INVERNESS MEDICAL INNOVATIONS INC
Form 424B2
May 22, 2002

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Filed pursuant to Rule 424(b)(2)
Registration No. 333-87180

PROSPECTUS SUPPLEMENT
(To Prospectus dated May 8, 2002)

1,600,000 Shares

Common Stock

Inverness Medical Innovations, Inc. is selling 1,600,000 shares of its common stock.

Our common stock is traded on the American Stock Exchange under the symbol "IMA." On May 21, 2002, the closing price of our common stock as quoted on the American Stock Exchange was $24.98 per share.

Our business involves significant risks. These risks are described under the caption "Supplemental Risk Factors" on page S-8 of this prospectus supplement and under the caption "Risk Factors" on page 2 of the accompanying prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	$23.000	$36,800,000
Underwriting discounts and commissions	$ 1.265	$ 2,024,000
Proceeds, before expenses, to Inverness Medical Innovations	$21.735	$34,776,000

The underwriter may also purchase up to an additional 240,000 shares of common stock at the public offering price, less the underwriting discounts and commissions, to cover over-allotments.

The underwriter expects to deliver the shares in New York, New York on May 28, 2002.

SG COWEN

May 21, 2002

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You should read this prospectus supplement, along with the accompanying prospectus, carefully before you invest. Both documents contain important information you should consider when making your investment decision. This prospectus supplement contains information about the common stock offered in this offering. This prospectus supplement may add, update or change information contained in the accompanying prospectus.

You should rely only on information contained in this prospectus supplement, the accompanying prospectus and the documents we incorporate by reference in this prospectus supplement and the accompanying prospectus. We have not authorized anyone to provide you with information that is different. We are offering to sell and seeking offers to buy shares of common stock only in jurisdictions where such offers and sales are permitted. The information contained in this prospectus supplement and the accompanying prospectus is accurate only as of their respective dates, regardless of the time of delivery of this prospectus supplement and the accompanying prospectus or of any sale of our common stock.

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PROSPECTUS SUPPLEMENT SUMMARY

This summary only highlights the more detailed information appearing elsewhere in this prospectus supplement. As this is a summary, it may not contain all information that is important to you. You should read this entire prospectus supplement and the accompanying prospectus, including the documents incorporated by reference, carefully before you decide to invest in our common stock.

This prospectus supplement and the accompanying prospectus contain forward-looking statements. You should read the explanation of the qualifications and limitations on such forward-looking statements on page 16 of the accompanying prospectus. You should also carefully consider the various risk factors beginning on page S-8 of this prospectus supplement and on page 2 of the accompanying prospectus, which risk factors may cause our actual results to differ materially from those indicated by such forward-looking statements. You should not place undue reliance on our forward-looking statements.

Unless the context otherwise requires, all references to "we," "us," "our company" or "the Company" in this prospectus supplement or the accompanying prospectus refer collectively to Inverness Medical Innovations, Inc. and its subsidiaries, and their respective predecessor entities for the applicable periods, considered as a single enterprise.

Inverness Medical Innovations, Inc.

We develop, manufacture and market consumer health care products, including self-test diagnostic products for the women's health market and vitamins and nutritional supplements. To a lesser extent, we develop, manufacture and market clinical diagnostic products for use by medical professionals. Our consumer self-test diagnostic products allow individuals to obtain accurate information regarding various medical conditions on a confidential, nonprescription basis, without the expense, inconvenience and delay associated with physician visits or laboratory testing. This information gives individuals greater control over their health and their lives, allowing them to make informed decisions and take action to protect their health, alone or in consultation with health care professionals.

Our existing self-test products are targeted at the women's health market, one of the largest existing markets for self-care diagnostics, and include home pregnancy detection tests and ovulation prediction tests. We also sell a wide variety of vitamins and nutritional supplements. Our clinical diagnostic products include test kits used by smaller laboratories, physicians' offices and other point-of-care sites for the detection of pregnancy and a wide variety of infectious diseases. We have more than 40 patents in the United States and more than 300 patents in various foreign countries.

Our History

On November 21, 2001, Johnson & Johnson acquired Inverness Medical Technology, Inc., or IMT, our former parent, in a merger transaction and, simultaneously, our company was split off from IMT as a separate publicly traded company. Immediately prior to the consummation of these transactions, IMT restructured its operations so that we would hold all of IMT's non-diabetes businesses (women's health, nutritional supplements and clinical diagnostics). At the closing of the transaction, all of the shares of our common stock held by IMT were split-off from IMT in a pro rata distribution to IMT's stockholders, and IMT (which then consisted of its diabetes business) merged with and became a wholly-owned subsidiary of Johnson & Johnson.

On December 20, 2001, we acquired Unipath Limited, a global leader in home pregnancy and ovulation testing and natural family planning, and its associated companies and assets from Unilever plc and certain affiliated entities. The Unipath acquisition provides us with leading brand name consumer diagnostic products that complement our existing value branded and private label home pregnancy detection and ovulation prediction products. In connection with the acquisition of the

Unipath business, we also acquired rights to certain antibody clones and other intellectual property rights.

On March 19, 2002, we acquired IVC Industries, Inc., a manufacturer and distributor of hundreds of different vitamin and nutritional supplement products sold under brand names and through private label arrangements with retailers. We are in the process of consolidating substantially all of our vitamin and nutritional supplement manufacturing at IVC and discontinuing most of our outsourced manufacturing arrangements.

Our Products

Consumer Products

Our consumer diagnostics business currently develops, manufactures and markets home pregnancy and ovulation prediction tests under our own brands and various private labels. Our ClearBlue brand of home pregnancy detection tests and our ClearPlan brand of ovulation prediction tests are global leaders in terms of both sales and technology, though ClearBlue has a smaller presence in the United States. Our Inverness Medical branded products are marketed to value-oriented consumers in the United States. In addition, we are a major domestic supplier of private label home pregnancy detection and ovulation prediction products. We also sell Persona, a contraceptive monitoring device sold overseas, primarily in Germany and the United Kingdom.

We also offer a wide variety of vitamins and nutritional supplements through retail drug store chains, mass merchandisers, food stores and warehouse clubs. We sell these products to value-oriented consumers under the Inverness Medical tradename, as well as under private labels. Through our recent acquisition of IVC, we are able to offer value-oriented customers IVC branded products. We also sell our Synergy Plus line of products primarily in health food stores.

Clinical Diagnostics

We develop, manufacture and sell qualitative, visually-interpreted rapid diagnostic tests for use by medical professionals under our Clearview label and through our Orgenics subsidiary. These products are used in point-of-care environments or small laboratories where a rapid response is desired or where the volume of testing is too low to warrant high volume methods. These products are used to confirm pregnancy as well as to detect several infectious diseases, including HIV, hepatitis, chlamydia, streptococcal group A and infectious mononucleosis.

Our Strategy

Our objective is to become the leading provider of innovative products in the areas of women's health and chronic disease self-management. The key elements of our strategy for achieving this goal are to:

Continue developing innovative diagnostic products. Prior to the split-off of our company as an independent public company in November 2001, our management team developed the first electrochemical blood glucose monitoring system and commercialized a system that measures blood glucose in the fastest time available with a small blood sample. In addition, our Unipath subsidiary, acquired in December 2001, was the first to develop a one-step home pregnancy test, a one-step ovulation test and an estrogen-based fertility monitor. We intend to leverage our collective experience in the rapid test diagnostic sector and our significant intellectual property portfolio to develop superior and innovative products in the areas of women's health and chronic disease self-management.

Expand the application of our technology to develop products in other focus areas. Currently, our diagnostic products are primarily used to detect pregnancy and predict ovulation. However, we believe there are additional market opportunities for us to pursue, both in women's health and in other areas.

For example, we believe that the aging population may provide opportunities in other areas of women's health, such as osteoporosis and menopause, creating demand for consumer diagnostic products in those areas. We plan to continue investing in research and development and intend to begin commercially launching new products in our targeted areas by 2004, with a goal of launching at least one significant new product each year.

Selectively acquire complementary product lines, companies and technologies. We plan to pursue selective acquisitions that could advance our technologies, establish new products and increase market penetration and breadth of our product offerings. We have significant experience in evaluating and completing acquisitions of businesses, technologies and intellectual property and in integrating acquired businesses and commercializing acquired technology. We have recently completed and are integrating two acquisitions, Unipath and IVC.

Maximize market penetration of our products. We will continue to leverage our global marketing and sales force to further penetrate our existing markets through our relationships with leading retailers, including Walgreens, CVS, RiteAid and Boots, as well as with drug wholesalers and mass merchandisers. We believe that our high level of service and ability to provide a wide range of high quality consumer products, which include premium and value-oriented brands and private label products, enhances our existing customer relationships and helps us develop new relationships.

Manufacture high quality products at low cost. One of the most significant contributors to our growth will be to leverage and enhance manufacturing operations for our products. We produce nearly all of our disposable consumer diagnostic products at our facilities in Bedford, England and Galway, Ireland, both of which are ISO and FDA registered establishments that employ modern production techniques to produce consistent, high quality products at low cost.

Corporate Information

Our principal executive offices are located at 51 Sawyer Road, Suite 200, Waltham, MA 02453. Our telephone number is (781) 647-3900. Our website address is www.invernessmedical.com. The information found on our website is not a part of this prospectus supplement or the accompanying prospectus. Our common stock is listed on the American Stock Exchange under the symbol "IMA."

Additional information regarding our company, including our audited financial statements, is contained in the documents incorporated by reference in this prospectus supplement and the accompanying prospectus. See "Incorporation of Documents by Reference" and "Where You Can Find More Information" on pages 24 and 25, respectively, of the accompanying prospectus.

The Offering

Common stock we are offering	1,600,000 shares
Common stock to be outstanding after this offering	10,726,588 shares
Underwriter's over-allotment option	240,000 shares
Use of proceeds	We intend to use the net proceeds from the sale of the common stock offered hereby for working capital and other general corporate purposes, including possible acquisitions and strategic transactions. You should read the discussion under the heading "Use of Proceeds" for more information.
American Stock Exchange symbol	IMA

The number of shares of our common stock to be outstanding after this offering is based upon our shares of common stock outstanding as of March 31, 2002 and assumes that no options or warrants have been exercised and no shares of Series A Preferred Stock have been converted since March 31, 2002. In addition, this information excludes:

- 4,720,492 shares of common stock issuable upon conversion of shares of our Series A Preferred Stock outstanding as of March 31, 2002;
- an aggregate of 2,303,018 shares of common stock subject to outstanding options as of March 31, 2002 at a weighted average exercise price of $14.70 per share;
- an additional 366,199 shares of common stock reserved for issuance upon exercise of options that may be granted subsequent to March 31, 2002 under our 2001 Stock Option and Incentive Plan;
- 500,000 shares of common stock reserved for issuance under our Employee Stock Purchase Plan;
- 563,818 shares of common stock issuable upon exercise of warrants outstanding as of March 31, 2002 at a weighted average exercise price of $14.32 per share; and
- up to 240,000 shares of common stock issuable upon exercise of the underwriter's over-allotment option.

You should read the discussion under the heading "Capitalization" for more information regarding the outstanding shares of our common stock and shares of our Series A Preferred Stock, as well as warrants and options to purchase our common stock.

Summary Consolidated Financial Data
(in thousands, except per share data)

The following summary consolidated historical financial data are derived from, and qualified by reference to, the consolidated financial statements and related notes as well as the pro forma financial statements incorporated by reference in this prospectus supplement and the accompanying prospectus.

	Historical					Pro Forma(1)		
	Year Ended December 31,			Three Months Ended March 31,		Year Ended December 31,	Three Months Ended March 31,	
	1999	2000	2001	2001	2002	2001	2001	2002
Consolidated Statement of Operations:								
Net revenue	$ 50,584	$ 51,051	$ 49,384	$ 11,812	$ 38,207	$ 212,819	$ 52,529	$ 48,654
Cost of sales	26,890	25,075	25,821	5,826	17,359	111,899	26,159	25,931
Gross profit	23,694	25,976	23,563	5,986	20,848	100,920	26,370	22,723
Operating expenses:								
Purchased in-process research and development			6,980					
Charge related to asset impairment					12,682			12,682
Research and development	1,396	1,360	1,809	299	3,366	12,065	2,732	3,366
Sales and marketing	11,010	10,585	10,976	2,289	10,576	54,596	13,330	12,131
General and administrative	7,339	7,178	11,814	1,883	6,889	36,751	7,668	8,472
Stock-based compensation			10,441		10,145	10,441		10,145
Total operating expenses	19,745	19,123	42,020	4,471	43,658	113,853	23,730	46,796
Operating income (loss)	3,949	6,853	(18,457)	1,515	(22,810)	(12,933)	2,640	(24,073)
Interest and other expenses, net	(2,585)	(2,292)	(3,871)	(451)	(3,617)	(8,490)	(2,845)	(3,963)
Income (loss) from continuing operations before income taxes	1,364	4,561	(22,328)	1,064	(26,427)	(21,423)	(205)	(28,036)
Provision for income taxes	1,007	1,781	2,134	354	507	5,701	139	437
Income (loss) from continuing operations	357	2,780	(24,462)	710	(26,934)	(27,124)	(344)	(28,473)
Income (loss) from discontinued operations	183	(598)	58	(581)		58	(581)	
Income (loss) before extraordinary item and accounting change	540	2,182	(24,404)	129	(26,934)	(27,066)	(925)	(28,473)
Extraordinary (loss) gain			(327)		8,506	(327)		8,506
Cumulative effect of a change in accounting principle					(12,148)			(12,148)
Net income (loss)	$ 540	$ 2,182	$ (24,731)	$ 129	$ (30,576)	$ (27,393)	$ (925)	$ (32,115)
Income (loss) per common share basic and diluted:(2)								
Income (loss) from continuing operations	$ 0.11	$ 0.59	$ (3.84)	$ 0.12	$ (4.02)	$ (4.26)	$ (0.06)	$ (4.24)
Net income (loss)	$ 0.16	$ 0.46	$ (3.88)	$ 0.02	$ (4.53)	$ (4.30)	$ (0.15)	$ (4.75)

	March 31, 2002	
	Actual	As Adjusted(3)

	March 31, 2002	
Balance Sheet Data:		
Cash and cash equivalents	$ 22,405	$ 56,872
Working capital	15,324	49,791
Total assets	264,398	298,865
Debt obligations	65,684	65,684
Redeemable convertible preferred stock	61,514	61,514
Total stockholders' equity	71,330	105,797

(1) Reflects the effect of our acquisitions of the Unipath business and IVC as if such acquisitions occurred on January 1, 2001, excluding a non-recurring charge for the write-off of a portion of the Unipath purchase price as in-process research and development.

(2) Computed as described in our historical financial statements and related notes incorporated by reference into this prospectus supplement and the accompanying prospectus.

(3) Reflects the receipt and application of the net proceeds from the sale of 1,600,000 shares of common stock offered hereby at an offering price of $23.00 per share after deducting underwriting discounts and commissions and estimated offering expenses.

SUPPLEMENTAL RISK FACTORS

An investment in our common stock involves various risks. In addition to the risks described under "Risk Factors" beginning on page 2 of the accompanying prospectus, you should carefully consider the following risk factors in conjunction with the other information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus before making a decision to purchase our common stock.

Shares eligible for public sale after this offering could adversely affect our stock price.

The market price of our common stock could decline as a result of sales by our existing stockholders after this offering or the perception that these sales could occur. These sales also might make it difficult for us to sell equity securities in the future at a time and price that we deem appropriate.

Immediately after the closing of this offering, based on the number of shares outstanding as of March 31, 2002, we will have outstanding 10,726,588 shares of common stock, or 10,966,588 shares of common stock if the underwriter exercises its option to purchase additional shares of the stock from us. These numbers exclude shares of common stock issued upon the exercise of options and warrants, and the conversion of shares of Series A Preferred Stock, occurring subsequent to March 31, 2002. The shares that we are selling in this offering may be resold immediately in the public market. This offering of 1,600,000 shares of common stock is being made pursuant to a shelf registration statement that permits the sale of up to 5,000,000 shares of common stock. This means that, while the shelf registration statement remains effective, and assuming the underwriter does not exercise its over-allotment option, we have the ability to sell up to an additional 3,400,000 shares of common stock under that registration statement.

Pursuant to the terms of a stock purchase agreement and other contractual arrangements, the holders of 5,560,238 shares of common stock issued or issuable upon conversion of our Series A Preferred Stock or upon exercise of certain of our warrants are entitled to have their shares registered under the Securities Act of 1933. Accordingly, we have filed a registration statement to permit the resale of such shares. When such registration statement is declared effective, such shares would be available for sale in the open market.

All of our executive officers and directors have generally agreed not to sell any shares of our common stock for a period of 90 days after the date of this prospectus supplement without the consent of SG Cowen Securities Corporation. As a result, the holders of an aggregate of 3,787,418 shares of common stock (consisting of outstanding shares of common stock and shares of common stock underlying Series A Preferred Stock), including 1,253,332 of the shares being registered for resale pursuant to the above-mentioned resale registration statement, will be contractually restricted from selling their shares for a period of 90 days after the date of this prospectus supplement. However, SG Cowen Securities Corporation can waive this restriction and allow these stockholders to sell their shares at any time. Sales of a substantial number of shares of our common stock following the expiration or waiver of these lock-up periods could cause our stock price to fall.

We also may issue shares of our common stock from time to time as consideration for future acquisitions and investments. In the event any such acquisition or investment is significant, the number of shares that we may issue may in turn be significant. In addition, we may grant registration rights covering shares issued in connection with any such acquisitions and investments.

Terrorist attacks, such as the attacks that occurred in New York and Washington, D.C. on September 11, 2001, and other attacks or acts of war could adversely affect our operations, profitability and the markets in which we operate.

On September 11, 2001, the United States was the target of terrorist attacks of unprecedented scope. Attacks such as these could cause major instability in the United States and international financial markets and reduce consumer confidence. The terrorist attacks and the national and global responses to these terrorist attacks, many of which are still being formulated, including recent military, diplomatic and financial responses and any possible reprisals in the future, could result in disruptions of our manufacturing operations and the distribution of our products. These developments will subject us to increased risks and, depending on their magnitude, could have a material adverse effect on our business.

Our independent public accountant, Arthur Andersen LLP, has been indicted on federal obstruction of justice charges. The indictment may impair our ability to access the capital markets, to make timely filings with the Securities and Exchange Commission and to satisfy any claims arising from the provision of auditing services to us.

Our independent public accountant, Arthur Andersen LLP, has informed us that on March 14, 2002, an indictment was unsealed charging it with federal obstruction of justice arising from the government's investigation of Enron Corp. Arthur Andersen has indicated that it intends to contest vigorously the indictment. As a public company we are required to file periodically with the Securities and Exchange Commission financial statements audited or reviewed by an independent public accountant. The Securities and Exchange Commission has recently adopted rules under which it will continue accepting financial statements audited or reviewed by Arthur Andersen. However, our access to the capital markets and our ability to make timely Securities and Exchange Commission filings, including filings incorporated by reference into this prospectus supplement and the accompanying prospectus, could be impaired if the Securities and Exchange Commission ceases accepting financial statements audited by Arthur Andersen or if for any reason Arthur Andersen is unable to perform auditing services for us.

Although we do not believe that the outcome of the current indictment would materially adversely affect us, should we seek to access the public capital markets after we complete the offering of the securities offered hereby, and, if prior to that time the Securities and Exchange Commission ceases accepting financial statements audited by Arthur Andersen or if Arthur Andersen becomes unable to make the representations to us required by the Securities and Exchange Commission, it is possible that our existing audited financial statements might not satisfy the Securities and Exchange Commission's requirements. In that case, we may be unable to access the public capital markets unless another independent accounting firm is able to audit the financial statements originally audited by Arthur Andersen.

It is also possible that events arising out of the indictment may adversely affect the ability of Arthur Andersen to satisfy any claims arising from its provision of auditing services to us, including claims that may arise out of Arthur Andersen's audits of our financial statements incorporated by reference into this prospectus supplement and the accompanying prospectus.

Any delay or inability to access the public capital markets caused by these circumstances could have a material adverse effect on our business, profitability and growth prospects.

Our business has substantial indebtedness which could result in adverse consequences for us.

As of March 31, 2002, we had approximately $66.7 million of outstanding indebtedness under our credit facilities and other debt-related instruments. Our substantial level of debt affects our future operations in several important ways, including the following:

- our ability to obtain additional financing may be impaired;
- our flexibility to adjust to market conditions is limited, leaving us vulnerable in a downturn in general economic conditions or in our business and less able to plan for, or react to, changes in our business and the industries in which we operate;

we may need to use a large portion of our cash flow from operations to pay principal and interest on our indebtedness, which would reduce the amount of cash available to finance our operations and other business activities and may require us, in order to meet our debt service obligations, to delay or reduce capital expenditures or the introduction of new products and/or forego business opportunities including acquisitions, research and development projects or product design enhancements; and

we may be at a competitive disadvantage compared to our competitors that have less debt.

Furthermore, there can be no assurance that our cash flow from operations and capital resources will be sufficient to pay our indebtedness. If our cash flow and capital resources prove inadequate we could face substantial liquidity problems and might be required to dispose of material assets or operations, restructure or refinance our debt or seek additional equity capital.

Additionally, the agreements governing our indebtedness subject us to various restrictions on our ability to engage in certain activities, including, among other things, our ability to:

incur additional indebtedness;

acquire other businesses;

make capital or finance lease expenditures; and

dispose of assets.

These restrictions may limit our ability to pursue business opportunities or strategies that we would otherwise consider to be in the best interests of our stockholders.

Our credit facilities contain certain financial covenants and other conditions which, if not satisfied, could result in the acceleration of the amounts due under our credit facilities and the limitation of our ability to borrow additional funds in the future.

As of March 31, 2002, we had approximately $59.3 million of outstanding indebtedness under our various credit facilities, substantially all of which were owed to The Royal Bank of Scotland plc and related entities and Congress Financial Corporation, IVC's lender. The agreements governing these various credit facilities subject us to various financial and other covenants with which we must comply on an ongoing or periodic basis. These include covenants pertaining to interest coverage, cash flow coverage, leverage and earnings before interest expense, taxes, depreciation and amortization, or EBITDA. If we violate any of these covenants, there may be a material adverse effect on us. Most notably, our outstanding debt under one or more of our credit facilities could become immediately due and our ability to borrow additional funds in the future may be limited. Additionally, under the terms of our credit facilities with The Royal Bank of Scotland plc and related entities, if either Ron Zwanziger or David Scott ceases to be a member of our Board of Directors, the full amount of our indebtedness under these credit facilities will accelerate. Mr. Zwanziger and Dr. Scott, both of whom are executive officers of our company, are currently serving on our Board of Directors; however, there is no assurance that they will continue to do so.

We could experience significant manufacturing delays, disruptions to our ongoing research and development and increased production costs if Unilever is unable to successfully assign or sublease to us the lease for the primary operating facility of the Unipath business which is located in Bedford, England.

The primary operating facility of the Unipath business that we acquired from Unilever is located in Bedford, England. The Bedford facility is a multi-purpose facility that is registered with the United States Food and Drug Administration, contains state-of-the-art research laboratories and is equipped with specialized manufacturing equipment. This facility currently provides the manufacturing for the Unipath business that we recently acquired, serves as our research and development center and serves as the administrative center for our European operations. We are currently using the Bedford facility pursuant to an agreement with Unilever which we entered into in connection with our acquisition of the Unipath business. Unilever currently leases this facility from a third party landlord. Pursuant to the terms of Unilever's lease, however, Unilever is not permitted to assign the lease or sublet the Bedford facility without obtaining the prior written consent of the landlord, which consent may not be unreasonably withheld.

The landlord of the Bedford facility has recently indicated that it will not consent to an assignment of the lease to us but will consider a sublease. The terms of our acquisition of the Unipath business obligate Unilever to use reasonable endeavors to obtain the landlord's consent to

assignment or to a sublease of the facility and, if necessary, to pursue the assignment or sublease through the courts. There are no assurances that Unilever will be successful in obtaining the landlord's consent to assignment of the lease to us or to a sublease to us. If Unilever is unable to successfully acquire such consent or otherwise enable us to realize the benefit of its lease of the Bedford facility, we may be forced to renegotiate a lease of the Bedford facility on substantially less favorable terms or seek alternative means of producing our products, conducting our research and housing our European administrative staff. In either case, we may experience manufacturing delays and disruptions to our ongoing research and development while we are resolving these issues and increased production costs in the future. Additionally, there are no assurances that we will be able to renegotiate a lease for the Bedford facility on terms that are acceptable to us or find an acceptable replacement for this facility. Any one or more of these events may have a material adverse effect on us.

USE OF PROCEEDS

We estimate that the net proceeds to us from the sale of our common stock in this offering will be approximately $34.5 million, at an offering price of $23.00 per share and after deducting the underwriting discounts and commissions and our estimated offering expenses. If the underwriter exercises its over-allotment option in full, the net proceeds from this offering will be approximately $39.7 million. We intend to use the net proceeds for general corporate purposes, including working capital, capital expenditures and costs in connection with possible acquisitions and strategic transactions, if and when suitable opportunities arise. In addition, we may choose to repay outstanding indebtedness with a portion of the net proceeds, although we do not have any obligations or present intentions to do so.

Due to the rapidly changing nature of the markets in which we operate, the amounts we actually spend for general corporate purposes will depend on a number of factors, including revenue growth, if any, and the amount of cash we generate from operations. As a result, we will retain broad discretion in the allocation and use of a significant portion of the net proceeds of this offering. Until allocated for specific use, we will invest these proceeds in government securities and other short-term, investment-grade securities.

DIVIDEND POLICY

We have never declared or paid any cash dividends on our common stock. We currently intend to retain earnings to support our growth strategy and do not anticipate paying cash dividends on our common stock in the foreseeable future. Payment of future dividends, if any, on our common stock will be at the discretion of our Board of Directors after taking into account various factors, including our financial condition, operating results, current and anticipated cash needs and plans for expansion.

PRICE RANGE OF COMMON STOCK

On November 23, 2001, our common stock began trading on the American Stock Exchange under the symbol "IMA." Prior to that date, there was no established public trading market for shares of our common stock. The following table sets forth, for the periods indicated, the high and low closing sale prices of our common stock on the American Stock Exchange.

Year ended December 31, 2001	**High**	**Low**
4th Quarter (beginning November 23)	$ 19.35	$ 15.47
Year ended December 31, 2002		
1st Quarter	$ 25.41	$ 18.00
2nd Quarter (through May 21, 2002)	$ 28.21	$ 22.75

On May 21, 2002, the last reported sale price of our common stock on the American Stock Exchange was $24.98 per share. As of May 8, 2002, there were 9,410,960 shares of our common stock outstanding and we had approximately 330 holders of record of our common stock. We believe that the number of beneficial owners of our common stock on that date was substantially greater.

CAPITALIZATION

The following table sets forth our capitalization as of March 31, 2002 (unaudited):

- on an actual basis; and
- on an as adjusted basis to give effect to the receipt and application of the net proceeds from the sale of 1,600,000 shares of common stock offered hereby at an offering price of $23.00 per share, after deducting underwriting discounts and commissions and estimated offering expenses we expect to pay.

You should read this table in conjunction with the consolidated financial statements and notes incorporated by reference herein and the information under "Selected Consolidated Financial Data."

	March 31, 2002	
	Actual	As Adjusted
	(in thousands, except share amounts)	
Current portion of long-term debt	$ 6,887	$ 6,887
Long-term liabilities:		
Long-term debt, net of current portion	$ 58,797	$ 58,797
Deferred income taxes	2,005	2,005
Other liabilities	3,800	3,800
Total long-term liabilities	64,602	64,602
Series A redeemable convertible preferred stock, $0.001 par value:		
Authorized 2,666,667 shares		
Issued 2,526,913 shares		
Outstanding 2,360,246 shares	61,514	61,514
Stockholders' equity:		
Preferred stock, $0.001 par value:		
Authorized 2,333,333 shares, none issued		
Common stock, $0.001 par value:		
Authorized 50,000,000 shares		
Issued and outstanding 9,126,588 actual shares and 10,726,588 as adjusted shares	9	11
Additional paid-in capital	151,663	186,128
Notes receivable from stockholders	(14,691)	(14,691)
Accumulated deficit	(66,741)	(66,741)
Accumulated other comprehensive income	1,090	1,090
Total stockholders' equity	71,330	105,797
Total capitalization	$ 197,446	$ 231,913

The information in the table above does not include:

4,720,492 shares of common stock issuable upon conversion of shares of our Series A Preferred Stock outstanding as of March 31, 2002;

an aggregate of 2,303,018 shares of common stock subject to outstanding options as of March 31, 2002 at a weighted average exercise price of $14.70 per share;

an additional 366,199 shares of common stock reserved for issuance upon exercise of options that may be granted subsequent to March 31, 2002 under our 2001 Stock Option and Incentive Plan;

500,000 shares of common stock reserved for issuance under our Employee Stock Purchase Plan;

563,818 shares of common stock issuable upon exercise of warrants outstanding as of March 31, 2002 at a weighted average exercise price of $14.32 per share; and

up to 240,000 shares issuable upon exercise of the underwriter's over-allotment option.

SELECTED CONSOLIDATED FINANCIAL DATA

You should read the following selected consolidated financial data in conjunction with our consolidated financial statements and notes and the other information contained in or incorporated by reference into this prospectus supplement and the accompanying prospectus. The selected consolidated balance sheet data as of December 31, 2000 and 2001 and the selected consolidated statement of operations data for the years ended December 31, 1999, 2000 and 2001 have been derived from our consolidated financial statements that have been audited by Arthur Andersen, LLP, independent public accountants, and are incorporated by reference into this prospectus supplement and the accompanying prospectus. The selected consolidated balance sheet data as of December 31, 1997, 1998 and 1999 and the selected consolidated statement of operations data for the years ended December 31, 1997 and 1998 have been derived from our audited consolidated financial statements not included or incorporated by reference in this prospectus supplement and the accompanying prospectus. The selected consolidated statement of operations data for the three-month periods ended March 31, 2001 and 2002 and the selected consolidated balance sheet data at March 31, 2002 are derived from unaudited consolidated financial statements incorporated by reference into this prospectus supplement and the accompanying prospectus. The unaudited consolidated financial statements for the three-month periods have been prepared on a basis consistent with our audited consolidated financial statements and, in the opinion of management, include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of our consolidated financial position and consolidated results of operations for these periods. The consolidated results of operations for the three months ended March 31, 2002 are not necessarily indicative of results for the year ending December 31, 2002 or any future period. The pro forma information is not necessarily indicative of either the results which would have actually been reported if the acquisitions of the Unipath business and IVC occurred on January 1, 2001 or results which may be reported in the future.

When you read this selected financial data, it is important that you also read the historical financial statements and related notes and the unaudited pro forma combined condensed financial statements and related notes incorporated by reference into this prospectus supplement and the accompanying prospectus, as well as the section of this prospectus supplement entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations." The historical results are not necessarily indicative of future results.

	Historical							Pro Forma(1)		
	Year Ended December 31,					Three Months Ended March 31,		Year Ended December 31,	Three Months Ended March 31,	
	1997	1998	1999	2000	2001	2001	2002	2001	2001	2002
	(in thousands, except per share data)									
Consolidated Statement of Operations:										
Net revenue	$ 50,635	$ 54,685	$ 50,584	$ 51,051	$ 49,384	$ 11,812	$ 38,207	$ 212,819	$ 52,529	$ 48,654

	Historical							Pro Forma(1)		
Cost of sales	24,724	26,720	26,890	25,075	25,821	5,826	17,359	111,899	26,159	25,931
Gross profit	25,911	27,965	23,694	25,976	23,563	5,986	20,848	100,920	26,370	22,723
Operating expenses:										
Purchased in-process research and development					6,980					
Charge related to asset impairment		5,859					12,682			12,682
Research and development	6,210	2,323	1,396	1,360	1,809	299	3,366	12,065	2,732	3,366
Sales and marketing	12,101	13,169	11,010	10,585	10,976	2,289	10,576	54,596	13,330	12,131
General and administrative	8,998	9,600	7,339	7,178	11,814	1,883	6,889	36,751	7,668	8,472
Stock-based compensation	81				10,441		10,145	10,441		10,145
Total operating expenses	27,390	30,951	19,745	19,123	42,020	4,471	43,658	113,853	23,730	46,796
Operating (loss) income	(1,479)	2,986	3,949	6,853	(18,457)	1,515	(22,810)	(12,933)	2,640	(24,073)
Interest and other expenses, net	(2,377)	(2,077)	(2,585)	(2,292)	(3,871)	(451)	(3,617)	(8,490)	(2,845)	(3,963)
(Loss) income from continuing operations before income taxes	(3,856)	(5,063)	1,364	4,561	(22,328)	1,064	(26,427)	(21,423)	(205)	(28,036)
Provision for income taxes	1,456	1,115	1,007	1,781	2,134	354	507	5,701	139	437
(Loss) income from continuing operations	(5,312)	(6,178)	357	2,780	(24,462)	710	(26,934)	(27,124)	(344)	(28,473)
(Loss) income from discontinued operations	(791)	(2,882)	183	(598)	58	(581)		58	(581)	
(Loss) income before extraordinary item and accounting change	(6,103)	(9,060)	540	2,182	(24,404)	129	(26,934)	(27,066)	(925)	(28,473)
Extraordinary (loss) gain					(327)		8,506	(327)		8,506
Cumulative effect of a change in accounting principle							(12,148)			(12,148)
Net (loss) income	$ (6,103)	$ (9,060)	$ 540	$ 2,182	$ (24,731)	$ 129	$ (30,576)	$ (27,393)	$ (925)	$ (32,115)
(Loss) income per common share basic and diluted:(2)										
(Loss) income from continuing operations	$ (3.32)	$ (2.53)	$ 0.11	$ 0.59	$ (3.84)	$ 0.12	$ (4.02)	$ (4.26)	$ (0.06)	$ (4.24)
Net (loss) income	$ (3.82)	$ (3.71)	$ 0.16	$ 0.46	$ (3.88)	$ 0.02	$ (4.53)	$ (4.30)	$ (0.15)	$ (4.75)

	December 31,					March 31,
	1997	1998	1999	2000	2001	2002
Balance Sheet Data:						
Cash and cash equivalents	$ 5,099	$ 1,111	$ 661	$ 3,071	$ 52,024	$ 22,405

			December 31,			March 31,
Working capital (deficit)	(1,401)	(1,986)	(4,060)	(6,464)	21,022	15,324
Total assets	67,182	70,191	72,210	74,958	278,571	264,398
Debt obligations	26,595	23,163	19,076	12,830	78,124	65,684
Redeemable convertible preferred stock					51,894	61,514
Total stockholders' equity	18,442	28,932	34,953	41,812	89,614	71,330

(1) Reflects the effect of our acquisitions of the Unipath business and IVC as if such acquisitions occurred on January 1, 2001, excluding a non-recurring charge for the write-off of a portion of the Unipath purchase price as in-process research and development.

(2) Computed as described in our historical financial statements and related notes incorporated by reference into this prospectus supplement and the accompanying prospectus.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We develop, manufacture and market consumer health care products, including self-test diagnostic products for the women's health market and vitamins and nutritional supplements. To a lesser extent, we develop, manufacture and market clinical diagnostic products for use by medical professionals. Our consumer self-test diagnostic products allow individuals to obtain accurate information regarding various medical conditions on a confidential, non-prescription basis, without the expense, inconvenience and delay associated with physician visits or laboratory testing. This information gives individuals greater control over their health and their lives, allowing them to make informed decisions and take action to protect their health, alone or in consultation with health care professionals. Our existing self-test products are targeted at the women's health market, one of the largest existing markets for self-care diagnostics, and include home pregnancy detection tests and ovulation prediction tests. We also sell a wide variety of vitamins and nutritional supplements. Our clinical diagnostic products include test kits used by smaller laboratories, physicians' offices and other point-of-care sites for the detection of pregnancy and a wide variety of infectious diseases.

On November 21, 2001, pursuant to an agreement and plan of split-off and merger dated May 23, 2001, Johnson & Johnson acquired Inverness Medical Technology, Inc., or IMT, our former parent, in a merger transaction and, simultaneously, our company, Inverness Medical Innovations, Inc., was split off from IMT as a separate publicly traded company. Immediately prior to the consummation of these transactions, IMT restructured its operations so that we and our subsidiaries would hold all of IMT's non-diabetes businesses (women's health, nutritional supplements and clinical diagnostics). At the closing of the transactions, all of the shares of our common stock held by IMT were split-off from IMT in a pro rata distribution to IMT's stockholders and IMT (which then consisted of its diabetes business) merged with and became a wholly-owned subsidiary of Johnson & Johnson.

On December 20, 2001, we acquired Unipath Limited, a global leader in home pregnancy and ovulation testing and natural family planning, and its associated companies and assets from Unilever Plc and certain entities affiliated with Unilever. The Unipath acquisition provides us with leading brand name consumer diagnostic products that compliment our existing value branded and private label home pregnancy detection and ovulation prediction products. In connection with the acquisition of the Unipath business, we also acquired rights to certain antibody clones and other intellectual property rights.

On March 19, 2002, we acquired IVC Industries, Inc., a manufacturer and distributor of hundreds of different vitamin and nutritional supplement products sold under brand names and through private label arrangements with retailers. With the addition of IVC, we intend to consolidate our vitamin and nutritional supplement manufacturing at IVC and discontinue most of our outsourced manufacturing arrangements. The aggregate purchase price of IVC was approximately $27.3 million, which consisted of $5.6 million in cash representing $2.50 for each outstanding share of IVC's common stock, fully-vested stock options to purchase an aggregate of 115,744 shares of our common stock with an aggregate fair value of $1.3 million, approximately $1.6 million in estimated costs to exit certain activities of IVC, primarily severance costs, $17.4 million in assumed debt and approximately $1.4 million in estimated direct acquisition costs. The acquisition was funded by our existing cash.

Our businesses have developed to a significant extent through strategic acquisitions as well as through internal development. We intend to pursue aggressively opportunities for the acquisition of or investment in new and complementary businesses, products and technologies. We are currently considering potential strategic acquisitions. However, we currently have no material binding commitments or agreements with respect to any such acquisitions. We may not enter into any agreements relating to any such acquisitions or, if we do, we may not complete any of them. In order

to finance any such acquisitions, one or more of which may be very significant to our company, we may have to incur indebtedness, use our existing cash and/or issue securities. We currently have no commitments for any financing and we may be unable to obtain financing, if required, on terms and conditions acceptable to us. We may sell equity securities at a discount to our common stock's then market value due to the illiquidity of privately placed securities or otherwise. Any issuance of equity securities may result in substantial dilution to existing stockholders, which may be increased as a result of any discount to our common stock's market price.

Results of Operations

Three Months Ended March 31, 2002 Compared to Three Months Ended March 31, 2001

Net Product Sales. Net product sales for the three months ended March 31, 2002 increased $25.7 million, or 217%, to $37.5 million from $11.8 million for the three months ended March 31, 2001. The significant increase resulted predominantly from the recently acquired Unipath business which had net product sales of $21.6 million for the three months ended March 31, 2002. Our nutritional supplements business experienced growth in net product sales of $2.1 million, of which $1.6 million resulted from the addition of IVC. Additionally, our subsidiary in Ireland, Cambridge Diagnostics Ireland Limited, or CDIL, contributed $2.2 million of the increase in net product sales through its diabetes related packaging contract with a subsidiary of Johnson & Johnson. Consistent with total net product sales, net product sales of our consumer products segment, which includes our consumer diagnostic products and our vitamins and nutritional supplements, were $32.9 million for the three months ended March 31, 2002, an increase of $23.7 million, or 259%, as compared to $9.2 million for the three months ended March 31, 2001. Net product sales of our clinical diagnostics products segment for the three months ended March 31, 2002 increased $2.7 million, or 101%, to $5.3 million from $2.7 million for the three months ended March 31, 2001. The increase in sales of our clinical diagnostic products was entirely the result of the addition of the Unipath business.

License and Other Revenue. License and other revenue represent license and royalty fees from intellectual property license agreements with third parties. These license agreements were acquired as part of the Unipath business. For the three months ended March 31, 2002, license revenue was $706,000. There were no license and other revenue for the three months ended March 31, 2001.

Gross Profit. Total gross profit for the three months ended March 31, 2002 increased $14.9 million, or 248%, to $20.8 million from $6.0 million for the three months ended March 31, 2001. Total gross margin of net product sales was 56% for the three months ended March 31, 2002 compared to 51% for the three months ended March 31, 2001. The increase in gross profit and margin of total net product sales primarily resulted from the addition of the Unipath business which generated total gross profit of $14.0 million and gross margin of 65% for the three months ended March 31, 2002. Only $291,000 of the increase in total gross profit resulted from the addition of IVC since March 19, 2002 with a corresponding gross margin of 18%. As a result of IVC's lower gross margins, we expect overall gross margins of approximately 50% in future quarters. Gross profit from our consumer diagnostic product sales was $18.2 million for the three months ended March 31, 2002, an increase of $13.6 million, or 298%, from $4.6 million for the three months ended March 31, 2001. Gross margin from our consumer diagnostic product sales was 56% for the three months ended March 31, 2002 as compared to 50% for the three months ended March 31, 2001. Gross profit from our clinical diagnostics product sales was $2.7 million for the three months ended March 31, 2002, an increase of $1.3 million, or 88%, from $1.4 million for the three months ended March 31, 2001. Gross margin from our clinical diagnostic product sales was 52% for the three months ended March 31, 2002 as compared to 54% for the three months ended March 31, 2001.

Charge Related to Asset Impairment. During the three months ended March 31, 2002, we recorded a noncash impairment charge of $12.7 million to write off a portion of the value that was assigned to

trademarks and brand names related to certain of our nutritional supplement lines we bought in 1997. This charge was recorded in connection with the results of a separate impairment review performed on the carrying value of the goodwill related to such nutritional supplement lines, as discussed below in the caption "Cumulative Effect of a Change in Accounting Principle." No impairment charge was recorded during the three

months ended March 31, 2001.

Research and Development Expense. Research and development expense for the three months ended March 31, 2002 increased $3.1 million, or 1027%, to $3.4 million from $299,000 for the three months ended March 31, 2001. The significant increase resulted from the addition of the Unipath business, which houses a large research and development center in its facility in Bedford, England. Prior to the acquisition of the Unipath business, our research and development expense was primarily related to clinical diagnostic products incurred by our Orgenics subsidiary in Israel. We anticipate a continuing increase in research and development activities and expenses in the future as a result of the addition of the Unipath business.

Sales and Marketing Expense. Sales and marketing expense for the three months ended March 31, 2002 increased $8.3 million, or 362%, to $10.6 million from $2.3 million for the three months ended March 31, 2001. Of this increase, $7.6 million resulted from the addition of the Unipath business and $184,000 resulted from the addition of IVC since its acquisition date. The remaining increase in sales and marketing expenses resulted primarily from our new radio advertising efforts in an attempt to boost our nutritional supplement product sales. Sales and marketing expense as a percentage of net product sales increased to 28% for the three months ended March 31, 2002 from 19% for the three months ended March 31, 2001.

General and Administrative Expense. General and administrative expense for the three months ended March 31, 2002 increased $5.0 million, or 266%, to $6.9 million from $1.9 million for the three months ended March 31, 2001. The addition of the Unipath business contributed $3.5 million to this increase in general and administrative expenses. During the three months ended March 31, 2002, we also incurred approximately $1.0 million in legal fees for our defenses in certain litigations which were inactive during the three months ended March 31, 2001. The remaining increase in general and administrative expense resulted primarily from increases in other professional fees, insurance and rent due to the relocation of our corporate headquarters in May 2001. General and administrative expense as a percentage of net product sales increased to 18% for the three months ended March 31, 2002 from 16% for the three months ended March 31, 2001.

Stock-Based Compensation. During the three months ended March 31, 2002, we recorded noncash compensation expenses of $10.1 million. This amount represents the amortization of the remaining deferred compensation recorded in 2001 in connection with the sale of restricted stock to our chief executive officer. We recorded this deferred compensation because the stock was sold below the market value of our stock on the measurement date. The deferred compensation was originally set to amortize over the vesting period of the restricted stock. However, because of an amendment in the terms of the restricted stock agreement in February 2002, we fully amortized the deferred compensation during the three months ended March 31, 2002. There was no charge for stock-based compensation during the three months ended March 31, 2001.

Interest Expense. Interest expense for the three months ended March 31, 2002 increased $3.8 million, or 1013%, to $4.1 million from $373,000 for the three months ended March 31, 2001. The significant increase in interest expense resulted from various debt financings obtained to fund the acquisition of the Unipath business in December 2001. Also, of the total increase in interest expense, $2.7 million was noncash and represented the amortization of original issue discount and beneficial conversion features related to such debt financings.

Other Income (Expense), Net. Other income (expense), net, includes interest income and other income and expenses. Interest income for the three months ended March 31, 2002 increased by $334,000, or 785%, to $376,000 from $43,000 for the three months ended March 31, 2001. The increase in interest income resulted from higher average cash balances during the three months ended March 31, 2002 due to a $41.4 million capitalization by IMT during our split-off from IMT in November 2001. A significant portion of other income and expense generally represents foreign currency exchange gains and losses. For the three months ended March 31, 2002, we recognized $188,000 in realized and unrealized foreign exchange transaction gains as compared to losses of $122,000 for the three months ended March 31, 2001.

Income Taxes. For the three months ended March 31, 2002, we recorded provisions of $507,000 for income taxes compared to $354,000 for the three months ended March 31, 2001. Of the provision recorded for the three months ended March 31, 2002, $471,000 related to the Unipath business. The remaining business recorded a total provision of $35,000 for the three months ended March 31, 2002 as compared to $354,000 for the three months ended March 31, 2001. This decrease resulted from corporate losses available to offset profits in the U.S. businesses.

(Loss) Income from Continuing Operations. Loss from continuing operations was $26.9 million, or $4.02 per basic and diluted common share, for the three months ended March 31, 2002 compared to income from continuing operations of $710,000, or $0.12 per basic and diluted common share, for the three months ended March 31, 2001. The significant loss for the three months ended March 31, 2002 resulted from various factors as described above.

Loss from Discontinued Operations. During the three months ended March 31, 2001, we recorded a loss from discontinued operations of $581,000. The discontinued operations represent the diabetes related segments of the entities that we acquired through the split-off from IMT that were then transferred back to IMT on November 21, 2001.

Extraordinary Gain. During the three months ended March 31, 2002, we recorded an extraordinary gain of $8.5 million related to the early retirement of our subordinated promissory notes and the repurchase of the beneficial conversion feature associated with these subordinated promissory notes.

Cumulative Effect of a Change in Accounting Principle. On January 1, 2002, we adopted Statement of Financial Accounting Standard (SFAS) No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 142 requires annual independent appraisals to be obtained for all reporting units, as defined in the statement, with values recorded for goodwill and other intangible assets. Based on the results of an independent appraisal obtained on the nutritional supplements business that we acquired in 1997, we recorded an impairment charge of $12.1 million to write-off the carrying value of the goodwill related to that business.

Net (Loss) Income. Net loss for the three months ended March 31, 2002 was $30.6 million as compared to net income of $129,000 for the three months ended March 31, 2001. The basic and diluted net loss per common share for the three months ended March 31, 2002 was $4.53 compared to a basic and diluted income per common share of $0.02 for the three months ended March 31, 2001.

Year Ended December 31, 2001 Compared to Year Ended December 31, 2000

Net Product Sales. Net product sales in 2001 decreased $1.7 million, or 3%, to $49.4 million from $51.1 million in 2000. The product sales decline was predominantly due to decreases in product sales of certain of our nutritional supplement product lines, which are included in our consumer products business segment. The net sales of our nutritional supplements decreased by $5.8 million, or 31%, to $13.1 million in 2001 compared to $18.9 million in 2000. Our marketing efforts in the past have been

limited due to the size and resources of our company, which, added to the effect of the competitive nature of this business, caused our nutritional supplements sales to decline. Partially offsetting the decrease in product sales of nutritional supplements is the increase in consumer diagnostic products, such as pregnancy and ovulation tests, which are also included in our consumer products business segment. Net product sales of consumer diagnostic products were $25.7 million in 2001, an increase of $4.2 million, or 15%, from $21.5 million in 2000. Approximately $1.9 million of the consumer diagnostic product sales increase was contributed by the Unipath business that we acquired on December 20, 2001. Net sales of our clinical diagnostics products in 2001 decreased $90,000, or 1%, to $10.6 million from $10.7 million in 2000.

Gross Profit. Total gross profit for 2001 decreased $2.4 million, or 9%, to $23.6 million from $26.0 million in 2000. Gross margin of net product sales was 48% in 2001 compared to 51% in 2000. The decrease in gross profit and margin primarily resulted from the net decline in sales of our consumer products, primarily nutritional supplements. Gross profit from our nutritional supplements product sales was $6.3 million in 2001, a decrease of $3.9 million, or 39%, from $10.2 million in 2000. The decreased nutritional supplements gross profit was partially offset by the increase in consumer diagnostics gross profit. Gross profit from consumer diagnostic product sales was $11.3 million in 2001, an increase of $1.8 million, or 19%, from $9.5 million in 2000. Gross profit from our clinical diagnostics product sales was $6.0 million in 2001, a decrease of $281,000, or 4%, from $6.3 million in 2000.

Purchased In-Process Research and Development. In the fourth quarter of 2001, we recorded a $7.0 million noncash charge for an in-process research and development project that we acquired as a part of the Unipath business. This charge represented the portion of the purchase price paid for the Unipath business allocated to this in-process research and development project that had not achieved technological feasibility and did not have future alternative uses. We did not record any such charges in 2000.

Research and Development Expense. Research and development expense in 2001 increased $450,000, or 33%, to $1.8 million from $1.4 million in 2000. To date most of our research and development expense was related to clinical diagnostic products. We anticipate an increase in research and development activities and expenses in the future as a result of the acquired Unipath business.

Sales and Marketing Expense. Sales and marketing expenses in 2001 increased $391,000, or 4%, to $11.0 million from $10.6 million in 2000. The increase resulted primarily from the addition of the Unipath business since its acquisition date. Sales and marketing expense as a percentage of net product sales increased to 22% in 2001 from 21% in 2000.

General and Administrative Expense. General and administrative expense in 2001 increased $4.6 million, or 65%, to $11.8 million from $7.2 million in 2000. General and administrative expense as a percentage of net product sales increased to 24% in 2001 from 14% in 2000. Approximately $2.5 million of this increase was caused by legal fees incurred in our active defenses of certain litigation matters in 2001. Other

increases in general and administrative expenses relate to other professional fees, facilities costs due to a relocation of our United States office in 2001, salaries, insurance and the addition of the Unipath business.

Stock-Based Compensation. During 2001, we recorded noncash compensation expenses in connection with the sale of restricted stock to our chief executive officer and stock option grants to certain key executives because these securities were sold or granted below the market value of our stock on the measurement date. As a result of a February 2002 amendment to the terms of the chief executive officer's restricted stock award, we will fully amortize the remaining portion of the deferred compensation expense associated with the restricted stock (approximately $10.1 million) in the first quarter of 2002.

Interest Expense. Interest expense in 2001 remained consistent (a $49,000, or 3%, decrease) at $1.9 million compared to 2000. We expect to incur increased interest expense in the future as a result of the new debt issued in connection with the acquisition of the Unipath business.

Other Expense, Net. Other expense, net, includes interest income and other income and expenses. Interest income in 2001 increased by $358,000 to $385,000 from $27,000 in 2000. The increase in interest income resulted from higher average cash balances from contributions by IMT in 2001. A significant portion of other income and expense generally represents foreign currency exchange gains and losses. In 2001, we recognized $727,000 in realized and unrealized foreign exchange transaction losses as compared to losses of $389,000 in 2000. In 2001, we also settled a lawsuit for which we recorded a loss of $1.7 million as other expense.

Income Taxes. In 2001, we recorded provisions of $2.1 million for income taxes compared to $1.8 million in 2000. The increase is primarily due to the write-off of certain deferred tax assets which we do not believe will provide us with future tax benefits as a result of the split-off and merger with IMT and Johnson & Johnson in November 2001.

(Loss) Income from Continuing Operations. Loss from continuing operations was $24.5 million, or $3.84 per basic and diluted common share, for 2001 compared to income from continuing operations of $2.8 million, or $0.59 per basic and diluted common share, for 2000. The significant loss in 2001 resulted from the various factors described above.

Income (Loss) from Discontinued Operations. In 2001, we had income from discontinued operations of $58,000 compared to a loss from discontinued operations of $598,000 in 2000. The discontinued operations represent the diabetes related segments that were acquired by Johnson & Johnson on November 21, 2001.

Extraordinary Loss on Early Extinguishment of Debt. The amount charged to extraordinary loss in 2001 represents the write-off of the remaining unamortized financing costs related to a third-party debt IMT assumed and paid-off at the split-off and merger.

Net (Loss) Income. Net loss for 2001 was $24.7 million as compared to net income of $2.2 million for 2000. The basic and diluted loss per common share for 2001 was $3.88 compared to a basic and diluted income per common share of $0.46 for 2000. The significant loss in 2001 resulted from the various factors described above.

Year Ended December 31, 2000 Compared to Year Ended December 31, 1999

Net Product Sales. Net product sales in 2000 increased $467,000, or 1%, to $51.1 million from $50.6 million in 1999. The primary reason for the increase in product sales was increased sales of our consumer diagnostic products, which are included in our consumer products business segment. Net sales of consumer diagnostic products were $21.5 million in 2000, an increase of $3.0 million, or 16%, from $18.5 million in 1999. The aforementioned increase was partially offset by decreases in the sales of our nutritional supplements, also included in our consumer products business segment, and clinical diagnostic products. Net sales of our nutritional supplements decreased by $2.2 million, or 10%, to $18.9 million in 2000 compared to $21.0 million in 1999. Net sales of our clinical diagnostics products in 2000 decreased $383,000, or 4%, to $10.7 million from $11.1 million in 1999.

Gross Profit. Total gross profit for 2000 increased $2.3 million, or 10%, to $26.0 million from $23.7 million in 1999. Gross margin of net product sales was 51% in 2000 compared to 47% in 1999. The gross profit increased primarily as a result of increased sales of pregnancy tests combined with reduced costs to manufacture those tests. This increase was partially offset by a lower gross profit on the sales of nutritional supplements.

Research and Development Expense. Research and development expense remained consistent (decrease of $36,000 from 1999 to 2000) at $1.4 million for both years. Most of the research and development expense was related to clinical diagnostic products.

Sales and Marketing Expense. Sales and marketing expenses in 2000 decreased $426,000, or 4%, to $10.6 million from $11.0 million in 1999. The decrease resulted primarily from lower selling and marketing expenditures related to our nutritional supplements. Sales and marketing expense as a percentage of net product sales decreased to 21% in 2000 from 22% in 1999.

General and Administrative Expense. General and administrative expense in 2000 decreased $161,000, or 2%, to $7.2 million from $7.3 million in 1999. General and administrative expense as a percentage of net product sales decreased to 14% in 2000 from 15% in 1999.

Interest Expense. Interest expense in 2000 decreased $118,000, or 6%, to $1.9 million from $2.0 million in 1999. The decrease in interest expense primarily resulted from a lower total average outstanding debt balance during 2000 as compared to 1999.

Other Expense, Net. Other expense, net, includes interest income and other income and expenses. Interest income in 2000 decreased by $3,000 to $27,000 from $30,000 in 1999. A significant portion of other income and expense generally represents foreign currency exchange gains and losses. In 2000, we recognized $389,000 in realized and unrealized foreign exchange transaction losses as compared to losses of $531,000 in 1999.

Income Taxes. In 2000, we recorded provisions of $1.8 million for income taxes compared to $1.0 million in 1999. Our effective tax rate is substantially higher than the combined federal and statutory rate due to foreign and divisional losses for which we have not recorded a tax benefit.

Income from Continuing Operations. Income from continuing operations was $2.8 million, or $0.59 per basic and diluted common share, for 2000 compared to income from continuing operations of $357,000, or $0.11 per basic and diluted common share, for 1999. The increase in income was due to greater profits on sales of pregnancy and ovulation tests, partially offset by a decrease in the income on nutritional supplements, and reduced sales and marketing expenditures.

(Loss) Income from Discontinued Operations. In 2000, we had a loss from discontinued operations of $598,000 compared to an income from discontinued operations of $183,000 in 1999. The discontinued operations represent the diabetes related segments that were acquired by Johnson & Johnson on November 21, 2001.

Net Income. Net income for 2000 was $2.2 million as compared to net income of $540,000 for 1999. The basic and diluted earnings per common share for 2000 were $0.46 compared to a basic and diluted earnings per common share of $0.16 for 1999.

Quarterly Financial Information

The following table sets forth unaudited quarterly consolidated operating results for each of our last nine quarters. We prepared this information on a basis consistent with our audited consolidated financial statements and included all adjustments, consisting only of normal recurring adjustments, that we consider necessary for a fair presentation of the data. These quarterly results are not necessarily indicative of future results of operations. This information should be read in conjunction with our consolidated financial statements and notes included elsewhere or incorporated by reference in this prospectus supplement and the accompanying prospectus.

	2000				2001				2002
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter
	(In thousands, except per share data)								
Net revenue	$ 13,455	$ 12,743	$ 12,519	$ 12,334	$ 11,812	$ 12,272	$ 11,590	$ 13,711	$ 38,207
Gross profit	6,908	6,856	6,026	6,186	5,986	6,478	5,591	5,508	20,848
Operating income (loss)	1,983	1,952	1,327	1,591	1,515	1,462	(17)	(21,417)	(22,810)
Income (loss) from continuing operations	835	1,067	317	561	710	151	(288)	(25,035)	(26,934)

	2000				2001				2002
Income (loss) per share from continuing operations basic and diluted(1)	0.21	0.23	0.06	0.11	0.12	0.02	(0.04)	(3.86)	(4.02)

(1) Computed as described in our historical financial statements and related notes incorporated by reference into this prospectus supplement and the accompanying prospectus.

Liquidity and Capital Resources

As of March 31, 2002, we had cash and cash equivalents of $22.4 million, a $29.6 million decrease from December 31, 2001. We have historically funded our business through operating cash flows, proceeds from borrowings and the issuance of equity securities, as well as contributions from IMT, our former parent, and affiliated companies of IMT. We used $4.7 million in cash for our operating activities during the three months ended March 31, 2002, which was due to a net decrease in accounts payable and accrued expenses of $3.7 million and an inventory increase of $2.3 million, offset by $420,000 in earnings adjusted for noncash expenses and decreases in other current assets of $865,000. During the three months ended March 31, 2002, we used cash of $11.7 million for our investing activities, of which $8.1 million was used for the acquisition of IVC, $3.4 million was used for restructuring costs and additional acquisition costs related to the Unipath business, and $384,000 was used for capital expenditure purposes. During the three months ended March 31, 2002, we used cash of $13.0 million for financing activities, which primarily consisted of principal prepayments of $20.0 million on the subordinated promissory notes, $10.0 million on the term loans with The Royal Bank of Scotland plc and $3.2 million on IVC's bank debt, net of a total of $20.9 million in proceeds received from issuance of preferred stock and stock option and warrant exercises. We also incurred $498,000 in financing costs related to various debt instruments. Working capital was $15.3 million as of March 31, 2002 compared to $21.0 million as of December 31, 2001.

On March 19, 2002, we acquired IVC, a manufacturer and distributor of vitamins and other nutritional supplements. We intend to consolidate substantially all of our vitamin and nutritional supplement manufacturing at IVC and discontinue most of our outsourced manufacturing arrangements. The aggregate purchase price of IVC was approximately $27.3 million, which consisted of $5.6 million in cash representing $2.50 for each outstanding share of IVC's common stock, fully-vested stock options to purchase an aggregate of 115,744 shares of our common stock with an aggregate fair value of $1.3 million, approximately $1.6 million in estimated costs to exit certain activities of IVC, primarily severance costs, $17.4 million in assumed debt, including capital leases, and approximately $1.4 million in estimated direct acquisition costs. The acquisition was funded by our existing cash. Since the acquisition of IVC, we have made principal payments and prepayments on IVC's debt of $3.2 million. Of the remaining $14.2 million of IVC debt outstanding as of March 31,

2002, $6.9 million related to a credit agreement with Congress Financial Corporation (Congress), a subsidiary of First Union Corporation, and $7.3 million related to various notes payable and capital leases. Under the credit agreement with Congress, as amended, IVC can borrow up to $15.0 million under a revolving credit commitment, subject to borrowing base limitations, as defined in the agreement. IVC also has outstanding $4.2 million under a term loan commitment. The loans with Congress mature on October 16, 2003. Borrowings under the revolving credit commitment and the term loan bear interest at either 1.50% above the bank's prime rate or, at IVC's option, at 3.75% above the Adjusted Eurodollar Rate used by the bank. The notes are collateralized by substantially all of IVC's assets. The credit agreement with Congress requires IVC to maintain minimum tangible net worth and contains various restrictions customary in such financial arrangements, including limitations on the payment of cash dividends. IVC's other notes payable and capital leases mature on various dates through July 2008.

On December 20, 2001, one of our wholly-owned subsidiaries entered into a series of credit agreements (the RBS Credit Agreements) with The Royal Bank of Scotland plc and related entities for credit facilities in the aggregate amount of $70.0 million, which were amended during the three months ended March 31, 2002. The RBS Credit Agreements consisted of various term loans aggregating $62.5 million, of which $10.0 million were denominated in Japanese Yen, and a $7.5 million multicurrency revolving line of credit. The proceeds of the term loans were used to finance a portion of the cash used to acquire the Unipath business. In March 2002, in connection with the amendments to the RBS Credit Agreements, we elected to make a $10.0 million principal prepayment on the senior term loans which therefore had a balance of $42.2 million as of March 31, 2002. The total outstanding loan balance under the RBS Credit Agreements as of March 31, 2002 was $52.3 million, including capitalized interest, as discussed below. The revolving line of credit is designated for use to cover certain of our liabilities and foreign exchange futures contracts. As of March 31, 2002, there were no outstanding borrowings against the revolving line of credit. We and certain of our subsidiaries are the guarantors of all obligations due under the RBS Credit Agreements. Borrowings under the RBS Credit Agreements are secured by the stock of our European subsidiaries, our intellectual property rights and the assets of our business in the United States. We must make mandatory prepayments on the loans under the RBS Credit Agreements if we meet certain cash flow thresholds, collect insurance proceeds in excess of certain thresholds, receive payments or sell assets not in the ordinary course of our business, or upon a sale or change of control of

our company. The per annum interest rate on the loans is the London Interbank Offered Rate (LIBOR) plus a spread from 1.50% to 3.50% (and an additional 2.00% in case of default), depending on the type of loan (senior or junior) and the interest period. On the loans in which the spread may vary, the spread depends on the ratio of our total debt to EBITDA. Interest at 4.00% per annum is capitalized on the junior loan which, including such capitalized interest, had a principal balance of $10.1 million at March 31, 2002. Capitalized interest may be paid upon agreement with the lender of our senior debt. The amount of capitalized interest as of March 31, 2002, was $109,000. In February 2002, we entered into an interest rate swap agreement with the bank, which applies to $34.8 million to $41.7 million of the term loans that are denominated in U.S. Dollars, depending upon the interest period, and protects against fluctuations in the LIBOR rate. Under the interest rate swap agreement, the LIBOR rate is set at a minimum of 3.36% and a maximum of 5.00%. Through June 30, 2002, the LIBOR rate under the interest rate swap agreement is set at 3.36%. Under the RBS Credit Agreements, as amended, we must comply with various financial and nonfinancial covenants starting in the second quarter of 2002. The primary financial covenants pertain to, among other things, interest coverage, cash flow coverage, leverage and EBITDA. Failure to comply with these covenants may have a material adverse impact on our financial condition.

On March 6, 2002, we prepaid our then outstanding subordinated promissory notes (Subordinated Notes) having an aggregate principal amount of $20,000,000 and related accrued interest of $568,000 using the proceeds from the issuance of Series A Preferred Stock. The original maturity date of the Subordinated Notes was April 1, 2002, with an extension option, and interest accrued at 12% per

annum, or 18% if and when the maturity date was extended. The Subordinated Notes were convertible into shares of our Series A Preferred Stock at the option of the holder.

During 1999, our CDIL subsidiary financed the purchase of one of the buildings that houses its manufacturing activities through a mortgage loan with the seller. The outstanding balance of the CDIL mortgage was $176,000 as of March 31, 2002. The CDIL mortgage bears interest at 6% and is payable semiannually through 2003.

Our Orgenics subsidiary had bank debt balances totaling $153,000 as of March 31, 2002. Orgenics' bank debt is collaterized by certain of Orgenics' assets. The notes bear interest at various rates ranging from 3.43% to 4.25% and are payable on various dates through 2003.

In March 2002, we sold to private investors 531,913 shares of our Series A Preferred Stock at a price of $39.01 per share for gross proceeds of $20.75 million for purposes of prepaying the $20.0 million of Subordinated Notes and related accrued interest. The terms of these shares of Series A Preferred Stock are the same as those shares issued in December 2001. Each share of Series A Preferred Stock accrues dividends on a quarterly basis at $2.10 per annum, but only on those days when the closing price of our company's common stock is less than $15.00. As our common stock price did not close below $15.00 following the issuance of the Series A Preferred Stock, no dividends were recorded during the three months ended March 31, 2002. Dividends accrued are payable only if declared by the Board of Directors. Until December 31, 2003, accrued dividends, if any, must be paid in shares of our common stock. The number of shares of common stock to be issued in payment of any accrued dividends is equal to such number as is determined by dividing the aggregate amount of the accrued dividend then payable by the greater of (i) $15.00 and (ii) the average market price during the 30 trading day period immediately preceding the date such dividend is declared. Thereafter, we have the option to pay dividends in cash or common stock. The number of shares of common stock to be issued upon any voluntary conversion of one share of Series A Preferred Stock is equal to such number as is determined by dividing $30.00 by the conversion price in effect at the time of conversion. The conversion price was initially $15.00 and is subject to adjustment. The effective purchase price for the shares of common stock underlying the Series A Preferred Stock issued in March 2002 represented a $2.70 (or 12%) discount to the fair value of our common stock on the issuance date. Starting on December 20, 2003, we may convert the Series A Preferred Stock into common stock in the event that the average closing price of our common stock exceeds $20.00 for any consecutive 30 trading day period. The Series A Preferred Stock may be redeemed upon a vote by the holders of at least two-thirds of the outstanding Series A Preferred Stock on or after June 30, 2011. The redemption price per share of Series A Preferred Stock will be equal to $30.00 plus a premium calculated at 5% per annum from the date of issuance.

As of December 31, 2001, we had approximately $24.8 million of foreign net operating loss carryforwards. These losses are available to reduce foreign taxable income, if any, in applicable jurisdictions in future years. We have recorded a valuation allowance against the portion of the deferred tax assets related to foreign net operating losses and other foreign deferred tax assets to reflect uncertainties that might affect the realization of the deferred tax assets, as these assets can only be realized via profitable foreign operations.

Based on outstanding debt and other commitments as of March 31, 2002, we will be required to use approximately $11.7 million in cash over the next 12 months to meet debt maturities (approximately $6.9 million), minimum lease payments (approximately $3.7 million) and capital expenditure commitments (approximately $1.1 million). Based upon our current operating plans and business conditions, we believe that our existing capital resources and credit facilities will be adequate to fund our operations, including these outstanding debt and other commitments, for at least the next 12 months. We cannot be certain, however, that our underlying assumed levels of revenues and expenses will be realized. In addition, we may expand our research and development of, and may pursue the acquisition of, new products and technologies, whether through licensing arrangements,

business acquisitions, or otherwise. If we decide to pursue such activities or if our operating results fail to meet our expectations, we could be required to seek additional funding through public or private financings or other arrangements. In such event, adequate funds may not be available when needed, or, if available, may not be on acceptable terms, which could have a negative effect on our business and results of operations. In addition, if we raise additional funds by issuing equity or convertible securities, dilution to then existing stockholders may result.

Critical Accounting Policies

The consolidated financial statements incorporated by reference into this prospectus supplement and the accompanying prospectus are prepared in accordance with accounting principles generally accepted in the United States. The accounting policies discussed below are considered by our management to be critical to an understanding of our financial statements because their application depends on management's judgment, with financial reporting results relying on estimations and assumptions about the effect of matters that are inherently uncertain. Specific risks for these critical accounting policies are described in the following paragraphs. For all of these policies, management cautions that future events rarely develop exactly as forecast and the best estimates routinely require adjustment. In addition, the "Notes to Consolidated Financial Statements" included in our annual report on Form 10-K, as amended, for the year ended December 31, 2001, which is incorporated by reference herein, include a comprehensive summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements.

Revenue Recognition

We recognize revenue in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 101 and its related amendments (collectively, SAB No. 101). SAB No. 101 requires that four basic criteria be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services rendered; (3) the fee is fixed and determinable; and (4) collection is reasonably assured.

The majority of our revenues are derived from product sales. We recognize revenue upon product shipment to third-party customers, at which time title is transferred, less a reserve for estimated product returns and allowances. Determination of the reserve for estimated product returns and allowances is based on our management's analyses and judgments regarding certain conditions, as discussed below in the critical accounting policy "Use of Estimates for Sales Returns and Other Allowances and Allowance for Doubtful Accounts." Should future changes in conditions prove management's conclusions and judgments on previous analyses to be incorrect, revenue recognized for any reporting period could be adversely affected.

Since the acquisition of the Unipath business in late December 2001, we also receive license and royalty revenue from agreements with third-parties licensees. Revenue from fixed fee license and royalty agreements are recognized on a straight-line basis over the license or royalty period. License and royalty fees that are calculated based on the licensees' sales are recognized upon receipt of the license or royalty payments because we would not be able to determine such fees until such time.

Use of Estimates for Sales Returns and Other Allowances and Allowance for Doubtful Accounts

Sales arrangements with customers for our products generally require us to accept product returns. From time to time, we also enter into sales incentive arrangements with our customers, which generally reduce the sale prices of our products. Against product revenue recognized in any reporting period, we must establish allowances for potential future product returns and claims resulting from our sales incentive arrangements. Calculation of these allowances requires significant judgments and estimates. When evaluating the adequacy of the sales returns and other allowances, our management analyzes historical returns, current economic trends, and changes in customer demand and acceptance of our

products. Material differences in the amount and timing of our product revenue for any reporting period may result if changes in conditions arise that would require management to make different judgments or utilize different estimates. Our provision for sales returns and other allowances related to sales incentive arrangements amounted to approximately $5.9 million for the three months ended March 31, 2002.

Similarly, our management must make estimates of the uncollectibility of our accounts receivable balances. When evaluating the adequacy of the allowance for doubtful accounts, management analyzes specific accounts receivable balances, historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms. Our accounts receivable balance was $27.1 million, net of an allowance for doubtful accounts of $1.3 million as of March 31, 2002.

Valuation of Goodwill and Other Long-Lived and Intangible Assets

Our long-lived assets include property, plant and equipment, goodwill and other intangible assets. As of March 31, 2002, the balances of property, plant and equipment, goodwill and other intangible assets, net of accumulated depreciation and amortization, were $42.6 million, $74.3 million and $61.9 million, respectively. For purposes of determining whether there are any impairment losses, our management has historically examined the carrying value of our identifiable long-lived tangible and intangible assets and goodwill when indicators of impairment are present. Effective January 1, 2002, SFAS No. 142 requires that independent impairment reviews be obtained on the carrying values of all goodwill on an annual basis. For all long-lived tangible and intangible assets and goodwill, if an impairment loss is identified based on the fair value of the asset, such loss would be charged to expense in the period we identify the impairment.

Valuation of Goodwill. During the three months ended March 31, 2002, we obtained an independent review on the carrying value of our existing goodwill in accordance with SFAS No. 142 which provides specific guidance for determining and measuring impairment of goodwill. Based upon the results of the review, we recorded an impairment charge of $12.1 million, representing the remaining goodwill related to our reporting unit that comprises the nutritional supplement lines we acquired in 1997. This amount represented the excess of the carrying value over the fair value of such asset. The fair value was determined using a combination of the income approach and the market approach of valuing a business. The income approach valued the business by discounting projected future cash flows and the market approach valued the security underlying the business by comparing it to those of similar businesses. The most significant facts and circumstances that led to the conclusion of this impairment were (a) future cash flows from these nutritional supplement lines are expected to be reduced, (b) selling, general and administrative expenses relating to these nutritional supplement lines are forecasted to increase as a percentage of sales, and (c) this nutritional supplements business has been experiencing a larger percentage decline in revenues than most of the comparable businesses of other companies. Because future cash flows and operating results used in the independent review are based on management's projections and assumptions, future events can cause actual results to differ from those projections. In such event, the full impairment charge of $12.1 million taken during the three months ended March 31, 2002 may not be justified.

Valuation of Other Long-Lived Tangible and Intangible Assets. Factors we generally consider important which could trigger an impairment review on the carrying value of other long-lived tangible and intangible assets include the following: (1) significant underperformance relative to expected historical or projected future operating results; (2) significant changes in the manner of our use of the acquired assets or the strategy for our overall business; (3) underutilization of our tangible assets; (4) discontinuance of product lines by ourselves or our customers; (5) significant negative industry or economic trends; (6) significant decline in our stock price for a sustained period; (7) significant decline

in our market capitalization relative to net book value; and (8) goodwill impairment identified during an independent review under SFAS No. 142.

Because the independent appraisal of the fair value of the reporting unit underlying our nutritional supplements business indicated an impairment of goodwill related to that reporting unit, as discussed above, we proceeded to also obtain an independent impairment review of the carrying value assigned to related trademarks and brand names. The results of this review also indicated an impairment of the carrying value of such trademarks and brand names because the full carrying amount of these intangible assets was not expected to be recoverable and exceeded its fair value. The carrying amount of these intangible assets was not recoverable because it exceeded the sum of the undiscounted cash flows expected to result from the use and eventual disposition of these assets. The fair value of these intangible assets was determined using a combination of the discounted cash flow approach and the relief from royalty approach, the latter of which valued the brand names as if they were licensed from a third party. Based on these results, we recorded another impairment charge of $12.7 million to write-off a portion of the carrying value of these trademarks and brand names during the three months ended March 31, 2002. The remaining carrying value of these intangible assets was $4.2 million at March 31, 2002, which is being amortized over the assets remaining useful lives of 20 years. The impairment was measured partly based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model. Although we believe that the remaining carrying value of our long-lived tangible and intangible assets were realizable as of March 31, 2002, future events could cause us to conclude otherwise.

Accounting for Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves us estimating our actual current tax exposure and assessing temporary differences resulting from differing treatment of items, such as reserves and accruals and lives assigned to long-lived and intangible assets, for tax and accounting purposes. These differences result in deferred tax assets and liabilities. We must then assess the likelihood that our 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 increase this allowance in a period, we must include an expense within our tax provision.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We have recorded a valuation allowance of $12.3 million as of December 31, 2001, due to uncertainties related to the future benefits from our deferred tax assets, primarily consisting of certain foreign net operating losses and tax credits, before these losses and credits expire. 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 establish an additional valuation allowance which could materially impact our tax provision.

Legal Contingencies

Because of the nature of our business, we may from time to time be subject to consumer product claims or various other lawsuits arising in the ordinary course of our business and we expect this will continue to be the case in the future. These lawsuits generally seek damages, sometimes in substantial amounts, for personal injuries or other commercial claims. In addition, we aggressively defend our patent and other intellectual property rights. This often involves bringing infringement or other commercial claims against third parties, which can be expensive and can result in counterclaims against us. We are currently involved in certain legal proceedings, as described in our reports filed from time

to time with the Securities and Exchange Commission, including our quarterly report on Form 10-Q for the quarter ending March 31, 2002. We do not accrue for potential losses on legal proceedings where our company is the defendant when we are not able to quantify our potential liability, if any, due to uncertainty as to the nature, extent and validity of the claims against us, uncertainty as to the nature and extent of the damages or other relief sought by the plaintiff and the complexity of the issues involved. Our potential liability, if any, in a particular case may become quantifiable as the case progresses, which will require us to begin accruing for the expected loss.

Recently Issued Accounting Standards

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 142, which addresses changes in the financial accounting and reporting for acquired goodwill and other intangible assets with indefinite lives. Effective January 1, 2002, all existing acquired goodwill and other intangible assets with indefinite lives are no longer amortized to expense, with early adoption required for all goodwill and other intangible assets with indefinite lives acquired subsequent to June 30, 2001. The statement also provides specific guidance for determining and measuring impairment of all goodwill and other intangible assets. We recorded goodwill amortization of approximately $151,000 for the three months ended March 31, 2001. At March 31, 2002, the total amount of goodwill affected by this statement was $74.3 million, which was all acquired subsequent to June 30, 2001. Also, at the adoption of SFAS No. 142, we recorded a goodwill impairment charge of $12.1 million during the three months ended March 31, 2002.

In August 2001, the FASB issued SFAS No. 144, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement requires that a long-lived asset to be abandoned, exchanged for a similar productive asset, or distributed to owners in a spin-off be considered held and used until it is disposed of. The changes in this statement require that one accounting model be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired, and broaden the presentation of discontinued operations to include more disposal transactions. SFAS No. 144 also provides guidance for determining and measuring impairment of long-lived and intangible assets, which do not materially differ from previous guidance. The provisions of this statement are effective for financial statements issued for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years, with early adoption encouraged. The provisions of this statement generally are to be applied prospectively. During the three months ended March 31, 2002, we recorded an impairment charge to our carrying value of certain trademarks and brand names of $12.7 million in accordance with SFAS No. 144.

Quantitative and Qualitative Disclosures about Market Risk

The following discussion about our market risk disclosures involves forward-looking statements. Actual results could differ materially from those discussed in the forward-looking statements. We are exposed to market risk related to changes in interest rates and foreign currency exchange rates. We do not use derivative financial instruments for speculative or trading purposes.

Interest Rate Risk

We are exposed to market risk from changes in interest rates primarily through our investing and financing activities. In addition, our ability to finance future acquisition transactions or fund working capital requirements may be impacted if we are not able to obtain appropriate financing at acceptable rates.

Our investing strategy, to manage interest rate exposure, is to invest in short-term, highly liquid investments. Our investment policy also requires investment in approved instruments with an initial maximum allowable maturity of 18 months and an average maturity of our portfolio that should not exceed 6 months, with at least $500,000 cash available at all times. Currently, our short-term investments are in money market funds with original maturities of 90 days or less. At March 31, 2002, our short-term investments approximated market value.

In December 2001, we entered into the RBS Credit Agreements with The Royal Bank of Scotland plc and related entities for credit facilities in the aggregate amount of $70 million. The RBS Credit Agreements consisted of term loans aggregating $62.5 million, of which $10 million were denominated in Japanese Yen, and a $7.5 million multicurrency revolving line of credit. To date, we have not utilized the revolving line of credit. The aggregate outstanding loan balance under the RBS Credit Agreements as of March 31, 2002 was $52.3 million, including capitalized interest of approximately $109,000 but net of a reduction of approximately $334,000 resulting from a change in the United States Dollar-to-Japanese Yen exchange rate. The term loans and revolving line of credit allow us to borrow at LIBOR plus a spread from 1.5% to 3.5% (and an additional 2% in case of default), depending on the type of loan (senior or junior) and the interest period. On the loans in which the spread may vary, the spread depends on the ratio of our total debt to EBITDA. In February 2002, we entered into an interest rate swap agreement with the bank, as required by the RBS Credit Agreements, which will protect both our company and the bank from interest rate fluctuations. Under the interest rate swap agreement, the LIBOR rate is set at a minimum of 3.36% and a maximum of 5% and applies to $34.8 million to $41.7 million of the term loans denominated in United States Dollars, depending upon the interest period. This interest rate swap agreement is effective for the period from February 25, 2002 to December 31, 2004. Had there not been an interest rate swap agreement in place as of March 31, 2002, the LIBOR applicable to the term loans denominated in United States Dollars would have been 1.9%. The LIBOR applicable to the term loan denominated in Japanese Yen was 0.10% at March 31, 2002. If the LIBOR rate increases one percentage point, as compared to the rate at March 31, 2002, taking into consideration the terms of the interest rate swap agreement, we estimate an increase in our interest expense of approximately $103,000 over the next twelve months. If the LIBOR rate increases two percentage points, as compared to the rate at March 31, 2002, taking into consideration the terms of the interest rate swap agreement, we estimate an increase in our interest expense of approximately $544,000 over the next twelve months.

Our recently acquired IVC subsidiary has a credit agreement with Congress Financial Corporation, which allows IVC to borrow up to $15.0 million under a revolving credit commitment, subject to borrowing base limitations, as defined in the agreement. IVC also has outstanding $4.2 million under a term loan commitment. The loans with Congress mature on October 16, 2003. As of March 31, 2002, total borrowings outstanding under the credit agreement with Congress were $6.9 million. Borrowings under the revolving credit commitment and the term loan bear interest at either 1.5% above the bank's prime rate or, at IVC's option, at 3.75% above the Adjusted Eurodollar Rate used by the bank. As of March 31, 2002, the interest rate on $5.5 million of the outstanding borrowings was at the Adjusted Eurodollar Rate of 2% plus the spread of 3.75% and the interest rate on the remaining $1.4 million of the outstanding borrowings was at the prime rate of 4.75% plus the spread of 1.5%. If both the Adjusted Eurodollar Rate and the prime rate increase one percentage point, as compared to the respective rates at March 31, 2002, we estimate an increase in IVC's interest expense of approximately $60,000 over the next twelve months. If both the Adjusted Eurodollar Rate and the prime rate increase two percentage points, as compared to the respective rates at March 31, 2002, we estimate an increase in IVC's interest expense of approximately $120,000 over the next twelve months.

Foreign Currency Risk

We face exposure to movements in foreign currency exchange rates. During the three months ended March 31, 2002, the net impact of foreign currency changes was a gain of $188,000. We expect this exposure to increase because of our expansion into markets outside of the United States as a result of our recent acquisitions of the Unipath business and IVC. Historically, we have not used derivative financial instruments or other financial instruments to hedge economic exposures or for trading. However, because significant amounts of the revenue and expenses of the Unipath business are denominated in foreign currencies, starting in early 2002 we began utilizing foreign exchange forward contracts to minimize exposure to the risk that the eventual net cash inflows and outflows resulting

from the sale of products to foreign customers and purchases from foreign suppliers will be adversely affected by changes in exchange rates. Our goal is to utilize foreign exchange forward contracts for recognized receivables and payables and firmly committed cash inflows and outflows. The use of these derivative financial instruments allows us to reduce our overall exposure to exchange rate movements, since the gains and losses on these contracts are expected to substantially offset losses and gains on the assets, liabilities and transactions to which these contracts relate. Cash inflows and outflows denominated in the same foreign currency are netted on a legal entity basis and the corresponding net cash flow exposure is appropriately hedged. As of March 31, 2002, we did not have outstanding foreign exchange forward contracts.

Additionally, as described above, in December 2001 we entered into a series of credit agreements with The Royal Bank of Scotland plc and related entities pursuant to which we borrowed $10.0 million denominated in Japanese Yen (or 1,283 million Japanese Yen). As of March 31, 2002, the outstanding balance of this loan was $8.1 million, net of a reduction of approximately $334,000 resulting from a change in the

dollar-to-yen exchange rate. We have not entered into a foreign exchange forward contract to hedge this loan; however, if we do not expect to collect sufficient payments in yen from our royalty contracts recently acquired as part of the Unipath business, we may do so in the future. As of March 31, 2002, the dollar-to-yen exchange rate was approximately 132.77. If the dollar-to-yen exchange rate decreased by ten percent, as compared to the rate at March 31, 2002, we estimate that the outstanding principal amount owed by us under this loan would have been higher by approximately $900,000 on that date. If the dollar-to-yen exchange rate decreased by twenty percent, as compared to the rate at March 31, 2002, we estimate that the outstanding amount owed by us under this loan would have been higher by approximately $2.0 million on that date. If, on the maturity dates over the next twelve months, the dollar-to-yen exchange rate was lower by ten percent, as compared to the rate at March 31, 2002, we would have to pay approximately $118,000 more in principal repayments during that period. If, on the maturity dates over the next twelve months, the dollar-to-yen exchange rate was lower by twenty percent, as compared to the rate at March 31, 2002, we would have to pay approximately $265,000 more in principal repayments during that period.

BUSINESS

The description herein of our business has been derived from a more complete description thereof contained in our annual report on Form 10-K, as amended, for the year ended December 31, 2001 and other filings with the Securities and Exchange Commission incorporated by reference into this prospectus supplement and the accompanying prospectus. As a result, it may not include all information that is important to you. You should read this entire prospectus supplement and the accompanying prospectus, including the documents incorporated by reference, carefully before deciding whether to invest in our common stock.

Overview

We develop, manufacture and market consumer health care products, including self-test diagnostic products for the women's health market and vitamins and nutritional supplements. To a lesser extent, we develop, manufacture and market clinical diagnostic products for use by medical professionals. Our consumer self-test diagnostic products allow individuals to obtain accurate information regarding various medical conditions on a confidential, non-prescription basis, without the expense, inconvenience and delay associated with physician visits or laboratory testing. This information gives individuals greater control over their health and their lives, allowing them to make informed decisions and take action to protect their health, alone or in consultation with health care professionals. Our existing self-test products are targeted at the women's health market, one of the largest existing markets for self-care diagnostics, and include home pregnancy detection tests and ovulation prediction tests. We also sell a wide variety of vitamins and nutritional supplements. Our clinical diagnostic products include test kits used by smaller laboratories, physicians' offices and other point-of-care sites for the detection of pregnancy and a wide variety of infectious diseases.

On November 21, 2001, Johnson & Johnson acquired Inverness Medical Technology, Inc., or IMT, our former parent, in a merger transaction and, simultaneously, our company was split off from IMT as a separate publicly traded company. Immediately prior to the consummation of these transactions, IMT restructured its operations so that we would hold all of IMT's non-diabetes businesses (women's health, nutritional supplements and clinical diagnostics). At the closing of the transaction, all of the shares of our common stock held by IMT were split-off from IMT in a pro rata distribution to IMT's stockholders (the Split-Off), and IMT merged with and became a wholly-owned subsidiary of Johnson & Johnson.

On December 20, 2001, we acquired Unipath Limited, a global leader in home pregnancy and ovulation testing and natural family planning, and its associated companies and assets from Unilever plc and certain entities affiliated with Unilever. The Unipath acquisition provides us with leading brand name consumer diagnostic products that compliment our existing value branded and private label home pregnancy detection and ovulation prediction products. Together with the acquisition of the Unipath business, we also acquired rights to certain antibody clones and other intellectual property rights. The consideration paid to Unilever for the Unipath business was 103 million pounds sterling (approximately 150 million United States dollars) in cash, subject to certain adjustments provided for in the sale agreement.

On March 19, 2002, we acquired IVC Industries, Inc., a manufacturer and distributor of hundreds of different vitamin and nutritional supplement products sold under brand names and through private label arrangements with retailers. With the addition of IVC, we intend to consolidate substantially all of our vitamin and nutritional supplement manufacturing at IVC and discontinue most of our outsourced manufacturing arrangements. The aggregate purchase price of IVC was approximately $27.3 million, which included $17.4 million in assumed debt.

Strategy

Our objective is to become the leading provider of innovative products in the areas of women's health and chronic disease self-management. The key elements of our strategy for achieving this goal are to:

Continue developing innovative diagnostic products. Prior to the split-off of our company as an independent public company in November 2001, our management team developed the first electrochemical blood glucose monitoring system and commercialized a system that measures blood glucose in the fastest time available with a small blood sample. In addition, our Unipath subsidiary, acquired in December 2001, was the first to develop a one-step home pregnancy test, a one-step ovulation test and an estrogen-based fertility monitor. We intend to leverage our collective experience in the rapid test diagnostic sector and our significant intellectual property portfolio to develop superior and innovative products in the areas of women's health and chronic disease self-management.

Expand the application of our technology to develop products in other focus areas. Currently, our diagnostic products are primarily used to detect pregnancy and predict ovulation. However, we believe there are additional market opportunities for us to pursue, both in women's health and in other areas. For example, we believe that the aging population may provide opportunities in other areas of women's health, such as osteoporosis and menopause, creating demand for consumer diagnostic products in those areas. We plan to continue investing in research and development and intend to begin commercially launching new products in our targeted areas by 2004, with a goal of launching at least one significant new product each year.

Selectively acquire complementary product lines, companies and technologies. We plan to pursue selective acquisitions that could advance our technologies, establish new products and increase market penetration and breadth of our product offerings. We have significant experience in evaluating and completing acquisitions of businesses, technologies and intellectual property and in integrating acquired businesses and commercializing acquired technology. We have recently completed and are integrating two acquisitions, Unipath and IVC.

Maximize market penetration of our products. We will continue to leverage our global marketing and sales force to further penetrate our existing markets through our relationships with leading retailers, including Walgreens, CVS, RiteAid and Boots, as well as with drug wholesalers and mass merchandisers. We believe that our high level of service and ability to provide a wide range of high quality consumer products, which include premium and value-oriented brands and private label products, enhances our existing customer relationships and helps us develop new relationships.

Manufacture high quality products at low cost. One of the most significant contributors to our growth will be to leverage and enhance manufacturing operations for our products. We produce nearly all of our disposable consumer diagnostic products at our facilities in Bedford, England and Galway, Ireland, both of which are ISO and FDA registered establishments that employ modern production techniques to produce consistent, high quality products at low cost.

Industry

Consumer Products

Consumer Diagnostic Products. Our current consumer diagnostic products target the women's health market. A.C. Neilson & Co. estimates total United States retail sales of pregnancy and ovulation prediction tests at approximately $278 million for the 52 weeks ending March 30, 2002, approximately 85% of which represents sales of pregnancy detection tests and approximately 15% of which represents sales of ovulation prediction tests. We believe that the demand for ovulation prediction products is growing steadily because of increased awareness of the incidence of infertility, as well as a desire on the

part of couples to plan conception with more certainty. The demand for pregnancy test products is growing also, but at a slower pace.

There are numerous pregnancy self-tests on the market, which are typically urine-based tests and provide results in less than five minutes. Ovulation prediction urine-based tests inform women of the best time to conceive a baby by detecting the surge of the luteinizing hormone, which precedes ovulation. Ovulation prediction tests are generally easy to use and are becoming widely accepted by professional fertility care providers and the general public.

Vitamins and Nutritional Supplements. The Dietary Supplement Information Bureau estimates that the total mass merchandise retail sales of vitamins and nutritional supplements in the United States during 2000 was $5.7 billion. Growth in the industry is primarily driven by media commentary regarding the quality and efficacy of nutritional supplements. Well-established market segments, where competition is greater and

media commentary less frequent, generally experience relatively slow and stable growth. There has been little or no growth in the overall nutritional supplements industry over the last year, as the decline of the herbal supplement segment, which was extremely active in the past, has offset the growth in particular new mineral and non-herbal supplements. Slow growth has resulted in retailers reducing shelf space for nutritional supplements and forced many under-performing items out of distribution, including several broad product lines. Sales growth of store brand, or private label, products has outpaced the overall industry growth, as retailers continue to add to the number of private label nutritional products on their shelves.

Clinical Diagnostics

The clinical diagnostics market consists of products designed to assist medical professionals in analyzing human body fluids or other materials for markers of medical conditions, including pregnancy or disease, or the presence of agents that may signal disease.

Customers can be divided into two segments. One segment consists of centralized laboratories that increasingly benefit from computerization and automation. The second segment consists of small and medium-sized non-centralized laboratories and testing locations, including small blood banks, doctors' offices and some rapid response laboratories in larger medical centers. Clinical diagnostics products that serve this second segment are rapid result, point-of-care tests that offer an alternative to traditional high volume, multi-step immunoassays (which use antibodies to measure hormone levels) that require skilled operators and centralized processing.

We believe that the demand for infectious disease diagnostic products is growing faster than demand in other segments of the point-of-care immunoassay market due to the increasing incidence of certain diseases or groups of diseases, including viral hepatitis, acquired immuno deficiency syndrome, tuberculosis, as well as chlamydia and other sexually transmitted diseases.

We also believe there is a growing demand in the clinical diagnostics market for fast, high-quality, inexpensive, self-contained diagnostic kits resulting in part from efforts in many nations to control health care expenditures.

Products

Consumer Products

Consumer Diagnostics. Our consumer diagnostics business currently develops, manufactures and markets home pregnancy and ovulation prediction tests under our own brands and under various private labels. Our ClearBlue brand of home pregnancy detection tests and our ClearPlan brand of ovulations prediction tests are global leaders in terms of both sales and technology, though ClearBlue has a smaller presence in the United States. Our Inverness Medical branded products are marketed to value-oriented consumers in the United States. In addition, we are a major United States supplier of

private label home pregnancy detection and ovulation prediction products. We also sell Persona, a contraceptive monitoring device sold overseas, primarily in Germany and the United Kingdom.

Pregnancy Test Products. We market our pregnancy self-test kits in both stick and cassette versions. The stick version has an exposed wick which absorbs urine when placed in the urine stream. The cassette version requires the user to first collect a urine sample in a cup and then use an enclosed dropper to place the urine sample in the test well. Both versions employ identical technology enabling the display of visual results in approximately three minutes. We manufacture our pregnancy test kits at our facilities in Bedford, England and Galway, Ireland and sell them over-the-counter through drug store chains, grocery chains and mass merchandisers under their own store brand label as well as under our own brand names.

Ovulation Prediction Products. We market our ovulation prediction self-test kits in stick and cassette versions, each of which operates in a manner similar to the comparable version of our pregnancy self-test kits. We market our ovulation prediction test kits under our own brand names and under various store brand labels of retail drugstore chains, grocery stores and mass merchandisers. Our ovulation prediction test kit provides 24 to 48 hours notice of when ovulation is likely to occur. By identifying the days when a woman is most fertile, these products assist couples in their family planning. Clinically accurate results are available in approximately three minutes.

We also market an advanced ovulation prediction self-test device called the ClearPlan Easy Fertility Monitor. The Fertility Monitor not only detects the surge of the luteinizing hormone, which causes ovulation, but it also identifies additional days when a woman can conceive by detecting a rise in estrogen levels. The Fertility Monitor is comprised of a hand held monitoring device and disposable urine test sticks. This product is sold primarily in the United States and Canada.

Our ovulation prediction products are primarily manufactured at our facilities in Bedford, England and Galway, Ireland, except for the Fertility Monitor hand held monitoring device which we purchase from third party suppliers.

Persona. Persona is a diagnostic monitoring device that serves as a natural method of contraception by allowing the user to monitor her menstrual cycle. Persona is comprised of a hand held monitoring device and disposable urine test sticks. Persona is sold in Europe, primarily in Germany and the United Kingdom, where it is classed as a contraceptive device. Persona does not currently have regulatory approval in the United States.

Vitamins and Nutritional Supplements. As a result of our recent acquisition of IVC, we now market a wider variety of vitamins and nutritional supplements through retail drug store chains, mass merchandisers, food stores and warehouse clubs. Through IVC, we acquired a comprehensive assortment of vitamin, mineral and nutritional supplement products. These products will be marketed under the Inverness Medical tradename, as well as under private label and are positioned as high quality, lower priced alternatives to nationally advertised brands. The acquired IVC branded products are high quality products sold at moderate prices through national and regional drug store, club stores, supermarket and mass merchandising chains. Our Synergy Plus line of products is sold primarily in health food stores. The acquisition of IVC also expands our vitamin and nutritional supplements business outside of United States for the first time because the products we acquired from IVC are marketed internationally.

Our nutritional supplement products that predate our acquisition of IVC include Stresstabs, a B-complex vitamin with added antioxidants; Ferro-Sequels, a time release iron supplement; Protegra, an antioxidant vitamin and mineral supplement; Posture, a calcium supplement; ALLBEE, a line of B-complex vitamins; and Z-BEC, a zinc supplement with B-complex vitamins and added antioxidants.

We also market our products under the SmartCare program, which assists consumers in matching their health concerns to the appropriate supplement products that we sell. SmartCare provides a means of linking our various nutritional supplement products, allowing for greater efficiencies in advertising, promotion and merchandising. We have not yet determined whether we will be able to expand this program to include products that we acquired from IVC.

Clinical Diagnostic Products

Clearview Products. Through our acquisition of the Unipath business, we acquired and currently develop, manufacture and sell six qualitative, visually-interpreted rapid diagnostic tests for use by medical professionals. These products, which are primarily sold under the Clearview label, are used in point-of-care environments where a rapid response is desired or where the volume of testing is too low to warrant high volume methods.

The six Clearview products are:

Clearview HCG II and Easy HCG. These tests are used to confirm pregnancy and also to rule out pregnancy in patients with abdominal pain, late menses and spotting.

Clearview Chlamydia MF. This test provides a protocol to rapidly detect chlamydia trachomatis infection in men (urine specimen) and women (endocervical swab). The test delivers comparable performance of laboratory immunoassays, but takes only 30 minutes to achieve a result. In the United States, this product is approved for evaluation of females only.

Clearview Strep A. The test is used to detect streptococcal group A in pharyngeal swabs from patients with sore throat and other symptoms. The test gives results in five minutes.

Clearview IM. This test is used to diagnose or rule out infectious mononucleosis. Results are available in five minutes for serum plasma specimen and 15 minutes for whole blood. This test is not sold in the United States.

Clearview C Diff A. This test is used to diagnose clostridium difficile-associated diarrhea and to monitor the effectiveness of antibiotic treatment. The test is sold under the Clearview brand in the United States. We also manufacture and supply this test to an unrelated third party for sale outside the United States.

Listeria. This test is used to detect the presence of listeria monocytogenes, a microorganism, in foods and raw materials used in the food industry. We manufacture and supply this test for an unrelated third party who markets it globally under its own brand name.

Orgenics Products. Our wholly-owned subsidiary, Orgenics Ltd., which is located in Yavne, Israel, develops, manufactures and sells clinical diagnostic products based on several proprietary technological platforms. These platforms are used to detect a wide variety of infectious diseases, including HIV-1, HIV-2, hepatitis, chlamydia and TORCH. The products are designed to enable small to medium-sized laboratories to economically analyze low volumes of test specimens.

Our Orgenics clinical diagnostic products are based on three primary platforms: ImmunoComb, DoubleCheck and ImmunoGold. ImmunoComb is our main platform and currently serves as the basis for 25 diagnostic products. The platform is based upon a plastic "comb" with twelve projections upon which antigens or antibodies are applied and which is inserted into a vessel containing a patient's specimen. This manual testing platform provides the sensitivity, accuracy and versatility of more expensive automated testing platforms at lower prices. DoubleCheck is a single test device through which a specimen migrates to a reaction zone where it filters through and subsequently binds to immobilized antigens or antibodies. DoubleCheck produces results in less than 15 minutes. ImmunoGold consists of a strip containing antigens or antibodies immobilized along a line to which a pad containing gold conjugate is attached. When rehydrated by the liquid specimen the gold particles migrate laterally along the strip where they react with immobilized reagents to produce a sharp red line. ImmunoGold produces results in about five minutes and has the advantages of not requiring refrigerated storage or addition of reagents during the test procedure.

Marketing and Sales

Consumer Products

Consumer Diagnostic Products. We market and sell our consumer diagnostic products worldwide through third party brokers and our sales force under our own trade and brand names as well as under store brands. Our customers include retail drug store chains, drug wholesalers, grocery retailers and mass merchandisers in North America and Europe. Our ClearBlue and ClearPlan brand products are global leaders in terms of both sales and technology, though ClearBlue has a smaller presence in the United States. Our ClearBlue and ClearPlan products are generally marketed globally as premium products and compete intensively with other premium brand name products. Persona is also marketed as a premium product in Europe. Marketing of premium branded products focuses on brand awareness and feature and performance differentiation. This is achieved primarily through mass media television advertising. Within the United States, where our ClearBlue brand has not yet established the high level of brand awareness and brand loyalty typical of a premium brand, we are attempting to build market share by offering value-oriented pricing as well as by aggressively advertising the brand. Our Inverness Medical branded products compete primarily based on price and are not heavily advertised. Private label arrangements accounted for 63% of our consumer diagnostics revenues during 2001 without reference to the Unipath business, which was not acquired until December 20, 2001. Our three largest customers are Walgreens, CVS and Rite Aid, each of which sells both branded and private label products purchased from us.

Vitamins and Nutritional Supplements. We primarily market and sell our vitamins and nutritional supplements under our own brand names to retail drug store chains, drug wholesalers, grocery retailers and mass merchandisers in the United States and Canada. We also have distribution agreements in place to support the sale of certain of our products in the Middle East, Mexico, South Africa, Europe and the Pacific Rim. Our three largest customers during 2001 were Walgreens, Wal-Mart and McKesson Corporation. IVC's largest customer has historically been Costco Wholesale, which accounted for 57% of IVC's sales during its fiscal year ending July 31, 2001. Our rights to the trademarks Stresstabs, Ferro-Sequels, Posture, Protegra, ALLBEE and Z-BEC are limited to use in North America, but we are not restricted from marketing the formulations sold under those brand names in North America under other brand names outside of North America.

Clinical Diagnostic Products

Our Clearview products are sold worldwide through third party distributors and in Germany by our own sales force. However, we sell our C Diff A test under our Clearview brand only in the United States. We otherwise manufacture and sell our C Diff A test, as well as our Listeria test product, to an unaffiliated company who markets the products under its own brands. That arrangement prohibits us from selling these tests

directly or to other resellers. Five countries, the United States, Germany, the United Kingdom, Japan and China, represent 80% of our sales of Clearview products. Our Orgenics business has sales offices in Israel, France, Russia, Brazil, Nigeria and Colombia which market our clinical diagnostics products to smaller laboratories, blood banks, physicians' offices and other patient point-of-care sites in more than 90 countries, principally in Europe, Latin America, Africa and Asia.

Manufacturing

Consumer Products

Consumer Diagnostic Products. We produce nearly all of our disposable consumer diagnostic products at our facilities in Bedford, England and Galway, Ireland. Both facilities are ISO 9001 and EN 46001 certified, FDA registered establishments that employ modern production techniques to produce consistent, high quality components. A significant portion of our products produced and assembled at our Galway plant are subsequently packaged by a third party in the United States. We rely on third

parties for nearly all our production materials. We purchase our electronic consumer diagnostic products, the Fertility Monitor and Persona, to our specifications from third party suppliers in Europe. We also purchase a small number of low cost, disposable products from third party suppliers for distribution in Europe. Because most components of our diagnostic products are produced to our specifications, some of our suppliers are single source suppliers with few, if any, alternative sources immediately available.

We own one-half and lease one-half of our Galway facility and are currently using the Bedford facility pursuant to an agreement with Unilever entered into in connection with our acquisition of the Unipath business.

Vitamins and Nutritional Supplements. Through our acquisition of IVC, we acquired manufacturing facilities in Freehold and Irvington, New Jersey. IVC manufactured substantially all of its products at these locations. The facilities located in Freehold, New Jersey are equipped with large-volume blending, tableting and coating equipment, high-speed packaging equipment, including "cartoning," "stretch carding" and "blister carding" equipment, and testing and quality control laboratories. IVC internally manufactures all of its softgel products at the Irvington facility. We intend to consolidate manufacturing of substantially all of our vitamin and nutritional supplement products in these acquired facilities, both of which currently have substantial additional capacity. These facilities have been certified by an independent auditing firm to be in compliance with Good Manufacturing Practices. We currently manufacture our non-IVC nutritional supplement products domestically through third parties.

Clinical Diagnostics Products.

Our clinical diagnostic products are manufactured at our facilities in Bedford, England, which is described above, and in Yavne, Israel. The Yavne manufacturing facility is ISO 9001 and EN 46001 certified, as well as Good Manufacturing Practices certified by the Israeli Ministry of Health.

Research and Development

Our research and development efforts are currently focused on developing new products and enhanced features for our lines of women's health and clinical diagnostics products, as well as the development of product lines targeting new markets. Our research and development staff consists of approximately 70 people, many of whom have extensive experience in the consumer diagnostics industry. Most of our research and development activities are carried out in Bedford, England, Galway, Ireland and Yavne, Israel. We may, from time to time, supplement our internal research and development efforts with third parties' efforts either through co-development or licensing arrangements, or through product or technology acquisitions. In connection with co-development or licensing activities that we may enter into in the future, we may provide financial development assistance to these parties and may also utilize our own research and development resources to design certain portions of such products. We expect research and development expenses to continue to increase as we seek to enhance our existing products and develop additional products.

Foreign Operations

Our business relies heavily on our foreign operations. Three of our manufacturing facilities are outside the United States, in Bedford, England, Galway, Ireland and Yavne, Israel. Orgenics has always made substantially all of its sales outside of the United States. Through our recent acquisitions of the Unipath business and IVC, we expect foreign sales to grow significantly. The Unipath business generated approximately 70% of its net product sales outside of the United States during 2001 and IVC generated almost 14% of its net product sales outside of the United States during its fiscal year ending July 31, 2001.

Competition

General

We have existing competitors, as well as a number of potential new competitors, who have greater name recognition, and significantly greater financial, technical and marketing resources than we do. These strengths may allow them to devote greater resources than we can to the development, marketing and sales of products. These competitors may also engage in more extensive research and development, undertake more far-reaching marketing campaigns and adopt more aggressive pricing policies and make more attractive offers to existing and potential employees, customers and clients.

We expect that industry forces will impact us and our competitors. Our competitors will likely strive to improve their product offerings and price competitiveness. We also expect our competitors to develop new strategic relationships with providers, referral sources and payors, which could result in increased competition. The introduction of new and enhanced services, acquisitions and industry consolidation, and the development of strategic relationships by our competitors could cause a decline in sales or loss of market acceptance of our products, intensify price competition or make our products less attractive.

Consumer Products

Consumer Diagnostic Products. Competition in the pregnancy detection and ovulation prediction market is intense. Our competitors in the United States, and worldwide, are numerous and include, among others, large medical and consumer products companies as well as numerous private label manufacturers. Our competitors for the sale of pregnancy test products include Abbott Laboratories, Acon Laboratories, Advanced Biotechnologies, Becton Dickinson, Biotech Atlantic, Armkel, London International Holdings, Pfizer, Princeton BioMeditech Corporation, Syntron Bioresearch and Quidel Corp. Our competitors for the sale of ovulation predictors include Becton Dickinson, Armkel, Princeton Biomeditech, Syntron and Quidel. Competition among branded consumer diagnostics products is based on brand recognition and price. Products sold under well-established or "premium" brand names can demand higher prices and maintain high market shares due to brand loyalty. Outside of the United States, ClearBlue is a premium brand and is a market leader. In the United States, where ClearBlue is less well-established, although still a leading brand, the premium brands can demand higher pricing than we can. Our ClearPlan ovulation prediction products qualify as premium brands worldwide and are market leaders both in the United States and globally. Our Inverness Medical-branded consumer products compete based on price and do not attempt to compete based on brand recognition. For private label manufacturers, competition is based primarily on the delivery of products at lower prices that have substantially the same features and performance as brand name products. ClearPlan Fertility Monitor and Persona are unique products, and their competitors or markets are not easily defined.

Many of our competitors have substantially greater financial, production, marketing and distribution resources than we do. However, we believe that we can continue to compete effectively in the consumer diagnostics market based on our research and development capabilities, advanced manufacturing expertise, diversified product positioning, global market presence and established wholesale and retail distribution networks.

Vitamins and Nutritional Supplements. In the branded nutritional supplements industry, competition is based principally upon brand name recognition, price, quality, customer service and marketing support. There are numerous companies in this industry selling products to retailers. A number of these companies, particularly manufacturers of nationally advertised brand name products, are substantially larger than we are and have greater financial resources. Among the major competitors of our branded products that are sold though supermarkets and other mass retailers are Wyeth, formerly known as American Home Products, Pharmavite, Leiner Health Products, Royal Numico and

SmithKline Beecham. There are also several manufacturers that produce store brand nutritional supplements with formulations very similar to those of nationally marketed brands, including ours. Major competitors of our Synergy Plus brand, which is sold through health food stores and independent drug stores, include Twinlab Corporation, Wyeth and Weider Nutritional International.

The market for private label vitamins and nutritional supplements is extremely price sensitive, with quality, customer service and marketing support also being important. Many of the companies listed above as competitors of our mass marketed branded vitamins and nutritionals also sell to private label customers and constitute our major competitors for private label business. In addition, there are several companies, such as

Perrigo and Contract Pharmacal, that compete only in the private label business.

Clinical Diagnostic Products

Clearview Products. Our main competitors in the point-of-care immunoassay market are Abbott Laboratories and Quidel Corporation. Other notable competitors in all or some product segments are Thermo Biostar, Biosite Diagnostics, Beckman Coulter, Becton Dickinson, and a host of small but aggressive companies such as Syntron Bioresearch, Princeton BioMeditech Corporation, Applied Biotech, Vedalab and Trinity Biotech. Some automated immunoassay systems can be considered as competitors when labor shortages force laboratories to automate or when the costs of such systems are lower. Such systems are provided by Abbott, Bayer, Roche Diagnostics, Beckman and other large diagnostic companies. In the infectious disease area, new technologies utilizing simplification techniques for analyzing molecular DNA gene sequences such as lygase chain reaction or polymerase chain reaction from Abbott, Roche and Gen-Probe are making in-roads into this market.

Orgenics Products. The main competitors of our ImmunoComb products are standard enzyme linked immuno sorbent assay, or ELISA, systems, such as those produced by Organon, Inc., Bio-Rad, Abbott, Ortho, Roche and others. ELISA tests are generally used by high-volume batch processors such as blood banks and other centralized laboratories. The primary competitors of our other rapid test platforms also include multinational corporations that tend to concentrate their efforts on sales of automated diagnostic systems to centralized laboratories. These multinational corporations have greater resources and more extensive sales networks than we have. Other competitors include Trinity Biotech, Savyon, Gull Laboratories and SDS, which are smaller companies operating primarily in our niche market. Some of these companies do not have the international sales network or the number of products that we have.

Patents and Proprietary Technology; Trademarks

The medical products industry, including the diagnostic testing industry, places considerable importance on obtaining patent and trade secret protection for new technologies, products and processes. Our success will depend, in part, on our ability to obtain patent protection for our products and manufacturing processes to preserve our trade secrets and to avoid infringing the proprietary rights of third parties.

However, we cannot assure you as to the success or timeliness in obtaining any such patents or as to the breadth or degree of protection that any such patents might afford us. The patent position of medical products and diagnostic testing firms is often highly uncertain and usually involves complex legal and factual questions. There is a substantial backlog of patents at the United States Patent and Trademark Office and in other patent registration offices around the world. No consistent policy has emerged regarding the breadth of claims covered in medical product patents. Accordingly, we cannot assure you that patent applications relating to our products or technology will result in patents being issued, that, if issued, such patents will afford adequate protection to our products or that our competitors will not be able to design around such patents.

The medical products industry, including the diagnostic testing industry, historically has been characterized by extensive litigation regarding patents, licenses and other intellectual property rights. We could and have incurred substantial costs in defending ourselves against patent infringement claims and in asserting such claims against others. To determine the priority of inventions, we may also have to participate in interference proceedings declared by the United States Patent and Trademark Office or foreign patent and trademark authorities, which could also result in substantial costs to us. If the outcome of any such litigation is adverse to us, our business could be materially adversely affected.

In addition, we sometimes obtain licenses to patents or other proprietary rights of third parties to manufacture and market our products. We cannot assure you that licenses required under any such patents or proprietary rights would be made available on terms acceptable to us, if at all. If we do not obtain such licenses, we may encounter delays in product market introductions while we attempt to design around such patents or other rights, or we may be unable to develop, manufacture or sell such products in certain countries, or at all.

We also seek to protect our proprietary technology, including technology that may not be patented or patentable, in part through confidentiality agreements and, if applicable, inventors' rights agreements with collaborators, advisors, employees and consultants. We cannot assure you that these agreements will not be breached, that we will have adequate remedies for any breach or that our trade secrets will not otherwise be disclosed to, or discovered by, competitors or potential competitors. Moreover, we may from time to time conduct research through academic advisors and collaborators who are prohibited by their academic institutions from entering into confidentiality or inventors' rights agreements.

Finally, we believe that certain of our trademarks in our consumer products product lines are valuable assets and are important to the marketing of our products. Substantially all of these trademarks have been registered with the United States Patent and Trademark Office or internationally, as appropriate. We cannot assure you, however, that registrations will afford us adequate protection and will not be challenged as unenforceable or invalid, or will not be infringed. In addition, we could incur substantial costs in defending suits brought against us or in

prosecuting suits in which we assert rights under such registrations.

Employees

As of March 25, 2002, we had a total of 1,171 full-time employees, of which 454 employees are located in the United States. In addition, we utilize the services of a number of consultants specializing in research and development in our targeted markets, regulatory compliance, strategic planning, marketing and legal matters.

MANAGEMENT

The following biographical descriptions set forth certain information regarding our directors, executive officers and other key employees.

Name	Age	Position
Ron Zwanziger	48	Chairman of the Board, President and Chief Executive Officer
David Scott, Ph.D.	45	Director and Chief Scientific Officer
Anthony J. Bernardo	50	Vice President and Chief Operating Officer President of Inverness Medical, Inc.
Jerry McAleer, Ph.D.	47	Vice President, Research and Development Managing Director of Unipath Ltd.
David Toohey	45	Vice President, European Operations
Duane L. James	42	Vice President, Finance and Treasurer
John Yonkin	42	Vice President, U.S. Sales & Marketing
Doug Shaffer	44	Vice President, U.S. Operations
Paul T. Hempel	53	General Counsel and Secretary
Ernest A. Carabillo, Jr.	63	Director
Carol R. Goldberg	71	Director
Robert P. Khederian	49	Director
John F. Levy	55	Director
Peter Townsend	67	Director
Alfred M. Zeien	72	Director

Ron Zwanziger has served as our Chairman, Chief Executive Officer and President since May 11, 2001. Prior to the Split-Off, Mr. Zwanziger served as Chairman, Chief Executive Officer and President of Inverness Medical Technology since its inception in 1992. From 1981 to 1991, he was Chairman and Chief Executive Officer of MediSense, a medical device company.

David Scott, Ph.D. has served on the Board since July 31, 2001 and is our Chief Scientific Officer. Prior to the Split-Off, Dr. Scott served as chairman of Inverness Medical Limited, a subsidiary of Inverness Medical Technology, since July 1999 and served as a managing director of Inverness Medical Limited from July 1995 to July 1999. Dr. Scott served as Managing Director of Great Alarm Limited, a consulting company, from October 1993 to April 1995. Between October 1984 and September 1993, he held several positions at MediSense UK, most recently as managing director where he was responsible for managing product development, as well as the mass manufacture of one of its principal products, ExacTech.

Anthony J. Bernardo has served as a Vice President since the Split-Off and on February 19, 2002 was appointed our Vice President & Chief Operating Officer. He has also served as President and Chief Operating Officer of Inverness Medical, Inc., our primary U.S. operating subsidiary, since the Split-Off. Prior to the Split-Off, Mr. Bernardo served as Vice President of New Business Development of Inverness Medical Technology since April 2000. Prior to April 2000, Mr. Bernardo served as Vice President and Senior Director of Operations for a division of Polaroid Corporation from April 1997. From 1991 to 1997, he held several executive management positions with Dade International Inc., most recently as Vice President of Site Operations for the Paramax Chemistry unit where he was responsible for the integration of the diagnostics business unit acquired from DuPont.

Jerry McAleer, Ph.D. has served as our Vice President, Research and Development since the Split-Off. Prior to the Split-Off, Dr. McAleer served as Vice President of Research and Development of Inverness Medical Technology and Inverness Medical Limited, one of its subsidiaries, since 1999. From 1995 to 1999, Dr. McAleer served as Director of Development of Inverness Medical Limited and headed the development of Inverness Medical Technology's electrochemical glucose strips. Prior to joining Inverness Medical Technology, Dr. McAleer held senior research and development positions at MediSense from 1985 to 1993 and more recently, at Ecossensors, Inc., an environmental research company, where he was responsible for the development of electrochemically based assay systems.

David Toohey was appointed Vice President, European Operations on February 19, 2002 and had served as our Vice President, New Products since the Split-Off. He was also appointed Managing Director of Unipath Ltd. when we acquired the Unipath businesses on December 20, 2001. Prior to the Split-Off, Mr. Toohey was employed by Inverness Medical Technology as its Vice President, New Products since May 2001. Prior to joining Inverness Medical Technology, Mr. Toohey served as Vice President of Operations at Boston Scientific Corporation's Galway, Ireland facility. Between 1995 and 2001, he oversaw the growth of that facility initially as General Manager, later as Managing Director and finally as Vice President of Operations. Prior to that time he held various executive positions at Bausch & Lomb, Inc., Digital Equipment Corp. and Mars, Inc.

Duane L. James has served as our Vice President, Finance since the Split-Off and as our Treasurer since our company's inception. Prior to the Split-Off, Mr. James served as Vice President, Finance and Treasurer of Inverness Medical Technology since October 2000. Prior to October 2000, Mr. James served as Inverness Medical Technology's Chief Accounting Officer since August 1998 and as its Corporate Controller from February 1996 until August 1998. From June 1991 to February 1996, he held positions at Aquila Biopharmaceuticals, Inc. ranging from Accounting Manager to Corporate Controller.

John Yonkin has served as our Vice President, U.S. Sales & Marketing since the Split-Off. Prior to the Split-Off, Mr. Yonkin served as Inverness Medical Technology's Vice President of U.S. sales since October 1998 and General Manager since January 2000. He also served as Manager of Product Development for Inverness Medical Technology from October 1997 until October 1998. From January 1995 to September 1997, Mr. Yonkin was Director of National Accounts for Genzyme Genetics, a subsidiary of Genzyme, Inc., a leader in Genetic testing services for hospitals, physicians and managed healthcare companies. Previously, he worked for MediSense, a medical device company, in a number of marketing and sales capacities.

Douglas Shaffer has served as our Vice President, U.S. Operations since the Split-Off. Prior to the Split-Off, Mr. Schaffer served as Vice President, U.S. Operations of Inverness Medical Technology since January 2001. Prior to January 2001, he served as Inverness Medical Technology's Controller, U.S. Operations since December 1996. Before joining Inverness Medical Technology, Mr. Shaffer served as a division controller for several different divisions of MKS Instruments, Inc., a leading producer of gas management instrumentation.

Paul T. Hempel has served as General Counsel and Secretary since the inception of our company. Prior to the Split-Off, Mr. Hempel served as General Counsel and Assistant Secretary of Inverness Medical Technology since October 1, 2000. He was a founding stockholder and Managing Director of Erickson Schaffer Peterson Hempel & Israel PC from 1996 to 2000. Prior to 1996, Mr. Hempel was a partner and managed the business practice at Bowditch & Dewey LLP.

Ernest A. Carabillo, Jr. has served on the Board since May 30, 2001. Prior to the split-off, Mr. Carabillo served as a director of Inverness Medical Technology since May 2000. He is the founder and President of EXPERTech Associates, Inc., which provides regulatory, clinical and quality management consulting services to medical device companies, where he has served as President since 1990. He has also served in management positions at Baxter Healthcare, C.R. Bard and the medical

device/pharmaceutical division of Union Carbide. Mr. Carabillo has served as the head of three different divisions of the Food and Drug Administration and Department of Justice and as Associate Director of Regulatory Affairs for the President's Office of Drug Abuse Policy.

Carol R. Goldberg has served on the Board since May 30, 2001. Prior to the Split-Off, Ms. Goldberg served as a director of Inverness Medical Technology since August 1992. Since December 1989, she has served as President of The AVCAR Group, Ltd., an investment and management consulting firm in Boston, Massachusetts. Ms. Goldberg is a director and serves on the compensation committee of the board of directors of America Service Group, Inc., a managed healthcare company, The Gillette Company, a consumer products company, and Konover Property Trust, Inc., a real estate investment trust. Ms. Goldberg is a member of the Board's Compensation Committee.

Robert P. Khederian has served on the Board since July 31, 2001. Mr. Khederian is the Chairman of Belmont Capital, a venture capital firm he founded in 1996. From 1984 through 1996, he was founder and Chairman of Medical Specialties Group, Inc., a nationwide distributor of medical products which was acquired by Bain Capital. Since 1998, Mr. Khederian has served as the Managing Partner of Provident Capital

Partners and First Healthcare Partners, both of which are investment banking firms based in Boston, Massachusetts. Mr. Khederian is also a director of Cambridge Heart, Inc. Mr. Khederian is a member of the Board's Audit Committee.

John F. Levy has served on the Board since May 30, 2001. Prior to the Split-Off, Mr. Levy served as a director of Inverness Medical Technology since August 1996. Since 1993, he has been an independent consultant. Mr. Levy served as President and Chief Executive Officer of Waban, Inc., a warehouse merchandising company, from 1989 to 1993. Mr. Levy is a member of the Board's Audit Committee.

Peter Townsend has served on the Board since May 30, 2001. Prior to the Split-Off, Mr. Townsend served as a director of Inverness Medical Technology since August 1996. From 1991 to 1995, when he retired, Mr. Townsend served as Chief Executive Officer and a director of Enviromed plc, a medical products company currently known as Theratese plc. Mr. Townsend is a member of the Board's Audit Committee.

Alfred M. Zeien has served on the Board since July 31, 2001. From 1991 until his retirement in 1999, Mr. Zeien served as Chairman and Chief Executive Officer of The Gillette Company, a consumer products company. Mr. Zeien currently serves on the boards of EMC Corporation, Massachusetts Mutual Life Insurance Company, Raytheon Company, Polaroid Corporation and Bernard Technologies. Mr. Zeien is a member of the Board's Compensation Committee.

Board of Directors

Our Board of Directors is currently comprised of eight members. The eight directors are divided into three classes as follows: two Class I Directors (Messrs. Carabillo and Levy), three Class II Directors (Ms. Goldberg and Messrs. Zeien and Zwanziger) and three Class III Directors (Messrs. Khederian, Scott and Townsend). The members of each class serve for a staggered three-year term and, at each annual meeting of stockholders, a class of directors is elected for a three-year term to succeed the directors of the same class whose terms are expiring. The current terms of the Class I Directors, Class II Directors and Class III Directors will expire at the annual meetings of stockholders held following the end of calendar years 2001, 2002 and 2003, respectively.

PRINCIPAL STOCKHOLDERS

The following table furnishes information as to shares of our common stock and Series A Preferred Stock beneficially owned by:

- each person or entity known by us to beneficially own more than five percent of either our common stock or the Series A Preferred Stock;
- each of our directors;
- each of our five most highly compensated executive officers for the last fiscal year; and
- all of our directors and executive officers as a group.

Unless otherwise stated, beneficial ownership is calculated as of March 31, 2002. For the purpose of this table, a person, group or entity is deemed to have "beneficial ownership" of any shares that such person, group or entity has the right to acquire within 60 days after such date through the exercise of options or warrants or the conversion of convertible securities.

	Common Stock		Series A Preferred Stock(1)	
Name and Address of Beneficial Owner (2)	Amount and Nature of Beneficial Ownership(3)	Percent(4)	Amount and Nature of Beneficial Ownership(3)	Percent(4)
Deutsche Bank AG(5)	705,600	7.73%		
Zwanziger Family Ventures, LLC(6)	1,686,283	16.00%	500,000	21.18%

	Common Stock		Series A Preferred Stock(1)	
Orit Goldstein(7)	909,832	9.29%	333,333	14.12%
Leroy Schecter(8)	479,336	5.07%	166,667	7.06%
Cooper Hill Partners(9)	333,334	3.52%	166,667	7.06%
Goldman, Sachs & Co.(10)	333,332	3.52%	166,666	7.06%
Galleon Group(11)	589,678	6.28%	128,172	5.43%
Oxford Bioscience Partners(12)	384,600	4.04%	192,300	8.15%
Perry Capital(13)	662,949	6.83%	292,613	12.40%
Ron Zwanziger(14)	3,226,609	30.33%	500,000	21.18%
David Scott, Ph.D.(15).	573,516	6.17%		
Kenneth D. Legg, Ph.D.(16)	96,212	1.05%		
Jerry McAleer, Ph.D.(17)	420,319	4.52%		
David Toohey(18)	10,000	*		
Ernest A. Carabillo, Jr.(19)	25,549	*	10,000	*
Carol R. Goldberg(20)	81,905	*	16,666	*
Robert P. Khederian(21)	210,000	2.25%	100,000	4.24%
John F. Levy(22)	109,693	1.20%		
Peter Townsend	10,285	*		
Alfred M. Zeien				
All current executive officers and directors (15 persons)(23)	4,719,057	41.75%	626,666	26.55%

*
Represents less than 1%

(1)
Each share of Series A Preferred Stock is currently convertible into two shares of common stock.

(2)
The address of each director or executive officer (and any related persons or entities) is c/o the Company at its principal office.

(3)
Unless otherwise indicated, the stockholders identified in this table have sole voting and investment power with respect to the shares beneficially owned by them.

(4)
The number of shares outstanding used in calculating the percentage for each person, group or entity listed includes the number of shares underlying options, warrants and convertible securities held by such person or group that were exercisable or convertible within 60 days from March 31, 2002, but excludes shares of stock underlying options, warrants or convertible securities held by any other person.

(5)
The address of Deutsche Bank AG is Taunusanlage 12, D-60325, Frankfort am Main, Federal Republic of Germany. The information for Deutsche Bank AG contained herein is based upon information contained in a Schedule 13G filed with the Securities and Exchange Commission on February 1, 2002.

(6)
Consists of 273,689 shares of common stock, 412,594 shares of common stock underlying warrants exercisable within 60 days from March 31, 2002, and 500,000 shares of Series A Preferred Stock which are currently convertible into 1,000,000 shares of common stock, all of which are owned by Zwanziger Family Ventures, LLC (Zwanziger Family Ventures). Ron Zwanziger, our Chairman, Chief Executive Officer and President, and Janet M. Zwanziger, his spouse, are the managers of Zwanziger Family Ventures and each have shared voting and investment power over these securities.

(7)

Orit Goldstein is the sister of Ron Zwanziger, our Chairman, Chief Executive Officer and President. Of the shares of common stock attributed to her, Ms. Goldstein disclaims beneficial ownership of (i) 4,894 shares owned by her husband, (ii) 900 shares held in her husband's IRA, and (iii) 100,230 shares owned by the Zwanziger Family Trust, of which Ms. Goldstein is a trustee.

(8)

Consists of 146,002 shares of common stock and 166,667 shares of Series A Preferred Stock which are currently convertible into 333,334 shares of common stock. The address of Leroy Schecter is 55 Passaic Ave., Kearny, NJ 07032.

(9)

Consists of 166,667 shares of Series A Preferred Stock which are currently convertible into 333,334 shares of common stock held in the name of several private investment funds controlled by Cooper Hill Partners, LLC and Cooper Hill Partners, L.P., two institutional investment managers under the common control of Jeffrey Casdin and Casdin Capital, LLC. The address of Cooper Hill Partners is 230 Park Avenue, 20th Floor, New York, NY 10169.

(10)

Consists of 166,666 shares of Series A Preferred Stock which are currently convertible into 333,332 shares of common stock held in the name of several private investment funds managed by Goldman, Sachs & Co.'s Private Equity Group. The address of Goldman, Sachs & Co. is 32 Old Slip, 21stFloor, New York, NY 10005.

(11)

Consists of 333,334 shares of common stock and 128,172 shares of Series A Preferred Stock which are currently convertible into 256,344 shares of common stock held in the name of two private investment funds managed by The Galleon Group. The address of The Galleon Group is 135 East 57th Street, 16th Floor, New York, NY 10022.

(12)

Consists of 192,300 shares of Series A Preferred Stock which are currently convertible into 384,600 shares of common stock held in the name of two private investment funds managed by Oxford Bioscience Partners. The address of Oxford Bioscience Partners is 31 St. James Avenue, #905, Boston, MA 02116.

(13)

Consists of 77,723 shares of common stock and 292,613 shares of Series A Preferred Stock which are currently convertible into 585,226 shares of common stock held in the name of several private investment funds managed by Perry Capital. The address of Perry Capital is 599 Lexington Avenue, 36thFloor, New York, NY 10022.

(14)

Consists of 1,714,530 shares of common stock, 512,079 shares of common stock underlying options and warrants exercisable within 60 days from March 31, 2002, and 500,000 shares of Series A

Preferred Stock which are currently convertible into 1,000,000 shares of common stock. Of the shares attributed to Mr. Zwanziger, 273,689 shares of common stock, 412,594 shares of common stock underlying warrants exercisable within 60 days from March 31, 2002 and all of the shares of Series A Preferred Stock listed are owned by Zwanziger Family Ventures, a limited liability company managed by Mr. Zwanziger and his spouse. Of the other shares attributed to him, Mr. Zwanziger disclaims beneficial ownership of (i) 2,600 shares owned by his wife, Janet Zwanziger and (ii) 7,600 shares owned by the Zwanziger Goldstein Foundation, a charitable foundation where Mr. Zwanziger and his spouse, along with three others, serve as directors.

(15)

Consists of 411,554 shares of common stock and 161,962 shares of common stock underlying options or warrants exercisable within 60 days from March 31, 2002.

(16)

Consists of 52,712 shares of common stock and 43,500 shares of common stock underlying options or warrants exercisable within 60 days from March 31, 2002. Dr. Legg disclaims beneficial ownership of 1,079 shares of common stock owned by his son and 3,960 shares held in trust for the benefit of his son. Dr. Legg retired on February 15, 2001.

(17)

Consists of 250,059 shares of common stock and 170,260 shares of common stock underlying options or warrants exercisable within 60 days from March 31, 2002.

(18)

Consists of common stock underlying options exercisable within 60 days from March 31, 2002.

(19)

Consists of 5,549 shares of common stock and 10,000 shares of Series A Preferred Stock which are currently convertible into 20,000 shares of common stock.

(20)

Consists of 21,413 shares of common stock, 27,160 shares of common stock underlying options or warrants exercisable within 60 days from March 31, 2002, and 16,666 shares of Series A Preferred Stock which are currently convertible into 33,332 shares of common stock. Ms. Goldberg disclaims beneficial ownership of 8,333 shares of Series A Preferred Stock owned by the Avram J. Goldberg and Carol R. Goldberg Charitable Remainder Unitrust.

(21)

Consists of 10,000 shares of common stock and 100,000 shares of Series A Preferred Stock which are currently convertible into 200,000 shares of common stock.

(22)

Consists of 100,977 shares of common stock and 8,716 shares of common stock underlying options or warrants exercisable within 60 days from March 31, 2002. Mr. Levy disclaims beneficial ownership of warrants to purchase 1,007 shares of common stock owned by a charitable remainder unitrust.

(23)

Includes 923,756 shares of common stock underlying options or warrants exercisable within 60 days from March 31, 2002 and 626,666 shares of Series A Preferred Stock which are currently convertible into 1,253,332 shares of common stock.

UNDERWRITING

We and the underwriter, SG Cowen Securities Corporation, have entered into an underwriting agreement with respect to the shares being offered. Subject to the terms and conditions of the underwriting agreement, the underwriter has agreed to purchase from us 1,600,000 shares at the public offering price, less the underwriting discounts and commissions, as set forth on the cover page of this prospectus supplement.

The underwriting agreement provides that the obligations of the underwriter to purchase the shares of common stock offered hereby are conditional and may be terminated at its discretion based on its assessment of the state of the financial markets. The obligations of the underwriter may also be terminated upon the occurrence of other events specified in the underwriting agreement. The underwriter is committed to purchase all of the shares of common stock being offered by us if any shares are purchased.

The underwriter proposes to offer the shares of common stock to the public at the public offering price set forth on the cover of this prospectus supplement. The underwriting fee is an amount equal to the offering price to the public less the amount paid per share by the underwriter to us. The underwriter may offer the common stock to securities dealers at the price to the public less a concession not in excess of $0.76 per share. Securities dealers may reallow a concession not in excess of $0.10 per share to other dealers. After the shares of common stock are released for sale to the public, the underwriter may vary the offering price and other selling terms from time to time.

We have granted to the underwriter an option, exercisable not later than 30 days after the date of this prospectus supplement, to purchase up to an aggregate of 240,000 additional shares of common stock at the public offering price set forth on the cover page of this prospectus supplement less the underwriting discounts and commissions. The underwriter may exercise this option only to cover over-allotments, if any, made in connection with the sale of the common stock offered hereby.

The following table shows the underwriting discounts and commissions that we are to pay to the underwriter in connection with this offering. These amounts are shown assuming no exercise and full exercise of the underwriter's option to purchase additional shares of common stock.

	Payable by Inverness Medical Innovations, Inc.

	Payable by Inverness Medical Innovations, Inc.	
	No Exercise	Full Exercise
Per share	$ 1.265	$ 1.265
Total	$ 2,024,000	$ 2,327,600

We estimate that the total expenses of this offering, excluding underwriting discounts and commissions, will be approximately $309,000.

We have agreed to indemnify the underwriter against certain civil liabilities, including liabilities under the Securities Act and liabilities arising from breaches of representations and warranties contained in the underwriting agreement, and to contribute to payments the underwriter may be required to make in respect of any such liabilities.

We, and our directors and executive officers, have agreed with the underwriter that, for a period of 90 days following the date of this prospectus supplement, we, and our directors and executive officers, will not dispose of or hedge any shares of common stock or any securities convertible into or exchangeable for shares of common stock. Notwithstanding the foregoing, we are permitted to issue up to 500,000 shares of our common stock in connection with the acquisition of a business, product line or technology or in connection with a strategic alliance, provided that the recipients of such shares agree to restrictions substantially similar to those described in this paragraph. The underwriter may, in its sole discretion, at any time without prior notice, release all or any portion of the shares from the

restrictions described in this paragraph. In connection with this offering, we expect that Ron Zwanziger, our Chairman, Chief Executive Officer and President, will purchase approximately 100,000 shares of the common stock being offered hereby at the public offering price. Such shares will be subject to the restrictions described above.

The underwriter has advised us that it does not intend to confirm sales to any account over which it exercises discretionary authority. The underwriter is delivering this prospectus supplement only in printed form.

The underwriter may engage in over-allotment, stabilizing transactions, syndicate covering transactions, penalty bids and passive market making in accordance with Regulation M under the Securities Exchange Act. Over-allotment involves syndicate sales in excess of the offering size, which creates a syndicate short position. Stabilizing transactions permit bids to purchase the underlying security so long as the stabilizing bids do not exceed a specified maximum. Syndicate covering transactions involve purchases of the shares of common stock in the open market after the distribution has been completed in order to cover syndicate short positions. Penalty bids permit the underwriter to reclaim a selling concession from a syndicate member when the shares of common stock originally sold by such syndicate member are purchased in a syndicate covering transaction to cover syndicate short positions. Penalty bids may have the effect of deterring syndicate members from selling to people who have a history of quickly selling their shares. In passive market making, market makers in the shares of common stock who are underwriters or prospective underwriters may, subject to certain limitations, make bids for or purchases of the shares of common stock until the time, if any, at which a stabilizing bid is made. These stabilizing transactions, syndicate covering transactions and penalty bids may cause the price of the shares of common stock to be higher than it would otherwise be in the absence of these transactions. These transactions may be effected on the American Stock Exchange or otherwise and, if commenced, may be discontinued at any time.

Our common stock is traded on the American Stock Exchange under the symbol "IMA."

$
(181
)

(56,712
)

$
(165,227
)

$ 16,436	$ 941,049	$ 132,231

See Notes to Consolidated Financial Statements.

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ASHFORD HOSPITALITY TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Three Months Ended March 31,	
	2012	2011
Cash Flows from Operating Activities	(Unaudited)	
Net income (loss)	$(24,553)	$43,882
Adjustments to reconcile net income (loss) to net cash flow provided by operating activities:		
Depreciation and amortization	34,355	32,973
Impairment charges	(92)	(340)
Amortization of loan costs, write-off of loan costs, and exit fees	1,212	2,051
Equity in (earnings) loss of unconsolidated joint ventures	10,304	(28,124)
Income from financing derivatives	(7,969)	(18,003)
Gain on disposition of hotel properties	—	(2,802)
Realized and unrealized gains on trading securities	(1,407)	—
Purchases of trading securities	(27,647)	—
Sales of trading securities	27,512	—
Net settlement of trading derivatives	(2,069)	—
Unrealized loss on derivatives	9,941	16,817
Equity-based compensation	5,146	1,814
Changes in operating assets and liabilities:		
Restricted cash	(12,170)	(5,819)
Accounts receivable and inventories	(10,482)	(42,382)
Prepaid expenses and other assets	179	1,208
Accounts payable and accrued expenses	7,816	16,898
Due to/from related parties	(1,650)	(1,532)
Due to/from third-party hotel managers	4,367	(978)
Other liabilities	(532)	286
Net cash provided by operating activities	12,261	15,949
Cash Flows from Investing Activities		
Proceeds from payments of notes receivable	62	313
Net proceeds from sales of hotel properties	—	143,915
Investment in unconsolidated joint venture	—	(145,750)
Acquisition of condominium properties	—	(12,000)
Improvements and additions to hotel properties	(23,253)	(13,921)
Net cash used in investing activities	(23,191)	(27,443)
Cash Flows from Financing Activities		
Repayments of indebtedness and capital leases	(6,193)	(125,219)
Payments of deferred loan costs	(210)	(2,166)
Payments of dividends	(16,941)	(7,291)
Cash income from derivatives	7,963	18,203
Issuance of common stock	—	2,814
Issuances of preferred stock	8,724	—
Contributions from noncontrolling interests in consolidated joint ventures	300	—
Distributions to noncontrolling interests in consolidated joint ventures	—	(127)
Other	64	1
Net cash used in financing activities	(6,293)	(113,785)

Net decrease in cash and cash equivalents	(17,223)	(125,279)
Cash and cash equivalents at beginning of period	167,609	217,690
Cash and cash equivalents at end of period	$150,386	$92,411
Supplemental Cash Flow Information		
Interest paid	$33,998	$32,239
Income taxes refunded	$(857)	$(63)
Supplemental Disclosure of Non-Cash Investing and Financing Activity		
Accrued interest added to principal of indebtedness	$1,180	$1,034
Asset contributed to unconsolidated joint venture	$—	$15,000

See Notes to Consolidated Financial Statements.

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ASHFORD HOSPITALITY TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Organization and Description of Business

Ashford Hospitality Trust, Inc., together with its subsidiaries (“Ashford”), is a self-advised real estate investment trust (“REIT”) focused on investing in the hospitality industry across all segments and in all methods including direct real estate, securities, equity, and debt. We commenced operations in August 2003 with the acquisition of six hotels in connection with our initial public offering. We own our lodging investments and conduct our business through Ashford Hospitality Limited Partnership ("AHLP"), our operating partnership. Ashford OP General Partner LLC, a wholly-owned subsidiary of Ashford, serves as the sole general partner of our operating partnership. In this report, the terms “the Company,” “we,” “us,” or “our” refer to Ashford Hospitality Trust, Inc. and all entities included in its consolidated financial statements.

As of March 31, 2012 we owned interests in the following hotel properties (all located in the United States):
•92 hotel properties directly and four hotel properties through majority-owned investments in consolidated joint ventures, which represents 20,656 total rooms (or 20,395 net rooms excluding those attributable to our joint venture partners),
•28 hotel properties through a 71.74% common equity interest and a 50.0% preferred equity interest in an unconsolidated joint venture (“PIM Highland JV”), which represents 8,084 total rooms (or 5,800 net rooms excluding those attributable to our joint venture partner), and
•94 hotel condominium units at WorldQuest Resort in Orlando, Florida.

As of March 31, 2012, we also owned one mezzanine loan receivable with a carrying value of $3.1 million and one $8.1 million note receivable in connection with a joint venture restructuring.

For federal income tax purposes, we elected to be treated as a REIT, which imposes limitations related to operating hotels. As of March 31, 2012, our 96 consolidated hotel properties ("legacy hotel properties") were leased or owned by our wholly owned subsidiaries that are treated as taxable REIT subsidiaries for federal income tax purposes (collectively, these subsidiaries are referred to as “Ashford TRS”). Ashford TRS then engages third-party or affiliated hotel management companies to operate the hotels under management contracts. Hotel operating results related to these properties are included in the consolidated statements of operations. As of March 31, 2012, the 28 hotel properties owned by our unconsolidated joint venture, PIM Highland JV, are leased to its wholly owned subsidiary that is treated as a taxable REIT subsidiary for federal income tax purposes.

Remington Lodging & Hospitality, LLC, together with its affiliates (“Remington Lodging”), is beneficially wholly owned by Mr. Archie Bennett, Jr., our Chairman, and Mr. Monty J. Bennett, our Chief Executive Officer. As of March 31, 2012, Remington Lodging managed 45 of our 96 legacy hotel properties as well as WorldQuest Resort, while third-party management companies managed the remaining 51 hotel properties. In addition, Remington Lodging also managed 19 of the 28 PIM Highland JV hotel properties.

2. Significant Accounting Policies

Basis of Presentation – The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation

have been included. These consolidated financial statements include the accounts of Ashford, its majority-owned subsidiaries, and its majority-owned joint ventures in which it has a controlling interest. All significant intercompany accounts and transactions between consolidated entities have been eliminated in these consolidated financial statements. These financial statements and related notes should be read in conjunction with the consolidated financial statements and notes thereto included in our 2011 Annual Report to Shareholders on Form 10-K and Form 10-K/A filed with the Securities and Exchange Commission ("SEC") on February 28, 2012 and March 26, 2012, respectively.

The following items affect our reporting comparability related to our consolidated financial statements:

- Historical seasonality patterns at some of our properties cause fluctuations in our overall operating results. Consequently, operating results for the three months ended March 31, 2012 are not necessarily indicative of the results that may be

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ASHFORD HOSPITALITY TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

expected for the year ending December 31, 2012.

- Marriott International, Inc. (“Marriott”) manages 40 of our legacy hotel properties. For these Marriott-managed hotels, the fiscal year reflects twelve weeks of operations in each of the first three quarters of the year and 16 weeks for the fourth quarter of the year. Therefore, in any given quarterly period, period-over-period results will have different ending dates. For Marriott-managed hotels, the first quarters of 2012 and 2011 ended March 23 and March 25, respectively.

Use of Estimates – The preparation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Investments in Hotel Properties – Hotel properties are generally stated at cost. However, four hotel properties contributed upon Ashford's formation in 2003 are stated at the predecessor's historical cost, net of impairment charges, if any, plus a partial step-up related to the acquisition of noncontrolling interests from third parties associated with certain of these properties. For hotel properties owned through our majority-owned joint ventures, the carrying basis attributable to the joint venture partners' minority ownership is recorded at the predecessor's historical cost, net of any impairment charges, while the carrying basis attributable to our majority ownership is recorded based on the allocated purchase price of our ownership interests in the joint ventures. All improvements and additions which extend the useful life of the hotel properties are capitalized.

Impairment of Investment in Hotel Properties – Hotel properties are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. We test impairment by using current or projected cash flows over the estimated useful life of the asset. In evaluating the impairment of hotel properties, we make many assumptions and estimates, including projected cash flows, expected holding period, and expected useful life. We may also use fair values of comparable assets. If an asset is deemed to be impaired, we record an impairment charge for the amount that the property's net book value exceeds its estimated fair value. No impairment charges were recorded for investment in hotel properties included in our continuing operations for the three months ended March 31, 2012 and 2011.

Notes Receivable – Mezzanine loan financing, classified as notes receivable, represents loans held for investment and intended to be held to maturity. Accordingly, these notes are recorded at cost, net of unamortized loan origination costs and fees, loan purchase discounts, and allowance for losses when a loan is deemed to be impaired. Premiums, discounts, and net origination fees are amortized or accreted as an adjustment to interest income using the effective interest method over the life of the loan. We discontinue recording interest and amortizing discounts/premiums when the contractual payment of interest and/or principal is not received. Payments received on impaired nonaccrual loans are recorded as adjustments to impairment charges. No interest income was recorded for the three months ended March 31, 2012 and 2011.

Variable interest entities (“VIEs”), as defined by authoritative accounting guidance, must be consolidated by their controlling interest beneficiaries if the VIEs do not effectively disperse risks among the parties involved. Our remaining mezzanine note receivable at March 31, 2012 is secured by a hotel property and is subordinate to the controlling interest in the secured hotel property. Although the note receivable is considered to be a variable interest in the entity that owns the related hotel, we are not considered to be the primary beneficiary of the hotel property as a result of holding the loan. Therefore, we do not consolidate the hotel property for which we have provided financing.

We will evaluate interests in entities acquired or created in the future to determine whether such entities should be consolidated. In evaluating VIEs, our analysis involves considerable management judgment and assumptions.

Impairment of Notes Receivable – We review notes receivable for impairment each reporting period. A loan is impaired when, based on current information and events, collection of all amounts recorded as assets on the balance sheet is no longer considered probable. We apply normal loan review and underwriting procedures (as may be implemented or modified from time to time) in making that judgment.

When a loan is impaired, we measure impairment based on the present value of expected cash flows discounted at the loan's effective interest rate against the value of the asset recorded on the balance sheet. We may also measure impairment based on a loan's observable market price or the fair value of collateral if the loan is collateral-dependent. Loan impairments are recorded as a valuation allowance and a charge to earnings. Our assessment of impairment is based on considerable judgment and estimates. No impairment charges were recorded during the three months ended March 31, 2012 and 2011. Valuation adjustments of $92,000 and $340,000 on previously impaired notes were credited to impairment charges during the three months ended March 31, 2012 and 2011, respectively.

Investments in Unconsolidated Joint Ventures – Investments in unconsolidated joint ventures, in which we have ownership interests ranging from 14.4% to 71.74%, are accounted for under the equity method of accounting by recording the initial investment and our percentage of interest in the joint ventures' net income (loss). We review investments in our unconsolidated joint ventures for impairment in each reporting period. An investment is impaired when its estimated fair value is less than the carrying amount of our investment. Any impairment is recorded in equity earnings (loss) in unconsolidated joint ventures. No such impairments were recorded in the three months ended March 31, 2012 and 2011.

Our investments in unconsolidated joint ventures are considered to be variable interests in the underlying entities. VIEs, as defined by authoritative accounting guidance, must be consolidated by a reporting entity if the reporting entity is the primary beneficiary because it has (i) the power to direct the VIE's activities that most significantly impact the VIE's economic performance, (ii) an implicit financial responsibility to ensure that the VIE operates as designed, and (iii) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE. Because we do not have the power and financial responsibility to direct our unconsolidated joint ventures' activities and operations, we are not considered to be the primary beneficiary of these joint ventures. Although we have a 71.74% majority ownership in PIM Highland JV, all major decisions related to the joint venture, including establishment of policies and operating procedures with respect to business affairs and incurring obligations and expenditures, are subject to the approval of an executive committee, which is comprised of four persons with us and our joint venture partner each designating two of those persons. As a result, we utilize the equity accounting method with respect to PIM Highland JV, which had a carrying value of $169.2 million at March 31, 2012 based on our share of the joint venture's equity. We will evaluate the interests in entities acquired or created in the future to determine whether such entities should be consolidated. In evaluating VIEs, our analysis involves considerable management judgment and assumptions.

Assets Held for Sale and Discontinued Operations – We classify assets as held for sale when management has obtained a firm commitment from a buyer and consummation of the sale is considered probable and expected within one year. In addition, we deconsolidate a property when it becomes subject to the control of a government, court, administrator, or regulator and we effectively lose control of the property/subsidiary. When deconsolidating a property/subsidiary, we recognize a gain or loss in net income measured as the difference between the fair value of any consideration received, the fair value of any retained noncontrolling investment in the former subsidiary at the date the subsidiary is deconsolidated, and the carrying amount of the former property/subsidiary. The related operations of assets held for sale are reported as discontinued if a) such operations and cash flows can be clearly distinguished, both operationally and financially, from our ongoing operations, b) such operations and cash flows will be eliminated from ongoing operations once the disposal occurs, and c) we will not have any significant continuing involvement subsequent to the disposal.

During the three months ended March 31, 2012, no hotel properties were classified as assets held for sale or reported as discontinued operations. During the three months ended March 31, 2011, assets held for sale and discontinued operations included four hotel properties, of which three were sold and a net gain of $2.8 million was recognized.

Investments in Securities and Other – Securities and other investments, including U.S. treasury bills, stocks, and put and call options of certain publicly traded companies, are recorded at fair value. Put and call options are considered derivatives. The fair value of these investments is based on the closing price as of the balance sheet date and is reported as "Investments in securities and other" or "Liabilities associated with investments in securities and other" in the consolidated balance sheets. On the consolidated statements of operations, net investment income, including interest income (expense), dividends and related costs incurred, and realized gains or losses, is reported as a component of

“Other income” while unrealized gains and losses on these investments are reported as “Unrealized gain (loss) on investments."

Revenue Recognition – Hotel revenues, including room, food, beverage, and ancillary revenues such as long-distance telephone service, laundry, parking, and space rentals, are recognized when services have been rendered. In 2011, rental income represents income from leasing a hotel property to a third-party tenant on a triple-net operating lease, which included base rent recognized on a straight-line basis over the lease term and variable rent recognized when earned. The remaining 11% ownership in this hotel property was assigned to us in December 2011 and the lease agreement was canceled. Interest income is recognized when earned. We discontinue recording interest and amortizing discounts/premiums when the contractual payment of interest and/or principal is not received. Asset management fees are recognized when services are rendered. Taxes collected from customers and submitted to taxing authorities are not recorded in revenue.

Derivatives and Hedges – We primarily use interest rate derivatives to hedge our risks and to capitalize on the historical correlation between changes in LIBOR (London Interbank Offered Rate) and RevPAR (Revenue per Available Room). Interest

rate derivatives could include swaps, caps, floors, flooridors, and corridors. We assess the effectiveness of each hedging relationship by comparing changes in fair value or cash flows of the derivative hedging instrument with the changes in fair value or cash flows of the designated hedged item or transaction. We also use credit default swaps to hedge financial and capital market risk. All these derivatives are subject to master netting settlement arrangements and the credit default swaps are subject to credit support annexes. For credit default swaps, cash collateral is posted by us as well as our counterparty. We offset the fair value of the derivative and the obligation/right to return/reclaim cash collateral.

All derivatives are recorded at fair value and reported as “Derivative assets” or “Derivative liabilities.” Accrued interest on non-hedge designated interest rate derivatives is included in “Accounts receivable, net” in the consolidated balance sheets. For interest rate derivatives designated as cash flow hedges:

a) the effective portion of changes in fair value is initially reported as a component of “Accumulated Other Comprehensive Income (Loss)” (“OCI”) in the equity section of the consolidated balance sheets and reclassified to interest expense in the consolidated statements of operations in the period during which the hedged transaction affects earnings, and

b) the ineffective portion of changes in fair value is recognized directly in earnings as “Unrealized gain (loss) on derivatives” in the consolidated statements of operations.

For non-hedge designated interest rate derivatives and credit default swap derivatives, changes in the fair value are recognized in earnings as “Unrealized gain (loss) on derivatives” in the consolidated statements of operations.

Recently Adopted Accounting Standards – In May 2011, the FASB issued accounting guidance for common fair value measurement and disclosure requirements. The guidance requires disclosures of (i) quantitative information about the significant unobservable inputs used for level 3 measurements; (ii) description of the valuation processes surrounding level 3 measurements; (iii) narrative description of the sensitivity of recurring level 3 measurements to unobservable inputs; (iv) hierarchy classification for items whose fair value is only disclosed in the footnotes; and (v) any transfers between level 1 and 2 of the fair value hierarchy. The new accounting guidance is effective during interim and annual periods beginning after December 15, 2011. We have adopted this accounting guidance and made the additional required disclosures in Notes 10, 11, and 12. The adoption of this accounting guidance did not affect our financial position or results of operations.

Recently Issued Accounting Standards – In December 2011, the FASB issued accounting guidance to clarify how to determine whether a reporting entity should derecognize the in-substance real estate upon loan defaults when it ceases to have controlling interest in a subsidiary that is in-substance real estate. Under this guidance, a reporting entity would not satisfy the requirements to derecognize the in-substance real estate before the legal transfer of the real estate to the lender and the extinguishment of the related non-recourse indebtedness. That is, even if the reporting entity ceases to have a controlling financial interest, the reporting entity would continue to include the real estate, debt, and the results of the subsidiary’s operations in its consolidated financial statements until legal title to the real estate is transferred to legally satisfy the debt. The new accounting guidance is effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2012. Early adoption is permitted. We do not expect any impact on our financial position and results of operations from the adoption of this accounting guidance as our current accounting policy is to derecognize the in-substance real estate when the legal title to the real estate is transferred to legally satisfy the non-recourse indebtedness.

In December 2011, the FASB issued accounting guidance to require disclosures about offsetting assets and liabilities. Entities are required to disclose both gross and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. This scope would include derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, and securities-borrowing and securities-lending arrangements. The new accounting guidance is effective for fiscal years, and interim periods within those years, beginning after January 1, 2013 and the disclosures should be reported retrospectively for all comparative periods presented. We do not expect any material impact on our financial position and results of operations from the adoption of this accounting guidance, but will make the required additional disclosures upon adoption.

Reclassifications – Certain amounts in the consolidated financial statements for the three months ended March 31, 2011 have been reclassified for discontinued operations. These reclassifications have no effect on our cash flows, equity, or net income (loss) previously reported.

3. Summary of Significant Transactions

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Credit Facility Capacity Expansion - On February 21, 2012, we expanded our borrowing capacity under our $105.0 million senior credit facility to an aggregate $145.0 million, with the option, subject to lender approval, to further expand the facility to an aggregate size of $225.0 million.

At-the-Market Preferred Stock Offering – On March 2, 2012, we commenced issuances of preferred stock under our at-the-market (“ATM”) program with an investment banking firm pursuant to which we may issue up to 700,000 shares of 8.55% Series A Cumulative Preferred Stock and up to 700,000 shares of 8.45% Series D Cumulative Preferred Stock at market prices up to $30.0 million in total proceeds. During the three months ended March 31, 2012, we issued 120,731 shares of 8.55% Series A Cumulative Preferred Stock for $3.0 million gross proceeds and 249,682 shares of 8.45% Series D Cumulative Preferred Stock for $6.2 million gross proceeds. Such proceeds, net of commissions and other expenses, were $8.7 million.

4. Investments in Hotel Properties

Investments in hotel properties consisted of the following (in thousands):

	March 31, 2012	December 31, 2011
Land	$487,184	$487,184
Buildings and improvements	2,787,844	2,779,828
Furniture, fixtures, and equipment	291,835	276,292
Construction in progress	4,325	5,841
Condominium properties	12,668	12,661
Total cost	3,583,856	3,561,806
Accumulated depreciation	(638,150)	(603,907)
Investment in hotel properties, net	$2,945,706	$2,957,899

5. Notes Receivable

As of March 31, 2012 and December 31, 2011, in connection with the restructuring of a joint venture, we owned a note receivable of $8.1 million from a city government. The note bears interest at a rate of 12.85% and matures in 2018.

In addition, as of March 31, 2012 and December 31, 2011, we had one mezzanine loan receivable with a net carrying value of $3.1 million, net of a valuation allowance of $8.7 million. This note is secured by one hotel property, bears interest at a rate of 6.09%, and matures in 2017. All required payments on this loan are current. Ongoing payments are treated as reductions of carrying value with related valuation allowance adjustments recorded as credits to impairment charges.

6. Investment in Unconsolidated Joint Ventures

Effective March 10, 2011, PIM Highland JV, a 28-hotel-property portfolio, became an investment in unconsolidated joint venture when we acquired a 71.74% common equity interest and a $25.0 million, or 50%, preferred equity interest earning an accrued but unpaid 15% annual return with priority over common equity distributions. Although we have majority ownership in PIM Highland JV, all major decisions related to the joint venture, including

establishment of policies and operating procedures with respect to business affairs and incurring obligations and expenditures, are subject to the approval of an executive committee, which is comprised of four persons with us and our joint venture partner each designating two of those persons. As a result, we utilize the equity accounting method with respect to PIM Highland JV, which had a carrying value of $169.2 million and $179.5 million at March 31, 2012 and December 31, 2011, respectively. Upon its inception in 2011, PIM Highland JV recognized a gain of $82.1 million (which was finalized in the fourth quarter of 2011), of which our share was $46.3 million, related to a discounted purchase and settlement of a preexisting relationship.

Mortgage and mezzanine loans securing PIM Highland JV are nonrecourse to the borrowers, except for customary exceptions or carve-outs that trigger recourse liability to the borrowers in certain limited instances. Recourse obligations typically include only the payment of costs and liabilities suffered by the lenders as a result of the occurrence of certain bad acts on the part of the borrower. However, in certain cases, the carve-outs could trigger recourse obligations on the part of the borrower with

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respect to repayment of all or a portion of the outstanding principal amount of the loans. We have entered into customary guaranty agreements pursuant to which we guaranty payment of any recourse liabilities of the borrowers that result from the non-recourse carve-outs (which include, but are not limited to, fraud, misrepresentation, willful conduct resulting in waste, misappropriations of rents following an event of default, voluntary bankruptcy filings, unpermitted transfers of collateral, and certain environmental liabilities). In the opinion of management, none of these guaranty agreements, either individually or in the aggregate, are likely to have a material adverse effect on our business, results of operations, or financial condition.

The following tables summarize the consolidated balance sheets as of March 31, 2012 and December 31, 2011 and the consolidated statements of operations for the three months ended March 31, 2012 and the period from March 10, 2011 (inception) through March 31, 2011 of the PIM Highland JV (in thousands):

PIM Highland JV
Consolidated Balance Sheets

	March 31, 2012	December 31, 2011
Total assets	$1,391,145	$1,400,264
Total liabilities	1,137,597	1,132,977
Members' equity	253,548	267,287
Total liabilities and members' equity	$1,391,145	$1,400,264
Our ownership interest in PIM Highland JV	$169,224	$179,527

PIM Highland JV
Consolidated Statements of Operations

	Three Months Ended March 31, 2012	Period From March 10 to March 31, 2011
Total revenue	$93,252	$23,479
Total expenses	90,067	39,801
Operating income (loss)	3,185	(16,322)
Interest expense and amortization of loan costs	(15,525)	(3,868)
Gain recognized at acquisition (1)	—	75,372
Other expenses	(1,398)	(829)
Net income (loss)	$(13,738)	$54,353
Our equity in earnings (loss) of PIM Highland JV	$(10,304)	$28,124

(1) In the fourth quarter of 2011, upon completion of the purchase price allocation, this gain was adjusted to $82.1 million.

Additionally, as of March 31, 2012 and December 31, 2011, we had a 14.4% subordinated beneficial interest in a trust that holds the Four Seasons hotel property in Nevis, which had a zero carrying value.

7. Assets Held for Sale and Discontinued Operations

In the three months ended March 31, 2011, we completed the sales of the JW Marriott San Francisco in California, the Hilton Rye Town in New York, and the Hampton Inn Houston in Texas, and recognized a net gain of $2.8 million. In the third quarter of 2011, we completed the sale of the Hampton Inn hotel in Jacksonville, Florida. Operating results of these hotel properties are reported as discontinued operations for all periods presented. No hotel properties were recorded as discontinued operations for the three months ended March 31, 2012.

The following table summarizes the operating results of the discontinued hotel properties (in thousands):

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	Three Months Ended March 31, 2011
Hotel revenues	$9,502
Hotel operating expenses	(7,495)
Operating income	2,007
Property taxes, insurance, and other	(682)
Depreciation and amortization	(196)
Gain on disposal of properties	2,802
Interest expense and amortization of loan costs	(687)
Write-off of premiums, loan costs, and exit fees	(948)
Income from discontinued operations before income tax expense	2,296
Income tax expense	(85)
Income from discontinued operations	2,211
Income from discontinued operations attributable to noncontrolling interest in consolidated joint venture	(1,031)
Income from discontinued operations attributable to redeemable noncontrolling interest in operating partnership	(145)
Income from discontinued operations attributable to the Company	$1,035

8. Indebtedness

Indebtedness consisted of the following (in thousands):

Indebtedness	Collateral	Maturity	Interest Rate	March 31, 2012	December 31, 2011	
Mortgage loan	10 hotels	May-12	LIBOR (1) + 1.65%	$167,202	$167,202	
Mortgage loan	2 hotels	Aug-13	LIBOR (1) + 2.75%	144,667	145,667	
Mortgage loan[(2)]	5 hotels	Mar-14	LIBOR (1) + 4.50%	177,193	178,400	
Mortgage loan	1 hotel	May-14	8.32%	5,429	5,476	
Senior credit facility	Various	Sep-14	LIBOR (1) + 2.75% to 3.5%	—	—	
Mortgage loan	1 hotel	Dec-14	Greater of 5.5% or LIBOR (1) + 3.5%	19,740	19,740	
Mortgage loan	8 hotels	Dec-14	5.75%	106,321	106,863	
Mortgage loan	10 hotels	Jul-15	5.22%	155,006	155,831	
Mortgage loan	8 hotels	Dec-15	5.7%	98,319	98,786	
Mortgage loan [(3)]	5 hotels	Dec-15	12.72%	152,042	151,185	
Mortgage loan	5 hotels	Feb-16	5.53%	111,885	112,453	
Mortgage loan	5 hotels	Feb-16	5.53%	92,787	93,257	
Mortgage loan	5 hotels	Feb-16	5.53%	80,374	80,782	
Mortgage loan	1 hotel	Apr-17	5.91%	35,000	35,000	[(4)]
Mortgage loan	2 hotels	Apr-17	5.95%	128,251	128,251	
Mortgage loan	3 hotels	Apr-17	5.95%	260,980	260,980	

Mortgage loan	5 hotels	Apr-17	5.95%	115,600	115,600	
Mortgage loan	5 hotels	Apr-17	5.95%	103,906	103,906	
Mortgage loan	5 hotels	Apr-17	5.95%	158,105	158,105	
Mortgage loan	7 hotels	Apr-17	5.95%	126,466	126,466	
TIF loan	1 hotel	Jun-18	12.85%	8,098	8,098	(4)
Mortgage loan	1 hotel	Nov-20	6.26%	103,458	103,759	
Mortgage loan	1 hotel	Apr-34	Greater of 6% or Prime + 1%	6,616	6,651	
Total				$2,357,445	$2,362,458	

(1) LIBOR rates were 0.241% and 0.295% at March 31, 2012 and December 31, 2011, respectively.
(2) This mortgage loan has a one-year extension option subject to satisfaction of certain conditions.
(3) This mortgage loan includes reverse amortization of 8% on $45 million of the original principal balance plus 12% on the cumulative reverse

amortization. Since the date at which we obtained this loan, the reverse amortization has resulted in a principal increase of $9.7 million.
(4) These mortgage loans are collateralized by the same property.

On February 21, 2012, we expanded our borrowing capacity under our $105.0 million senior credit facility to an aggregate $145.0 million, with the option, subject to lender approval, to further expand the facility to an aggregate size of $225.0 million.

We are required to maintain certain financial ratios under various debt and derivative agreements. If we violate covenants in any debt or derivative agreement, we could be required to repay all or a portion of our indebtedness before maturity at a time when we might be unable to arrange financing for such repayment on attractive terms, if at all. Violations of certain debt covenants may result in us being unable to borrow unused amounts under a line of credit, even if repayment of some or all borrowings is not required. The assets of certain of our subsidiaries are pledged under non-recourse indebtedness and are not available to satisfy the debts and other obligations of Ashford or AHLP, our operating partnership, and the liabilities of such subsidiaries do not constitute the obligations of Ashford or AHLP. Presently, our existing financial covenants are non-recourse and primarily relate to maintaining minimum debt coverage ratios, maintaining an overall minimum net worth, maintaining a maximum loan-to-value ratio, and maintaining an overall minimum total assets. As of March 31, 2012, we were in compliance in all material respects with all covenants or other requirements set forth in our debt and related agreements as amended.

We have derivative agreements that incorporate the loan covenant provisions of our senior credit facility requiring us to maintain certain minimum financial covenant ratios with respect to our indebtedness. Failure to comply with the covenant provisions would result in us being in default on any derivative instrument obligations covered by the applicable agreement. At March 31, 2012, we were in compliance with all the covenants under the senior credit facility and the fair value of derivatives that incorporate our senior credit facility covenant provisions was an asset of $30.2 million, consisting of interest rate derivatives.

9. Income (Loss) Per Share

Basic income (loss) per common share is calculated using the two-class method, or the treasury stock method if more dilutive, by dividing net income (loss) attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted income (loss) per common share reflects the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted into common shares, whereby such exercise or conversion would result in lower income per share. The following table reconciles the amounts used in calculating basic and diluted income (loss) per share (in thousands, except per share amounts):

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	Three Months Ended March 31,	
	2012	2011
Income (loss) from continuing operations allocated to common shareholders:		
Income (loss) from continuing operations attributable to the Company	$(21,218)	$36,798
Less: Dividends on preferred stocks	(8,331)	(6,555)
Less: Dividends on common stock	(7,397)	(5,830)
Less: Dividends on unvested restricted shares	(104)	(110)
Less: Income from continuing operations allocated to unvested shares	—	(452)
Undistributed income (loss) from continuing operations allocated to common shareholders	(37,050)	23,851
Add back: Dividends on common stock	7,397	5,830
Total distributed and undistributed income (loss) from continuing operations - basic	$(29,653)	$29,681
Add back: Income allocated to Series B-1 convertible preferred stock	—	1,024
Add back: Income from continuing operations allocated to operating partnership units	—	4,973
Total distributed and undistributed income (loss) from continuing operations - diluted	$(29,653)	$35,678
Income from discontinued operations allocated to common shareholders:		
Income from discontinued operations attributable to the Company	$—	$1,035
Less: (Income) from discontinued operations allocated to unvested shares	—	(20)
Income from discontinued operations allocated to common shareholders - basic	$—	$1,015
Add back: Income from discontinued operations allocated to operating partnership units	—	145
Income from discontinued operations allocated to common shareholders - diluted	$—	$1,160
Weighted average shares outstanding:		
Weighted average common shares outstanding	67,152	57,931
Effect of assumed conversion of Series B-1 convertible preferred stock	—	7,248
Effect of assumed conversion of operating partnership units	—	14,151
Weighted average diluted shares outstanding	67,152	79,330
Basic income (loss) per share:		
Income (loss) from continuing operations allocated to common shareholders per share	$(0.44)	$0.51
Income from discontinued operations allocated to common shareholders per share	—	0.02
Net income (loss) allocated to common shareholders per share	$(0.44)	$0.53
Diluted income (loss) per share:		
Income (loss) from continuing operations allocated to common shareholders per share	$(0.44)	$0.45
Income from discontinued operations allocated to common shareholders per share	—	0.01
Net income (loss) allocated to common shareholders per share	$(0.44)	$0.46

Due to the anti-dilutive effect, the computation of diluted income (loss) per diluted share does not reflect adjustments for the following items (in thousands):

Income (loss) from continuing operations distributed to common shareholders is not adjusted for:		
Income allocated to unvested restricted shares	$104	$563
Loss attributable to noncontrolling interest in operating partnership units	(3,057)	—
Total	$(2,953)	$563
Weighted average diluted shares are not adjusted for:		
Effect of unvested restricted shares	431	788
Effect of assumed conversion of operating partnership units	16,682	—
Total	17,113	788

10. Derivative Instruments and Hedging

Interest Rate Derivatives – We are exposed to risks arising from our business operations, economic conditions, and financial markets. To manage these risks, we primarily use interest rate derivatives to hedge our debt and potentially improve

cash flows. We also use non-hedge derivatives to capitalize on the historical correlation between changes in LIBOR and RevPAR. Interest rate derivatives may include interest rate swaps, caps, flooridors, and corridors. All these derivatives are subject to master netting settlement arrangements. To mitigate nonperformance risk, we routinely rely on a third party's analysis of the creditworthiness of the counterparties, which supports our belief that the counterparties' nonperformance risk is limited. All derivatives are recorded at fair value.

Credit Default Swap Derivatives – In August 2011, we entered into credit default swap transactions for a notional amount of $100.0 million to hedge financial and capital market risk for an upfront cost of $8.2 million that was subsequently returned to us as collateral by our counterparty. A credit default swap is a derivative contract that functions like an insurance policy against the credit risk of an entity or obligation. The seller of protection assumes the credit risk of the reference obligation from the buyer (us) of protection in exchange for annual premium payments. If a default or a loss, as defined in the credit default swap agreements, occurs on the underlying bonds, then the buyer of protection is protected against those losses. The only liability for us, the buyer, is the annual premium and any change in value of the underlying CMBX index (if the trade is terminated prior to maturity). For all CMBX trades completed to date, we were the buyer of protection. Credit default swaps are subject to master netting settlement arrangements and credit support annexes. Assuming the underlying bonds pay off at par over their remaining average life, our total exposure for these trades is approximately $8.5 million. Cash collateral is posted by us as well as our counterparty. We offset the fair value of the derivative and the obligation/right to return/reclaim cash collateral. The change in the market value of the credit default swaps is settled net through posting cash collateral or reclaiming cash collateral between us and our counterparty when the change in the market value is over $250,000. As of March 31, 2012 and December 31, 2011, the credit default swap had a net carrying value of a liability of $129,000 and $2,000, respectively, which is included in "Liabilities associated with investments in securities and other" in the consolidated balance sheets. For the three months ended March 31, 2012, we recognized an unrealized loss of $2.2 million that is included in "Unrealized loss on derivatives" in the consolidated statements of operations.

Investment in Securities and Other – During the second quarter of 2011, our Board of Directors authorized the formation of a subsidiary to invest in public securities, including stocks, and put and call options. Put and call option transactions are considered derivatives. At March 31, 2012, we had investments in these derivatives totaling $262,000 and liabilities of $906,000. At December 31, 2011, we had investments in these derivatives totaling $1.0 million and liabilities of $486,000.

11. Fair Value Measurements

Fair Value Hierarchy – Both financial instruments measured at fair value, either on a recurring or nonrecurring basis, and financial instruments not measured at fair value are classified for disclosure purposes in a hierarchy consisting of three levels based on the observability of inputs in the market place as discussed below:

- Level 1: Fair value measurements that are quoted prices (unadjusted) in active markets that we have the ability to access for identical assets or liabilities. Market price data generally is obtained from exchange or dealer markets.
- Level 2: Fair value measurements based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.
- Level 3: Fair value measurements based on valuation techniques that use significant inputs that are unobservable. The circumstances for using these measurements include those in which there is little, if any, market activity for the asset or liability.

The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash receipts/payments and the discounted expected variable cash payments/receipts. The fair values of interest rate caps, floors, flooridors, and corridors are determined using the market standard methodology of discounting the future expected cash receipts that would occur if variable interest rates fell below the strike rates of the floors or rise above the strike rates of the caps. The variable interest rates used in the calculation of projected receipts and payments on the swaps, caps, and floors are based on an expectation of future interest rates derived from observable market interest rate curves (LIBOR forward curves) and volatilities (level 2 inputs). We also incorporate credit valuation adjustments (level 3 inputs) to appropriately reflect both our own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements.

The fair value of the credit default swaps is obtained from a third party who publishes various information including the index composition and price data (level 2 inputs). The fair value of the credit default swaps does not contain credit-risk-related adjustments as the change in the fair value is settled net through posting cash collateral or reclaiming cash collateral between us and our counterparty.

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The fair value of investments in securities and other and liabilities associated with investments in securities and other, including stocks, put and call options, and other investments, are carried at fair market value based on their closing prices (level 1 inputs).

When a majority of the inputs used to value our derivatives fall within level 2 of the fair value hierarchy, the derivative valuations in their entirety are classified in level 2 of the fair value hierarchy. However, when the valuation adjustments associated with our derivatives utilize level 3 inputs, such as estimates of current credit spreads, to evaluate the likelihood of default by us and our counterparties, which we consider significant (10% or more) to the overall valuation of our derivatives, the derivative valuations in their entirety are classified in level 3 of the fair value hierarchy. Transfers of inputs between levels are determined at the end of each reporting period. In determining the fair values of our derivatives at March 31, 2012, the LIBOR interest rate forward curve (level 2 inputs) assumed an uptrend from 0.242% to 0.627% for the remaining term of our derivatives. The credit spreads (level 3 inputs) used in determining the fair values of the hedge and non-hedge designated derivatives assumed an uptrend in nonperformance risk for us and all of our counterparties through the maturity dates.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents our assets and liabilities measured at fair value on a recurring basis aggregated by the level within which measurements fall in the fair value hierarchy (in thousands):

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	Quoted Market Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting (4)	Total	
March 31, 2012:						
Assets						
Derivative Assets:						
Interest rate derivatives - non-hedges	$—	$ 49,997	$ —	$ —	$49,997	(1)
Interest rate derivatives - hedges	—	3	—	—	3	(1)
Put and call options	262	—	—	—	262	(2)
Non-derivative Assets:						
Equity and US treasury securities	27,243	—	—	—	27,243	(2)
Total	27,505	50,000	—	—	77,505	
Liabilities						
Derivative Liabilities:						
Interest rate derivatives - non-hedges	—	(19,837)	—	—	(19,837)	(1)
Credit default swaps	—	4,659	—	(4,788)	(129)	(3)
Short-equity put options	(130)	—	—	—	(130)	(3)
Short-equity call options	(776)	—	—	—	(776)	(3)
Non-derivative Liabilities:						
Margin account balance	(5,928)	—	—	—	(5,928)	(3)
Total	(6,834)	(15,178)	—	(4,788)	(26,800)	
Net	$20,671	$ 34,822	$ —	$ (4,788)	$50,705	
December 31, 2011:						
Assets						
Derivative Assets:						
Interest rate derivatives - non-hedges	$—	$ 59,397	$ —	$ —	$59,397	(1)
Interest rate derivatives - hedges	—	12	—	—	12	(1)
Put and call options	1,011	—	—	—	1,011	(2)
Non-derivative Assets:						
Equity securities	20,363	—	—	—	20,363	(2)
Total	21,374	59,409	—	—	80,783	
Liabilities						
Derivative Liabilities:						
Interest rate derivatives - non-hedges	$—	$ (21,491)	$ —	$ —	$(21,491)	(1)
Credit default swaps	—	6,855	—	(6,857)	(2)	(3)
Short-equity put options	(71)	—	—	—	(71)	(3)
Short-equity call options	(415)	—	—	—	(415)	(3)
Non-derivative Liabilities:						
Margin account balance	(1,758)	—	—	—	(1,758)	(3)
Total	(2,244)	(14,636)	—	(6,857)	(23,737)	
Net	$19,130	$ 44,773	$ —	$ (6,857)	$57,046	

(1) Reported net as “Derivative assets” in the consolidated balance sheets.
(2) Reported as “Investments in securities and other” in the consolidated balance sheets.
(3) Reported as “Liabilities associated with investments in securities and other” in the consolidated balance sheets.
(4) Represents cash collateral posted by our counterparty.

Effect of Fair-Value-Measured Assets and Liabilities on Consolidated Statements of Operations

The following table summarizes the effect of fair-value-measured assets and liabilities on the consolidated statement of operations for the three months ended March 31, 2012 and 2011 (in thousands):

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	Gain (Loss) Recognized In Income		Interest Savings (Cost) Recognized In Income		Reclassified from Accumulated OCI into Interest Expense	
	Three Months Ended March 31,		Three Months Ended March 31,		Three Months Ended March 31,	
	2012	2011	2012	2011	2012	2011
Assets						
Derivative Assets:						
Interest rate derivatives	$(9,399)	$(21,847)	$13,353	$23,176	$12	$186
Put and call options	(1,367)	—	—	—	—	—
Non-derivative Assets:						
Equity and US treasury securities	2,624	—	—	—	—	—
Total	(8,142)	(21,847)	13,353	23,176	12	186
Liabilities						
Derivative Liabilities:						
Interest rate derivatives	1,653	5,030	(5,384)	(5,173)	—	—
Credit default swaps	(2,195)	—	—	—	—	—
Short-equity put options	513	—	—	—	—	—
Short-equity call options	(363)	—	—	—	—	—
Total	(392)	5,030	(5,384)	(5,173)	—	—
Net	$(8,534)	$(16,817)	$7,969	$18,003	$12	$186
Total combined						
Interest rate derivatives	$(7,746)	$(16,817)	$7,969	$18,003	$12	$186
Credit default swaps	(2,195)	—	—	—	—	—
Total derivatives	(9,941) [1]	(16,817) [1]	7,969 [2]	18,003 [2]	12	186
Unrealized gain on investments in securities and other	1,785 [3]	—	—	—	—	—
Realized loss on investments in securities and other	(378) [2]	—	—	—	—	—
Net	$(8,534)	$(16,817)	$7,969	$18,003	$12	$186

[1] Reported as “Unrealized loss on derivatives” in the consolidated statements of operations.
[2] Included in “Other income” in the consolidated statements of operations.
[3] Reported as “Unrealized gain on investments” in the consolidated statements of operations.

For the three months ended March 31, 2012 and 2011, the change in fair values of our interest rate derivatives that were recognized as change in other comprehensive income totaled ($9,000) and $8,000, respectively.

During the next twelve months, we expect $23,000 of accumulated comprehensive loss will be reclassified to interest expense.

12. Fair Value of Financial Instruments

Determining estimated fair values of our financial instruments such as notes receivable and indebtedness requires considerable judgment to interpret market data. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. Accordingly, the estimates presented are not necessarily indicative of the amounts at which these instruments could be purchased, sold, or settled. The carrying amounts and estimated fair values of financial instruments, for periods indicated, were as follows (in thousands):

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	March 31, 2012		December 31, 2011	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets and liabilities measured at fair value:				
Investments in securities and other	$27,505	$27,505	$21,374	$21,374
Derivative assets	$30,163	$30,163	$37,918	$37,918
Liabilities associated with investments in securities and other	$6,963	$6,963	$2,246	$2,246
Financial assets not measured at fair value:				
Cash and cash equivalents	$150,386	$150,386	$167,609	$167,609
Restricted cash	$96,239	$96,239	$84,069	$84,069
Accounts receivable	$39,039	$39,039	$28,623	$28,623
Notes receivable	$11,229	$12,134 to $13,412	$11,199	$11,715 to $12,947
Due from third-party hotel managers	$59,210	$59,210	$62,747	$62,747
Financial liabilities not measured at fair value:				
Indebtedness	$2,357,445	$2,170,641 to $2,299,129	$2,362,458	$2,180,027 to $2,409,503
Accounts payable and accrued expenses	$87,713	$87,713	$82,282	$82,282
Dividends payable	$18,103	$18,103	$16,941	$16,941
Due to related party	$919	$919	$2,569	$2,569
Due to third-party hotel managers	$2,432	$2,432	$1,602	$1,602

Cash, cash equivalents, and restricted cash. These financial assets bear interest at market rates and have maturities of less than 90 days. The carrying value approximates fair value due to the short-term nature. This is considered a level 1 valuation technique.

Accounts receivable, due to/from related party or third-party hotel managers, accounts payable, accrued expenses, and dividends payable. The carrying values of these financial instruments approximate their fair values due to the short-term nature of these financial instruments. This is considered a level 1 valuation technique.

Notes receivable. Fair value of the notes receivable may be determined by using similar loans with similar collateral. Since there is very little to no trading activity, we relied on our internal analysis of what we believe a willing buyer would pay for these notes. We estimated the fair value of notes receivable to be approximately 8.1% to 19.4% higher than the carrying value of $11.2 million at March 31, 2012 and approximately 4.6% to 15.6% higher than the carrying value of $11.2 million at December 31, 2011. This is considered a level 2 valuation technique.

Investments in securities and other. Investments in securities and other consist of a margin account balance, treasury bills, public equity securities, and put and call options. The fair value of these investments is based on quoted market closing prices at the balance sheet dates. See Notes 10 and 11 for a complete description of the methodology and assumptions utilized in determining the fair values.

Indebtedness. Fair value of the indebtedness is determined using future cash flows discounted at current replacement rates for these instruments. For variable-rate instruments, cash flows are determined using a forward interest rate yield curve. The current replacement rates are determined by using the U.S. Treasury yield curve or the index to which these financial instruments are tied and adjusted for the credit spreads. Credit spreads take into consideration general market conditions, maturity, and collateral. For March 31, 2012 and December 31, 2011 indebtedness valuations, we used estimated future cash flows discounted at applicable index forward curves adjusted for credit spreads. We estimated the fair value of the total indebtedness to be approximately 92.1% to 97.5% of the carrying value of $2.4 billion at March 31, 2012 and approximately 92.3% to 102.0% of the carrying value of $2.4 billion at December 31, 2011. This is considered a level 2 valuation technique.

Derivative assets and liabilities associated with investments in securities and other. Fair value of the interest rate derivatives are determined using the net present value of the expected cash flows of each derivative based on the market-based interest rate curve and adjusted for credit spreads of Ashford and the counterparties. Fair value of the credit default swap derivatives is obtained from a third party who publishes the CMBX index composition and price data. Fair value of liabilities associated with

investments in securities and other is determined based on the quoted market closing prices at the balance sheet dates. See Notes 10 and 11 for a complete description of the methodology and assumptions utilized in determining the fair values.

13. Redeemable Noncontrolling Interests

Redeemable noncontrolling interests in the operating partnership represents the limited partners' proportionate share of equity in earnings/losses of the operating partnership, which is an allocation of net income/loss attributable to the common unit holders based on the weighted average ownership percentage of these limited partners' common units and units issued under our Long-Term Incentive Plan (the “LTIP units”) that are vested throughout the period plus distributions paid to these limited partners with regard to Class B units. Class B common units have a fixed dividend rate of 7.2% and priority in payment of cash dividends over common units but otherwise have no preference over common units. Aside from Class B units, all other outstanding units represent common units. Beginning one year after issuance, each common unit of limited partnership interest (including each Class B common unit) may be redeemed for either cash or, at Ashford's sole discretion, one share of Ashford's common stock. Class B common units are convertible at the option of Ashford or the holder into an equivalent number of common units any time after July 13, 2016.

LTIP units, which are issued to certain executives and employees as compensation, have vesting periods ranging from three to five years. Upon vesting, each LTIP unit can be converted by the holder into one common partnership unit of the operating partnership which then can be redeemed for cash or, at our election, settled in our common stock. As of March 31, 2012, we have issued 5.7 million LTIP units in total, of which all but 1.3 million and 1.2 million issued in March 2012 and May 2011, respectively, had reached full economic parity with the common units and are convertible into common partnership units. All the LTIP units issued had an aggregate value of $52.6 million at the date of grant which is being amortized over their vesting periods. Compensation expense of $3.6 million and $855,000 was recognized for the three months ended March 31, 2012 and 2011, respectively. The unamortized value of LTIP units was $34.9 million at March 31, 2012, which will be amortized over periods from 0.4 to 4 years. During the three months ended March 31, 2012, no operating partnership units were presented for redemption and converted to shares of our common stock.

Redeemable noncontrolling interests, including the LTIP units, in our operating partnership as of March 31, 2012 and December 31, 2011 were $132.2 million and $112.8 million, respectively. The carrying value of redeemable noncontrolling interests as of March 31, 2012 and December 31, 2011 included adjustments of $81.5 million and $66.4 million, respectively, to reflect the excess of the redemption value over the accumulated historical costs. These redeemable noncontrolling interests were allocated net income (loss) of ($3.1) million and $5.1 million for the three months ended March 31, 2012 and 2011, respectively. During the three months ended March 31, 2012 and 2011, we declared cash distributions to operating partnership units totaling $2.3 million and $1.8 million, respectively. These distributions are recorded as a reduction of redeemable noncontrolling interests in the operating partnership.

14. Equity and Equity-Based Compensation

At-the-Market Preferred Stock Offering – On March 2, 2012, we commenced issuances of preferred stock under our at-the-market program ("ATM'") with an investment banking firm, pursuant to which we may issue up to 700,000 shares of 8.55% Series A Cumulative Preferred Stock and up to 700,000 shares of 8.45% Series D Cumulative Preferred Stock at market prices up to $30.0 million in total proceeds. During the three months ended March 31, 2012, we issued 120,731 shares of 8.55% Series A Cumulative Preferred Stock for $3.0 million gross proceeds and 249,682

shares of 8.45% Series D Cumulative Preferred Stock for $6.2 million gross proceeds. Such proceeds, net of commissions and other expenses, were $8.7 million.

Common Dividends – During the three months ended March 31, 2012 and 2011, the Board of Directors declared dividends of $0.11 and $0.10 per outstanding common share, respectively, with an annualized target of $0.44 per share for 2012.

Equity-Based Compensation – During the three months ended March 31, 2012 and 2011, we recognized compensation expense of $1.6 million and $959,000, respectively, related to our equity-based compensation plan. As of March 31, 2012, the unamortized amount of the unvested shares of restricted equity was $4.1 million and is being amortized over periods from two days to 3.8 years.

Preferred Dividends – During the three months ended March 31, 2012, the Board of Directors declared dividends of $0.5344 per share, or $860,000, for our 8.55% Series A preferred stock, $0.5281 per share, or $4.9 million, for our 8.45% Series D preferred stock, and $0.5625 per share, or $2.6 million, for our 9% Series E preferred stock. During the three months ended

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March 31, 2011, the Board of Directors declared dividends of $0.5344 per share, or $795,000, for our 8.55% Series A preferred stock and $0.5281 per share, or $4.7 million, for our 8.45% Series D preferred stock.

Noncontrolling Interests in Consolidated Joint Ventures – Noncontrolling joint venture partners have ownership interests ranging from 15% to 25% in four hotel properties with a total carrying value of $16.4 million at March 31, 2012 and December 31, 2011, and are reported in equity in the consolidated balance sheets. Noncontrolling interests in consolidated joint ventures were allocated (loss) income of ($278,000) and $931,000 for the three months ended March 31, 2012 and 2011, respectively.

15. Commitments and Contingencies

Restricted Cash – Under certain management and debt agreements for our hotel properties existing at March 31, 2012, escrow payments are required for insurance, real estate taxes, and debt service. In addition, for certain properties based on the terms of the underlying debt and management agreements, we escrow 4% to 6% of gross revenues for capital improvements.

Franchise Fees – Under franchise agreements for our hotel properties existing at March 31, 2012, we pay franchisor royalty fees between 2.5% and 7.3% of gross room revenue and, in some cases, food and beverage revenues. Additionally, we pay fees for marketing, reservations, and other related activities aggregating between 1% and 3.75% of gross room revenue and, in some cases, food and beverage revenues. These franchise agreements expire on varying dates between 2013 and 2030. When a franchise term expires, the franchisor has no obligation to renew the franchise. A franchise termination could have a material adverse effect on the operations or the underlying value of the affected hotel due to loss of associated name recognition, marketing support, and centralized reservation systems provided by the franchisor. A franchise termination could also have a material adverse effect on cash available for distribution to shareholders. In addition, if we breach the franchise agreement and the franchisor terminates a franchise prior to its expiration date, we may be liable for up to three times the average annual fees incurred for that property.

For the three months ended March 31, 2012 and 2011, our continuing operations incurred franchise fees of $7.3 million and $6.6 million, respectively, which are included in other expenses in the accompanying consolidated statements of operations.

Management Fees – Under management agreements for our hotel properties existing at March 31, 2012, we pay a) monthly property management fees equal to the greater of $10,000 (CPI adjusted since 2003) or 3% of gross revenues, or in some cases 1.5% to 7% of gross revenues, as well as annual incentive management fees, if applicable, b) market service fees on approved capital improvements, including project management fees of up to 4% of project costs, for certain hotels, and c) other general fees at current market rates as approved by our independent directors, if required. These management agreements expire from 2012 through 2028, with renewal options. If we terminate a management agreement prior to its expiration, we may be liable for estimated management fees through the remaining term, liquidated damages, or in certain circumstances we may substitute a new management agreement.

Taxes – We and our subsidiaries file income tax returns in the federal jurisdiction and various states. Tax years 2008 through 2011 remain subject to potential examination by certain federal and state taxing authorities. In 2009 and 2010, the Internal Revenue Service (IRS) audited one of our taxable REIT subsidiaries that leases two of our hotel properties for the tax year ended December 31, 2007. In September 2010, the IRS issued a notice of proposed adjustment based on Internal Revenue Code (IRC) Section 482 that reduced the amount of rent we charged to the taxable REIT subsidiary. We own a 75% interest in the hotel properties and the taxable REIT subsidiary at issue. We strongly

disagreed with the IRS' position and, in October 2010, filed a written protest with the IRS and requested an IRS Appeals Office conference, which was eventually granted but later postponed due to the REIT IRS audit discussed below. In determining amounts payable by our TRS subsidiaries under our leases, we engaged a third party to prepare a transfer pricing study which concluded that the lease terms were consistent with arm's length terms as required by applicable Treasury regulations. If the IRS were to prevail in its proposed adjustment, our taxable REIT subsidiary would owe approximately $1.1 million of additional U.S. federal income taxes plus possible additional state income taxes of $199,000, net of federal benefit. However, in August 2011, the IRS commenced an audit of our REIT for the tax year ended December 31, 2007. In October 2011, the IRS issued an income tax adjustment to the REIT as an alternative to the September 2010 TRS proposed adjustment. The REIT adjustment is based on the REIT 100% federal excise tax on our share of the amount by which the rent was held to be greater than the arm's length rate. If the IRS were to prevail in this adjustment, our REIT would owe approximately $5.1 million of U.S. federal excise taxes. If the IRS chooses to pursue the REIT 100% excise tax case over the TRS IRC Section 482 case, the excise taxes assessed on the REIT would be in lieu of the TRS adjustment. In December 2011, we filed a written protest with the IRS in regards to the REIT adjustment and an updated written protest in regards to the IRC Section 482 adjustment. In addition, we requested, and the IRS agreed, that the IRS Appeals Office review both the REIT case

and the TRS case simultaneously and we anticipate this will occur by the end of the third quarter of 2012. We believe the IRS transfer pricing methodologies applied in the audit contain flaws and that the IRS adjustment to the rent charges is inconsistent with the U.S. federal tax laws related to REITs and true leases. We believe we will prevail in the eventual settlement of the audit and that the settlement will not have a material adverse effect on our financial condition and results of operations. U.S federal income tax assessment statutes of limitations generally limit the time the IRS has to make assessments to within three years after a return is due or filed, whichever is later. Hence, the statute of limitations related to tax returns for both the TRS and REIT for the 2007 tax year were due to expire on September 15, 2011. As a result, the IRS in 2011, prior to this expiration date, requested that we agree to extend the assessment statute of limitations to December 31, 2012 for both the TRS and the REIT. We consented to the extensions of time in order to obtain additional time to prepare our written protests and request an appeals conference for both the IRS and the REIT case. In addition, the IRS commenced audits of the same TRS for the tax years ended December 31, 2008 and 2009, in May 2011 and July 2011, respectively, and has indicated that it will also commence audits of the REIT for the same periods. In March 2012, the IRS requested and we consented to extend the statue of limitations for both the TRS and REIT for the 2008 tax year to March 31, 2013. We have concluded that the positions reported on the tax returns under audit by the IRS are, solely on their technical merits, more-likely-than-not to be sustained upon examination.

During 2010, the Canadian taxing authorities selected our TRS subsidiary that leased our one Canadian hotel for audit for the tax years ended December 31, 2007, 2008, and 2009. The Canadian hotel was sold in June 2008 and the TRS ceased activity in Canada at that time. In March 2012, the Canadian taxing authorities completed the audits. Their adjustments are nominal in amount and should not result in the assessment of any additional taxes.

If we dispose of the four remaining properties contributed in connection with our initial public offering in 2003 in exchange for units of operating partnership, we may be obligated to indemnify the contributors, including our Chairman and Chief Executive Officer, each of whom have substantial ownership interests, against the tax consequences of the sale. In addition, we agreed to use commercially reasonable efforts to maintain non-recourse mortgage indebtedness of at least $16.0 million, which allows contributors of the Las Vegas hotel property to defer gain recognition in connection with their contribution. Additionally, for certain periods of time, we are prohibited from selling or transferring the Marriott Crystal Gateway in Arlington, Virginia, if as a result of such transactions, the entity from which we acquired the property would recognize a gain for federal tax purposes.

In general, tax indemnities equal the federal, state, and local income tax liabilities the contributor or their specified assignee incurs with respect to the gain allocated to the contributor. The contribution agreements' terms generally require us to gross up tax indemnity payments for the amount of income taxes due as a result of such tax indemnities.

Potential Pension Liabilities – Upon our 2006 acquisition of a hotel property, certain employees of such hotel were unionized and covered by a multi-employer defined benefit pension plan. At that time, there were no unfunded pension liabilities. Subsequent to our acquisition, such employees, who are employees of the hotel manager, elected to decertify from the union. At the time of this election, the union indicated there may be unfunded pension liabilities. The union filed a complaint with the National Labor Relations Board seeking, among other things, to overturn the decertification election. Pending the final determination of the decertification suit, including appeals, the pension fund entered into a settlement agreement with the hotel manager providing that (a) the hotel manager will continue to make pension fund payments pursuant to the collective bargaining agreement and (b) if the union loses the suit, the hotel manager will have an unfunded pension liability equal to the difference between $1.7 million and the total amount of pension payments made by the hotel manager following the settlement agreement, which is payable in annual installments of $84,000 until the 20th year following the settlement agreement. We have agreed to indemnify the hotel

manager for the payment of the unfunded pension liability as set forth in the settlement agreement. Remington Lodging, an affiliate, is the hotel manager.

Litigation – We are currently subject to litigation arising in the normal course of our business. In the opinion of management, none of these lawsuits or claims against us, either individually or in the aggregate, is likely to have a material adverse effect on our business, results of operations, or financial condition. In addition, management believes we have adequate insurance in place to cover any such significant litigation.

16. Segment Reporting

We operate in two business segments within the hotel lodging industry: direct hotel investments and hotel financing. Direct hotel investments refers to owning hotels through either acquisition or new development. We report operating results of direct hotel investments on an aggregate basis as substantially all of our hotel investments have similar economic characteristics and exhibit similar long-term financial performance. Hotel financing refers to owning subordinate hotel-related mortgages through

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acquisition or origination. We do not allocate corporate-level accounts to our operating segments, including corporate general and administrative expenses, non-operating interest income, interest expense and amortization of loan costs, and income tax expense/benefit. Financial information related to our reportable segments was as follows (in thousands):

	Direct Hotel Investments	Hotel Financing	Corporate	Consolidated
Three Months Ended March 31, 2012:				
Total revenue	$225,887	$—	$—	$225,887
Total hotel operating expenses	146,879	—	—	146,879
Property taxes, insurance, and other	12,153	—	—	12,153
Depreciation and amortization	34,355	—	—	34,355
Impairment charges	—	(92)	—	(92)
Corporate general and administrative	—	—	10,247	10,247
Total expenses (income)	193,387	(92)	10,247	203,542
Operating income (loss)	32,500	92	(10,247)	22,345
Equity in earnings (loss) of unconsolidated joint ventures	(10,304)	—	—	(10,304)
Interest income	—	—	32	32
Other income	—	—	7,613	7,613
Interest expense and amortization of loan costs	—	—	(35,204)	(35,204)
Unrealized gain on investments	—	—	1,785	1,785
Unrealized loss on derivatives	—	—	(9,941)	(9,941)
Income (loss) from continuing operations before income taxes	22,196	92	(45,962)	(23,674)
Income tax expense	—	—	(879)	(879)
Income (loss) from continuing operations	$22,196	$92	$(46,841)	$(24,553)
As of March 31, 2012:				
Total assets	$3,293,145	$3,599	$269,423	$3,566,167

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

	Direct Hotel Investments	Hotel Financing	Corporate	Consolidated
Three Months Ended March 31, 2011:				
Total revenue	$211,790	$—	$—	$211,790
Total hotel operating expenses	137,860	—	—	137,860
Property taxes, insurance, and other	10,887	—	—	10,887
Depreciation and amortization	32,777	—	—	32,777
Impairment charges	—	(340)	—	(340)
Transaction acquisition costs	—	—	(1,224)	(1,224)
Corporate general and administrative	—	—	13,883	13,883
Total expenses (income)	181,524	(340)	12,659	193,843
Operating income (loss)	30,266	340	(12,659)	17,947
Equity in earnings of unconsolidated joint ventures	28,124	—	—	28,124
Interest income	—	—	36	36
Other income	—	30,000	18,003	48,003
Interest expense and amortization of loan costs	—	—	(34,578)	(34,578)
Unrealized loss on derivatives	—	—	(16,817)	(16,817)
Income (loss) from continuing operations before income taxes	58,390	30,340	(46,015)	42,715
Income tax expense	—	—	(1,044)	(1,044)
Income (loss) from continuing operations	$58,390	$30,340	$(47,059)	$41,671
As of March 31, 2011:				
Total assets	$3,404,240	$51,385	$191,142	$3,646,767

ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

The following discussion should be read in conjunction with the unaudited financial statements and notes thereto appearing elsewhere herein. This report contains forward-looking statements within the meaning of the federal securities laws. Ashford Hospitality Trust, Inc. (the "Company" or "we" or "our" or "us") cautions investors that any forward-looking statements presented herein, or which management may express orally or in writing from time to time, are based on management's beliefs and assumptions at that time. Throughout this report, words such as "anticipate," "believe," "expect," "intend," "may," "might," "plan," "estimate," "project," "should," "will," "result," and other expressions, which do not relate solely to historical matters, are intended to identify forward-looking statements. Such statements are subject to risks, uncertainties, and assumptions and are not guarantees of future performance, which may be affected by known and unknown risks, trends, uncertainties, and factors beyond our control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, or projected. We caution investors that while forward-looking statements reflect our good-faith beliefs at the time such statements are made, said statements are not guarantees of future performance and are affected by actual events that occur after such statements are made. We expressly disclaim any responsibility to update forward-looking statements, whether as a result of new information, future events, or otherwise. Accordingly, investors should use caution in relying on past forward-looking statements, which were based

on results and trends at the time those statements were made, to anticipate future results or trends.

Some risks and uncertainties that may cause our actual results, performance, or achievements to differ materially from those expressed or implied by forward-looking statements include, among others, those discussed in our Form 10- K for the year ended December 31, 2011, as filed with the Securities and Exchange Commission on February 28, 2012. These risks and uncertainties continue to be relevant to our performance and financial condition. Moreover, we operate in a very competitive and rapidly changing environment where new risk factors emerge from time to time. It is not possible for management to predict all such risk factors, nor can management assess the impact of all such risk factors on our business or the extent to which any factor,

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or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as indicators of actual results.

EXECUTIVE OVERVIEW

General

Following the recession of 2008-2009, the lodging industry began experiencing improvement in fundamentals, specifically occupancy, in 2010 which has continued into 2012. Room rates, measured by the average daily rate, or ADR, which typically lags occupancy growth in the early stage of a recovery, have shown upward growth. We believe the improvements in the economy will continue to positively impact the lodging industry and hotel operating results for the remainder of 2012, and we intend to continue to seek ways to benefit from the cyclical nature of the hotel industry. We believe that in the current cycle, hotel values and cash flows, for the most part, peaked in 2007, and we believe we will not achieve similar cash flows and values in the immediate future. Industry experts have suggested that cash flows within our industry may achieve these previous highs again in 2014 through 2016.

Based on our primary business objectives and forecasted operating conditions, our current key priorities and financial strategies include, among other things:

•acquisition of hotel properties;
•disposition of hotel properties;
•investing in securities;
•pursuing capital market activities to enhance long-term shareholder value;
•preserving capital, enhancing liquidity, and continuing current cost saving measures;
•implementing selective capital improvements designed to increase profitability;
•implementing effective asset management strategies to minimize operating costs and increase revenues;
•financing or refinancing hotels on competitive terms;
•utilizing hedges and derivatives to mitigate risks; and
•making other investments or divestitures that our Board of Directors deems appropriate.

Our investment strategies continue to focus on the upscale and upper-upscale segments within the lodging industry. We believe that as supply, demand, and capital market cycles change, we will be able to shift our investment strategies to take advantage of new lodging-related investment opportunities as they may develop. Our Board of Directors may change our investment strategies at any time without shareholder approval or notice.

LIQUIDITY AND CAPITAL RESOURCES

Our cash position from operations is affected primarily by macro industry movements in occupancy and rate as well as our ability to control costs. Further, interest rates greatly affect the cost of our debt service as well as the financial hedges we put in place. We monitor very closely the industry fundamentals as well as interest rates. Capital expenditures above our reserves will affect cash flow as well.

On February 21, 2012, we expanded our borrowing capacity under our $105.0 million senior credit facility to an aggregate $145.0 million, with the option, subject to lender approval, to further expand the facility to an aggregate size of $225.0 million.

On March 2, 2012, we commenced issuances of preferred stock under our at-the-market (“ATM”) program with an investment banking firm pursuant to which we may issue up to 700,000 shares of 8.55% Series A Cumulative Preferred Stock and up to 700,000 shares of 8.45% Series D Cumulative Preferred Stock at market prices up to $30.0 million in total proceeds. During the three months ended March 31, 2012, we issued 120,731 shares of 8.55% Series A Cumulative Preferred Stock for $3.0 million gross proceeds and 249,682 shares of 8.45% Series D Cumulative Preferred Stock for $6.2 million gross proceeds. Proceeds are expected to be used for general corporate purposes, investments, or reduction of debt.

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In February 2010, we entered into a Standby Equity Distribution Agreement ("SEDA") with YA Global Master SPV Ltd. ("YA Global"), which terminates in 2013, that is available to provide us additional liquidity if needed. Pursuant to SEDA, YA Global has agreed to purchase up to $50.0 million (which may be increased to $65.0 million pursuant to the SEDA) of newly issued shares of our common stock if notified to do so by us in accordance with the SEDA. No shares were sold under SEDA during 2012 and 2011.

Our principal sources of funds to meet our cash requirements include: positive cash flow from operations, capital market activities, property refinancing proceeds, asset sales, and net cash derived from interest rate derivatives. Additionally, our principal uses of funds are expected to include possible operating shortfalls, owner-funded capital expenditures, new investments and debt interest and principal payments. Items that impacted our cash flow and liquidity during the periods indicated are summarized as follows:

Net Cash Flows Provided by Operating Activities. Net cash flows provided by operating activities, pursuant to our Consolidated Statement of Cash Flows which includes the changes in balance sheet items, were $12.3 million and $15.9 million for the three months ended March 31, 2012 and 2011, respectively. The decrease in cash flows from operating activities was primarily due to an increase in restricted cash due to additional cash deposits for certain loans and capital expenditures, which was partially offset by the timing of collecting receivables from hotel guests, paying vendors, and settling with hotel managers.

Net Cash Flows Used in Investing Activities. For the three months ended March 31, 2012, investing activities used net cash flows of $23.2 million. Net cash outlays primarily consisted of $23.3 million of capital improvements made to various hotel properties. For the three months ended March 31, 2011, investing activities used net cash flows of $27.4 million. Cash outlays consisted of $145.8 million for the acquisition of a 71.74% interest in PIM Highland JV, $12.0 million for the acquisition of investment in hotel condominiums, and $13.9 million for capital improvements made to various hotel properties. Cash inflows consisted of $143.9 million from the sale of three hotel properties.

Net Cash Flows Used in Financing Activities. For the three months ended March 31, 2012, net cash flows used in financing activities were $6.3 million. Cash outlays primarily consisted of $16.9 million for dividend payments to common and preferred stockholders and unit holders and $6.2 million for repayments of indebtedness. These cash outlays were partially offset by cash inflows of $8.7 million from issuances of our Series A and Series E preferred stock under our ATM program and $8.0 million in proceeds from the counterparties of our interest rate derivatives. For the three months ended March 31, 2011, net cash flows used in financing activities were $113.8 million. Cash outlays primarily consisted of $7.3 million for dividend payments to common and preferred stockholders and unit holders, $2.2 million payment for loan modification and extension fees, and $125.2 million for repayments of indebtedness and capital leases. These cash outlays were partially offset by cash inflows of $2.8 million from the issuance of 300,000 shares of common stock and $18.2 million in proceeds from the counterparties of our interest rate derivatives.

We are required to maintain certain financial ratios under various debt and derivative agreements. If we violate covenants in any debt or derivative agreement, we could be required to repay all or a portion of our indebtedness before maturity at a time when we might be unable to arrange financing for such repayment on attractive terms, if at all. Violations of certain debt covenants may result in us being unable to borrow unused amounts under a line of credit, even if repayment of some or all borrowings is not required. In any event, financial covenants under our current or future debt obligations could impair our planned business strategies by limiting our ability to borrow (i) beyond certain amounts or (ii) for certain purposes. Presently, our existing financial debt covenants primarily relate to maintaining minimum debt coverage ratios, maintaining an overall minimum net worth, maintaining a maximum loan to value ratio, and maintaining an overall minimum total assets. As of March 31, 2012, we were in compliance in all material respects with all covenants or other requirements set forth in our debt and related agreements as amended.

Mortgage and mezzanine loans securing PIM Highland JV are nonrecourse to the borrowers, except for customary exceptions or carve-outs that trigger recourse liability to the borrowers in certain limited instances. Recourse obligations typically include only the payment of costs and liabilities suffered by the lenders as a result of the occurrence of certain bad acts on the part of the borrower. However, in certain cases, the carve-outs could trigger recourse obligations on the part of the borrower with respect to repayment of all or a portion of the outstanding principal amount of the loans. We have entered into customary guaranty agreements pursuant to which we guaranty payment of any recourse liabilities of the borrowers that result from the non-recourse carve-outs (which include, but are not limited to, fraud, misrepresentation, willful conduct resulting in waste, misappropriations of rents following an event of default, voluntary bankruptcy filings, unpermitted transfers of collateral, and certain environmental liabilities). In the opinion of management, none of these guaranty agreements, either individually or in the aggregate, are likely to have a material adverse effect on our business, results of operations, or financial condition.

At March 31, 2012, our only recourse obligation is our $145.0 million senior credit facility held by four banks, which

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expires in September 2014. Currently, there is no outstanding balance on this credit facility. The primary covenants of this senior credit facility include (i) the minimum fixed charge coverage ratio, as defined, of 1.35x through expiration (ours was 1.58x at March 31, 2012); and (ii) the maximum leverage ratio, as defined, of 65% (ours was 58.7% at March 31, 2012). In the event we borrow on this credit facility, we may be unable to refinance a portion or all of this senior credit facility before maturity. However, if it becomes necessary to pay down the principal balance, if any, at maturity, we believe we will be able to accomplish that with cash on hand, cash flows from operations, equity raises, or, to the extent necessary, asset sales.

Based upon the current level of operations, management believes that our cash flow from operations along with our cash balances and the amount available under our senior credit facility ($145.0 million at March 31, 2012) will be adequate to meet upcoming anticipated requirements for interest and principal payments on debt, working capital, and capital expenditures for the next 12 months. With respect to upcoming maturities, we will continue to proactively address our upcoming 2012 and 2013 maturities. No assurances can be given that we will obtain additional financings or, if we do, what the amount and terms will be. Our failure to obtain future financing under favorable terms could adversely impact our ability to execute our business strategy. In addition, we may selectively pursue debt financing on individual properties.

We are committed to an investment strategy where we will opportunistically pursue hotel-related investments as suitable situations arise. Funds for future hotel-related investments are expected to be derived, in whole or in part, from cash on hand, future borrowings under a credit facility or other loans, or proceeds from additional issuances of common stock, preferred stock, or other securities, asset sales, and joint ventures. However, we have no formal commitment or understanding to invest in additional assets, and there can be no assurance that we will successfully make additional investments. We may, when conditions are suitable, look at additional capital raising opportunities.

Our existing hotels are mostly located in developed areas that contain competing hotel properties. The future occupancy, ADR, and RevPAR of any individual hotel could be materially and adversely affected by an increase in the number or quality of competitive hotel properties in its market area. Competition could also affect the quality and quantity of future investment opportunities.

Dividend Policy. During the three months ended March 31, 2012 and 2011, the Board of Directors declared dividends of $0.11 and $0.10 per outstanding common share, respectively. In December 2011, the Board of Directors approved our dividend policy for 2012 and we expect to pay a quarterly dividend of $0.11 per share for the reminder of 2012. The adoption of a dividend policy does not commit our Board of Directors to declare future dividends or the amount thereof. The Board of Directors will continue to review its dividend policy on a quarterly basis. We may incur indebtedness to meet distribution requirements imposed on REITs under the Internal Revenue Code to the extent that working capital and cash flow from our investments are insufficient to fund required distributions. Or, we may elect to pay dividends on our common stock in cash or a combination of cash and shares of securities as permitted under federal income tax laws governing REIT distribution requirements. We may pay dividends in excess of our cash flow.

RESULTS OF OPERATIONS

The following table summarizes the changes in key line items from our consolidated statements of operations (in thousands):

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	Three Months Ended March 31, 2012	2011	Favorable/ (Unfavorable) Change
Total revenue	$225,887	$211,790	$ 14,097
Total hotel operating expenses	$(146,879)	$(137,860)	$ (9,019)
Property taxes, insurance and other	$(12,153)	$(10,887)	$ (1,266)
Depreciation and amortization	$(34,355)	$(32,777)	$ (1,578)
Impairment charges	$92	$340	$ (248)
Transaction acquisition costs	$—	$1,224	$ (1,224)
Corporate, general, and administrative	$(10,247)	$(13,883)	$ 3,636
Operating income	$22,345	$17,947	$ 4,398
Equity in earnings (loss) of unconsolidated joint ventures	$(10,304)	$28,124	$ (38,428)
Interest income	$32	$36	$ (4)
Other income	$7,613	$48,003	$ (40,390)
Interest expense and amortization of loan costs	$(35,204)	$(34,578)	$ (626)
Unrealized gain on investments	$1,785	$—	$ 1,785
Unrealized loss on derivatives	$(9,941)	$(16,817)	$ 6,876
Income tax expense	$(879)	$(1,044)	$ 165
Income (loss) from continuing operations	$(24,553)	$41,671	$ (66,224)
Income from discontinued operations	$—	$2,211	$ (2,211)
Net income (loss)	$(24,553)	$43,882	$ (68,435)
(Income) loss from consolidated joint ventures attributable to noncontrolling interests	$278	$(931)	$ 1,209
Net (income) loss attributable to redeemable noncontrolling interests in operating partnership	$3,057	$(5,118)	$ 8,175
Net income (loss) attributable to the Company	$(21,218)	$37,833	$ (59,051)

The following table illustrates key performance indicators for the 96 hotel properties (“comparable hotels”) included in continuing operations that we have owned throughout the entire three months ended March 31, 2012 and 2011:

	Three Months Ended March 31, 2012		2011	
RevPar (revenue per available room)	$95.61		$92.32	
Occupancy	70.97	%	69.87	%
ADR (average daily rate)	$134.72		$132.14	

Comparison of the Three Months Ended March 31, 2012 and 2011

Revenue. Rooms revenue for the three months ended March 31, 2012 (the “2012 quarter”) increased $11.7 million, or 7.2%, to $174.5 million from $162.8 million for the three months ended March 31, 2011 (the “2011 quarter”). The increase in room revenue was partially due to the continued improvements in occupancy coupled with an increase in average daily rate at our comparable hotels. During the 2012 quarter, we experienced a 110 basis-points increase in occupancy and a 2.0% increase in room rates as the economy continues to improve. Food and beverage experienced a similar increase of $3.3 million, or 8.6%, due to improved occupancy. Other revenue, which consists mainly of telecommunications, parking, spa, and golf fees, experienced a slight increase of $217,000. In addition, in the 2012 quarter, hotel revenue increased by $878,000 and $3.9 million related to the acquisition of WorldQuest condominium properties in March 2011 and the assignment to us of the remaining 11% ownership interest in a joint venture which previously held a hotel property under a triple-net lease in December 2011, respectively.

Rental income from the triple-net operating lease decreased $1.2 million. As discussed above, we were assigned the remaining 11% ownership interest in the joint venture which previously held a property under a triple-net lease. Consequently, the lease agreement was canceled and rental income is no longer recorded related to this lease.

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Asset management fees and other were $75,000 and $68,000 for the 2012 quarter and the 2011 quarter, respectively.

Hotel Operating Expenses. Hotel operating expenses consist of direct expenses from departments associated with revenue streams and indirect expenses associated with support departments and management fees. We experienced increases of $4.9 million in direct expenses and $4.2 million in indirect expenses and management fees in the 2012 quarter. The increase in these expenses is primarily attributable to higher occupancy and higher management fees resulting from increased hotel revenues and higher sales and marketing expenses. In addition, WorldQuest condominium properties and the consolidation of the previously mentioned triple-net lease hotel property contributed $728,000 and $3.6 million, respectively, to the increase in total hotel operating expenses during the 2012 quarter. Direct expenses were 30.3% of total hotel revenue for the 2012 quarter and 30.0% for the 2011 quarter.

Property Taxes, Insurance, and Other. Property taxes, insurance, and other increased $1.3 million for the 2012 quarter to $12.2 million. The increase is primarily due to a) a $1.4 million increase in property taxes resulting from refunds and reductions in the 2011 quarter related to successful appeals and increased property value assessments related to certain hotels in the 2012 quarter and b) a gain of $244,000 recognized on an insurance settlement in 2011. These increases were partially offset by decreased insurance expense of $393,000 resulting from lower premiums for insurance policies renewed since March 31, 2011 and lower uninsured losses incurred.

Depreciation and Amortization. Depreciation and amortization decreased $1.6 million for the 2012 quarter compared to the 2011 quarter primarily due to certain assets that had been fully depreciated since March 31, 2011, which is partially offset by an increase in depreciation expense resulting from capital improvements made at certain hotel properties since March 31, 2011.

Impairment Charges. We recorded credits to impairment charges of $92,000 and $340,000 for the 2012 quarter and 2011 quarter, respectively, for cash received and resulting valuation adjustments on previously impaired mezzanine loans.

Transaction Acquisition Costs. In the 2011 quarter, we recorded a credit to transaction acquisition costs of $1.2 million related to costs reimbursed by the joint venture associated with the acquisition of a 71.74% interest in PIM Highland JV.

Corporate, General, and Administrative. Corporate, general, and administrative expenses decreased to $10.2 million for the 2012 quarter compared to $13.9 million for the 2011 quarter. This decrease is primarily attributable to $5.5 million in legal costs associated with the settlement of litigation incurred in the 2011 quarter offset by a $3.3 million increase in non-cash stock/unit-based compensation primarily due to the higher expense recognized on restricted stock/unit-based awards granted in 2012 and 2011 at a higher cost per share and a $991,000 fair-market adjustment related to modified employment terms. Aside from these items, other corporate general and administrative expenses decreased $1.5 million during the 2012 quarter primarily attributable to decreases in employee bonuses.

Equity in Earnings (Loss) of Unconsolidated Joint Ventures. We recorded equity in earnings (loss) of unconsolidated joint ventures of ($10.3 million) and $28.1 million for the 2012 quarter and the 2011 quarter, respectively. Included in the 2011 quarter was a gain of $75.4 million recognized by the PIM Highland JV at acquisition, of which our share was $43.2 million, and $17.6 million of transaction costs recorded for the acquisition. Excluding the gain and the transaction costs, our equity loss would have been $2.4 million for the 2011 quarter.

Interest Income. Interest income was $32,000 and $36,000 for the 2012 quarter and the 2011 quarter, respectively.

Other Income. Other income was $7.6 million and $48.0 million for the 2012 quarter and the 2011 quarter, respectively. Income from the non-hedge interest rate swaps, floors, and flooridors accounted for $7.9 million and

$18.0 million of the 2012 quarter and the 2011 quarter, respectively. For the 2012 quarter, other income included $378,000 of realized loss on investments in securities and other. For the 2011 quarter, other income included a gain of $30.0 million recognized from a litigation settlement.

Interest Expense and Amortization of Loan Costs. Interest expense and amortization of loan costs increased $626,000 to $35.2 million for the 2012 quarter from $34.6 million for the 2011 quarter. The slight increase is primarily due to a nominal increase in weighted average interest rate and increased amortization of loan costs of $133,000.

Unrealized Gain on Investments. During the 2012 quarter, we recorded an unrealized gain on investments of $1.8 million based on the closing price of securities at March 31, 2012. We did not have securities of this nature during the 2011 quarter.

Unrealized Loss on Derivatives. For the 2012 quarter, we recorded an unrealized loss of $9.9 million, consisting of $7.7 million related to interest-rate derivatives and $2.2 million related to credit default swaps. In the 2011 quarter, we recorded an unrealized loss of $16.8 million related to interest-rate derivatives. The fair value of interest-rate derivatives is primarily based

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on movements in the LIBOR forward curve and the passage of time. The fair value of credit default swaps, which we entered into in August 2011, is based on the change in value of the CMBX indices. The fair value of investment in security derivatives is based on overall security market fluctuations.

Income Tax Expense. We recorded income tax expense of $879,000 and $1.0 million for the 2012 quarter and the 2011 quarter, respectively. The decrease in income tax expense is primarily due to the utilization of net operating loss carryforwards for the state of California portion of the income tax provision for our largest TRS subsidiary. For tax years 2011 and 2010, California had suspended the net operating loss carryforward deduction.

Income from Discontinued Operations. No hotels were considered discontinued operations for the 2012 quarter. For the 2011 quarter, discontinued operations reported income from operations of $2.2 million related to four hotel properties, three of which were sold during the 2011 quarter. During the 2011 quarter, we completed the sale of the JW Marriott hotel in San Francisco, California, the Hilton hotel in Rye Town, New York, and the Hampton Inn hotel in Houston, Texas, and recorded a net gain of $2.8 million related to these sales. In addition to these three hotels, discontinued operations for the 2011 quarter also include the operating results of the Hampton Inn hotel in Jacksonville, FL, which was sold in the third quarter of 2011.

(Income) Loss from Consolidated Joint Ventures Attributable to Noncontrolling Interests. Noncontrolling interest partners in consolidated joint ventures were allocated (income) loss of $278,000 and ($931,000) during the 2012 quarter and 2011 quarter, respectively. In the 2011 quarter, we recorded a gain of $2.1 million from the sale of the Hampton Inn hotel in Houston, Texas, that was held by a joint venture.

Net (Income) Loss Attributable to Redeemable Noncontrolling Interests in Operating Partnership. Noncontrolling interests in operating partnership were allocated net (income) loss of $3.1 million and ($5.1 million) in the 2012 quarter and the 2011 quarter, respectively. Redeemable noncontrolling interests represented ownership interests of 11.46% and 19.2% in the operating partnership at March 31, 2012 and 2011, respectively. The decrease was primarily due to the net increase in common stock outstanding resulting from the issuance of additional shares of our common stock, the conversion of Series B-1 preferred stock to common stock, and grants of equity-based compensation since March 31, 2011.

SEASONALITY

Our properties' operations historically have been seasonal as certain properties maintain higher occupancy rates during the summer months and some during the winter months. This seasonality pattern can cause fluctuations in our quarterly lease revenue under our percentage leases. We anticipate that our cash flows from the operations of our properties will be sufficient to enable us to make quarterly distributions to maintain our REIT status. To the extent that cash flows from operations are insufficient during any quarter due to temporary or seasonal fluctuations in lease revenue, we expect to utilize other cash on hand or borrowings to fund required distributions. However, we cannot make any assurances that we will make distributions in the future.

CONTRACTUAL OBLIGATIONS

There have been no material changes since December 31, 2011, outside of the ordinary course of business, to contractual obligations specified in the table of contractual obligations included in the section “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in our 2011 Form 10-K.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our accounting policies that are critical or the most important to understand our financial condition and results of operations and that require management to make the most difficult judgments are described in our 2011 Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on February 28, 2012. There have been no material changes in these critical accounting policies.

RECENTLY ISSUED ACCOUNTING STANDARDS

In December 2011, the FASB issued accounting guidance to clarify how to determine whether a reporting entity should derecognize the in-substance real estate upon loan defaults when it ceases to have controlling interest in a subsidiary that is in-substance real estate. Under this guidance, a reporting entity would not satisfy the requirements to derecognize the in-substance real estate before the legal transfer of the real estate to the lender and the extinguishment of the related non-recourse indebtedness. That is, even if the reporting entity ceases to have a controlling financial interest, the reporting entity would continue to include the real estate, debt, and the results of the subsidiary's operations in its consolidated financial statements until legal title to the real

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estate is transferred to legally satisfy the debt. The new accounting guidance is effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2012. Early adoption is permitted. We do not expect any impact on our financial position and results of operations from the adoption of this accounting guidance as our current accounting policy is to derecognize the in-substance real estate when the legal title to the real estate is transferred to legally satisfy the non-recourse indebtedness.

In December 2011, the FASB issued accounting guidance to require disclosures about offsetting assets and liabilities. Entities are required to disclose both gross and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. This scope would include derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, and securities-borrowing and securities-lending arrangements. The new accounting guidance is effective for fiscal years, and interim periods within those years, beginning after January 1, 2013 and the disclosures should be reported retrospectively for all comparative periods presented. We do not expect any material impact on our financial position and results of operations from the adoption of this accounting guidance, but will make the required additional disclosures upon adoption.

NON-GAAP FINANCIAL MEASURES

The following non-GAAP presentations of EBITDA, Adjusted EBITDA, FFO, and Adjusted FFO are made to assist our investors in evaluating our operating performance.

EBITDA is defined as net income (loss) attributable to the Company before interest expense, interest income other than interest income from mezzanine loans, income taxes, depreciation and amortization, and noncontrolling interests in the operating partnership. We adjust EBITDA to exclude certain additional items such as gains or losses on sales of properties, write-off of loan costs, premiums, and exit fees, impairment of assets, acquisition-related costs, non-cash items, and various other items which are detailed in the following table. We present EBITDA and Adjusted EBITDA because we believe these measurements a) more accurately reflect the ongoing performance of our hotel assets and other investments, b) provide more useful information to investors as indicators of our ability to meet our future debt payment and working capital requirements, and c) provide an overall evaluation of our financial condition. EBITDA and Adjusted EBITDA as calculated by us may not be comparable to EBITDA and Adjusted EBITDA reported by other companies that do not define EBITDA and Adjusted EBITDA exactly as we define the terms. EBITDA and Adjusted EBITDA does not represent cash generated from operating activities determined in accordance with generally accepted accounting principles (“GAAP”) and should not be considered as an alternative to operating income or net income determined in accordance with GAAP as an indicator of performance or as an alternative to cash flows from operating activities as determined by GAAP as an indicator of liquidity.

The following table reconciles net income (loss) to EBITDA and Adjusted EBITDA (in thousands):

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	Three Months Ended March 31,	
	2012	2011
	(Unaudited)	
Net income (loss)	$(24,553)	$43,882
(Income) loss from consolidated joint ventures attributable to noncontrolling interests	278	(931)
Net (income) loss attributable to redeemable noncontrolling interests in operating partnership	3,057	(5,118)
Net income (loss) attributable to the Company	(21,218)	37,833
Interest income	(32)	(36)
Interest expense and amortization of loan costs	34,851	34,817
Depreciation and amortization	33,583	32,161
Impairment charges	(92)	(340)
Income tax expense	879	1,129
Net income (loss) attributable to redeemable noncontrolling interests in operating partnership	(3,057)	5,118
Equity in (earnings) loss of unconsolidated joint ventures	10,304	(28,124)
Company's portion of EBITDA of unconsolidated joint ventures	14,564	46,046
EBITDA	69,782	128,604
Amortization of unfavorable management contract liabilities	(565)	(565)
Gain on sale/disposition of properties	—	(2,802)
Write-off of loan costs, premiums, and exit fees, net	—	948
Other income [1]	(7,613)	(48,003)
Transaction acquisition costs	—	(1,224)
Legal costs related to a litigation settlement [2]	—	5,500
Unrealized gain on investments	(1,785)	—
Unrealized loss on derivatives	9,941	16,817
Fair-market-value adjustments related to modified employment terms	991	—
Company's portion of adjustments to EBITDA of unconsolidated joint ventures	95	(41,011)
Adjusted EBITDA	$70,846	$58,264

(1) Other income primarily consisting of income from interest rate derivatives in both periods, net realized loss on investments in securities and other in 2012, and a $30 million gain from a litigation settlement in 2011 are excluded from Adjusted EBITDA.

(2) Legal costs associated with a litigation settlement are excluded from Adjusted EBITDA.

We calculate Funds From Operations (“FFO”) and Adjusted FFO ("AFFO") in the following table. FFO is calculated on the basis defined by the National Association of Real Estate Investment Trusts (“NAREIT”), which is net income (loss), computed in accordance with GAAP, excluding gains or losses on sales of properties, asset impairment adjustments, and extraordinary items as defined by GAAP, plus depreciation and amortization of real estate assets, and after adjustments for unconsolidated joint ventures and noncontrolling interests in the operating partnership. Adjustments for unconsolidated joint ventures are calculated to reflect funds from operations on the same basis. NAREIT developed FFO as a relative measure of performance of an equity REIT to recognize that income-producing real estate historically has not depreciated on the basis determined by GAAP. Our calculation of AFFO excludes write-off of loan costs, premiums, and exit fees, acquisition-related costs, dividends on our Series B-1 preferred stock, which was outstanding as of March 31, 2011, non-cash items, our share of adjustments to FFO related to unconsolidated joint ventures, and various other items as detailed in the following table. We consider FFO and AFFO to be appropriate measures of our ongoing normalized operating performance as a REIT. We compute FFO in accordance with our interpretation of standards established by NAREIT, which may not be comparable to FFO reported by other REITs

that either do not define the term in accordance with the current NAREIT definition or interpret the NAREIT definition differently than us. FFO and AFFO do not represent cash generated from operating activities as determined by GAAP and should not be considered as an alternative to a) GAAP net income or loss as an indication of our financial performance or b) GAAP cash flows from operating activities as a measure of our liquidity, nor is it indicative of funds available to satisfy our cash needs, including our ability to make cash distributions. However, to facilitate a clear understanding of our historical operating results, we believe that FFO and AFFO should be considered along with our net income or loss and cash flows reported in the consolidated financial statements.

The following table reconciles net income (loss) to FFO (in thousands):

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	Three Months Ended March 31,	
	2012	2011
	(Unaudited)	
Net income (loss)	$(24,553)	$43,882
(Income) loss from consolidated joint ventures attributable to noncontrolling interests	278	(931)
Net (income) loss attributable to redeemable noncontrolling interests in operating partnership	3,057	(5,118)
Preferred dividends	(8,331)	(6,555)
Net income (loss) attributable to common shareholders	(29,549)	31,278
Depreciation and amortization of real estate	33,517	32,100
Impairment charges	(92)	(340)
Gain on sale/disposition of properties	—	(2,802)
Net income (loss) attributable to redeemable noncontrolling interests in operating partnership	(3,057)	5,118
Equity in (earnings) loss of unconsolidated joint ventures	10,304	(28,124)
Company's portion of FFO of unconsolidated joint ventures	2,455	(10,972)
FFO available to common shareholders	13,578	26,258
Dividends on convertible preferred stock	—	1,025
Write-off of loan costs, premiums, and exit fees, net	—	948
Transaction acquisition costs	—	(1,224)
Legal costs related to a litigation settlement [2]	—	5,500
Other income [1]	356	(30,000)
Unrealized gain on investments	(1,785)	—
Unrealized loss on derivatives	9,941	16,817
Fair-market-value adjustment related to a modified employment terms	991	—
Company's portion of adjustments to FFO of unconsolidated joint ventures	95	13,061
Adjusted FFO available to common shareholders	$23,176	$32,385

[1] Other income in 2012 primarily represents net realized loss on investments in securities and other which is excluded from Adjusted FFO.

Other income in 2011 represents a gain from a litigation settlement which is excluded from Adjusted FFO.

[2] Legal costs associated with a litigation settlement are excluded from Adjusted FFO.

HOTEL PORTFOLIO

The following table presents certain information related to our hotel properties as of March 31, 2012:

Hotel Property	Location	Service Type	Total Rooms	% Owned	Owned Rooms
Fee Simple Properties					
Embassy Suites	Austin, TX	Full service	150	100	%150
Embassy Suites	Dallas, TX	Full service	150	100	%150
Embassy Suites	Herndon, VA	Full service	150	100	%150
Embassy Suites	Las Vegas, NV	Full service	220	100	%220
Embassy Suites	Syracuse, NY	Full service	215	100	%215
Embassy Suites	Flagstaff, AZ	Full service	119	100	%119
Embassy Suites	Houston, TX	Full service	150	100	%150
Embassy Suites	West Palm Beach, FL	Full service	160	100	%160
Embassy Suites	Philadelphia, PA	Full service	263	100	%263

Embassy Suites	Walnut Creek, CA	Full service	249	100	%249
Embassy Suites	Arlington, VA	Full service	267	100	%267
Embassy Suites	Portland, OR	Full service	276	100	%276
Embassy Suites	Santa Clara, CA	Full service	257	100	%257
Embassy Suites	Orlando, FL	Full service	174	100	%174
Hilton Garden Inn	Jacksonville, FL	Select service	119	100	%119
Hilton	Houston, TX	Full service	243	100	%243
Hilton	St. Petersburg, FL	Full service	333	100	%333
Hilton	Santa Fe, NM	Full service	157	100	%157
Hilton	Bloomington, MN	Full service	300	100	%300

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Hilton	Washington, DC	Full service	544	75	%408
Hilton	Costa Mesa, CA	Full service	486	100	%486
Hilton	Tucson, AZ	Full service	428	100	%428
Homewood Suites	Mobile, AL	Select service	86	100	%86
Hampton Inn	Lawrenceville, GA	Select service	86	100	%86
Hampton Inn	Evansville, IN	Select service	141	100	%141
Hampton Inn	Terre Haute, IN	Select service	112	100	%112
Hampton Inn	Buford, GA	Select service	92	100	%92
Marriott	Durham, NC	Full service	225	100	%225
Marriott	Arlington, VA	Full service	697	100	%697
Marriott	Seattle, WA	Full service	358	100	%358
Marriott	Bridgewater, NJ	Full service	347	100	%347
Marriott	Plano, TX	Full service	404	100	%404
Marriott	Dallas, TX	Full service	266	100	%266
SpringHill Suites by Marriott	Jacksonville, FL	Select service	102	100	%102
SpringHill Suites by Marriott	Baltimore, MD	Select service	133	100	%133
SpringHill Suites by Marriott	Kennesaw, GA	Select service	90	100	%90
SpringHill Suites by Marriott	Buford, GA	Select service	96	100	%96
SpringHill Suites by Marriott	Gaithersburg, MD	Select service	162	100	%162
SpringHill Suites by Marriott	Centreville, VA	Select service	136	100	%136
SpringHill Suites by Marriott	Charlotte, NC	Select service	136	100	%136
SpringHill Suites by Marriott	Durham, NC	Select service	120	100	%120
SpringHill Suites by Marriott	Orlando, FL	Select service	400	100	%400
SpringHill Suites by Marriott	Manhattan Beach, CA	Select service	164	100	%164
SpringHill Suites by Marriott	Plymouth Meeting, PA	Select service	199	100	%199
SpringHill Suites by Marriott	Glen Allen, VA	Select service	136	100	%136
Fairfield Inn by Marriott	Kennesaw, GA	Select service	87	100	%87
Fairfield Inn by Marriott	Orlando, FL	Select service	388	100	%388
Courtyard by Marriott	Bloomington, IN	Select service	117	100	%117
Courtyard by Marriott	Columbus, IN	Select service	90	100	%90
Courtyard by Marriott	Louisville, KY	Select service	150	100	%150
Courtyard by Marriott	Crystal City, VA	Select service	272	100	%272
Courtyard by Marriott	Ft. Lauderdale, FL	Select service	174	100	%174
Courtyard by Marriott	Overland Park, KS	Select service	168	100	%168
Courtyard by Marriott	Palm Desert, CA	Select service	151	100	%151
Courtyard by Marriott	Foothill Ranch, CA	Select service	156	100	%156
Courtyard by Marriott	Alpharetta, GA	Select service	154	100	%154
Courtyard by Marriott	Philadelphia, PA	Select service	498	100	%498
Courtyard by Marriott	Seattle, WA	Select service	250	100	%250
Courtyard by Marriott	San Francisco, CA	Select service	405	100	%405
Courtyard by Marriott	Orlando, FL	Select service	312	100	%312
Courtyard by Marriott	Oakland, CA	Select service	156	100	%156
Courtyard by Marriott	Scottsdale, AZ	Select service	180	100	%180
Courtyard by Marriott	Plano, TX	Select service	153	100	%153
Courtyard by Marriott	Edison, NJ	Select service	146	100	%146
Courtyard by Marriott	Newark, CA	Select service	181	100	%181
Courtyard by Marriott	Manchester, CT	Select service	90	85	%77
Courtyard by Marriott	Basking Ridge, NJ	Select service	235	100	%235
Marriott Residence Inn	Lake Buena Vista, FL	Select service	210	100	%210

Marriott Residence Inn	Evansville, IN	Select service	78	100	%78
Marriott Residence Inn	Orlando, FL	Select service	350	100	%350
Marriott Residence Inn	Falls Church, VA	Select service	159	100	%159
Marriott Residence Inn	San Diego, CA	Select service	150	100	%150

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Marriott Residence Inn	Salt Lake City, UT	Select service	144	100	%144
Marriott Residence Inn	Palm Desert, CA	Select service	130	100	%130
Marriott Residence Inn	Las Vegas, NV	Select service	256	100	%256
Marriott Residence Inn	Phoenix, AZ	Select service	200	100	%200
Marriott Residence Inn	Plano, TX	Select service	126	100	%126
Marriott Residence Inn	Newark, CA	Select service	168	100	%168
Marriott Residence Inn	Manchester CT	Select service	96	85	%82
Marriott Residence Inn Buckhead	Atlanta, GA	Select service	150	100	%150
Marriott Residence Inn	Jacksonville, FL	Select service	120	100	%120
TownePlace Suites by Marriott	Manhattan Beach, CA	Select service	144	100	%144
One Ocean	Atlantic Beach, FL	Full service	193	100	%193
Sheraton Hotel	Langhorne, PA	Full service	187	100	%187
Sheraton Hotel	Minneapolis, MN	Full service	222	100	%222
Sheraton Hotel	Indianapolis, IN	Full service	371	100	%371
Sheraton Hotel	Anchorage, AK	Full service	370	100	%370
Sheraton Hotel	San Diego, CA	Full service	260	100	%260
Hyatt Regency	Coral Gables, FL	Full service	242	100	%242
Crowne Plaza	Beverly Hills, CA	Full service	260	100	%260
Annapolis Historic Inn	Annapolis, MD	Full service	124	100	%124
Air Rights/Ground Lease Properties					
Doubletree Guest Suites	Columbus, OH	Full service	194	100	%194
Hilton	Ft. Worth, TX	Full service	294	100	%294
Hilton	La Jolla, CA	Full service	394	75	%296
Crowne Plaza	Key West, FL	Full service	160	100	%160
Renaissance	Tampa, FL	Full service	293	100	%293
Total			20,656		20,395

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Our primary market risk exposure consists of changes in interest rates on borrowings under our debt instruments and our derivatives portfolio that bear interest at variable rates that fluctuate with market interest rates. The analysis below presents the sensitivity of the market value of our financial instruments to selected changes in market interest rates.

At March 31, 2012, our total indebtedness of $2.4 billion included $515.4 million of variable-rate debt. The impact on the results of operations of a 25-basis point change in interest rate on the outstanding balance of variable-rate debt at March 31, 2012 would be approximately $1.2 million per year. Interest rate changes will have no impact on the remaining $1.8 billion of fixed-rate debt.

The above amounts were determined based on the impact of hypothetical interest rates on our borrowings and assume no changes in our capital structure. As the information presented above includes only those exposures that existed at March 31, 2012, it does not consider exposures or positions that could arise after that date. Accordingly, the information presented herein has limited predictive value. As a result, the ultimate realized gain or loss with respect to interest rate fluctuations will depend on exposures that arise during the period, the hedging strategies at the time, and the related interest rates.

We primarily use interest rate derivatives to capitalize on the historical correlation between changes in LIBOR and RevPAR. We have entered into various interest rate swap, cap, floor, and flooridor transactions that were not designated as hedges. Changes in the fair market values of these transactions are noncash items and recorded in earnings. These interest rate derivatives have resulted in total income of approximately $204.1 million from their

inception in 2008 through March 31, 2012. Based on the LIBOR rates in effect on March 31, 2012, these derivatives are expected to result in income of approximately $24.1 million for the remainder of 2012.

In August 2011, we entered into credit default swap transactions for a notional amount of $100.0 million to hedge financial and capital market risk for an upfront cost of $8.2 million that was subsequently returned to us as collateral by our counterparty. A credit default swap is a derivative contract that functions like an insurance policy against the credit

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risk of an entity or obligation. The seller of protection assumes the credit risk of the reference obligation from the buyer (us) of protection in exchange for annual premium payments. If a default or a loss, as defined in the credit default swap agreements, occurs on the underlying bonds, then the buyer of protection is protected against those losses. The only liability for us, the buyer, is the annual premium and any change in value of the underlying CMBX index (if the trade is terminated prior to maturity). For all CMBX trades completed to date, we were the buyer of protection. Credit default swaps are subject to master netting settlement arrangements and credit support annexes. Assuming the underlying bonds pay off at par over their remaining average life, our total exposure for these trades is approximately $8.5 million.

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, our management has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of March 31, 2012 (“Evaluation Date”). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective (i) to ensure that information required to be disclosed in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms; and (ii) to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are currently subject to litigation arising in the normal course of our business. In the opinion of management, none of these lawsuits or claims against us, either individually or in the aggregate, is likely to have a material adverse effect on our business, results of operations, or financial condition. In addition, we believe we have adequate insurance in place to cover such litigation.

ITEM 1A. RISK FACTORS

The discussion of our business and operations should be read together with the risk factors contained in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, filed with the Securities and Exchange Commission, which describe various risks and uncertainties to which we are or may become subject. These risks and uncertainties have the potential to affect our business, financial condition, results of operations, cash flows, strategies, or prospects in a material and adverse manner. At March 31, 2012, there have been no material changes to the risk factors set forth in our Annual Report on Form 10-K for the year ended December 31, 2011.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

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ITEM 6. EXHIBITS

Exhibit	Description
10.36.1*	First Amendment to Credit Agreement, dated February 21, 2012, by and among Ashford Hospitality Limited Partnership, Ashford Hospitality Trust, Inc., KeyBanc Capital Markets, and KeyBank, National Association
12.0*	Statement Regarding Computation of Ratios of Earnings to Combined Fixed Charges and Preferred Stock Dividends
31.1*	Certifications of Chief Executive Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of Securities Exchange Act of 1934, as amended
31.2*	Certifications of Chief Financial Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of Securities Exchange Act of 1934, as amended
32.1*	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

The following materials from the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2012, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Operations; (iii) Consolidated Statements Comprehensive Income (Loss); (iii) Consolidated Statement of Cash Flows; and (iv) Notes to the Consolidated Financial Statements. In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be “filed” for purposes of Section 18 of the Securities Exchange Act of 1934 (the “Exchange Act”), or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act of 1933 or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

101.INS	XBRL Instance Document	Submitted electronically with this report.
101.SCH	XBRL Taxonomy Extension Schema Document	Submitted electronically with this report.
101.CAL	XBRL Taxonomy Calculation Linkbase Document	Submitted electronically with this report.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Submitted electronically with this report.
101.LAB	XBRL Taxonomy Label Linkbase Document.	Submitted electronically with this report.
101.PRE	XBRL Taxonomy Presentation Linkbase Document.	

	Submitted electronically with this report.

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* Filed herewith.

SIGNATURES

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

Date:	May 8, 2012	By: /s/ MONTY J. BENNETT Monty J. Bennett Chief Executive Officer
Date:	May 8, 2012	By: /s/ DAVID J. KIMICHIK David J. Kimichik Chief Financial Officer

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