7 million relates to facility exit costs. As of December 31, 2009, $5.2 million in exit costs remain unpaid.

In conjunction with our acquisition of HemoSense, we formulated restructuring plans during 2007 to realize operating efficiencies and cost savings. Additionally, in March 2008, we announced plans to close the HemoSense facility in San Jose, California. We transitioned the manufacturing of the related products to our Biosite facility in San Diego, California and transitioned the sales and distribution of the products to our shared services center in Orlando, Florida. Since inception of the plans, we recorded $1.5 million in exit costs, of which $1.3 million relates to severance costs to involuntarily terminate employees and $0.2 million relates to facility and other exit costs. As of December 31, 2009, all costs have been paid.

See Note 22 for additional restructuring charges related to the Cholestech and HemoSense facility closures and integrations.

In conjunction with our acquisition of Matritech, we formulated a plan to exit the leased facility of Matritech in Newton, Massachusetts and recorded $1.5 million in facility exit costs. As of December 31, 2009, $0.6 million of the facility exit costs remain unpaid.

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) Business Combinations (Continued)

In conjunction with our acquisition of Alere Medical and ParadigmHealth, we recorded $2.2 million related to executive change in control agreements and severance costs to involuntarily terminate employees. As of December 31, 2009, all costs have been paid.

Although we believe our plans and estimated exit costs for our 2007 acquisitions are reasonable, actual spending for exit activities may differ from current estimated exit costs.

(iii) Other Acquisitions

As a result of our acquisition of Ostex in 2003, we established a restructuring plan whereby we exited the facilities of Ostex in Seattle, Washington, and combined the activities of Ostex with our existing manufacturing and distribution facilities. Total severance costs associated with involuntarily terminated employees were $1.6 million, all of which has been paid as of December 31, 2006. Facility exit costs, including costs to vacate the Ostex facilities and lease commitments, were $2.4 million, of which $0.4 million remains unpaid as of December 31, 2009.

(e) Pro Forma Financial Information

The following table presents selected unaudited financial information, including the assets of Matria and the ACON Second Territory Business, as if the acquisition of these entities had occurred on January 1, 2008. Pro forma results exclude adjustments for various other less significant acquisitions completed since January 1, 2008, as these acquisitions did not materially affect our results of operations. The less significant 2008 and 2009 acquisitions contributed $173.5 million of net revenue in 2009.

The pro forma results are derived from the historical financial results of the acquired businesses for the periods presented and are not necessarily indicative of the results that would have occurred had the acquisitions been consummated on January 1, 2008 (in thousands, except per share amount).

	2009	2008
	(unaudited)	
Pro forma net revenue	$ 1,937,529	$ 1,740,825
Pro forma net income (loss)	$ 34,049	$ (29,199)
Pro forma net income (loss) per common share basic(1)	$ 0.14	$ (0.62)
Pro forma net income (loss) per common share diluted(1)	$ 0.14	$ (0.62)

(1) Net income (loss) per common share amounts are computed as described in Note 14.

(5) Goodwill and Other Intangible Assets

The following is a summary of goodwill and other intangible assets as of December 31, 2009 (in thousands, except useful life):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Useful Life
Amortized intangible assets:				
Core technology and patents	$ 558,036	$ 136,317	$ 421,719	1-20 years
Other intangible assets:				
Supplier relationships	18,939	11,781	7,158	1.8-15 years
Trademarks and trade names	174,856	37,720	137,136	2-25 years

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(5) Goodwill and Other Intangible Assets (Continued)

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Useful Life
License agreements	10,825	9,881	944	5-8.5 years
Customer relationships	1,395,786	343,728	1,052,058	1.5-26 years
Manufacturing know-how	7,259	4,190	3,069	5-15 years
Other	103,642	39,299	64,343	0.5-11 years
Total other intangible assets	1,711,307	446,599	1,264,708	
Total intangible assets with finite lives	$ 2,269,343	$ 582,916	$ 1,686,427	
Intangible assets with indefinite lives:				
Goodwill	$ 3,463,358	$	$ 3,463,358	
Other intangible assets(1)	43,644		43,644	
Total intangible assets with indefinite lives	$ 3,507,002	$	$ 3,507,002	

(1) Primarily includes trademarks and trade names.

The following is a summary of goodwill and other intangible assets as of December 31, 2008 (in thousands, except useful life):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Useful Life
Amortized intangible assets:				
Core technology and patents	$ 547,816	$ 88,509	$ 459,307	1-20 years
Other intangible assets:				
Supplier relationships	17,167	10,477	6,690	1.8-15 years
Trademarks and trade names	142,867	22,028	120,839	2-25 years
License agreements	10,445	9,655	790	5-8.5 years
Customer relationships	1,151,893	175,150	976,743	1.5-26 years
Manufacturing know-how	7,208	3,825	3,383	5-15 years
Other	78,469	20,378	58,091	0.5-11 years

Total other intangible assets	1,408,049	241,513	1,166,536
Total intangible assets with finite lives	$ 1,955,865	$ 330,022	$ 1,625,843
Intangible assets with indefinite lives:			
Goodwill	$ 3,045,883	$	$ 3,045,883
Other intangible assets(1)	42,909		42,909
Total intangible assets with indefinite lives	$ 3,088,792	$	$ 3,088,792

(1) Primarily includes trademarks and trade names.

We amortize intangible assets with finite lives, except customer relationships, using primarily the straight-line method over the above estimated useful lives of the respective intangible asset. We believe that the straight-line method is appropriate, as it approximates the pattern in which economic benefits are consumed in

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(5) Goodwill and Other Intangible Assets (Continued)

circumstances where such patterns can be reliably determined. In certain circumstances, such as certain customer relationship assets, accelerated amortization is recognized which reflect estimate of the cash flows. Amortization expense of intangible assets, which in the aggregate amounted to $255.4 million, $213.8 million and $61.4 million in 2009, 2008 and 2007, respectively, is included in cost of net revenue, research and development, sales and marketing and general and administrative in the accompanying consolidated statements of operations. The allocation of amortization expense to the expense categories is based on the intended usage and the expected benefits of the intangible assets in relation to the expense categories.

The following is a summary of estimated aggregate amortization expense of intangible assets for each of the five succeeding fiscal years as of December 31, 2009 (in thousands):

2010	$ 270,655
2011	$ 231,792
2012	$ 196,035
2013	$ 164,816
2014	$ 143,373

We perform annual impairment tests of the carrying value of our goodwill by reporting unit. Our annual impairment review on September 30, 2009 did not indicate that goodwill related to our professional diagnostics, health management and consumer diagnostics reporting units were impaired. For further discussion see Note 2(h).

We allocate goodwill by reporting unit based on the relative percentage of estimated future revenues generated for the respective reporting unit as of the acquisition date. Goodwill amounts allocated to our professional diagnostics, health management and consumer diagnostics reporting units are summarized as follows (in thousands):

	Professional Diagnostics	Health Management	Consumer Diagnostics	Total
Goodwill at December 31, 2007	$ 1,634,600	$ 463,066	$ 50,984	$ 2,148,650
Acquisitions(1)	93,473	817,113	1,497	912,083
Other(2)	(14,850)			(14,850)
Goodwill at December 31, 2008	$ 1,713,223	$ 1,280,179	$ 52,481	$ 3,045,883
Acquisitions(1)	262,567	141,964		404,531
Other(2)	13,133	62	(251)	12,944
Goodwill at December 31, 2009	$ 1,988,923	$ 1,422,205	$ 52,230	$ 3,463,358

(1) Includes initial purchase price allocation, purchase accounting adjustments recorded to the acquired entities opening balance sheet and additional payments made for earn-outs and milestones achieved.

(2) These amounts relate primarily to adjustments resulting from fluctuations in foreign currency exchange rates.

We generally expense costs incurred to internally-develop intangible assets, except for costs that are incurred to establish patents and trademarks, such as legal fees for initiating, filing and obtaining the patents and trademarks. As of December 31, 2009, we had approximately $8.8 million of costs capitalized, net of amortization, in connection with establishing patents and trademarks which are included in other intangible assets, net, in the accompanying consolidated balance sheets. Upon the initial filing of the patents and

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(5) Goodwill and Other Intangible Assets (Continued)

trademarks, we commence amortization of such intangible assets over their estimated useful lives. Costs incurred to maintain the patents and trademarks are expensed as incurred.

(6) Long-term Debt

We had the following long-term debt balances outstanding (in thousands):

	December 31, 2009	December 31, 2008
First Lien Credit Agreement Term loans	$ 951,000	$ 960,750
First Lien Credit Agreement Revolving line-of-credit	142,000	142,000
Second Lien Credit Agreement	250,000	250,000
3% Senior subordinated convertible notes	150,000	150,000
9% Senior subordinated notes	388,278	
7.875% Senior notes	243,959	
Lines-of-credit	2,902	3,503
Other	19,346	13,362
	2,147,485	1,519,615
Less: Current portion	(18,970)	(19,058)
	$ 2,128,515	$ 1,500,557

The following describes each of the above listed debt instruments:

(a) First Lien Credit Agreement and Second Lien Credit Agreement

On June 26, 2007, in conjunction with our acquisition of Biosite, we entered into a First Lien Credit Agreement, or senior secured credit facility, and a Second Lien Credit Agreement, or junior secured credit facility, collectively, secured credit facility, with certain lenders, General Electric Capital Corporation as administrative agent and collateral agent, and certain other agents and arrangers, and certain related guaranty and security agreements. The senior secured credit facility initially provided for term loans in the aggregate amount of $900.0 million and, subject to our continued compliance with the senior secured credit facility, a $150.0 million revolving line-of-credit. The junior secured credit facility provides for term loans in the aggregate amount of $250.0 million. We may repay any future borrowings under the senior secured credit facility revolving line-of-credit at any time, but in no event later than June 26, 2013. We must repay the entire junior facility term loan on June 26, 2015. As of December 31, 2009, the term loans and the revolving line-of-credit under the senior secured credit facility bore interest at 3.89% and 3.64%, respectively. The term loan under the junior secured credit facility bore interest at 6.14%.

On November 15, 2007, we amended the senior secured credit facility, increasing the total amount of credit available to us to $1,125,000,000 resulting from the increase in the term loans to the aggregate amount of $975.0 million. Additionally, under the amendment, we must repay the senior secured credit facility term loans as follows: (a) in two initial installments in the amount of $2,250,000 each on September 30, 2007 and December 31, 2007 (each of which installment payment has been made), (b) in twenty-five consecutive quarterly installments, beginning on March 31, 2008 and continuing through March 31, 2014, in the amount of $2,437,500 each and (c) in a final installment on June 26, 2014 in an amount equal to the then outstanding principal balance of the senior secured credit facility term loans.

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(6) Long-term Debt (Continued)

As of December 31, 2009, aggregate borrowings amounted to $142.0 million under the senior secured credit facility revolving line-of-credit and $1.2 billion under the term loans. Interest expense related to the secured credit facility for the year ended December 31, 2009, including amortized deferred financing costs, was $64.3 million. As of December 31, 2009, accrued interest related to the secured credit facility amounted to $0.9 million. As of December 31, 2009, we were in compliance with all debt covenants related to the above debt, which consisted principally of maximum consolidated leverage and minimum interest coverage requirements.

In August 2007, we entered into interest rate swap contracts, with an effective date of September 28, 2007, that have a total notional value of $350.0 million and have a maturity date of September 28, 2010. These interest rate swap contracts pay us variable interest at the three-month LIBOR rate, and we pay the counterparties a fixed rate of 4.85%. These interest rate swap contracts were entered into to convert $350.0 million of the $1.2 billion variable rate term loan under the senior credit facility into fixed rate debt.

In January 2009, we entered into interest rate swap contracts, with an effective date of January 14, 2009, that have a total notional value of $500.0 million and have a maturity date of January 5, 2011. These interest rate swap contracts pay us variable interest at the one-month LIBOR rate, and we pay the counterparties a fixed rate of 1.195%. These interest rate swap contracts were entered into to convert $500.0 million of the $1.2 billion variable rate term loan under the secured credit facility into fixed rate debt.

(b) 3% Senior Subordinated Convertible Notes, Principal Amount $150.0 million

On May 14, 2007, we sold $150.0 million principal amount of 3% senior subordinated convertible notes due 2016 (the Convertible Notes) in a private placement to qualified institutional buyers. At the initial conversion price of $52.30, the Convertible Notes were convertible into an aggregate 2,868,120 shares of our common stock. The conversion price was subject to adjustment one year from the date of sale. Based upon the daily volume-weighted price per share of our common stock for the thirty consecutive trading days ending May 9, 2008, the conversion price decreased from $52.30 to $43.98 in May 2008. The decrease in conversion price resulted in additional shares of our common stock becoming issuable upon conversion of our senior subordinated convertible notes. The senior subordinated convertible notes are now convertible into 3.4 million shares of our common stock at a conversion price of $43.98. Interest accrues at 3% per annum, compounded daily, on the outstanding principal amount and is payable in arrears on May 15th and November 15th, which started on November 15, 2007. Interest expense for the year ended December 31, 2009 and 2008, including amortized deferred costs, was $5.1 million and $5.0 million, respectively.

(c) 9% Senior Subordinated Notes

On May 12, 2009, we completed the sale of $400.0 million aggregate principal amount of 9% senior subordinated notes due 2016, or the 9% subordinated notes, in a public offering. Net proceeds from this offering amounted to $379.5 million, which was net of underwriters commissions totaling $8.0 million and original issue discount totaling $12.5 million. The net proceeds are intended to be used for general corporate purposes. At December 31, 2009, we had $388.3 million in indebtedness under our 9% subordinated notes.

The 9% subordinated notes, which were issued under an Indenture dated May 12, 2009, as amended or supplemented, the Indenture, accrue interest from the date of their issuance, or May 12, 2009, at the rate of 9% per year. Interest on the notes are payable semi-annually on May 15 and November 15, commencing on November 15, 2009. The notes mature on May 15, 2016, unless earlier redeemed.

We may redeem the 9% subordinated notes, in whole or part, at any time on or after May 15, 2013, by paying the principal amount of the notes being redeemed plus a declining premium, plus accrued and unpaid interest to ,but excluding, the redemption date. The premium declines from 4.50% during the twelve months

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(6) Long-term Debt (Continued)

after May 15, 2013 to 2.25% during the twelve months after May 15, 2014 to zero on and after May 15, 2015. At any time prior to May 15, 2012, we may redeem up to 35% of the aggregate principal amount of the 9% subordinated notes with money that we raise in certain equity offerings so long as (i) we pay 109% of the principal amount of the notes being redeemed, plus accrued and unpaid interest to (but excluding) the redemption date; (ii) we redeem the notes within 90 days of completing such equity offering; and (iii) at least 65% of the aggregate principal amount of the 9% subordinated notes remains outstanding afterwards. In addition, at any time prior to May 15, 2013, we may redeem some or all of the 9% subordinated notes by paying the principal amount of the notes being redeemed plus the payment of a make-whole premium, plus accrued and unpaid interest to, but excluding, the redemption date.

If a change of control occurs, subject to specified conditions, we must give holders of the 9% subordinated notes an opportunity to sell their notes to us at a purchase price of 101% of the principal amount of the notes, plus accrued and unpaid interest to, but excluding, the date of the purchase.

If we, or our, subsidiaries engage in asset sales, we, or they, generally must either invest the net cash proceeds from such sales in our or their businesses within a specified period of time, prepay senior debt or make an offer to purchase a principal amount of the 9% subordinated notes equal to the excess net cash proceeds, subject to certain exceptions. The purchase price of the notes will be 100% of their principal amount, plus accrued and unpaid interest.

The 9% subordinated notes are unsecured and are subordinated in right of payment to all of our existing and future senior debt, including our borrowing under our secured credit facilities. Our obligations under the 9% subordinated notes and the Indenture are fully and unconditionally guaranteed, jointly and severally, on an unsecured senior subordinated basis by certain of our domestic subsidiaries, and the obligations of such domestic subsidiaries under their guarantees are subordinated in right of payment to all of their existing and future senior debt. See Note 28 for guarantor financial information.

The Indenture contains covenants that will limit our ability, and the ability of our subsidiaries, to, among other things, incur additional debt; pay dividends on capital stock or redeem, repurchase or retire capital stock or subordinated debt; make certain investments; create liens on assets; transfer or sell assets; engage in transactions with affiliates; create restrictions on our or their ability pay dividends or make loans, asset transfers or other payments to us or them; issue capital stock; engage in any business, other than our or their existing businesses and related businesses; enter into sale and leaseback transactions; incur layered indebtedness and consolidate, merge or transfer all or substantially all of our, or their, assets, taken as a whole. These covenants are subject to certain exceptions and qualifications.

Interest expense related to our 9% subordinated notes for the year ended December 31, 2009, including amortization of deferred financing costs and original issue discounts, was $25.0 million. As of December 31, 2009, accrued interest related to the senior subordinated notes amounted to $5.0 million.

(d) 7.875% Senior Notes

During the third quarter of 2009, we sold a total of $250.0 million aggregate principal amount of 7.875% senior notes due 2016, or the 7.875% senior notes, in two separate transactions. On August 11, 2009, we sold $150.0 million aggregate principal amount of 7.875% senior notes in a public offering. Net proceeds from this offering amounted to approximately $145.0 million, which was net of underwriters commissions totaling $2.2 million and original issue discount totaling $2.8 million. The net proceeds were used to fund our acquisition of Concateno. At December 31, 2009, we had $147.3 million in indebtedness under this issuance of our 7.875% senior notes.

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(6) Long-term Debt (Continued)

On September 28, 2009, we sold $100.0 million aggregate principal amount of 7.875% senior notes in a private placement to initial purchasers, who agreed to resell the notes only to qualified institutional buyers. We also agreed to file a registration statement with the SEC so that the holders of these notes may exchange the notes for registered notes that have substantially identical terms as the original notes. Net proceeds from this offering amounted to approximately $95.0 million, which was net of the initial purchasers original issue discount totaling $3.5 million and offering expenses totaling approximately $1.5 million. The net proceeds were used to partially fund our acquisition of Free & Clear. At December 31, 2009, we had $96.6 million in indebtedness under this issuance of our 7.875% senior notes.

The 7.875% senior notes were issued under an Indenture dated August 11, 2009, as amended or supplemented, the Indenture. The 7.875% senior notes accrue interest from the dates of their respective issuances at the rate of 7.875% per year. Interest on the notes are payable semi-annually on February 1 and August 1, commencing on February 1, 2010. The notes mature on February 1, 2016, unless earlier redeemed.

We may redeem the 7.875% senior notes, in whole or part, at any time on or after February 1, 2013, by paying the principal amount of the notes being redeemed plus a declining premium, plus accrued and unpaid interest to ,but excluding, the redemption date. The premium declines from 3.938% during the twelve months on and after February 1, 2013 to 1.969% during the twelve months on and after February 1, 2014 to zero on and after February 1, 2015. At any time prior to August 1, 2012, we may redeem up to 35% of the aggregate principal amount of the 7.875% senior notes with money that we raise in certain equity offerings, so long as (i) we pay 107.875% of the principal amount of the notes being redeemed, plus accrued and unpaid interest to, but excluding, the redemption date; (ii) we redeem the notes within 90 days of completing such equity offering; and (iii) at least 65% of the aggregate principal amount of the 7.875% senior notes remains outstanding afterwards. In addition, at any time prior to February 1, 2013, we may redeem some or all of the 7.875% senior notes by paying the principal amount of the notes being redeemed plus the payment of a make-whole premium, plus accrued and unpaid interest to, but excluding, the redemption date.

If a change of control occurs, subject to specified conditions, we must give holders of the 7.875% senior notes an opportunity to sell their notes to us at a purchase price of 101% of the principal amount of the notes, plus accrued and unpaid interest to, but excluding, the date of the purchase.

If we, or our, subsidiaries engage in asset sales, we, or they, generally must either invest the net cash proceeds from such sales in our or their businesses within a specified period of time, prepay certain indebtedness or make an offer to purchase a principal amount of the 7.875% senior notes equal to the excess net cash proceeds, subject to certain exceptions. The purchase price of the notes will be 100% of their principal amount, plus accrued and unpaid interest.

The 7.875% senior notes are unsecured and are equal in right of payment to all of our existing and future senior debt, including our borrowing under our secured credit facilities. Our obligations under the 7.875% senior notes and the Indenture are fully and unconditionally guaranteed, jointly and severally, on an unsecured senior basis by certain of our domestic subsidiaries, and the obligations of such domestic subsidiaries under their guarantees are equal in right of payment to all of their existing and future senior debt. See Note 28 for guarantor financial information.

The Indenture contains covenants that will limit our ability, and the ability of our subsidiaries, to, among other things, incur additional debt; pay dividends on capital stock or redeem, repurchase or retire capital stock or subordinated debt; make certain investments; create liens on assets; transfer or sell assets; engage in transactions with affiliates; create restrictions on our or their ability pay dividends or make loans, asset transfers or other payments to us or them; issue capital stock; engage in any business, other than our or their existing businesses and related businesses; enter into sale and leaseback transactions; incur layered

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(6) Long-term Debt (Continued)

indebtedness and consolidate, merge or transfer all or substantially all of our, or their, assets, taken as a whole. These covenants are subject to certain exceptions and qualifications.

Interest expense related to our 7.875% senior notes for the year ended December 31, 2009, including amortization of deferred financing costs and original issue discounts, was $7.3 million. As of December 31, 2009, accrued interest related to the senior subordinated notes amounted to $7.8 million.

(e) Prior Senior Credit Facility

As of December 31, 2006, $44.8 million of borrowings were outstanding under our then senior credit facility dated June 30, 2005. On February 1, 2007, using a portion of the proceeds from our January 2007 sale of 6.9 million shares of common stock, we paid the remaining principal balance outstanding and accrued interest under the June 2005 senior credit facility. We terminated our June 2005 senior credit facility in conjunction with our refinancing activities discussed above. We had no outstanding loans under the June 2005 senior credit facility at the time it was terminated. For the year ended December 31, 2007, interest expense, including amortization of deferred financing costs, under this senior credit facility was $4.7 million. Included in interest expense is the write-off of $2.6 million in unamortized deferred financing costs.

(f) Senior Subordinated Notes, 8.75%, Principal Amount $150.0 million

On June 26, 2007, we fully repaid our 8.75% senior subordinated notes due 2012. The total amount repaid, including principal of $150.0 million and a prepayment premium of $9.3 million, was $159.3 million. Accrued interest of $4.8 million was also paid as part of the final settlement of these Notes and unamortized deferred financing costs of $3.7 million were written off as a result of the repayment.

(g) Lines-of-credit

Some of our subsidiaries maintain a local line-of-credit for short-term advances. At December 31, 2009, a total of $2.9 million was borrowed against these local lines-of-credit.

(h) Other Debt

Included in other debt above, for the year ended December 31, 2009, are borrowings by certain of our subsidiaries from various financial institutions. The borrowed funds are used to fund capital expenditure and working capital requirements. Interest expense on these borrowings was $1.5 million for the year ended December 31, 2009.

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(6) Long-term Debt (Continued)

(i) Maturities of Long-term Debt

The following is a summary of the maturities of long-term debt outstanding on December 31, 2009 (in thousands):

2010	$	18,970
2011		12,372
2012		10,382
2013		152,005
2014		912,000
Thereafter		1,059,519
		2,165,248
Less: Original issue discounts		(17,763)
	$	2,147,485

(7) Fair Value Measurements

We apply fair value measurement accounting to value our financial assets and liabilities. Fair value measurement accounting provides a framework for measuring fair value under U.S. GAAP and requires expanded disclosures regarding fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A fair value hierarchy requires an entity to maximize the use of observable inputs, where available, and minimize the use of unobservable inputs when measuring fair value.

Described below are the three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities. Our Level 1 assets and liabilities include investments in marketable securities related to a deferred compensation plan assumed in a business combination. The liabilities associated with this plan relate to deferred compensation, which is indexed to the performance of the underlying investments.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Our Level 2 liabilities include interest rate swap contracts.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. The fair value of the contingent consideration obligations related to the acquisitions of

Accordant, Free & Clear, JSM, Mologic and Tapestry are valued using Level 3 inputs.

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(7) Fair Value Measurements (Continued)

The following table presents information about our assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2009, and indicates the fair value hierarchy of the valuation techniques we utilized to determine such fair value (in thousands):

Description	December 31, 2009	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Assets:				
Marketable securities	$ 2,450	$ 2,450	$	$
Total assets	$ 2,450	$ 2,450	$	$
Liabilities:				
Interest rate swap liability(1)	$ 15,945	$	$ 15,945	$
Contingent consideration obligations(2)	43,178			43,178
Total liabilities	$ 59,123	$	$ 15,945	$ 43,178

(1) Included in other long-term liabilities on our accompanying consolidated balances sheets.

(2) The fair value measurement of the contingent consideration obligations related to the acquisitions of Accordant, Free & Clear, JSM, Mologic and Tapestry are valued using Level 3 inputs. We determine the fair value of the contingent consideration obligations based on a probability-weighted approach derived from earn-out criteria estimates and a probability assessment with respect to the likelihood of achieving the various earn-out criteria. The measurement is based upon significant inputs not observable in the market. Changes in the value of these contingent consideration obligations are recorded as income or expense, a component of operating income in our accompanying consolidated statements of operations.

Changes in the fair value of our Level 3 contingent consideration obligations during the year ended December 31, 2009 were as follows (in thousands):

Fair value of contingent consideration obligations, January 1, 2009	$
Acquisition date fair value of contingent consideration obligations recorded	41,359

Payments	
Adjustments, net (income) expense	1,819
Fair value of contingent consideration obligations, December 31, 2009	$ 43,178

At December 31, 2009, the carrying amounts of cash and cash equivalents, restricted cash, marketable securities, receivables, accounts payable and other current liabilities approximated their estimated fair values because of the short maturity of these financial instruments.

Both the carrying amounts and estimated fair values of our long-term debt were $2.1 billion at December 31, 2009. The estimated fair value of our long-term debt was determined using market sources that were derived from available market information and may not be representative of actual values that could have been or will be realized in the future.

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(7) Fair Value Measurements (Continued)

During 2009, we wrote down long-lived assets by $7.0 million, primarily as a result of various restructuring plans, as well as a write-down recorded in connection with an idle facility. These write-downs were based upon Level 3 inputs.

(8) Capital Leases

The following is a schedule of the future minimum lease payments under the capital leases, together with the present value of such payments as of December 31, 2009 (in thousands):

2010	$ 920
2011	658
2012	179
2013	82
2014	18
Total future minimum lease payments	1,857
Less: Imputed interest	(18)
Present value of future minimum lease payments	1,839
Less: Current portion	(899)
	$ 940

At December 31, 2009, the capitalized amounts of the building, machinery and equipment and computer equipment under capital leases were as follows (in thousands):

Machinery, laboratory equipment and tooling	$ 2,917
Computer equipment	217
Furniture and fixtures	43
Leasehold improvements	57
	3,234
Less: Accumulated amortization	(1,183)
	$ 2,051

The amortization expense of assets recorded under capital leases is included in depreciation and amortization expense of property, plant and equipment.

(9) Postretirement Benefit Plans

(a) Employee Savings Plans

Our company and several of our U.S.-based subsidiaries sponsor various 401(k) savings plans, to which eligible domestic employees may voluntarily contribute a portion of their income, subject to statutory limitations. In addition to the participants own contributions to these 401(k) savings plans, we match such contributions up to a designated level. Total matching contributions related to employee savings plans were \$6.4 million, \$4.6 million and \$1.5 million in 2009, 2008 and 2007, respectively.

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(9) Postretirement Benefit Plans (Continued)

(b) U.K. Pension Plans

Changes in benefit obligations, plan assets, funded status and amounts recognized on the accompanying balance sheet as of and for the years ended December 31, 2009 and 2008, for our Defined Benefit Plan, were as follows (in thousands):

	2009	2008
Change in projected benefit obligation		
Benefit obligation at beginning of year	$ 9,078	$ 12,627
Interest cost	596	677
Actuarial loss	1,990	534
Benefits paid	(127)	(182)
Curtailment loss (gain)	313	(1,113)
Foreign exchange impact	1,059	(3,465)
Benefit obligation at end of year	$ 12,909	$ 9,078
Change in accumulated benefit obligation		
Benefit obligation at beginning of year	$ 6,567	$ 9,159
Interest cost	596	677
Actuarial loss	1,990	534
Benefits paid	(127)	(182)
Curtailment loss (gain)	313	(1,113)
Foreign exchange impact	784	(2,508)
Benefit obligation at end of year	$ 10,123	$ 6,567
Change in plan assets		
Fair value of plan assets at beginning of year	$ 5,928	$ 9,143
Actual return on plan assets	1,477	(1,543)
Employer contribution	854	835
Benefits paid	(127)	(182)
Foreign exchange impact	701	(2,325)
Fair value of plan assets at end of year	$ 8,833	$ 5,928
Funded status at end of year	$ (4,076)	$ (3,150)

The net amounts recognized in the accompanying consolidated balance sheets are as follows (in thousands):

	2009	2008
Accrued benefit liability	$ (1,250)	$ (603)
Long-term benefit liability	(7,080)	(5,498)
Intangible asset	4,254	2,951
Net amount recognized	$ (4,076)	$ (3,150)

The measurement date used to determine plan assets and benefit obligations for the Defined Benefit Plan was December 31, 2009 and 2008.

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(9) Postretirement Benefit Plans (Continued)

The following table provides the weighted-average actuarial assumptions:

	2009	2008
Assumptions used to determine benefit obligations:		
Discount rate	5.70%	6.10%
Rate of compensation increase	4.25%	3.85%
Assumptions used to determine net periodic benefit cost:		
Discount rate	6.10%	5.80%
Expected return on plan assets	6.55%	7.20%
Rate of compensation increase	3.85%	4.15%

The actuarial assumptions are reviewed on an annual basis. The overall expected long-term rate of return on plan assets assumption was determined based on historical investment return rates on portfolios with a high proportion of equity securities.

The annual cost of the Defined Benefit Plan is as follows (in thousands):

	2009	2008	2007
Interest cost	$ 596	$ 677	$ 660
Expected return on plan assets	(444)	(634)	(620)
Amortization of net loss		(80)	(90)
Curtailment loss (gain)	313	(1,113)	
Net periodic benefit cost (benefit)	$ 465	$ (1,150)	$ (50)

The plan assets of the Defined Benefit Plan comprise of a mix of stocks and fixed income securities and other investments. At December 31, 2009, these stocks and fixed income securities represented 68% and 32%, respectively, of the market value of the pension assets. We expect to contribute approximately 0.5 million British Pounds Sterling (or $0.9 million at December 31, 2009) to the Defined Benefit Plan in 2010. We expect benefits to be paid to plan participants of approximately $0.2 million per year for each of the next five years and for benefits totaling $0.2 million to be paid annually for the five years thereafter.

Our overall investment strategy is to ensure the investments are spread across a range of investments varying by both investment class and geographical location which is achieved by investing largely in sub-funds of legal and general trading funds. Spreading the investments in this manner reduces the risk of a decline in a particular market having a substantial impact on the whole fund. The target allocation for the plan assets is a 70% holding in equities (both in the U.K. and overseas), with the remaining assets invested in investment grade corporate bonds.

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(9) Postretirement Benefit Plans (Continued)

The fair values of our pension plan assets at December 31, 2009 by asset category are presented in the following table. All fair values are based on quoted prices in active markets for identical assets (Level 1 in the fair value hierarchy).

Asset Category	Plan Assets at December 31, 2009	Plan Assets at December 31, 2008
Equity securities:		
U.K. equities	$ 2,997	$ 1,773
Overseas equities	3,037	1,955
Debt securities corporate bonds	2,581	1,857
Other cash	218	342
Total plan assets	$ 8,833	$ 5,928

Unipath Limited, or Unipath, contributed $0.8 million in 2009, $1.0 million in 2008 and $1.2 million in 2007 to a Defined Contribution Plan, which was recognized as an expense in the accompanying consolidated statement of operations.

(10) Derivative Financial Instruments

The following tables summarize the fair value of our derivative instruments and the effect of derivative instruments on/in our accompanying consolidated balance sheets and consolidated statements of operations and in accumulated other comprehensive income (loss) (in thousands):

Derivative Instruments	Balance Sheet Caption	Fair Value at December 31, 2009	Fair Value at December 31, 2008
Interest rate swap contracts(1)	Other long-term liabilities	$ 15,945	$ 21,132

	Amount of Gain Recognized During the Year Ended	Amount of Loss Recognized During the Year Ended

Derivative Instruments	Location of Gain (Loss) Recognized in Income	December 31, 2009	December 31, 2008
Interest rate swap contracts(1)	Other comprehensive income (loss)	$ 5,187	$ (11,614)

(1) See Note 6(a) regarding our interest rate swaps which qualify as cash flow hedges.

We use derivative financial instruments (interest rate swap contracts) in the management of our interest rate exposure related to our secured credit facilities. We do not hold or issue derivative financial instruments for speculative purposes.

(11) Commitments and Contingencies

(a) Operating Leases

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Commitments and Contingencies (Continued)

We have operating lease commitments for certain of our facilities and equipment that expire on various dates through 2020. The following schedule outlines future minimum annual rental payments under these leases at December 31, 2009 (in thousands):

2010	$ 29,628
2011	25,533
2012	21,155
2013	17,646
2014	25,493
Thereafter	37,105
	$ 156,560

Rent expense relating to operating leases was approximately $37.3 million, $34.2 million and $16.3 million during 2009, 2008 and 2007, respectively.

(b) Contingent Consideration Obligations

Effective January 1, 2009, we adopted changes issued by the FASB to accounting for business combinations. These changes apply to all assets acquired and liabilities assumed in a business combination that arise from certain contingencies and requires: (i) an acquirer to recognize at fair value, at the acquisition date, an asset acquired or liability assumed in a business combination that arises from a contingency if the acquisition-date fair value of that asset or liability can be determined during the measurement period; otherwise the asset or liability should be recognized at the acquisition date if certain defined criteria are met and (ii) contingent consideration arrangements of an acquiree assumed by the acquirer in a business combination be recognized initially at fair value. The adoption of this guidance was done on a prospective basis. For acquisitions completed prior to January 1, 2009, contingent consideration will be accounted for as an increase in the aggregate purchase price, if and when the contingencies occur.

We have contractual contingent consideration terms related to our acquisitions of Accordant, Ameditech, Binax, Inc., or Binax, Free & Clear, Gabmed, JSM, Mologic, Tapestry, Vision and our privately-owned health management business acquired in 2008.

(i) Accordant

With respect to Accordant, the terms of the acquisition agreement require us to pay an earn-out upon successfully meeting certain revenue and cash collection targets starting after the second anniversary of the acquisition date and completed prior to the third anniversary date of the acquisition. The maximum amount of the earn-out payment is $6.0 million and, if earned, payment will be made during 2012 and 2013.

We determined the acquisition date fair value of the contingent consideration obligation based on a probability-weighted income approach derived from revenue estimates and a probability assessment with respect to the likelihood of achieving the various earn-out criteria. The fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement as defined in fair value measurement accounting. The resultant probability-weighted cash flows were then discounted using a discount rate of 18%. At each reporting date, we revalue the contingent consideration obligation to the reporting date fair value and record increases and decreases in the fair value as income or expense in our consolidated statements of operations. Increases or decreases in the fair value of the contingent consideration obligations may result from changes in discount periods and rates, changes in the timing and amount of revenue estimates and changes in probability assumptions with respect to the likelihood of achieving the various earn-out criteria. We recorded expense of approximately $0.2 million in our consolidated statement of

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Commitments and Contingencies (Continued)

operations during the year ended December 31, 2009, as a result of a decrease in the discount period and fluctuations in the discount rate since the acquisition date. As of December 31, 2009, the fair value of the contingent consideration obligation was approximately $3.4 million.

(ii) Ameditech

With respect to Ameditech, the terms of the acquisition agreement require us to pay an earn-out upon successfully meeting certain revenue targets for the one-year period ending on the first anniversary of the acquisition date and the one-year period ending on the second anniversary of the acquisition date. The maximum amount of incremental consideration payable is $4.0 million. The first earn-out was achieved in the fourth quarter of 2009 resulting in an accrual of approximately $23,000. Contingent consideration is accounted for as an increase in the aggregate purchase price, if and when the contingency occurs.

(iii) Binax

With respect to Binax, the terms of the acquisition agreement provide for $11.0 million of contingent cash consideration payable to the Binax shareholders upon the successful completion of certain new product developments during the five years following the acquisition. The second milestone totaling $3.7 million was earned and paid in the fourth quarter of 2009. As of December 31, 2009, the remaining contingent consideration to be earned is approximately $3.7 million. Contingent consideration is accounted for as an increase in the aggregate purchase price, if and when the contingencies occur.

(iv) Free & Clear

With respect to Free & Clear, the terms of the acquisition agreement require us to pay an earn-out upon successfully meeting certain revenue and EBITDA targets during fiscal year 2010. The maximum amount of the earn-out payment is $30.0 million and, if earned, payment will be made in 2011.

We determined the acquisition date fair value of the contingent consideration obligation based on a probability-weighted income approach derived from 2010 revenue and EBITDA estimates and a probability assessment with respect to the likelihood of achieving the various earn-out criteria. The fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement as defined in fair value measurement accounting. The resultant probability-weighted cash flows were then discounted using a discount rate of 13%. At each reporting date, we revalue the contingent consideration obligation to the reporting date fair value and record increases and decreases in the fair value as income or expense in our consolidated statements of operations. Increases or decreases in the fair value of the contingent consideration obligations may result from changes in discount periods and rates, changes in the timing and amount of revenue estimates and changes in probability assumptions with respect to the likelihood of achieving the various earn-out criteria. We recorded expense of approximately $0.5 million in our consolidated statement of operations during the year ended December 31, 2009, as a result of a decrease in the discount period since the acquisition date. As of December 31, 2009, the fair value of the contingent consideration obligation was approximately $16.3 million.

(v) Gabmed

With respect to Gabmed, the terms of the acquisition agreement provide for contingent consideration totaling up to 750,000 payable in up to five annual amounts beginning in 2007, upon successfully meeting certain revenue and EBIT (earnings before interest and taxes) milestones in each of the respective annual periods. The first milestone, totaling 0.1 million ($0.2 million), was earned and paid during 2008. The second milestone totaling 0.2 million ($0.2 million) was earned and accrued during the fourth quarter of 2009. As of December 31, 2009, the remaining contingent consideration to be earned is approximately 0.5 million

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Commitments and Contingencies (Continued)

($0.7 million). Contingent consideration is accounted for as an increase in the aggregate purchase price, if and when the contingencies occur.

(vi) JSM

With respect to JSM, the terms of the acquisition agreement require us to pay an earn-out upon successfully meeting certain revenue and operating income targets during each of the fiscal years 2010-2012. The maximum amount of the earn-out payments is approximately $3.0 million.

We determined the acquisition date fair value of the contingent consideration obligation based on a probability-weighted income approach derived from revenue estimates and a probability assessment with respect to the likelihood of achieving the various earn-out criteria. The fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement as defined in fair value measurement accounting. The resultant probability-weighted cash flows were then discounted using a discount rate of 16%. At each reporting date, we revalue the contingent consideration obligation to the reporting date fair value and record increases and decreases in the fair value as income or expense in our consolidated statements of operations. Increases or decreases in the fair value of the contingent consideration obligations may result from changes in discount periods and rates, changes in the timing and amount of revenue estimates and changes in probability assumptions with respect to the likelihood of achieving the various earn-out criteria. We recorded income of approximately $8,000 in our consolidated statement of operations during the year ended December 31, 2009, as a result of a decrease in the discount period and fluctuations in the discount rate since the acquisition date. As of December 31, 2009, the fair value of the contingent consideration obligation was approximately $1.1 million.

(vii) Mologic

With respect to Mologic, the terms of the acquisition agreement require us to pay earn-outs upon successfully meeting five R&D project milestones during the four years following the acquisition. The maximum amount of the earn-out payments is $19.0 million, which will be paid in shares of our common stock.

We determined the acquisition date fair value of the contingent consideration obligation based on a probability-weighted income approach derived from the expected delivery value based upon the overall probability of achieving the targets before the corresponding delivery dates. The fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement as defined in fair value measurement accounting. The resultant probability-weighted earn-out amounts were then discounted using a discount rate of 6%. At each reporting date, we revalue the contingent consideration obligation to the reporting date fair value and record increases and decreases in the fair value as income or expense in our consolidated statements of operations. Increases or decreases in the fair value of the contingent consideration obligations may result from changes in discount periods and rates, changes in the timing and amount of revenue estimates and changes in probability assumptions with respect to the likelihood of achieving the various earn-out criteria. We recorded expense of approximately $0.4 million in our consolidated statement of operations during the year ended December 31, 2009, as a result of a decrease in the discount period, fluctuations in the discount rate since the acquisition date and adjustments to certain probability factors. As of December 31, 2009, the fair value of the contingent consideration obligation was approximately

$5.8 million.

(viii) Tapestry

With respect to Tapestry, the terms of the acquisition agreement require us to pay an earn-out upon successfully meeting certain revenue and EBITDA targets during each of the fiscal years 2010-2011. The maximum amount of the earn-out payments is $25.0 million which, if earned, will be paid in shares of our

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Commitments and Contingencies (Continued)

common stock, except in the case that the 2010 financial targets defined under the earn-out agreement are exceeded, in which case the seller may elect to be paid the 2010 earn-out in cash.

We determined the acquisition date fair value of the contingent consideration obligation based on a probability-weighted income approach derived from revenue estimates and a probability assessment with respect to the likelihood of achieving the various earn-out criteria. The fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement as defined in fair value measurement accounting. The resultant probability-weighted cash flows were then discounted using a discount rate of 16%. At each reporting date, we revalue the contingent consideration obligation to the reporting date fair value and record increases and decreases in the fair value as income or expense in our consolidated statements of operations. Increases or decreases in the fair value of the contingent consideration obligations may result from changes in discount periods and rates, changes in the timing and amount of revenue estimates and changes in probability assumptions with respect to the likelihood of achieving the various earn-out criteria. We recorded expense of approximately $0.7 million in our consolidated statement of operations during the year ended December 31, 2009, as a result of a decrease in the discount period, fluctuations in the discount rate since the acquisition date and adjustments to certain probability factors. As of December 31, 2009, the fair value of the contingent consideration obligation was approximately $16.7 million.

(ix) Vision

With respect to Vision, the terms of the acquisition agreement provide for incremental consideration payable to the former Vision shareholders upon the completion of certain product development milestones and successfully maintaining certain production levels and product costs during each of the two years following the acquisition date. The minimum and maximum amount of incremental consideration payable is approximately $1.0 million and $3.2 million, respectively. The first milestone was achieved during the third quarter of 2009 for which we made payment for $2.0 million during the fourth quarter of 2009. The contingent consideration was accounted for as an increase in the aggregate purchase price.

(x) Privately-owned health management business

With respect to our privately-owned health management business acquired in 2008, the terms of the acquisition agreement provide for contingent consideration payable upon successfully meeting certain revenue and EBITDA targets for the twelve months ending June 30, 2009 and December 31, 2010, respectively. The revenue milestone for the twelve months ended June 30, 2009 totaling approximately 3.0 million ($4.2 million) was earned and accrued as of June 30, 2009. The earn-out totaling approximately 3.0 million ($4.4 million) was paid during the third quarter of 2009. The contingent consideration was accounted for as an increase in the aggregate purchase price.

(c) Contingent Obligation

In November 2009, we entered into a distribution agreement with Epocal, Inc., or Epocal, to distribute the epoc® Blood Analysis System for blood gas and electrolyte testing for $20.0 million, which is recorded on our accompanying consolidated balance sheet in other intangible assets, net. We also entered into a definitive agreement to acquire all of the issued and outstanding equity securities of Epocal for a total potential purchase price of up to $255.0 million, including a base purchase price of up to $172.5 million if Epocal achieves certain gross margin and other financial milestones on or prior to October 31, 2014, plus additional payments of up to $82.5 million if Epocal achieves certain other milestones relating to its gross margin and product development efforts on or prior to this date. The acquisition will also be subject to other closing conditions, including the receipt of any required antitrust or other approvals.

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Commitments and Contingencies (Continued)

(d) Legal Proceedings

Healthways, Inc. and Robert Bosch North America Corp., v. Alere, Inc.

Healthways, Inc. and Robert Bosch North America Corp. filed a complaint in U.S. District Court in the Northern District of Illinois on November 5, 2008 against Alere Medical alleging infringement of 11 patents, licensed by Bosch from Healthways. Alere Medical answered the complaint and filed counterclaims seeking declarations that the patents are invalid and not infringed. The plaintiffs subsequently filed an amended complaint substituting Alere LLC, or Alere, our consolidated health management subsidiary, as the defendant in place of Alere Medical. On August 31, 2009, Plaintiffs filed a motion to dismiss Alere s affirmative defense and counterclaim that the patents-in-suit are unenforceable due to inequitable conduct. Alere opposed the motion and filed a motion to amend the existing pleadings to include newly discovered facts of inequitable conduct. A hearing for those motions is not yet scheduled. A trial date has not yet been scheduled. We believe that we have strong defenses to Healthways allegations and we intend to defend them vigorously. However, a ruling against Alere could potentially have a material adverse impact on our sales, operations or financial performance or could limit our current or future business opportunities.

Claims in the Ordinary Course and Other Matters

We are not a party to any other pending legal proceedings that we currently believe could have a material adverse impact on our sales, operations or financial performance. However, because of the nature of our business, we may be subject at any particular time to commercial disputes, consumer product claims, negligence claims or various other lawsuits arising in the ordinary course of our business, including infringement, employment or investor matters, and we expect that this will continue to be the case in the future. Such lawsuits generally seek damages, sometimes in substantial amounts.

As an example, our subsidiary Alere Medical continues to defend infringement claims brought by Health Hero Network, Inc., a subsidiary of Robert Bosch North America Corp., which alleges to have patented certain processes related to home monitoring of patients. Although that matter has been stayed pending reexamination of the Health Hero patents by the U.S. Patent and Trademark Office. Additionally, Alere Medical continue to defend a previously disclosed class action lawsuit brought by the Estate of Melissa Prince Quisenberry which relate to the March 14, 2007 sale of Alere Medical to an unrelated entity. While we believe that we have strong defenses to the claims brought by Health Hero and Quisenberry and we intend to defend them vigorously, these, or other claims, could potentially have a negative impact on our sales, operations or financial performance or could limit our existing or future business opportunities.

In addition, we aggressively defend our patent and other intellectual property rights. This often involves bringing infringement or other commercial claims against third parties. These suits can be expensive and result in counterclaims challenging the validity of our patents and other rights.

(12) Co-development Agreement with ITI Scotland Limited

On February 25, 2005, we entered into a co-development agreement with ITI Scotland Limited, or ITI, whereby ITI agreed to provide us with £30.0 million over three years to partially fund research and development programs focused on identifying novel biomarkers and near-patient and home-use tests for cardiovascular and other diseases (the programs). We agreed to invest £37.5 million in the programs over three years from the date of the agreement. Through our subsidiary, Stirling Medical Innovations Limited, or Stirling, we established a new research center in Stirling, Scotland, where we consolidated many of our existing cardiology programs and will ultimately commercialize products arising from the programs. ITI and Stirling will have exclusive rights to the developed technology in their respective fields of use. As qualified

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(12) Co-development Agreement with ITI Scotland Limited (Continued)

expenditures were made under the co-development arrangement, we recognized the fee earned during the period as a reduction of our related expenses, subject to certain limitations. As of December 31, 2007, we had earned full funding under this arrangement in the amount of £30.0 million ($56.0 million) and as such, no funding was earned in 2008. For the fiscal years ended December 31, 2007, we recognized $20.0 million of reimbursements, of which, $18.5 million offset our research and development spending and $1.5 million reduced our general, administrative and marketing spending incurred by Stirling. Though the funding arrangement has completed, Stirling continues to support ITI in exploiting the developed technology into their fields of interest.

(13) In-Process Research and Development

Effective January 1, 2009, we account for business combinations completed on or after January 1, 2009 in accordance with the revised guidance for accounting for business combinations, which prescribes new accounting treatment associated with acquired IPR&D. Prior to January 1, 2009, we measured acquired IPR&D at fair value and expensed it on acquisition date; however, effective January 1, 2009, acquired IPR&D will be measured at fair value and capitalized as an intangible asset and tested for impairment until completion of the programs and amortized from the date of completion over the estimated useful life.

In connection with two of our acquisitions completed in 2007, we acquired various IPR&D projects which were accounted for under the then authoritative guidance. In connection with the acquired IPR&D projects, substantial additional research and development will be required prior to any of our acquired IPR&D programs and technology platforms reaching technological feasibility. In addition, once research is completed, each product candidate acquired will need to complete a series of clinical trials and receive FDA or other regulatory approvals prior to commercialization. Our current estimates of the time and investment required to develop these products and technologies may change depending on the different applications that we may choose to pursue. We cannot give assurances that these programs will ever reach technological feasibility or develop into products that can be marketed profitably. For example, we have discontinued funding certain of the programs listed below. In addition, we cannot guarantee that we will be able to develop and commercialize products before our competitors develop and commercialize products for the same indications.

The following table sets forth IPR&D projects for companies and certain assets we acquired in 2007 (in thousands):

Company/ Year Assets Acquired	Purchase Price	IPR&D(1)	Programs Acquired	Discount Rate Used in Estimating Cash Flows(1)	Year of Expected Launch
Diamics/2007	$ 4,000	$ 682		63%	2009-2010

				PapMap (Pap Screening Methods)		
			1,049	C-Map (Automated Pap Screening)	63%	2009-2010
			3,094	POC (Point of Care Systems)	63%	2009-2010
		$	4,825			
Biosite/2007	$	1,800,000	$	13,000	Triage Sepsis Panel	15%	2008-2010
				156,000	Triage NGAL	15%	2008-2010
			$	169,000			

(1) Management assumes responsibility for determining the valuation of the acquired IPR&D projects. The fair value assigned to IPR&D for each acquisition is estimated by discounting, to present value, the cash flows expected once the acquired projects have reached technological feasibility. The cash flows are

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(13) In-Process Research and Development (Continued)

probability adjusted to reflect the risks of advancement through the product approval process. In estimating the future cash flows, we also considered the tangible and intangible assets required for successful exploitation of the technology resulting from the purchased IPR&D projects and adjusted future cash flows for a charge reflecting the contribution to value of these assets.

(14) Income (Loss) Per Common Share

The following tables set forth the computation of basic and diluted income (loss) per common share (in thousands, except per share amounts):

	2009	2008	2007
Income (loss) per common share basic:			
Numerator continuing operations:			
Income (loss) from continuing operations	$ 31,782	$ (20,720)	$ (244,335)
Less: Preferred stock dividends	(22,972)	(13,989)	
Income (loss) available to common stockholders continuing operations	$ 8,810	$ (34,709)	$ (244,335)
Numerator discontinued operations:			
Income (loss) from discontinued operations	1,934	(1,048)	(418)
Numerator net income (loss):			
Income (loss) from continuing operations	$ 31,782	$ (20,720)	$ (244,335)
Income (loss) from discontinued operations	1,934	(1,048)	(418)
Net income (loss)	33,716	(21,768)	(244,753)
Less: Preferred stock dividends	(22,972)	(13,989)	
Net income (loss) available to common stockholders	$ 10,744	$ (35,757)	$ (244,753)
Denominator:			
Weighted average shares outstanding	80,572	77,778	51,510
Income (loss) per common share from continuing operations	$ 0.11	$ (0.45)	$ (4.74)
Income (loss) per common share from discontinued operations	$ 0.02	$ (0.01)	$ (0.01)
Net income (loss) per common share	$ 0.13	$ (0.46)	$ (4.75)

	2009	2008	2007
Income (loss) per common share diluted:			
Numerator continuing operations:			
Income (loss) from continuing operations	$ 31,782	$ (20,720)	$ (244,335)
Less: Preferred stock dividends	(22,972)	(13,989)	
Income (loss) available to common stockholders continuing operations	$ 8,810	$ (34,709)	$ (244,335)

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(14) Income (Loss) Per Common Share (Continued)

	2009	2008	2007
Numerator discontinued operations:			
Income (loss) from discontinued operations	$ 1,934	$ (1,048)	$ (418)
Numerator net income (loss):			
Income (loss) from continuing operations	$ 31,782	$ (20,720)	$ (244,335)
Income (loss) from discontinued operations	1,934	(1,048)	(418)
Net income (loss)	$ 33,716	$ (21,768)	$ (244,753)
Less: Preferred stock dividends	(22,972)	(13,989)	
Net income (loss) available to common stockholders	$ 10,744	$ (35,757)	$ (244,753)
Denominator:			
Weighted average shares outstanding	80,572	77,778	51,510
Stock options	1,228		
Warrants	167		
Total shares	81,967	77,778	51,510
Income (loss) per common share from continuing operations	$ 0.11	$ (0.45)	$ (4.74)
Income (loss) per common share from discontinued operations	$ 0.02	$ (0.01)	$ (0.01)
Net income (loss) per common share	$ 0.13	$ (0.46)	$ (4.75)

We had dilutive securities outstanding on December 31, 2009 consisting of options and warrants to purchase an aggregate of 10.3 million shares of our common stock at a weighted average exercise price of $34.11 per share. We had the following potential dilutive securities outstanding on December 31, 2009: (a) 3.4 million shares issuable upon conversion of our $150.0 million, 3% senior subordinated convertible notes, convertible at $43.98 per share; (b) $1.7 million of subordinated convertible promissory notes, convertible at $61.49 per share; and (c) 2.0 million shares of our Series B convertible preferred stock, with an aggregate liquidation preference of approximately $793.7 million, convertible under certain circumstances at $69.32 per share into 11.4 million shares of our common stock. In addition, at December 31, 2009, we had 0.4 million common stock equivalents from the potential settlement of a portion of the deferred purchase price consideration related to the ACON Second Territory Business. These potential dilutive securities were not included in the computation of diluted net earnings per common share in 2009 because the inclusion thereof would be antidilutive.

We had the following potential dilutive securities outstanding on December 31, 2008: (a) options and warrants to purchase an aggregate of 10.6 million shares of our common stock at a weighted average exercise price of $32.15 per share, (b) 3.4 million shares issuable upon conversion of our $150.0 million, 3% senior subordinated convertible notes and (c) 1.9 million shares of our Series B convertible preferred stock, convertible under certain circumstances at $69.32 per share into 10.8 million shares of our common stock. Potential dilutive securities were not included in the computation of diluted net loss per common share in 2008 because the inclusion thereof would be antidilutive.

We had the following potential dilutive securities outstanding on December 31, 2007: (a) options and warrants to purchase an aggregate of 8.3 million shares of our common stock at a weighted average exercise

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(14) Income (Loss) Per Common Share (Continued)

price of $30.82 per share and (b) 1.8 million shares issuable upon conversion of our $150.0 million, 3% senior subordinated convertible notes. Potential dilutive securities were not included in the computation of diluted loss per common share in 2007 because the inclusion thereof would be antidilutive.

(15) Stockholders Equity

(a) Common Stock

As of December 31, 2009, we had 150.0 million shares of common stock, $0.001 par value, authorized, of which approximately 83.6 million shares were issued and outstanding, 11.0 million shares were reserved for issuance upon grant and exercise of stock options under current stock option plans, 1.1 million shares were reserved for issuance under our employee stock purchase plan and 0.5 million shares were reserved for issuance upon exercise of outstanding warrants. We had the following potential dilutive securities outstanding on December 31, 2009: $150.0 million, 3% senior subordinated convertible notes, convertible at $43.98 per share into 3.4 million shares of our common stock which are reserved; $1.7 million of subordinated convertible promissory notes, convertible at $61.49 per share into 27,647 shares of our common stock which are reserved and 2.0 million shares of our Series B convertible preferred stock, with an aggregate liquidation preference of approximately $793.7 million, convertible under certain circumstances at $69.32 per share into 11.4 million shares of our common stock which are reserved.

(b) Preferred Stock

As of December 31, 2009, we had 5.0 million shares of preferred stock, $0.001 par value, authorized, of which 2.3 million shares were designated as Series B Convertible Perpetual Preferred Stock, or Series B preferred stock. In connection with our acquisition of Matria, we issued shares of the Series B preferred stock and have paid dividends to date in shares of Series B preferred stock. At December 31, 2009, there were 2.0 million shares of Series B preferred stock outstanding with a fair value of approximately $532.8 million (Note 4(b)(i)).

Each share of Series B preferred stock, which has a liquidation preference of $400.00 per share, is convertible, at the option of the holder and only upon certain circumstances, into 5.7703 shares of our common stock, plus cash in lieu of fractional shares. The initial conversion price is $69.32 per share, subject to adjustment upon the occurrence of certain events, but will not be adjusted for accumulated and unpaid dividends. Upon a conversion of shares of the Series B preferred stock, we may, at our option, satisfy the entire conversion obligation in cash or through a combination of cash and common stock. Series B preferred stock outstanding at December 31, 2009 would convert into 11.4 million shares of our common stock which are reserved. There were no conversions as of December 31, 2009.

Generally, the shares of Series B preferred stock are convertible, at the option of the holder, if during any calendar quarter beginning with the second calendar quarter after the issuance date of the Series B preferred stock, if the closing sale price of our common stock for each of 20 or more trading days within any period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the conversion price per share of common stock in effect on the last trading day of the immediately preceding calendar quarter. In addition, the shares of Series B preferred stock are convertible, at the option of the holder, in certain other circumstances, including those relating to the trading price of the Series B preferred stock and upon the occurrence of certain fundamental changes or major corporate transactions. We also have the right, under certain circumstances relating to the trading price of our common stock, to force conversion of the Series B preferred stock. Depending on the timing of any such forced conversion, we may have to make certain payments relating to foregone dividends, which payments we can

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(15) Stockholders Equity (Continued)

make, at our option, in the form of cash, shares of our common stock, or a combination of cash and shares of our common stock.

Each share of Series B preferred stock accrues dividends at $12.00, or 3%, per annum, payable quarterly on January 15, April 15, July 15 and October 15 of each year, commencing following the first full calendar quarter after the issuance date. Dividends on the Series B preferred stock are cumulative from the date of issuance. For the year ended December 31, 2009, Series B preferred stock dividends amounted to $23.0 million, which reduced earnings available to common stockholders for purposes of calculating net income per common share in 2009 (Note 14). Accrued dividends are payable only if declared by our board of directors and, upon conversion by the Series B preferred stockholder, holders will not receive any cash payment representing accumulated dividends. If our board of directors declares a dividend payable, we have the right to pay the dividends in cash, shares of common stock, additional shares of Series B preferred stock or a similar convertible preferred stock or any combination thereof.

The holders of Series B preferred stock have liquidation preferences over the holders of our common stock and other classes of stock, if any, outstanding at the time of liquidation. Upon liquidation, the holders of outstanding Series B preferred stock would receive an amount equal to $400.00 per share of Series B preferred stock, plus any accumulated and unpaid dividends. As of December 31, 2009, the liquidation preference of the outstanding Series B preferred stock was $793.7 million. The holders of the Series B preferred stock have no voting rights, except with respect to matters affecting the Series B preferred stock (including the creation of a senior preferred stock).

We evaluated the terms and provisions of our Series B preferred stock to determine if it qualified for derivative accounting treatment. Based on our evaluation, these securities do not qualify for derivative accounting.

(c) Stock Options and Awards

In 2001, we adopted the 2001 Stock Option and Incentive Plan (as amended, the 2001 Plan) which currently allows for the issuance of up to 12.1 million shares of common stock and other awards. The 2001 Plan is administered by the Compensation Committee of the Board of Directors in order to select the individuals eligible to receive awards, determine or modify the terms and conditions of the awards granted, accelerate the vesting schedule of any award and generally administer and interpret the 2001 Plan. The key terms of the 2001 Plan permit the granting of incentive or nonqualified stock options with a term of up to ten years and the granting of stock appreciation rights, restricted stock awards, unrestricted stock awards, performance share awards and dividend equivalent rights. The 2001 Plan also provides for option grants to non-employee directors and automatic vesting acceleration of all options and stock appreciation rights upon a change in control, as defined by the 2001 Plan. As of December 31, 2009 and 2008, there were 1.1 million and 0.8 million, respectively, shares available for future grant under the 2001 plan.

The following summarizes all stock option activity during the year ended December 31 (in thousands, except exercise price):

	2009		2008		2007	
		Weighted		**Weighted**		**Weighted**

	Options		Average Exercise Price	Options		Average Exercise Price	Options		Average Exercise Price
Outstanding at January 1	10,155	$	32.65	7,836	$	31.42	3,775	$	21.11
Exchanged	315	$	29.78	1,820	$	30.52	3,606	$	23.48
Granted	1,243	$	36.28	1,787	$	34.13	2,807	$	49.53
Exercised	(1,319)	$	17.83	(836)	$	16.84	(2,204)	$	23.70

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(15) Stockholders Equity (Continued)

	2009		2008		2007	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Canceled/expired/forfeited	(556)	$ 39.21	(452)	$ 37.75	(148)	$ 33.33
Outstanding at December 31	9,838	$ 34.72	10,155	$ 32.65	7,836	$ 31.42
Exercisable at December 31	5,902	$ 31.71	5,866	$ 27.08	3,887	$ 20.03

The aggregate intrinsic value of the options outstanding at December 31, 2009 was $95.4 million. The aggregate intrinsic value of the options exercisable at December 31, 2009 was $72.8 million. The aggregate intrinsic value of stock options exercised during 2009, 2008 and 2007 was $25.7 million, $18.2 million, and $62.5 million, respectively. Based on equity awards outstanding as of December 31, 2009, there was $53.3 million of unrecognized compensation costs related to unvested share-based compensation arrangements that are expected to vest. Such costs are expected to be recognized over a weighted average period of 1.5 years.

(d) Warrants

The following is a summary of all warrant activity during the three years ended December 31:

	Number of Shares (in thousands)	Exercise Price	Weighted Average Exercise Price
Warrants outstanding and exercisable, December 31, 2006	306	$ 3.81-$24.00	$ 16.42
Exchanged	285	$ 14.52-$29.78	$ 28.98
Exercised	(122)	$ 13.54-$29.78	$ 19.31
Warrants outstanding and exercisable, December 31, 2007	469	$ 3.81-$29.78	$ 20.80
Exercised	(12)	$ 13.54-$20.06	$ 19.64
Warrants outstanding and exercisable, December 31, 2008	457	$ 3.81-$29.78	$ 20.83

Issued	4	$ 50.00	$	50.00
Warrants outstanding and exercisable, December 31, 2009	461	$ 3.81-$50.00	$	21.09

The following represents additional information related to warrants outstanding and exercisable at December 31, 2009:

	Outstanding and Exercisable			
Exercise Price	**Number of Shares (in thousands)**	**Weighted Average Remaining Contract Life (in years)**	**Weighted Average Exercise Price**	
$3.81-$3.93	4	0.48	$	3.87
$4.48-$4.57	1	0.54	$	4.54
$5.44-$5.57	4	0.58	$	5.53
$7.37-$7.55	2	0.66	$	7.48
$13.54-$18.12	219	1.97-2.72	$	14.41
$20.06-$29.78	152	5.78	$	29.66
$24.00	75	5.25	$	24.00

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(15) Stockholders Equity (Continued)

Exercise Price	Outstanding and Exercisable Number of Shares (in thousands)	Weighted Average Remaining Contract Life (in years)	Weighted Average Exercise Price
$50.00	4	6.50	$ 50.00
	461	4.05	$ 21.09

The majority of the warrants included in the table above were issued in connection with debt and equity financings, or amendments thereto, of which warrants to purchase an aggregate of 0.04 million shares of our common stock were issued to officers and directors of our company or entities controlled by these officers and directors and were outstanding at December 31, 2009. All outstanding warrants have been classified in equity.

(e) Employee Stock Purchase Plan

In 2001, we adopted the 2001 Employee Stock Purchase Plan under which eligible employees are allowed to purchase shares of our common stock at a discount through periodic payroll deductions. Purchases may occur at the end of every six month offering period at a purchase price equal to 85% of the market value of our common stock at either the beginning or end of the offering period, whichever is lower. We may issue up to 2.0 million shares of common stock under this plan. At December 31, 2009, 0.9 million shares had been issued under this plan.

(16) Stock-based Compensation

Our results of operations for the year ended December 31, 2009, 2008 and 2007 reflected compensation expense for new stock options granted since January 1, 2006, and vested under our stock incentive plan and employee stock purchase plan and the unvested portion of previous stock option grants which vested during the years ended December 31, 2009, 2008 and 2007. Stock-based compensation expense in the amount of $28.2 million ($22.6 million, net of tax), $26.4 million ($20.7 million, net of tax) and $57.5 million ($52.7 million, net of tax), was reflected in our consolidated statements of operations for the year ended December 31, 2009, 2008 and 2007, respectively, as follows (in thousands):

	2009	2008	2007
Cost of net revenue	$ 2,011	$ 1,504	$ 608
Research and development	5,246	4,627	2,215

Sales and marketing	4,236	4,264	1,699
General and administrative	16,727	16,010	52,958
	$ 28,220	$ 26,405	$ 57,480

Included in the amount above for general and administrative expense for the year ended December 31, 2009, is $1.0 million related to our assumption of certain Concateno options. The expense relates to the acceleration of certain unvested Concateno employee options. See Note 4(a) regarding our acquisition of Concateno.

Included in the amount above for general and administrative expense for the year ended December 31, 2007, is $45.2 million related to our assumption of Biosite options. The expense relates to the acceleration of unvested Biosite employee options. See Note 4(c) regarding our acquisition of Biosite.

For the year ended December 31, 2009, 2008 and 2007, the presentation of our cash flows reports the excess tax benefits from the exercise of stock options as financing cash flows. For the year ended

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(16) Stock-based Compensation (Continued)

December 31, 2009, 2008 and 2007, excess tax benefits generated from option exercises amounted to $9.3 million, $17.5 million and $0.9 million, respectively.

The following assumptions were used to estimate the fair value of options granted during the year ended December 31, 2009, 2008 and 2007, using a Black-Scholes option-pricing model:

	2009	2008	2007
Risk-free interest rate	1.92-2.58%	2.39-3.14%	3.15-5.00%
Expected dividend yield			
Expected life	5.20 years	5.19 years	6.25 years
Expected volatility	43-45%	37-43%	44%

The weighted average fair value under a Black-Scholes option pricing model of options granted to employees during 2009, 2008 and 2007 was $15.11, $10.66 and $24.05 per share, respectively. All options granted during these periods were granted at fair market value on the date of grant.

For the year ended December 31, 2009, we recorded compensation expense of $2.7 million related to our Employee Stock Purchase Plan. The fair value of the option component of the Employee Stock Purchase Plan shares were estimated at the date of grant using a Black-Scholes pricing model and assumed an expected volatility of 72% and 43%, a risk-free interest rate of 0.28% and 0.33% and an expected life of 181 days and 184 days, for each of the two respective offering periods. The charge is included in general and administrative in the table above.

For the year ended December 31, 2008, we recorded compensation expense of $2.8 million related to our Employee Stock Purchase Plan. The fair value of the option component of the Employee Stock Purchase Plan shares was estimated at the date of grant using a Black-Scholes pricing model and assumed an expected volatility of 43% and 54%, a risk-free interest rate of 3.32% and 2.13%, and an expected life of 181 days and 184 days, for each of the two respective offering periods. The charge is included in general and administrative in the table above.

For the year ended December 31, 2007, we recorded compensation expense of $1.5 million related to our Employee Stock Purchase Plan. The fair value of the option component of the Employee Stock Purchase Plan shares was estimated at the date of grant using a Black-Scholes pricing model and assumed an expected volatility of 33% and 69%, a risk-free interest rate of 4.94% and 4.17% and an expected life of 181 days and 184 days, for each of the two respective offering periods. The charge is included in general and administrative in the table above.

(17) Other Comprehensive Income

In general, comprehensive income combines net income and other changes in equity during the year from non-owner sources. Accumulated other comprehensive income is recorded as a component of stockholders equity. The following is a summary of the components of and changes in accumulated other comprehensive income as of December 31, 2009 and in each of the three years then ended (in thousands):

	Cumulative Translation Adjustment (Note 2(b))	Pension Liability Adjustment (Note 9(b))	Other(1)	Accumulated Other Comprehensive Income (loss)(2)
Balance at December 31, 2006	17,875	(3,738)	44	14,181
Period change	12,758	341	(6,011)	7,088
Balance at December 31, 2007	30,633	(3,397)	(5,967)	21,269

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(17) Other Comprehensive Income (Continued)

	Cumulative Translation Adjustment (Note 2(b))	Pension Liability Adjustment (Note 9(b))	Other(1)	Accumulated Other Comprehensive Income (loss)(2)
Period change	(32,889)	(562)	(16,663)	(50,114)
Balance at December 31, 2008	(2,256)	(3,959)	(22,630)	(28,845)
Period change	15,171	(1,137)	12,357	26,391
Balance at December 31, 2009	$ 12,915	$ (5,096)	$ (10,273)	$ (2,454)

(1) Other represents (realization of) unrealized gains on available-for-sale securities and interest rate swap.

(2) All of the components of accumulated other comprehensive income relate to our foreign subsidiaries, except item (1) above. No adjustments for income taxes were recorded against other comprehensive income of our foreign subsidiaries, as we intend to permanently invest in our foreign subsidiaries in the foreseeable future.

(18) Income Taxes

Our income tax provision (benefit) in 2009, 2008 and 2007 mainly represents those recorded by us and certain of our U.S. subsidiaries and by our foreign subsidiaries Unipath, Inverness Medical France, Inverness Medical Italia, Orgenics, Inverness Medical Japan, Inverness Medical UK, BBI, Inverness Medical Beijing, ABON and Inverness Medical Switzerland. Income (loss) before provision (benefit) for income taxes consists of the following (in thousands):

Continuing Operations:

	2009	2008	2007
United States	$ (14,032)	$ (52,805)	$ (236,487)
Foreign	54,280	14,558	(11,868)
	$ 40,248	$ (38,247)	$ (248,355)

Discontinued Operations:

	2009	2008	2007
United States	$ 2,069	$ (107)	$ 180
Foreign	33	(983)	(528)
	$ 2,102	$ (1,090)	$ (348)

Our primary temporary differences that give rise to the deferred tax asset and liability are NOL carryforwards, nondeductible reserves, accruals and differences in bases of the tangible and intangible assets, and the gain on the joint venture transaction. The income tax effects of these temporary differences are as follows (in thousands):

	2009	2008
NOL and capital loss carryforwards	$ 96,355	$ 102,484
Tax credit carryforwards	26,316	15,884
Nondeductible reserves	16,151	9,488
Nondeductible accruals	39,505	67,142

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(18) Income Taxes (Continued)

	2009	2008
Difference between book and tax bases of tangible assets	13,662	3,133
Difference between book and tax bases of intangible assets	38,956	35,986
Gain on joint venture	33,709	33,264
All other	30,476	1,162
Gross deferred tax asset	295,130	268,543
Less: Valuation allowance	(37,524)	(12,740)
Total deferred tax assets	257,606	255,803
Deferred tax liabilities:		
Difference between book and tax bases of tangible assets	32,248	10,824
Difference between book and tax bases of intangible assets	571,611	588,766
Other	8,317	366
Total deferred tax liability	612,176	599,956
Net deferred tax liability	$ 354,570	$ 344,153
Reported as:		
Deferred tax assets, current portion	$ 66,492	$ 104,311
Deferred tax assets, long-term	20,987	14,323
Deferred tax liabilities, current portion		
Deferred tax liabilities, long-term	(442,049)	(462,787)
Net deferred tax liability	$ (354,570)	$ (344,153)

As of December 31, 2009, we had approximately $184.5 million of domestic NOL and domestic capital loss carryforwards and $33.5 million of foreign NOL and foreign capital loss carryforwards, which either expire on various dates through 2028 or can be carried forward indefinitely. As of December 31, 2009, we had approximately $26.3 million of domestic R&D, foreign tax and AMT credits which either expire on various dates through 2029 or can be carried forward indefinitely. These loss carryforwards and tax credits are available to reduce future federal, state and foreign taxable income, if any. These loss carryforwards and tax credits are subject to review and possible adjustment by the appropriate tax authorities. The domestic NOL carryforwards include approximately $143.3 million of pre-acquisition losses at Matria, QAS, Paradigm Health, Biosite, Cholestech, Redwood, HemoSense, IMN, Ischemia and Ostex. Our domestic NOLs and tax credits are subject to the Internal Revenue Service, or IRS, Code Section 382 limitation. Section 382 imposes an annual limitation on the use of these losses to an amount equal to the value of the company at the time of the ownership change multiplied by the long-term tax exempt rate. The acquired

Section 382 limited amount for 2010 is approximately $79.6 million. In addition, the total NOL available for use in 2010 is approximately $128.4 million.

We have recorded a valuation allowance of $37.5 million as of December 31, 2009 due to uncertainties related to the future benefits, if any, from our deferred tax assets related primarily to our foreign businesses and certain U.S. net operating losses and tax credits. This is an increase of $24.8 million from the valuation allowance of $12.7 million as of December 31, 2008. The increase is primarily related to domestic state NOLs and domestic state credits. The valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(18) Income Taxes (Continued)

establish an additional valuation allowance or reduce our current valuation allowance which could materially impact our tax provision.

The accounting for the tax benefits of acquired deductible temporary differences and NOL carryforwards, which are not recognized at the acquisition date because a valuation allowance is established and which are recognized subsequent to the acquisitions, will be applied to reduce our income tax expense as required under a new accounting standard for business combinations, adopted January 1, 2009. As of December 31, 2009, $8.9 million of deferred tax assets with a valuation allowance pertains to acquired companies.

Our China-based manufacturing subsidiaries qualify for a reduced income tax rate in 2009 and in 2008. The general income tax rate is 25%. The income tax rate for ABON is 12.5% for 2009 and 2010, and for IM Shanghai it is 10% for 2009, 11% for 2010 and 24% for 2011. The reduced rates for 2009, 2010 and 2011 are grandfathered in the China Tax Reform Act. A tax rate of 15% or 25% will apply to 2011 and future years. The tax rate of 15% applies to companies with high technology status. ABON has been approved for high technology status. The reduced tax rate produced a tax expense of approximately $1.6 million in 2009. In the absence of the reduced tax rate for 2009 a tax rate of 25% would apply which would have resulted in a tax expense of approximately $3.4 million in 2009. The earnings per common share effect of the reduced tax rate is $0.02 for 2009. The reduced tax rate produced a tax expense of approximately $1.0 million in 2008. In the absence of the reduced tax rate for 2008 a tax rate of 25% would apply which would have resulted in a tax expense of approximately $2.0 million in 2008. The earnings per common share effect of the reduced tax rate was $0.01 for 2008.

The estimated amount of undistributed earnings of our foreign subsidiaries is $179.2 million at December 31, 2009. No amount for U.S. income tax has been provided on undistributed earnings of our foreign subsidiaries because we consider such earnings to be indefinitely reinvested. In the event of distribution of those earnings in the form of dividends or otherwise, we would be subject to both U.S. income taxes, subject to an adjustment, if any, for foreign tax credits, and foreign withholding taxes payable to certain foreign tax authorities. Determination of the amount of U.S. income tax liability that would be incurred is not practicable because of the complexities associated with this hypothetical calculation, however, unrecognized foreign tax credit carryforwards may be available to reduce some portion of the U.S. tax liability, if any.

The following table presents the components of our (benefit) provision for income taxes (in thousands) for continuing operations:

	2009	2008	2007
Current:			
Federal	$ (1,409)	$ 7,433	$ 2,434
State	2,435	7,250	2,073
Foreign	23,725	10,387	22,406
	24,751	25,070	26,913

Deferred:			
Federal	8,170	(5,859)	(5,024)
State	(3,017)	(4,233)	(1,530)
Foreign	(14,277)	(31,622)	(21,408)
	(9,124)	(41,714)	(27,962)
Total tax (benefit) provision	$ 15,627	$ (16,644)	$ (1,049)

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(18) Income Taxes (Continued)

The following table presents the components of our (benefit) provision for income taxes (in thousands) for discontinued operations:

	2009	2008	2007
Current:			
Federal	$	$	$
State			
Foreign			
Deferred:			
Federal	738	(38)	63
State	(269)	(4)	7
Foreign	(301)	0	0
	168	(42)	70
Total tax (benefit) provision	$ 168	$ (42)	$ 70

The following table presents a reconciliation from the U.S. statutory tax rate to our effective tax rate:

	2009	2008	2007
Statutory rate	35%	35%	35%
Effect of Biosite in-process R&D write-off			(24)
Effect of Diamics in-process R&D write-off			(1)
Effect of Biosite compensation charges and other non-cash compensation			(6)
Effect of losses and expenses not benefited			
Stock-based compensation	10	(10)	
Rate differential on foreign earnings	(8)	3	
Research and development benefit	(4)	6	1
State income taxes, net of federal benefit		2	(1)
Acquisition costs	6		
Deferred tax on indefinite-lived assets			
Accrual to return reconciliation			
Other permanent items	3	(4)	1
Change in valuation allowance	(3)	11	(4)

Effective tax rate	39%	43%	1%

During the year ended December 31, 2009, we decreased the liability for income taxes associated with uncertain tax positions by $6.2 million to a total of $4.9 million at December 31, 2009. The primary reasons for the decrease are due to our settlement of the allowable interest expense in a United Kingdom tax audit, which decreased the liability for income taxes associated with uncertain tax positions by $1.7 million, and the reclass of the acquired Biosite income tax reserve on R&D credits to valuation allowance, since these credits have not been used in a return, which decreased the liability for income taxes associated with uncertain tax positions by $3.5 million. In addition, we classified $4.9 million of income tax liabilities as non-current income tax liabilities because a payment of cash is not anticipated within one year of the balance sheet date.

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(18) Income Taxes (Continued)

These non-current income tax liabilities are recorded in other long-term liabilities in our consolidated balance sheet at December 31, 2009. We anticipate an increase every quarter to the total amount of unrecognized tax benefits. We do not anticipate a significant increase or decrease of the total amount of unrecognized tax benefits within twelve months of the reporting date.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

	Amount
Balances as of January 1, 2007	$ 2,248
Additions for tax positions taken during prior years	53
Additions for tax positions in current year acquisitions	6,229
Additions for tax positions taken during current year	235
Expiration of statutes of limitations or closure of tax audits	
Balances as of December 31, 2007	8,765
Additions for tax positions taken during prior years	63
Additions for tax positions in current and prior year acquisitions	2,296
Additions for tax positions taken during current year	143
Expiration of statutes of limitations or closure of tax audits	(134)
Balances as of December 31, 2008	11,133
Reductions for tax positions taken during prior years	(728)
Reductions for tax positions in current and prior year acquisitions	(3,535)
Additions for tax positions taken during current year	360
Expiration of statutes of limitations or closure of tax audits	(2,325)
Balance as of December 31, 2009	$ 4,905

Interest and penalties related to income tax liabilities are included in income tax expense. The interest and penalties recorded in 2009 amounted to $0.9 million. The balance of accrued interest and penalties recorded on the consolidated balance sheet at December 31, 2009 was $0.5 million.

With limited exceptions, we are subject to U.S. federal, state and local or non-U.S. income tax audits by tax authorities for 2004 through 2008. We are currently under income tax examination by the IRS and a number of state and foreign tax authorities and anticipate these audits will be completed by the end of 2010. We cannot currently estimate the impact of these audits due to the uncertainties associated with tax examinations.

(19) Financial Information by Segment

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Our chief operating decision-making group is composed of the chief executive officer and members of senior management. Our reportable operating segments are Professional Diagnostics, Health Management, Consumer Diagnostics and Corporate and Other. Our operating results include license and royalty revenue which are allocated to Professional Diagnostics and Consumer Diagnostics on the basis of the original license or royalty agreement.

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(19) Financial Information by Segment (Continued)

On January 15, 2010, we completed the sale of our vitamins and nutritional supplements business (Note 24). The sale included all of our private label and branded nutritionals businesses and represents the complete divestiture of our entire vitamins and nutritional supplements business segment. The results of the vitamins and nutritional supplements business, which represents our entire vitamins and nutritional supplements business segment, are included in income (loss) from discontinued operations, net of tax, for all periods presented. The net assets and net liabilities associated with the vitamins and nutritional supplements business have been reclassified to assets held for sale and liabilities related to assets held for sale within current assets and current liabilities, respectively, and have been presented in Corporate and Other as of December 31, 2009 and 2008.

Operating loss of $250.7 million for the year ended December 31, 2007 in our Corporate and Other segment includes the write-off of $173.8 million of IPR&D incurred in connection with our acquisitions of Biosite and Diamics and $45.2 million of stock-based compensation related to employee stock options assumed in the acquisition of Biosite.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. We evaluate performance of our operating segments based on revenue and operating income (loss). Revenues are attributed to geographic areas based on where the customer is located. Segment information for 2009, 2008 and 2007 are as follows (in thousands):

2009	Professional Diagnostics	Health Management	Consumer Diagnostics	Corporate and Other	Total
Net revenue to external customers	$ 1,263,511	$ 521,947	$ 137,183	$	$ 1,922,641
Operating income (loss)	$ 235,412	$ (6,829)	$ (2,008)	$ (80,525)	$ 146,050
Depreciation and amortization	$ 187,907	$ 116,800	$ 6,637	$ 1,091	$ 312,435
Restructuring charge	$ 14,536	$ 2,291	$ 563	$	$ 17,390
Stock-based compensation	$	$	$	$ 28,220	$ 28,220
Assets	$ 4,261,716	$ 2,031,260	$ 219,647	$ 431,369	$ 6,943,992
Expenditures for property, plant and equipment	$ 45,588	$ 50,871	$ 3,536	$ 611	$ 100,606

2008	Professional Diagnostics	Health Management	Consumer Diagnostics	Corporate and Other	Total
Net revenue to external customers	$ 1,051,301	$ 392,399	$ 138,853	$	$ 1,582,553
Operating income (loss)	$ 97,994	$ 11,241	$ 9,505	$ (54,048)	$ 64,692
Depreciation and amortization	$ 171,980	$ 85,990	$ 6,821	$ 863	$ 265,654
Restructuring charge	$ 36,196	$	$ 238	$	$ 36,434
Stock-based compensation	$	$	$	$ 26,405	$ 26,405

Assets	$ 3,687,685	$ 1,850,236	$ 223,383	$ 194,056	$ 5,955,360
Expenditures for property, plant and equipment	$ 46,859	$ 7,935	$ 1,917	$ 8,988	$ 65,699

2007	**Professional Diagnostics**	**Health Management**	**Consumer Diagnostics**	**Corporate and Other**	**Total**
Net revenue to external customers	$ 582,250	$ 23,374	$ 161,092	$	$ 766,716
Operating income (loss)	$ 61,067	$ (498)	$ 15,332	$ (250,693)	$ (174,792)

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(19) Financial Information by Segment (Continued)

2007	Professional Diagnostics	Health Management	Consumer Diagnostics	Corporate and Other	Total
Depreciation and amortization	$ 82,797	$ 4,487	$ 8,892	$ 1,806	$ 97,982
Restructuring charge	$ 3,965	$	$ 2,737	$	$ 6,702
Stock-based compensation	$	$	$	$ 57,480	$ 57,480
Expenditures for property, plant and equipment	$ 30,581	$ 2,257	$ 1,434	$ 1,559	$ 35,831

	2009	2008	2007
Revenue by Geographic Area:			
United States	$ 1,329,747	$ 1,121,477	$ 463,390
Europe	316,623	285,696	194,739
Other	276,271	175,380	108,587
	$ 1,922,641	$ 1,582,553	$ 766,716

	2009	2008
Long-lived Tangible Assets by Geographic Area:		
United States	$ 238,475	$ 212,445
United Kingdom	15,807	12,113
China	22,112	19,491
Other	47,994	30,429
	$ 324,388	$ 274,478

(20) Related Party Transactions

In November 2008, the Zwanziger Family Trust, a trust established for the benefit of the children of Ron Zwanziger, our Chairman, Chief Executive Officer and President, and the trustee of which is Mr. Zwanziger s sister, purchased certain of our securities from third parties in market transactions. The purchase consisted of approximately $1.0 million of each of the following securities: our common stock, our Series B Preferred Stock, our Convertible Notes, interests in our First Lien Credit Agreement and interests in our Second Lien Credit Agreement. To the extent we make principal and interest payments under the Convertible Notes and the credit facilities in accordance with their terms, the Zwanziger Family Trust, as a holder of Convertible Notes and as a lender under the credit facilities, will receive its proportionate share. In connection with its purchases of interests under our First Lien Credit Agreement and Second Lien Credit Agreement, the Trust agreed that, whenever the consent or vote of the lenders is required under the credit facilities, it will vote the outstanding principal amount of its holdings in the same proportion as the votes cast by the other lenders under these credit facilities.

In May 2007, we completed our 50/50 joint venture with P&G, or SPD, for the development, manufacturing, marketing and sale of existing and to-be-developed consumer diagnostic products, outside the cardiology, diabetes and oral care fields. Upon completion of the arrangement to form the joint venture, we ceased to consolidate the operating results of our consumer diagnostic products business related to the joint venture and instead account for our 50% interest in the results of the joint venture under the equity method of accounting.

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(20) Related Party Transactions (Continued)

At December 31, 2009, we had a net payable to the joint venture of $0.5 million as compared to a net receivable of $12.0 million from the joint venture as of December 31, 2008. Additionally, customer receivables associated with revenue earned after the joint venture was completed have been classified as other receivables within prepaid and other current assets on our accompanying consolidated balance sheets in the amount of $12.3 million and $16.2 million as of December 31, 2009 and 2008, respectively. In connection with the joint venture arrangement, the joint venture bears the collection risk associated with these receivables. Sales to the joint venture under our manufacturing agreement totaled $103.1 million, $103.0 million and $65.0 million during the year ended December 31, 2009, 2008 and 2007, respectively. Additionally, services revenue generated pursuant to the long-term services agreement with the joint venture totaled $1.8 million, $2.4 million and $2.5 million during the year ended December 31, 2009, 2008 and 2007, respectively. Sales under our manufacturing agreement and long-term services agreement are included in net product sales and services revenue, respectively, in our accompanying consolidated statements of operations.

Under the terms of our product supply agreement, SPD purchases products from our manufacturing facilities in the U.K. and China. SPD in turn sells a portion of those tests back to us for final assembly and packaging. Once packaged, the tests are sold to P&G for distribution to third-party customers in North America. As a result of these related transactions, we have recorded $14.5 million and $15.6 million of trade receivables which are included in accounts receivable on our accompanying consolidated balance sheets as of December 31, 2009 and 2008, respectively, and $23.2 million and $18.9 million of trade accounts payable which are included in accounts payable on our accompanying consolidated balance sheets as of December 31, 2009 and 2008, respectively. During 2009, we received $10.0 million in cash from SPD as a return of capital.

In July 2009, we sold one of our consumer-related Australian subsidiaries to SPD for approximately $0.2 million in connection with the original terms of the joint venture agreement to transition the distribution responsibilities of certain consumer diagnostic products to SPD. The sale of the subsidiary was completed at net book value resulting in no gain or loss on the transaction.

On March 22, 2007, we entered into a convertible loan agreement with BBI whereby we loaned them £7.5 million ($14.7 million as of the transaction date). Under the terms of the agreement, the loan amount would simultaneously convert into shares of BBI common stock per the prescribed conversion formula defined in the loan agreement, in the event the BBI consummated a specific target acquisition on or before September 30, 2007. On May 15, 2007, BBI consummated a specific target acquisition and the loan converted into 5,208,333 shares of BBI s common stock which is included in investments in unconsolidated entities on our accompanying consolidated balance sheet at December 31, 2007. In February 2008, we acquired the remaining outstanding shares of BBI common stock in connection with our acquisition of BBI (Note 4).

(21) Valuation and Qualifying Accounts

We have established reserves against accounts receivable for doubtful accounts, product returns, discounts and other allowances. The activity in the table below includes all accounts receivable reserves. Provisions for doubtful accounts are recorded as a component of general and administrative expenses. Provisions for returns, discounts and other allowances are charged against net product sales. The following table sets forth activities in our accounts receivable reserve accounts (in thousands):

	Balance at Beginning of Period	Provision	Amounts Charged Against Reserves	Balance at End of Period
Year ended December 31, 2007	$ 5,324	$ 18,841	$ (17,318)	$ 6,847
Year ended December 31, 2008	$ 6,847	$ 9,328	$ (6,214)	$ 9,961
Year ended December 31, 2009	$ 9,961	$ 9,314	$ (6,813)	$ 12,462

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(21) Valuation and Qualifying Accounts (Continued)

We have established reserves against obsolete and slow-moving inventories. The activity in the table below includes all inventory reserves. Provisions for obsolete and slow-moving inventories are recorded as a component of cost of net product sales. The following table sets forth activities in our inventory reserve accounts (in thousands):

	Balance at Beginning of Period	Provision	Amounts Charged Against Reserves	Balance at End of Period
Year ended December 31, 2007	$ 6,879	$ 6,371	$ (6,613)	$ 6,637
Year ended December 31, 2008	$ 6,637	$ 8,023	$ (5,042)	$ 9,618
Year ended December 31, 2009	$ 9,618	$ 6,954	$ (3,940)	$ 12,632

(22) Restructuring Activities

The following table sets forth the aggregate charges associated with restructuring plans recorded in operating income (loss) for the years ended December 31, (in thousands):

	2009	2008	2007
Cost of net revenue	$ 9,451	$ 17,894	$ 2,007
Research and development	1,076	7,230	2,518
Sales and marketing	1,856	4,219	772
General and administrative	5,009	7,091	1,405
	$ 17,392	$ 36,434	$ 6,702

(a) 2009 Restructuring Plans

In 2009, management developed plans to reduce costs and improve efficiencies in our health management reporting unit and business segment, as well as reduce costs and consolidate operating activities among several of our professional diagnostics related German subsidiaries. As a result of these plans, we recorded $3.2 million in restructuring charges during the year ended December 31, 2009, which included $2.5 million in severance costs, $0.5 million in contract cancellation costs, $0.1 million in present value accretion on facility exit costs and $0.1 million in fixed asset impairment costs. Of the $3.1 million included in operating income, $2.3 million and $0.8 million was included in our health management and professional diagnostics business segments, respectively. We also recorded $0.1 million in present value accretion related to Matria s facility exit costs to interest expense. As of December 31, 2009, $1.3 million in exit costs remain unpaid. We expect to incur an additional $0.5 million in facility exit costs under these plans during 2010, which will be included primarily in our professional diagnostics business segment.

(b) 2008 Restructuring Plans

In May 2008, we decided to close our facility located in Bedford, England and initiated steps to cease operations at this facility and transition the manufacturing operations principally to our manufacturing facilities in Shanghai and Hangzhou, China. Based upon this decision, during the year ended December 31, 2009, we recorded $5.5 million in restructuring charges, of which $2.8 million related primarily to severance-related costs, $1.3 million related to transition costs, $0.7 million related to fixed asset and inventory write-offs, $0.3 million related to a pension plan curtailment charge and $0.4 million related to the acceleration of facility restoration costs. During the year ended December 31, 2008, we recorded $12.6 million in restructuring charges, including $6.9 million related to the acceleration of facility restoration costs, $4.8 million of fixed asset impairments, $1.1 million in severance costs, $0.7 million in early termination lease

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(22) Restructuring Activities (Continued)

penalties and $0.9 million related to a pension plan curtailment gain associated with the Bedford employees being terminated. Of the $5.1 million included in operating income for the year ended December 31, 2009, $0.6 million and $4.5 million was charged to our consumer diagnostics and professional diagnostics business segments, respectively. The $5.7 million included in operating income for the year ended December 31, 2008 was charged to our professional diagnostics business segment. We also recorded $0.4 million and $6.9 million during the years ended December 31, 2009 and 2008, respectively, related to the accelerated present value accretion of our lease restoration costs due to the early termination of our facility lease, to interest expense.

In addition to the restructuring charges discussed above, $10.4 million and $14.5 million of charges associated with the Bedford facility closure was borne by SPD during the years ended December 31, 2009 and 2008, respectively. Included in the $10.4 million charges for the year ended December 31, 2009, was $7.3 million in severance and retention costs, $1.2 million of fixed asset and inventory impairments, $1.7 million in transition costs and $0.2 million in acceleration of facility exit costs. Included in the $14.5 million charges for the year ended December 31, 2008, was $8.4 million of fixed asset impairments, $3.2 million in early termination lease penalties, $2.6 million in severance and retention costs, $0.2 million facility exit costs and $0.1 million related to the acceleration of facility restoration costs. Of these restructuring charges, 50%, or $5.2 million and $7.2 million, has been included in equity earnings of unconsolidated entities, net of tax, in our consolidated statements of operations for the years ended December 31, 2009 and 2008, respectively. Of the total exit costs incurred jointly with SPD under this plan, including severance-related costs, lease penalties and restoration costs, $14.9 million remains unpaid as of December 31, 2009.

Since inception of the plan, we recorded $18.1 million in restructuring charges, including $7.3 million related to the acceleration of facility restoration costs, $5.5 million of fixed asset and inventory impairments, $3.9 million in severance costs, $0.7 million in early termination lease penalties, $1.3 million in transition costs and $0.6 million related to a pension plan curtailment gain associated with the Bedford employees being terminated. SPD has been allocated $24.9 million in restructuring charges since the inception of the plan, including $9.6 million of fixed asset and inventory impairments, $9.9 million in severance and retention costs, $2.9 million in early termination lease penalties, $2.2 million in facility exit costs and $0.3 million related to the acceleration of facility exit costs. We anticipate incurring additional costs of approximately $11.0 million related to the closure of this facility, including, but not limited to, severance and retention costs, rent obligations, transition costs and incremental interest expense associated with our lease obligations which will terminate the end of 2011. Of these additional anticipated costs, approximately $8.1 million will be borne by SPD and $2.9 million will be borne by us and included primarily in our professional diagnostics business segment. We expect the majority of these costs to be incurred by the end of the first half of 2010, which is our anticipated facility closure date.

In February 2008, we decided to cease research and development activities for one of the products in development at our Bedford, England facility, based upon comparison of the product under development with existing products acquired in the HemoSense acquisition. During the year ended December 31, 2008 and since inception of the plan, we recorded restructuring charges of $9.4 million, of which $6.8 million related to the impairment of fixed assets, $1.9 million related to the write-off of inventory, $0.5 million related to contractual obligations with suppliers and $0.2 million related to severance costs to involuntarily terminate employees working on the development of this product. The $9.4 million was included in our professional diagnostics business segment. Of the $0.7 million in contractual obligations and severance costs, all has been paid as of December 31, 2008. We do not expect to incur significant additional charges under this plan.

On March 18, 2008, we announced our plans to close our BioStar, Inc., or BioStar, facility in Louisville, Colorado and exit production of the BioStar OIA product line, along with our plans to close two of our newly-acquired facilities in the San Francisco, California area, relating to Cholestech and HemoSense and our newly-

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(22) Restructuring Activities (Continued)

acquired facility in Columbia, Maryland, relating to Panbio. The Cholestech operation, which was acquired in September 2007 and manufactures and distributes the Cholestech LDX system, a point-of-care monitor of blood cholesterol and related lipids used to test patients at risk of, or suffering from, heart disease and related conditions, has moved to our Biosite facility in San Diego, California as of the end of 2009. The HemoSense operation, which was acquired in November 2007 and manufactures and distributes the INRatio System, an easy-to-use, hand-held blood coagulation monitoring system for use by patients and healthcare professionals in the management of warfarin, a commonly-prescribed medication used to prevent blood clots, has moved to our Biosite facility. The operations of the Panbio distribution facility, which was acquired in January 2008, have transferred to our distribution center in Freehold, New Jersey.

BioStar manufacturing ceased at the end of June 2008, with BioStar OIA products available for purchase through the end of the first quarter of 2009. During the year ended December 31, 2009, we incurred $0.1 million in severance-related restructuring charges. During the year ended December 31, 2008, we incurred $10.6 million in restructuring charges related to this plan, which consisted of $5.1 million of intangible asset impairments, $1.4 million in severance-related costs, $0.6 million in fixed asset impairments, $1.2 million in facility exit costs and $2.3 million related to the write-off of inventory. Since the inception of the plan, we incurred $10.7 million in restructuring charges related to this plan, which consisted of $5.1 million of intangible assets impairment, $1.5 million in severance-related costs, $0.6 million in fixed asset impairments, $1.2 million in facility exit costs and $2.3 million related to the write-off of inventory. All costs related to this plan have been included in our professional diagnostics business segment. We do not expect to incur additional charges under this plan. As of December 31, 2009, all costs have been paid.

As a result of our plans to transition the businesses of Cholestech and HemoSense to Biosite and Panbio to Orlando, Florida and close these facilities, we incurred $8.2 million in restructuring charges during the year ended December 31, 2009, of which $2.4 million relates to fixed asset impairments, $1.7 million relates to severance and retention costs, $2.6 million in transition costs, $1.3 million in inventory write-offs and $0.2 million in present value accretion of facility lease costs. We incurred $3.8 million in restructuring charges during the year ended December 31, 2008, of which $2.7 million relates to severance and retention costs, $0.4 million in fixed asset impairments, $0.5 million in transition costs and $0.2 million in present value accretion of facility lease costs related to these plans. During the years ended December 31, 2009 and 2008, respectively, $8.0 million and $3.6 million in charges were included in operating income of our professional diagnostics business segment. We charged $0.2 million, related to the present value accretion of facility lease costs, to interest expense for each of the years ended December 31, 2009 and 2008. Since the inception of the plan, we incurred $12.0 million in restructuring charges, of which $4.4 million relates to severance and retention costs, $2.8 million in fixed asset impairments, $3.1 million in transition costs, $1.3 million in inventory write-offs and $0.4 million in present value accretion of facility lease costs related to these plans. Of the $7.9 million in severance and exit costs, $2.2 million remains unpaid as of December 31, 2009.

We anticipate incurring an additional $2.3 million in restructuring charges under our Cholestech plan, primarily related to severance, retention and outplacement benefits, along with other costs to transition the Cholestech operations to our Biosite facility and will be included in our professional diagnostics business segment. See Note 4(d) for further information and costs related to these plans.

In addition to transitioning the businesses of Cholestech and HemoSense to Biosite, we also made the decision to close our Innovacon facility in San Diego, California and move the operating activities to Biosite; the Innovacon business is the rapid diagnostics business that we acquired from ACON in March 2006. During the year ended December 31, 2008 and since inception, we recorded $0.6 million in restructuring charges, of which $0.5 million related to facility lease and exit costs and $0.1 million related to impairment of fixed assets. These charges are included in our professional diagnostics business segment. As of December 31, 2009,

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(22) Restructuring Activities (Continued)

all costs have been paid. We vacated the facility in August 2008 and do not anticipate incurring additional costs under this plan.

In April 2008, we initiated cost reduction efforts at our facilities in Stirling, Scotland, consolidating our business activities into one facility and with our Biosite operations. As a result of these efforts, we recorded $3.3 million in restructuring charges for the year ended December 31, 2008 and since inception of the plan, consisting of $2.0 million in fixed asset impairments, $1.0 million in severance costs and $0.3 million in facility exit costs. All costs related to this plan are included in our professional diagnostics business segment. Of the $1.3 million in severance and facility exit costs, $0.1 million remains unpaid at December 31, 2009. We do not expect to incur significant additional charges under this plan.

(c) 2007 Restructuring Plans

During 2007, we committed to several plans to restructure and integrate our worldwide sales, marketing, order management and fulfillment operations, as well as to evaluate certain research and development projects. The objectives of the plans were to eliminate redundant costs, improve customer responsiveness and improve operational efficiencies. As a result of these restructuring plans, we recorded $1.1 million in restructuring charges during the year ended December 31, 2009, primarily related to severance charges and outplacement services. We recorded $3.0 million in restructuring charges during the year ended December 31, 2008, including $2.6 million related to severance charges and outplacement services and $0.4 million related to facility exit costs. During the year ended December 31, 2007, we recorded $5.2 million in restructuring charges, including $1.2 million in severance costs and $4.0 million in fixed asset impairments. Since inception of the plan, we have recorded $9.3 million in restructuring charges, including $4.9 million related to severance charges and outplacement services, $0.4 million related to facility exit costs and $4.0 million related to impairment charges on fixed assets. The restructuring charges related to this plan are included in our professional diagnostics business segment. As of December 31, 2009, $0.4 million of severance-related charges and facility exit costs remain unpaid. We do not anticipate incurring significant additional charges related to this plan.

In addition, we recorded restructuring charges associated with the formation of our joint venture with P&G. In connection with the joint venture, we committed to a plan to close our sales offices in Germany and Sweden, as well as to evaluate redundancies in all departments of the consumer diagnostics business segment that are impacted by the formation of the joint venture. For the year ended December 31, 2008, we recorded $0.2 million in severance costs related to this plan. For the year ended December 31, 2007, we recorded $1.2 million in restructuring charges, of which $0.8 million relates to severance costs and $0.4 million relates to facility and other exit costs. We have recorded $1.4 million in restructuring charges since inception of the plan, of which $1.0 million relates to severance costs and $0.4 million relates to facility and other exit costs. Of the total $1.4 million in exit costs, $0.1 million remains unpaid as of December 31, 2009. We do not anticipate incurring additional charges related to this plan.

(d) 2006 Restructuring Plans

In May 2006, we committed to a plan to cease operations at our ABI manufacturing facility in San Diego, California and to write off certain excess manufacturing equipment at other impacted facilities. Additionally, in June 2006, we committed to a plan to reorganize the sales and marketing and customer service functions in certain of our U.S. professional diagnostics companies. For the year ended December 31, 2007, we recorded $0.4 million in net restructuring charges under these plans, which primarily relates to $0.6 million in facility exit costs, offset by a $0.2 million adjustment due to the finalization of fixed asset write-offs. Of the $0.4 million net charge, the $0.2 million adjustment was included in our consumer diagnostics segment, and $0.6 million was included in our professional diagnostics business segment.

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(22) Restructuring Activities (Continued)

Net restructuring charges since the commitment date consist of $6.7 million related to impairment of fixed assets and inventory, $2.7 million related to an impairment charge on an intangible asset, $2.5 million related to severance, and $0.6 million related to facility closing costs. Of the $12.5 million recorded in operating income, $8.2 million, $1.7 million and $2.6 million were included in our professional diagnostics, consumer diagnostics, and corporate and other business segments, respectively. As of December 31, 2009, substantially all costs have been paid.

(e) Restructuring Reserves

The following table summarizes our liabilities related to the restructuring activities associated with the plans discussed above (in thousands):

	Balance at Beginning of Period	Additions to the Reserve	Amounts Paid	Other(1)	Balance at End of Period
Year ended December 31, 2007	$ 1,565	$ 2,828	$ (3,264)	$ (6)	$ 1,123
Year ended December 31, 2008	$ 1,123	$ 25,642	$ (9,148)	$ (2,823)	$ 14,794
Year ended December 31, 2009	$ 14,794	$ 22,730	$ (18,021)	$ (597)	$ 18,906

(1) Represents foreign currency translation adjustment.

(23) Equity Investments

We account for the results from our equity investments under the equity method of accounting in accordance with ASC 323, *Investments Equity Methods and Joint Ventures,* based on the percentage of our ownership interest in the business. Our equity investments primarily include the following:

(i) Joint Venture with P&G

In May 2007, we completed our 50/50 joint venture with P&G for the development, manufacturing, marketing and sale of existing and to-be-developed consumer diagnostic products, outside the cardiology, diabetes and oral care fields. Upon completion of the arrangement to form the joint venture, we ceased to consolidate the operating results of our consumer diagnostics business related to the joint venture. For the years ended December 31, 2009 and 2007, we recorded earnings of $5.7 million, and $3.0 million, respectively, in equity earnings (losses) of unconsolidated entities, net of tax, in our accompanying consolidated statements of operations, which represented our 50% share of the joint venture s net income for the respective periods. For the year ended December 31, 2008, we recorded a loss of $0.9 million in equity earnings (losses) of unconsolidated entities, net of tax, in our accompanying consolidated statements of operations, which represented our 50% share of the joint venture s net loss for the respective period.

(ii) TechLab

In May 2006, we acquired 49% of TechLab, Inc., or TechLab, a privately-held developer, manufacturer and distributor of rapid non-invasive intestinal diagnostics tests in the areas of intestinal inflammation, antibiotic associated diarrhea and parasitology. For the years ended December 31, 2009, 2008 and 2007, we recorded earnings of $1.6 million, $1.5 million and $1.0 million, respectively, in equity earnings (losses) of unconsolidated entities, net of tax, in our accompanying consolidated statements of operations, which represented our minority share of TechLab s net income for the respective period.

(iii) Vedalab

In November 2006, we acquired our 40% investment in Vedalab S.A., or Vedalab, a French manufacturer and supplier of rapid diagnostic tests in the professional market. For the years ended December 31, 2009, 2008

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(23) Equity Investments (Continued)

and 2007, we recorded $0.4 million, $0.5 million and $0.3 million, respectively, in equity earnings (losses) of unconsolidated entities, net of tax, in our accompanying consolidated statements of operations, which represented our minority share of Vedalab s net income for the respective period.

Summarized financial information for the P&G joint venture and TechLab on a combined basis is as follows (in thousands):

Combined condensed results of operations:

	For The Years Ended December 31,		
	2009	2008	2007
Net revenue	$ 203,812	$ 204,912	$ 122,305
Gross profit	$ 134,351	$ 108,979	$ 62,011
Net income after taxes	$ 14,821	$ 1,209	$ 8,183

Combined condensed balance sheets:

	As of December 31,	
	2009	2008
Current assets	$ 87,880	$ 78,752
Non-current assets	26,881	25,269
Total assets	$ 114,761	$ 104,021
Current liabilities	$ 61,959	$ 59,655
Non-current liabilities	1,492	$ 847
Total liabilities	$ 63,451	$ 60,502

(24) Gain on Disposition

In September 2009, we disposed of our majority ownership interest in our Diamics operation, which was part of our professional diagnostics reporting unit and business segment. Since the date of acquisition, July 2007, under the principles of consolidation, we consolidated 100% of the operating results of the Diamics operations in our consolidated statement of operations. As a result of disposition, we recorded a gain of $3.4 million during the year ended December 31, 2009.

(25) Discontinued Operations

On January 15, 2010, we completed the sale of our vitamins and nutritional supplements business, for a purchase price of approximately $63.4 million in cash, subject to customary post-closing adjustments. The sale included all of our private label and branded nutritionals businesses and represents the complete divestiture of our entire vitamins and nutritional supplements business segment. We expect to recognize a pre-tax gain of approximately $19.8 million in the first quarter of 2010, subject to the post-closing adjustments. The results of the vitamins and nutritional supplements business, which represents our entire vitamins and nutritional supplements business segment, are included in income (loss) from discontinued operations, net of tax, for all periods presented. The net assets and net liabilities associated with the vitamins and nutritional supplements business have been reclassified to assets held for sale and liabilities related to assets held for sale as of December 31, 2009 and 2008.

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(25) Discontinued Operations (continued)

The following assets and liabilities have been segregated and classified as assets held for sale and liabilities related to assets held for sale, as appropriate, in the consolidated balance sheets as of December 31, 2009 and 2008. The amounts presented below were adjusted to exclude cash, intercompany receivables and payables and certain assets and liabilities between the business held for sale and the Company, which were excluded from the transaction (amounts in thousands).

	December 31,	
	2009	**2008**
Assets		
Accounts receivable, net of allowances of $2,919 and $2,874 at December 31, 2009 and 2008, respectively	$ 21,100	$ 19,239
Inventories, net	21,500	25,546
Prepaid expenses and other current assets	160	201
Property, plant and equipment, net	8,368	10,005
Goodwill	200	200
Other intangible assets with indefinite lives	135	75
Other intangible assets, net	2,581	2,794
Other non-current assets	104	106
Total assets held for sale	$ 54,148	$ 58,166
Liabilities		
Accounts payable	$ 8,299	$ 16,122
Accrued expenses and other current liabilities	3,230	3,042
Other long-term liabilities	29	29
Total liabilities related to assets held for sale	$ 11,558	$ 19,193

The following summarized financial information related to the vitamins and nutritionals supplements businesses have been segregated from continuing operations and reported as discontinued operations (amounts in thousands).

	2009	**2008**	**2007**
Net revenue	99,517	88,873	72,824
Income (loss) from discontinued operations before income taxes	2,102	(1,090)	(348)
Provision (benefit) for income taxes	168	(42)	70
Net income (loss) from discontinued operations	1,934	(1,048)	(418)

(26) Supplemental Cash Flow Information

Cash Paid for Interest and Income Taxes:

During fiscal 2009, 2008 and 2007, we made cash payments for interest totaling $87.3 million, $88.6 million and $65.0 million, respectively.

During fiscal 2009, 2008 and 2007, total net cash paid (received) for income taxes was $49.2 million, $5.5 million and $(31.5) million, respectively.

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(26) Supplemental Cash Flow Information (Continued)

Non-cash Investing Activities:

During fiscal 2009, 2008 and 2007, we issued shares of our common stock and exchanged employee stock options in connection with several of our acquisitions (dollars in thousands):

		Common Stock Issued			Employee Stock Options/ Restricted Stock Awards Exchanged		
Company Acquired	**Date of Acquisition**	**Number of Shares**		**Fair Value of Shares**	**Number of Shares**		**Fair Value of Shares**
Mologic Limited	October 6, 2009	128,513	$	5,115		$	
Concateno plc	August 11, 2009	2,091,800	$	70,218	315,227	$	2,881
GeneCare Medical Genetics Center, Inc.	July 1, 2009	4,000	$	57		$	
ACON Second Territory Business	April 30, 2009	1,210,842	$	42,427		$	
Matria Healthcare, Inc.	May 9, 2008		$		1,490,655	$	17,334
BBI Holdings Plc	February 12, 2008	251,085	$	14,397	355,238	$	3,639
Matritech, Inc.	December 12, 2007	616,671	$	35,592		$	
Biosystems S.A.	December 11, 2007	33,373	$	1,948		$	
Alere Medical, Inc.	November 16, 2007	2,762,182	$	161,086	380,894	$	20,614
HemoSense, Inc.	November 6, 2007	3,691,369	$	226,415	380,732	$	16,695
Cholestech Corporation	September 12, 2007	6,840,361	$	329,774	733,077	$	20,331
Spectral Diagnostics Private Limited(1)	July 27, 2007	93,558	$	3,737		$	
Biosite Incorporated(2)	June 29, 2007		$		753,863	$	28,453
Quality Assured Services, Inc.	June 7, 2007	273,642	$	12,834		$	
Instant Technologies, Inc.	December 28, 2007	463,399	$	21,530		$	

(1) The acquisition of Spectral Diagnostics Private Limited also included its affiliate Source Diagnostics (India) Private Limited.

(2) The value includes $2.6 million associated with net operating loss carryforwards related to stock options issued to Biosite Incorporated employees.

Non-cash Financing Activities:

During 2009 and 2008, we recorded non-cash charges to accumulated other comprehensive income of $11.4 million and $11.6 million, respectively, representing the change in fair market value of our interest rate swap agreement.

(27) Subsequent Event

We evaluated subsequent events occurring after the balance sheet date and up to the time of filing with the SEC our Annual Report on Form 10-K for the year ended December 31, 2009, and concluded there was no event of which management was aware that occurred after the balance sheet date that would require any adjustment to the accompanying consolidated financial statements.

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(27) Subsequent Event (continued)

In February 2010, we acquired Kroll Laboratory Specialists, Inc. located in Gretna, Louisiana, which provides forensic quality substance abuse testing products and services across the United States. The purchase price is approximately $110.0 million in cash and is subject to a customary working capital adjustment.

In February 2010, we acquired a 61.92% ownership interest in Standard Diagnostics, Inc. via a tender offer for approximately $165.0 million. Standard Diagnostics, a publicly-traded Korean company, specializes in the medical diagnostics industry. Its main product lines relate to diagnostic reagents and devices for hepatitis, infectious diseases, tumor markers, fertility, drugs of abuse, urine strips and protein strips.

(28) Guarantor Financial Information

Our 9% senior subordinated notes due 2016, as well as our 7.875% senior notes due 2016, are guaranteed by certain of our consolidated subsidiaries, or the Guarantor Subsidiaries. The guarantees are full and unconditional and joint and several. The following supplemental financial information sets forth, on a consolidating basis, audited balance sheets as of December 31, 2009, and 2008, and the related audited statements of operations and cash flows for each of the three years in the period ended December 31, 2009 for the Company, the Guarantor Subsidiaries and our other subsidiaries, or the Non-Guarantor Subsidiaries. The supplemental financial information reflects the investments of the Company and the Guarantor Subsidiaries in the Guarantor and Non-Guarantor Subsidiaries using the equity method of accounting.

We have extensive transactions and relationships between various members of the consolidated group. These transactions and relationships include intercompany pricing agreements, intellectual property royalty agreements and general and administrative and research and development cost-sharing agreements. Because of these relationships, it is possible that the terms of these transactions are not the same as those that would result from transactions among wholly unrelated parties.

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(28) Guarantor Financial Information (Continued)

CONSOLIDATING STATEMENT OF OPERATIONS
For the Year Ended December 31, 2009
(in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net product sales	$	$ 877,135	$ 597,266	$ (109,322)	$ 1,365,079
Services revenue		521,509	6,978		528,487
License and royalty revenue		6,441	26,470	(3,836)	29,075
Net revenue		1,405,085	630,714	(113,158)	1,922,641
Cost of net product sales	4,069	429,336	333,842	(147,744)	619,503
Cost of services revenue	700	236,016	3,310		240,026
Cost of license and royalty revenue		(16)	12,742	(3,836)	8,890
Cost of net revenue	4,769	665,336	349,894	(151,580)	868,419
Gross profit	(4,769)	739,749	280,820	38,422	1,054,222
Operating expenses:					
Research and development	27,503	59,137	26,208		112,848
Sales and marketing	8,239	310,986	122,421		441,646
General and administrative	68,909	213,346	74,778		357,033
Gain on dispositions	(2,682)		(673)		(3,355)
Operating (loss) income	(106,738)	156,280	58,086	38,422	146,050
Interest expense, including amortization and write-off of deferred financing costs	(102,627)	(50,261)	(11,505)	57,595	(106,798)
Other income (expense), net	55,476	(4,584)	7,699	(57,595)	996
(Loss) income from continuing operations before (benefit) provision for income taxes	(153,889)	101,435	54,280	38,422	40,248
(Benefit) provision for income taxes	(31,695)	36,144	10,987	191	15,627
(Loss) income from continuing operations before equity	(122,194)	65,291	43,293	38,231	24,621

earnings (loss) of unconsolidated entities, net of tax					
Equity in earnings of subsidiaries, net of tax	155,725			(155,725)	
Equity earnings of unconsolidated entities, net of tax	1,747		5,972	(93)	7,626
Income (loss) from continuing operations	35,278	65,291	49,265	(117,587)	32,247
Income (loss) from discontinued operations, net of tax	(1,097)	2,689	334	8	1,934
Net income (loss)	34,181	67,980	49,599	(117,579)	34,181
Less: Net income attributable to non-controlling interests			465		465
Net income (loss) attributable to Inverness Medical Innovations, Inc. and subsidiaries	34,181	67,980	49,134	(117,579)	33,716
Preferred stock dividends	(22,972)				(22,972)
Net income (loss) available to common stockholders	$ 11,209	$ 67,980	$ 49,134	$ (117,579)	$ 10,744

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(28) Guarantor Financial Information (Continued)

CONSOLIDATING STATEMENT OF OPERATIONS
For the Year Ended December 31, 2008
(in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net product sales	$	$ 782,085	$ 485,091	$ (115,911)	$ 1,151,265
Services revenue		402,758	2,704		405,462
License and royalty revenue		15,536	10,290		25,826
Net revenue		1,200,379	498,085	(115,911)	1,582,553
Cost of net product sales	2,541	368,178	285,862	(113,264)	543,317
Cost of services revenue	77	176,421	600		177,098
Cost of license and royalty revenue		3,759	6,438	(1,577)	8,620
Cost of net revenue	2,618	548,358	292,900	(114,841)	729,035
Gross profit	(2,618)	652,021	205,185	(1,070)	853,518
Operating expenses:					
Research and development	27,709	50,631	33,488		111,828
Sales and marketing	37,183	254,261	90,363	132	381,939
General and administrative	59,784	167,509	67,766		295,059
Operating (loss) income	(127,294)	179,620	13,568	(1,202)	64,692
Interest expense, including amortization and write-off of deferred financing costs	(90,328)	(72,435)	(15,986)	77,617	(101,132)
Other income (expense), net	78,604	(16,281)	13,442	(77,572)	(1,807)
(Loss) income from continuing operations before (benefit) provision for income taxes	(139,018)	90,904	11,024	(1,157)	(38,247)
(Benefit) provision for income taxes	(63,152)	46,709	(201)		(16,644)
(Loss) income from continuing operations before equity earnings (loss) of	(75,866)	44,195	11,225	(1,157)	(21,603)

unconsolidated entities, net of tax					
Equity in earnings of subsidiaries, net of tax	52,743			(52,743)	
Equity earnings of unconsolidated entities, net of tax	1,522	(23)	(379)	(70)	1,050
Income (loss) from continuing operations	(21,601)	44,172	10,846	(53,970)	(20,553)
Income (loss) from discontinued operations, net of tax		(112)	(891)	(45)	(1,048)
Net income (loss)	(21,601)	44,060	9,955	(54,015)	(21,601)
Less: Net income attributable to non-controlling interests			167		167
Net income (loss) attributable to Inverness Medical Innovations, Inc. and subsidiaries	(21,601)	44,060	9,788	(54,015)	(21,768)
Preferred stock dividends	(13,989)				(13,989)
Net income (loss) available to common stockholders	$ (35,590)	$ 44,060	$ 9,788	$ (54,015)	$ (35,757)

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(28) Guarantor Financial Information (Continued)

CONSOLIDATING STATEMENT OF OPERATIONS
For the Year Ended December 31, 2007
(in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net product sales	$ 10,494	$ 482,171	$ 318,590	$ (83,164)	$ 728,091
Services revenue		14,164	2,482		16,646
License and royalty revenue		14,047	17,962	(10,030)	21,979
Net revenue	10,494	510,382	339,034	(93,194)	766,716
Cost of net product sales	27,208	230,491	201,164	(93,318)	365,545
Cost of services revenue		5,261			5,261
Cost of license and royalty revenue		1,380	7,769		9,149
Cost of net revenue	27,208	237,132	208,933	(93,318)	379,955
Gross profit	(16,714)	273,250	130,101	124	386,761
Operating expenses:					
Research and development	6,614	27,910	35,023		69,547
Purchase of in-process research and development	169,000		4,825		173,825
Sales and marketing	25,395	93,430	44,203		163,028
General and administrative	78,499	40,298	36,356		155,153
Operating (loss) income	(296,222)	111,612	9,694	124	(174,792)
Interest expense, including amortization and write-off of deferred financing costs	(77,201)	(49,892)	(21,099)	65,205	(82,987)
Other income (expense), net	71,183	3,979	(573)	(65,165)	9,424
(Loss) income from continuing operations before (benefit) provision for income taxes	(302,240)	65,699	(11,978)	164	(248,355)
(Benefit) provision for income taxes	(12,949)	9,631	2,269		(1,049)
	(289,291)	56,068	(14,247)	164	(247,306)

(Loss) income from continuing operations before equity earnings (loss) of unconsolidated entities, net of tax					
Equity in earnings of subsidiaries, net of tax	44,870			(44,870)	
Equity earnings of unconsolidated entities, net of tax	1,069		3,348	(45)	4,372
Income (loss) from continuing operations	(243,352)	56,068	(10,899)	(44,751)	(242,934)
Income (loss) from discontinued operations, net of tax		195	(528)	(85)	(418)
Net income (loss)	(243,352)	56,263	(11,427)	(44,836)	(243,352)
Less: Net income attributable to non-controlling interests	(243)		476	1,168	1,401
Net income (loss) attributable to Inverness Medical Innovations, Inc. and subsidiaries	$ (243,109)	$ 56,263	$ (11,903)	$ (46,004)	$ (244,753)

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(28) Guarantor Financial Information (Continued)

CONSOLIDATING BALANCE SHEET
December 31, 2009
(in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$ 294,137	$ 82,602	$ 116,034	$	$ 492,773
Restricted cash		1,576	848		2,424
Marketable securities		947			947
Accounts receivable, net of allowances		197,442	169,291	(12,280)	354,453
Inventories, net		122,062	106,544	(7,067)	221,539
Deferred tax assets	36,907	27,947	1,638		66,492
Income tax receivable		1,107			1,107
Receivable from joint venture, net			1,637	(1,637)	
Prepaid expenses and other current assets	8,160	15,990	36,645	12,280	73,075
Assets held for sale		53,545	603		54,148
Intercompany receivables	861,596	329,771	12,500	(1,203,867)	
Total current assets	1,200,800	832,989	445,740	(1,212,571)	1,266,958
Property, plant and equipment, net	1,646	241,732	86,034	(5,024)	324,388
Goodwill	2,187,411	595,612	685,674	(5,339)	3,463,358
Other intangible assets with indefinite lives	700	21,120	21,824		43,644
Core technology and patents, net	23,242	319,047	79,430		421,719
Other intangible assets, net	79,609	866,104	318,995		1,264,708
Deferred financing costs, net, and other non-current assets	43,368	5,640	23,754		72,762
Investments in unconsolidated entities	1,525,927	367	38,443	(1,500,772)	63,965
Marketable securities	1,503				1,503
Deferred tax assets			20,987		20,987
Intercompany notes receivable	1,296,373	83,510		(1,379,883)	
Total assets	$ 6,360,579	$ 2,966,121	$ 1,720,881	$ (4,103,589)	$ 6,943,992

LIABILITIES AND STOCKHOLDERS EQUITY					
Current liabilities:					
Current portion of long-term debt	$ 9,750	$ 2,392	$ 6,828	$	$ 18,970
Current portion of capital lease obligations		499	400		899
Accounts payable	2,580	63,204	60,538		126,322
Accrued expenses and other current liabilities	(128,488)	278,203	130,017		279,732
Payable to joint venture, net		(1,242)	3,412	(1,637)	533
Liabilities related to assets held for sale		11,556	2		11,558
Intercompany payables	306,869	275,316	621,683	(1,203,868)	
Total current liabilities	190,711	629,928	822,880	(1,205,505)	438,014
Long-term liabilities:					
Long-term debt, net of current portion	2,125,006		3,509		2,128,515
Capital lease obligations, net of current portion		698	242		940
Deferred tax liabilities	(35,999)	423,303	54,745		442,049
Deferred gain on joint venture	16,309		272,458		288,767
Other long-term liabilities	68,464	16,603	31,751		116,818
Intercompany notes payable	503,064	746,456	127,822	(1,377,342)	
Total long-term liabilities	2,676,844	1,187,060	490,527	(1,377,342)	2,977,089
Equity	3,493,024	1,149,133	407,474	(1,520,742)	3,528,889
Total liabilities and equity	$ 6,360,579	$ 2,966,121	$ 1,720,881	$ (4,103,589)	$ 6,943,992

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(28) Guarantor Financial Information (Continued)

CONSOLIDATING BALANCE SHEET
December 31, 2008
(in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$ 1,743	$ 69,798	$ 69,783	$	$ 141,324
Restricted cash		1,160	1,588		2,748
Marketable securities		1,347	416		1,763
Accounts receivable, net of allowances		180,324	97,281	(16,236)	261,369
Inventories, net		106,539	71,311	(4,265)	173,585
Deferred tax assets	80,926	22,334	1,051		104,311
Income tax receivable		2,792	3,614		6,406
Receivable from joint venture, net			15,227	(3,209)	12,018
Prepaid expenses and other current assets	10,887	20,007	26,903	16,236	74,033
Assets held for sale		57,794	372		58,166
Intercompany receivables	455,746	248,177	75,686	(779,609)	
Total current assets	549,302	710,272	363,232	(787,083)	835,723
Property, plant and equipment, net	2,395	211,340	62,422	(1,679)	274,478
Goodwill	2,020,528	599,317	427,251	(1,213)	3,045,883
Other intangible assets with indefinite lives		21,120	21,789		42,909
Core technology and patents, net	43,700	331,892	83,715		459,307
Other intangible assets, net	277,389	769,663	119,484		1,166,536
Deferred financing costs, net, and other non-current assets	36,876	6,766	3,136		46,778
Investments in unconsolidated entities	872,848	751	57,681	(862,448)	68,832
Marketable securities	591				591
Deferred tax assets	(1,742)		16,065		14,323
Intercompany notes receivable	1,633,174	(50,660)	2,454	(1,584,968)	
Total assets	$ 5,435,061	$ 2,600,461	$ 1,157,229	$ (3,237,391)	$ 5,955,360

LIABILITIES AND STOCKHOLDERS EQUITY					
Current liabilities:					
Current portion of long-term debt	$ 9,750	$ 2,870	$ 6,438	$	$ 19,058
Current portion of capital lease obligations		265	186		451
Accounts payable	4,173	56,510	35,899		96,582
Accrued expenses and other current liabilities	(120,656)	260,356	93,599	(3,209)	230,090
Liabilities related to assets held for sale		19,170	23		19,193
Intercompany payables	155,443	198,939	425,229	(779,611)	
Total current liabilities	48,710	538,110	561,374	(782,820)	365,374
Long-term liabilities:					
Long-term debt, net of current portion	1,493,000	2,302	5,255		1,500,557
Capital lease obligations, net of current portion		66	402		468
Deferred tax liabilities	(36,399)	459,501	39,685		462,787
Deferred gain on joint venture	16,310		270,720		287,030
Other long-term liabilities	26,830	17,835	14,772		59,437
Intercompany notes payable	607,772	853,470	119,594	(1,580,836)	
Total long-term liabilities	2,107,513	1,333,174	450,428	(1,580,836)	2,310,279
Equity	3,278,838	729,177	145,427	(873,735)	3,279,707
Total liabilities and equity	$ 5,435,061	$ 2,600,461	$ 1,157,229	$ (3,237,391)	$ 5,955,360

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(28) Guarantor Financial Information (Continued)

CONSOLIDATING STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2009
(in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash Flows from Operating Activities:					
Net income (loss)	$ 34,181	$ 67,980	$ 49,599	$ (117,579)	$ 34,181
(Loss) Income from discontinued operations, net of tax	(1,097)	2,689	334	8	1,934
Income (loss) from continuing operations	35,278	65,291	49,265	(117,587)	32,247
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:					
Equity in earnings of subsidiaries, net of tax	(155,725)			155,725	
Interest expense related to amortization of original issue discounts and write-off of deferred financing costs	9,711		712		10,423
Depreciation and amortization	8,286	244,691	59,714	(256)	312,435
Non-cash stock-based compensation expense	28,220				28,220
Impairment of inventory			1,467		1,467
Impairment of long-lived assets		5,620	1,363		6,983
(Gain) loss on sale of fixed assets	4	1,150	51		1,205
Equity earnings of unconsolidated entities, net of tax	(1,747)		(5,972)	93	(7,626)
Deferred and other non-cash income taxes	(1,983)	(32,979)	44,934	(19,096)	(9,124)
Other non-cash items	292	1,835	1,137		3,264
Changes in assets and liabilities, net of acquisitions:					
Accounts receivable, net		(4,785)	(43,950)	12,280	(36,455)
Inventories, net		30,679	(12,666)	(34,438)	(16,425)
Prepaid expenses and other current assets	(4,741)	2,686	11,136		9,081

Accounts payable	(1,979)	844	3,252		2,117
Accrued expenses and other current liabilities	20,534	12,828	(78,807)		(45,445)
Other non-current liabilities	1,651	4,529	(8,889)		(2,709)
Intercompany payable (receivable)	(66,894)	(252,414)	319,308		
Net cash (used in) provided by continuing operations	(129,093)	79,975	342,055	(3,279)	289,658
Net cash (used in) provided by discontinued operations	(1,096)	(1,097)	59	7	(2,127)
Net cash provided by (used in) operating activities	(130,189)	78,878	342,114	(3,272)	287,531
Cash Flows from Investing Activities:					
Purchases of property, plant and equipment	(610)	(70,674)	(32,594)	3,272	(100,606)
Proceeds from sale of property, plant and equipment		454	349		803
Cash paid for acquisitions and transactional costs, net of cash acquired	(203,460)	15,455	(280,522)		(468,527)
Cash received from (paid for) investments in minority interests and marketable securities	980		11,580		12,560
Increase in other assets	(20,000)	(7,313)	(407)		(27,720)
Net cash (used in) provided by continuing operations	(223,090)	(62,078)	(301,594)	3,272	(583,490)
Net cash used in discontinued operations		(237)			(237)
Net cash (used in) provided by investing activities	(223,090)	(62,315)	(301,594)	3,272	(583,727)
Cash Flows from Financing Activities:					
Proceeds from borrowing under long-term debt	631,176	312	(311)		631,177
(Increase) decrease in restricted cash	4	(417)	831		418
Cash paid for financing costs	(17,756)				(17,756)
Proceeds from issuance of common stock, net of issuance costs	30,015				30,015
Repayments on long-term debt	(10,325)	(3,054)	2,324		(11,055)
Net proceeds (repayments) from revolving lines-of-credit			(7,251)		(7,251)
Tax benefit on exercised stock options	9,269				9,269
Principal payments of capital lease obligations		(584)	(214)		(798)

Other	(153)				(153)
Net cash provided by (used in) continuing operations	642,230	(3,743)	(4,621)		633,866
Net cash used in discontinued operations		(12)			(12)
Net cash provided by (used in) financing activities	642,230	(3,755)	(4,621)		633,854
Foreign exchange effect on cash and cash equivalents	3,443		10,348		13,791
Net (decrease) increase in cash and cash equivalents	292,394	12,808	46,247		351,449
Cash and cash equivalents, beginning of period	1,743	69,794	69,787		141,324
Cash and cash equivalents, end of period	$ 294,137	$ 82,602	$ 116,034	$	$ 492,773

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(28) Guarantor Financial Information (Continued)

CONSOLIDATING STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2008
(in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash Flows from Operating Activities:					
Net (loss) income	$ (21,601)	$ 44,060	$ 9,955	$ (54,015)	$ (21,601)
Income (loss) from discontinued operations, net of tax		(112)	(891)	(45)	(1,048)
(Loss) Income from continuing operations	(21,601)	44,172	10,846	(53,970)	(20,553)
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:					
Equity in earnings of subsidiaries, net of tax	(52,743)			52,743	
Interest expense related to amortization of deferred financing costs	5,930				5,930
Depreciation and amortization	48,754	173,963	42,937		265,654
Non-cash stock-based compensation expense	26,405				26,405
Impairment of inventory		2,300	1,893		4,193
Impairment of long-lived assets		6,117	13,914		20,031
(Gain) loss on sale of fixed assets	(1)	255	523		777
Equity earnings of unconsolidated entities, net of tax	(1,522)	23	379	70	(1,050)
Deferred and other non-cash income taxes	(957)	(25,455)	(15,302)		(41,714)
Other non-cash items	2,714	1,680	(16)		4,378
Changes in assets and liabilities, net of acquisitions:					
Accounts receivable, net		(28,321)	(12,225)	1,000	(39,546)
Inventories, net		(24,331)	(12,677)	(4,937)	(41,945)
Prepaid expenses and other current assets	616	11,645	(24,758)	5,111	(7,386)
Accounts payable	(84)	9,669	(2,392)		7,193
	(154,680)	111,764	15,476	(1,651)	(29,091)

Accrued expenses and other current liabilities					
Other non-current liabilities	(1,104)	139	4,365		3,400
Intercompany payable (receivable)	224,208	(282,185)	54,036	3,941	
Net cash provided by continuing operations	75,935	1,435	76,999	2,307	156,676
Net cash used in discontinued operations		(7,348)	(1,439)	(45)	(8,832)
Net cash provided by (used in) operating activities	75,935	(5,913)	75,560	2,262	147,844
Cash Flows from Investing Activities:					
Purchases of property, plant and equipment	(1,009)	(42,149)	(24,220)	1,679	(65,699)
Proceeds from sale of property, plant and equipment		96	974		1,070
Cash paid for acquisitions and transactional costs, net of cash acquired	(470,393)	10,185	(189,691)		(649,899)
Cash received from (paid for) investments in minority interests and marketable securities	1,372	(1,113)	11,874		12,133
Increase in other assets	(1,000)	(4,932)	(4,568)		(10,500)
Net cash (used in) provided by continuing operations	(471,030)	(37,913)	(205,631)	1,679	(712,895)
Net cash used in discontinued operations		(437)			(437)
Net cash (used in) provided by investing activities	(471,030)	(38,350)	(205,631)	1,679	(713,332)
Cash Flows from Financing Activities:					
(Increase) decrease in restricted cash		(1,145)	140,349		139,204
Issuance costs associated with preferred stock	(350)				(350)
Cash paid for financing costs	(1,401)				(1,401)
Other	(56)				(56)
Proceeds from issuance of common stock, net of issuance costs	20,675				20,675
Net repayments on long-term debt	(9,750)	(4,037)			(13,787)
Net proceeds (repayments) from revolving lines-of-credit	142,000	(2,320)	(2,438)		137,242
Tax benefit on exercised stock options	17,542				17,542
		(362)	(596)		(958)

Principal payments of capital lease obligations					
Net cash provided by (used in) continuing operations	168,660	(7,864)	137,315		298,111
Net cash used in discontinued operations		(342)			(342)
Net cash provided by (used in) financing activities	168,660	(8,206)	137,315		297,769
Foreign exchange effect on cash and cash equivalents		(866)	(882)	(3,941)	(5,689)
Net (decrease) increase in cash and cash equivalents	(226,435)	(53,335)	6,362		(273,408)
Cash and cash equivalents, beginning of period	228,178	123,133	63,421		414,732
Cash and cash equivalents, end of period	$ 1,743	$ 69,798	$ 69,783	$	$ 141,324

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INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(28) Guarantor Financial Information (Continued)

CONSOLIDATING STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2007
(in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash Flows from Operating Activities:					
Net (loss) income	$ (243,352)	$ 56,263	$ (11,427)	$ (44,836)	$ (243,352)
Income (loss) from discontinued operations, net of tax		195	(528)	(85)	(418)
Income (loss) from continuing operations	(243,352)	56,068	(10,899)	(44,751)	(242,934)
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:					
Equity in earnings of subsidiaries, net of tax	(44,870)			44,870	
Interest expense related to amortization and write-off of deferred financing costs	6,884	2,122	1,957		10,963
Depreciation and amortization	43,718	28,174	26,090		97,982
Non-cash stock-based compensation expense	52,210				52,210
Charge for in-process research and development	173,825				173,825
Impairment of long-lived assets		108	3,764		3,872
Loss (gain) on sale of fixed assets		115	(56)		59
Equity earnings of unconsolidated entities, net of tax	(1,069)		(3,348)	45	(4,372)
Interest in minority investments					
Deferred and other non-cash income taxes	(36,291)	3,050	3,694	1,539	(28,008)
Other non-cash items	197				197
Changes in assets and liabilities, net of acquisitions:					

Accounts receivable, net		25,796	(9,095)	29,451	46,152
Inventories, net		6,639	(9,230)	(79)	(2,670)
Prepaid expenses and other current assets	(2,669)	45,319	141	(27,595)	15,196
Accounts payable	2,198	(8,704)	4,350		(2,156)
Accrued expenses and other current liabilities	16,714	(34,766)	(12,389)	(3,395)	(33,836)
Other non-current liabilities	407	220	1,156		1,783
Intercompany payable (receivable)	1,385,254	(1,385,378)	5,391	(5,267)	
Net cash provided by (used in) continuing operations	1,353,156	(1,261,237)	1,526	(5,182)	88,263
Net cash provided by (used in) discontinued operations		18	559	(85)	492
Net cash provided by (used in) operating activities	1,353,156	(1,261,219)	2,085	(5,267)	88,755
Cash Flows from Investing Activities:					
Purchases of property, plant and equipment	(1,538)	(12,278)	(22,015)		(35,831)
Proceeds from sale of property, plant and equipment		171	93		264
Cash paid for acquisitions and transactional costs, net of cash acquired	(2,147,492)	179,154	(67,778)		(2,036,116)
Cash received, net of cash paid, from formation of joint venture	30,881		293,289		324,170
Cash (paid for) received from investments in minority interests and marketable securities	(1,471)	1,550	(10,256)		(10,177)
(Increase) decrease in other assets	(26,362)	3,316	(5,327)		(28,373)
Net cash (used in) provided by continuing operations	(2,145,982)	171,913	188,006		(1,786,063)
Net cash used in discontinued operations		(467)			(467)
Net cash (used in) provided by investing activities	(2,145,982)	171,446	188,006		(1,786,530)
Cash Flows from Financing Activities:					
Increase in restricted cash		(15)	(141,854)		(141,869)
Cash paid for financing costs	(40,347)	(164)	(164)		(40,675)
Proceeds from issuance of common stock, net of issuance costs	1,122,852				1,122,852

Net repayments on long-term debt			(22,326)		(22,326)
Net proceeds (repayments) from revolving lines-of-credit	1,166,601	(47,703)	(4,727)		1,114,171
Tax benefit on exercised stock options	867				867
Principal payments of capital lease obligations		(12)	(82)		(94)
Intercompany notes (receivable) payable	(1,245,000)	1,245,000			
Net cash provided by (used in) continuing operations	1,004,973	1,197,106	(169,153)		2,032,926
Net cash used in discontinued operations		(542)			(542)
Net cash provided by (used in) financing activities	1,004,973	1,196,564	(169,153)		2,032,384
Foreign exchange effect on cash and cash equivalents		761	2,991	5,267	9,019
Net increase in cash and cash equivalents	212,147	107,552	23,929		343,628
Cash and cash equivalents, beginning of period	16,031	20,074	34,999		71,104
Cash and cash equivalents, end of period	$ 228,178	$ 127,626	$ 58,928	$	$ 414,732