

GAIAM, INC  
Form 10-Q  
November 08, 2010  
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**United States**  
**Securities and Exchange Commission**  
Washington, D.C. 20549

**Form 10-Q**

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

For the quarterly period ended September 30, 2010

OR

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

Commission File Number 0-27517

**GAIAM, INC.**

(Exact name of registrant as specified in its charter)

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**COLORADO**  
 (State or other jurisdiction of  
 incorporation or organization)

**84-1113527**  
 (I.R.S. Employer  
 Identification No.)

**833 WEST SOUTH BOULDER ROAD,**  
**LOUISVILLE, COLORADO 80027**  
 (Address of principal executive offices)

**(303) 222-3600**  
 (Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.:

Large accelerated filer  Accelerated filer   
 Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
 Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES  NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

| Class                                    | Outstanding at November 5, 2010 |
|--|---------------------------------|
| Class A Common Stock (\$.0001 par value) | 17,866,780                      |
| Class B Common Stock (\$.0001 par value) | 5,400,000                       |

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**GAIAM, INC.**

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**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

This report may contain forward-looking statements that involve risks and uncertainties. The words anticipate, believe, plan, estimate, expect, strive, future, intend and similar expressions are intended to identify such forward-looking statements. Our actual results could differ materially from the results anticipated in these forward-looking statements as a result of certain factors set forth under Management's Discussion and Analysis of Financial Condition and Results of Operations, Quantitative and Qualitative Disclosures about Market Risk and elsewhere in this report. Risks and uncertainties that could cause actual results to differ include, without limitation, general economic conditions, competition, loss of key personnel, pricing, brand reputation, consumer trends, acquisitions, new initiatives undertaken by us, security and information systems, legal liability for website content, merchandise supply problems, failure of third parties to provide adequate service, our reliance on centralized customer service, overstocks and merchandise returns, our reliance on a centralized fulfillment center, increases in postage and shipping costs, E-commerce trends, future Internet related taxes, our founder's control of us, fluctuations in quarterly operating results, customer interest in our products, the effect of government regulation and other risks and uncertainties included in our filings with the Securities and Exchange Commission. We caution you that no forward-looking statement is a guarantee of future performance, and you should not place undue reliance on these forward-looking statements which reflect our view only as of the date of this report. We undertake no obligation to update any forward-looking information.

**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements (Unaudited)**  
**Unaudited Interim Condensed Consolidated Financial Statements**

We have prepared our unaudited interim condensed consolidated financial statements included herein pursuant to the rules and regulations of the United States Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to these rules and regulations, although we believe that the disclosures made are adequate to make the information not misleading. In our opinion, the unaudited interim condensed financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly, in all material respects, our consolidated financial position as of September 30, 2010, the interim results of operations for the three and nine months ended September 30, 2010 and 2009, and cash flows for the nine months ended September 30, 2010 and 2009. These interim statements have not been audited. The balance sheet as of December 31, 2009 was derived from our audited consolidated financial statements included in our annual report on Form 10-K. The interim condensed consolidated financial statements contained herein should be read in conjunction with our audited financial statements, including the notes thereto, for the year ended December 31, 2009.

**Table of Contents****GAIAM, INC.****Condensed consolidated balance sheets**

| (in thousands, except share and per share data)   | September 30,<br>2010<br>(Unaudited) | December 31,<br>2009 |
|---|--------------------------------------|----------------------|
| <b>ASSETS</b>   |                                      |                      |
| Current assets:   |                                      |                      |
| Cash and cash equivalents   | \$ 40,835                            | \$ 48,325            |
| Accounts receivable, net  | 37,147                               | 46,266               |
| Inventory, less allowances  | 30,801                               | 26,872               |
| Deferred advertising costs  | 2,655                                | 1,909                |
| Receivable and deferred tax assets  | 8,959                                | 10,179               |
| Other current assets  | 6,747                                | 5,681                |
| <b>Total current assets</b>   | <b>127,144</b>                       | <b>139,232</b>       |
| Property and equipment, net   | 27,788                               | 28,217               |
| Media library, net  | 15,504                               | 12,354               |
| Deferred tax assets, net  | 5,496                                | 4,414                |
| Goodwill  | 26,068                               | 24,166               |
| Other intangibles, net  | 507                                  | 652                  |
| Notes receivable and other assets   | 3,209                                | 3,178                |
| <b>Total assets</b>   | <b>\$ 205,716</b>                    | <b>\$ 212,213</b>    |
| <b>LIABILITIES AND EQUITY</b>   |                                      |                      |
| Current liabilities:  |                                      |                      |
| Accounts payable  | \$ 29,695                            | \$ 33,261            |
| Accrued liabilities   | 8,335                                | 11,061               |
| <b>Total current liabilities</b>  | <b>38,030</b>                        | <b>44,322</b>        |
| Commitments and contingencies   |                                      |                      |
| Equity:   |                                      |                      |
| Gaiam, Inc. shareholders' equity:   |                                      |                      |
| Class A common stock, \$.0001 par value, 150,000,000 shares authorized, 17,854,680 and 17,721,212 shares issued and outstanding at September 30, 2010 and December 31, 2009, respectively | 2                                    | 2                    |
| Class B common stock, \$.0001 par value, 50,000,000 shares authorized, 5,400,000 issued and outstanding at September 30, 2010 and December 31, 2009                                       | 1                                    | 1                    |
| Additional paid-in capital  | 160,632                              | 162,532              |
| Accumulated other comprehensive income  | 101                                  | 85                   |
| Accumulated deficit   | (9,920)                              | (9,979)              |
| <b>Total Gaiam, Inc. shareholders' equity</b>   | <b>150,816</b>                       | <b>152,641</b>       |
| Noncontrolling interest   | 16,870                               | 15,250               |
| <b>Total equity</b>   | <b>167,686</b>                       | <b>167,891</b>       |
| <b>Total liabilities and equity</b>   | <b>\$ 205,716</b>                    | <b>\$ 212,213</b>    |

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See accompanying notes to the interim condensed consolidated financial statements.

**Table of Contents****GAIAM, INC.****Condensed consolidated statements of operations**

| (in thousands, except per share data)  | For the Three Months Ended<br>September 30, |                     | For the Nine Months Ended<br>September 30, |                     |
|--|---|---------------------|--|---------------------|
|  | 2010<br>(unaudited)                         | 2009<br>(unaudited) | 2010<br>(unaudited)                        | 2009<br>(unaudited) |
| Net revenue  | \$ 72,328                                   | \$ 74,439           | \$ 190,937                                 | \$ 190,837          |
| Cost of goods sold   | 39,164                                      | 38,628              | 96,636                                     | 92,594              |
| Gross profit   | 33,164                                      | 35,811              | 94,301                                     | 98,243              |
| Expenses:  |   |                     |  |                     |
| Selling and operating  | 29,161                                      | 31,641              | 85,946                                     | 96,269              |
| Corporate, general and administration  | 2,930                                       | 3,225               | 8,965                                      | 9,431               |
| Total expenses   | 32,091                                      | 34,866              | 94,911                                     | 105,700             |
| Income (loss) from operations  | 1,073                                       | 945                 | (610)                                      | (7,457)             |
| Interest and other income  | 1,058                                       | 86                  | 1,197                                      | 221                 |
| Income (loss) before income taxes and noncontrolling interest                | 2,131                                       | 1,031               | 587  | (7,236)             |
| Income tax expense (benefit)   | 801   | 388                 | 71   | (2,699)             |
| Net income (loss)  | 1,330                                       | 643                 | 516  | (4,537)             |
| Net (income) loss attributable to noncontrolling interest                    | (478)                                       | (278)               | (457)                                      | 803                 |
| Net income (loss) attributable to Gaiam, Inc.                                | \$ 852                                      | \$ 365              | \$ 59                                      | \$ (3,734)          |
| Net income (loss) per share attributable to Gaiam, Inc. common shareholders: |   |                     |  |                     |
| Basic  | \$ 0.04                                     | \$ 0.02             | \$ 0.00                                    | \$ (0.16)           |
| Diluted  | \$ 0.04                                     | \$ 0.02             | \$ 0.00                                    | \$ (0.16)           |
| Weighted-average shares outstanding:   |   |                     |  |                     |
| Basic  | 23,253                                      | 23,085              | 23,212                                     | 23,370              |
| Diluted  | 23,352                                      | 23,167              | 23,361                                     | 23,370              |

See accompanying notes to the interim condensed consolidated financial statements.

**Table of Contents****GAIAM, INC.****Condensed consolidated statements of cash flows**

| (in thousands)  | For the Nine Months Ended<br>September 30, |                     |
|---|--|---------------------|
|   | 2010<br>(unaudited)                        | 2009<br>(unaudited) |
| <b>Operating activities</b>   |  |                     |
| Net income (loss)   | \$ 516                                     | \$ (4,537)          |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities:          |  |                     |
| Depreciation  | 2,323                                      | 2,400               |
| Amortization  | 3,251                                      | 3,083               |
| Share-based compensation expense  | 1,176                                      | 1,421               |
| Deferred and stock option income tax benefit  | (159)                                      | (2,747)             |
| Gain on re-measurement of equity investment to estimated fair value prior to business combination | (977)                                      |                     |
| Changes in operating assets and liabilities, net of effects from acquisitions:                    |  |                     |
| Accounts receivable, net  | 9,321                                      | 2,295               |
| Inventory, net  | (3,130)                                    | 14,771              |
| Deferred advertising costs  | (1,609)                                    | (1,662)             |
| Income taxes receivable   | 38   | 2,713               |
| Other current assets  | (1,500)                                    | (11)                |
| Accounts payable  | (3,772)                                    | 2,146               |
| Accrued liabilities   | (3,490)                                    | 1,063               |
| Net cash provided by operating activities   | 1,988                                      | 20,935              |
| <b>Investing activities</b>   |  |                     |
| Purchase of property, equipment and media rights  | (6,797)                                    | (5,613)             |
| Net cash used in investing activities   | (6,797)                                    | (5,613)             |
| <b>Financing activities</b>   |  |                     |
| Payment of dividends  | (3,478)                                    | (194)               |
| Net proceeds from issuance of common stock and tax benefits from option exercises                 | 788  | 154                 |
| Repurchase of Class A common stock, including related costs                                       |  | (2,810)             |
| Net cash used in financing activities   | (2,690)                                    | (2,850)             |
| Effects of exchange rates on cash and cash equivalents  | 9  |                     |
| Net change in cash and cash equivalents   | (7,490)                                    | 12,472              |
| Cash and cash equivalents at beginning of period  | 48,325                                     | 31,965              |
| Cash and cash equivalents at end of period  | \$ 40,835                                  | \$ 44,437           |
| <b>Supplemental cash flow information</b>   |  |                     |
| Interest paid   | \$ 1                                       | \$ 50               |
| Income taxes paid   | \$ 198                                     | \$ 423              |
| Common stock issued for acquisitions  | \$   | \$ 796              |



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See accompanying notes to the interim condensed consolidated financial statements

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### **Notes to interim condensed consolidated financial statements**

#### **1. Organization, Nature of Operations, and Principles of Consolidation**

References in this report to we , us , our or Gaiam refer to Gaiam, Inc. and its consolidated subsidiaries, unless we indicate otherwise. We are a lifestyle media company providing a broad selection of information, media, products and services to customers who value personal development, wellness, ecological lifestyles, responsible media and conscious community. We were incorporated under the laws of the State of Colorado on July 7, 1988.

We have prepared the accompanying unaudited interim condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States, or GAAP, and they include our accounts and those of our subsidiaries. Intercompany transactions and balances have been eliminated.

The unaudited condensed consolidated financial position, results of operations and cash flows for the interim periods disclosed in this report are not necessarily indicative of future financial results.

#### **2. Significant Accounting Policies**

No changes were made to our significant accounting policies during the three and nine months ended September 30, 2010, except that we adopted self-insurance accounting effective January 1, 2010, which did not have a material impact on our condensed consolidated financial statements.

##### *Use of Estimates and Reclassifications*

The preparation of financial statements in accordance with GAAP requires us to make estimates and assumptions that affect the amounts reported in the accompanying financial statements and disclosures. Although we base these estimates on our best knowledge of current events and actions that we may undertake in the future, actual results may be different from the estimates. We have made certain reclassifications to prior period amounts to conform to the current period presentations.

#### **3. Equity**

During the nine months ended September 30, 2010, we issued under our 2009 Long-Term Incentive Plan a total of 4,828 of our Class A common shares to our independent directors, in lieu of cash compensation, for services rendered in 2010 and issued 128,640 of our Class A common shares upon exercise of options under our 1999 Long-Term Incentive Plan.

On March 8, 2010, our board of directors declared out of additional paid-in capital a cash dividend of \$0.15 per share for our common shareholders of record on April 1, 2010, and, as a result, additional paid-in capital on our condensed consolidated balance sheet at September 30, 2010 was decreased by \$3.5 million.

Our subsidiary, Real Goods Solar, Inc. ( Real Goods Solar ), issued 18,392 of its Class A common shares valued at \$67,000 to compensate nonemployee board members for services rendered during the nine months ended September 30, 2010. As of September 30, 2010, we owned 54.6% of Real Goods Solar.

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The following is a reconciliation from December 31, 2009 to September 30, 2010 of the carrying amount of total equity, equity attributable to Gaiam, Inc., and equity attributable to the noncontrolling interest.

| (in thousands)   | Total      | Gaiam, Inc. Shareholders |                        |                         |  |            | Paid-in<br>Capital | Noncontrolling<br>Interest |
|--|------------|--------------------------|------------------------|-------------------------|--|------------|--------------------|----------------------------|
|  |            | Comprehensive<br>Income  | Accumulated<br>Deficit | Comprehensive<br>Income | Other<br>Class A<br>and Class B<br>Common<br>Stock |            |                    |                            |
| Balance at December 31, 2009   | \$ 167,891 | \$                       | \$ (9,979)             | \$ 85                   | \$ 3   | \$ 162,532 | \$ 15,250          |                            |
| Issuance of Gaiam, Inc.<br>common stock in conjunction with<br>compensation, including related tax<br>benefits | 1,439      |                          |                        |                         |  | 1,439      |                    |                            |
| Issuance of subsidiary stock and<br>share-based compensation   | 286        |                          |                        |                         |  | 139        | 147                |                            |
| Distribution of dividend   | (3,478)    |                          |                        |                         |  | (3,478)    |                    |                            |
| Adjustment to estimated fair value of<br>noncontrolling interest due to<br>business acquisitions               | 1,000      |                          |                        |                         |  |            | 1,000              |                            |
| Comprehensive income:  |            |                          |                        |                         |  |            |                    |                            |
| Net income   | 516        | 516                      | 59                     |                         |  |            | 457                |                            |
| Foreign currency translation<br>adjustment, net of taxes of \$14   | 32         | 32                       |                        | 16                      |  |            | 16                 |                            |
| Comprehensive income   | 548        | \$ 548                   |                        |                         |  |            |                    |                            |
| Balance at September 30, 2010  | \$ 167,686 |                          | \$ (9,920)             | \$ 101                  | \$ 3   | \$ 160,632 | \$ 16,870          |                            |

The following schedule reflects the effect of changes in Gaiam, Inc.'s ownership interest in Real Goods on Gaiam, Inc.'s equity.

| (in thousands, except share data)   | Nine Months Ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2010                               | 2009       |
| Net income (loss) attributable to Gaiam, Inc.   | \$ 59                              | \$ (3,734) |
| Increase in Gaiam, Inc.'s paid-in capital for the issuance of 18,392 and 394,741 Real Goods Solar Class A common shares for the nine months ended September 30, 2010 and 2009, respectively, and for share-based compensation | 139                                | 131        |
| Change from net income (loss) attributable to Gaiam, Inc. and transfers from the noncontrolling interest  | \$ 198                             | \$ (3,603) |

**Table of Contents****4. Comprehensive Income (Loss)**

Our comprehensive income (loss), net of related tax effects, was as follows:

| (in thousands)  | Three Months Ended<br>September 30, |               | Nine Months Ended<br>September 30, |                   |
|---|-------------------------------------|---------------|------------------------------------|-------------------|
|   | 2010                                | 2009          | 2010                               | 2009              |
| Net income (loss)   | \$ 1,330                            | \$ 643        | \$ 516                             | \$ (4,537)        |
| Other comprehensive income, foreign currency translation adjustment, net of related tax | 32                                  |               | 32                                 |                   |
| <b>Comprehensive income (loss)</b>  | <b>1,362</b>                        | <b>643</b>    | <b>548</b>                         | <b>(4,537)</b>    |
| Comprehensive (income) loss attributable to the noncontrolling interest                 | (494)                               | (278)         | (473)                              | 803               |
| <b>Comprehensive income (loss) attributable to Gaiam, Inc.</b>                          | <b>\$ 868</b>                       | <b>\$ 365</b> | <b>\$ 75</b>                       | <b>\$ (3,734)</b> |

**5. Share-Based Compensation**

During the nine months ended September 30, 2010, we granted 84,000 stock options to employees and board members under our 2009 Long-Term Incentive Plan and cancelled 57,460 stock options previously issued under our 1999 Long-Term Incentive Plan. Total share-based compensation expense was \$0.4 million for each of the three month periods ended September 30, 2010 and 2009, and \$1.2 million and \$1.4 million for the nine months ended September 30, 2010 and 2009, respectively, and is shown in corporate, general and administration expenses on our condensed consolidated statements of operations.

Also during the first nine months of 2010, Real Goods Solar granted 519,000 and cancelled 35,000 stock options under the Real Goods Solar 2009 Long-Term Incentive Plan. The new stock options commence vesting 2% over 50 months only upon the attainment of a certain amount of pre-tax income for the year ended December 31, 2010. For these performance based stock options, the attainment of the performance condition became probable during the third quarter of 2010 and, therefore, Real Goods Solar recorded \$0.1 million of compensation expense for these grants.

**6. Mergers and Acquisitions**

On July 1, 2010, we increased our ownership interest in an existing equity investment and, as a result, recognized a gain, representing the investment's estimated fair value immediately before acquiring control, of \$1.0 million, which was reported in interest and other income on our consolidated condensed statements of operations for the three and nine months ended September 30, 2010. We used a combination of the income and market approaches to estimate the fair value of this equity investment immediately before increasing our ownership interest. For the income approach, we used historical unaudited financial statements, projected financial information and other records and documents. Selected publicly-traded companies were used to develop multiples for the market approach.

**7. Income Taxes**

Our income tax provision for the nine months ended September 30, 2010 includes benefits resulting from enhanced charitable donation deductions and other permanent differences.

**8. Net Income (Loss) Per Share Attributable To Gaiam, Inc. Common Shareholders**

Basic net income (loss) per share attributable to Gaiam, Inc. common shareholders excludes any dilutive effects of options. We compute basic net income (loss) per share attributable to Gaiam, Inc. common shareholders using the weighted average number of common shares outstanding during the period. We compute diluted net income (loss) per share attributable to Gaiam, Inc. common shareholders using the weighted average number of common shares and common stock equivalents outstanding during the period. We excluded common stock equivalents of 628,000 and 897,000 for the three months ended September 30, 2010 and 2009, respectively, and 552,000 and 1,285,000 for the nine months ended

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September 30, 2010 and 2009, respectively, from the computation of diluted net income (loss) per share attributable to Gaiam, Inc. common shareholders because their effect was antidilutive.

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The following table sets forth the computation of basic and diluted net income (loss) per share attributable to Gaiam, Inc. common shareholders:

| (in thousands, except per share data)   | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|---------|------------------------------------|------------|
|   | 2010                                | 2009    | 2010                               | 2009       |
| Numerator for basic and diluted net income (loss) per share attributable to Gaiam, Inc. common shareholders   | \$ 852                              | \$ 365  | \$ 59                              | \$ (3,734) |
| Denominator:  |                                     |         |                                    |            |
| Weighted average shares for basic net income (loss) per share attributable to Gaiam, Inc. common shareholders | 23,253                              | 23,085  | 23,212                             | 23,370     |
| Effect of dilutive securities:  |                                     |         |                                    |            |
| Weighted average of common stock and stock options  | 99                                  | 82      | 149                                |            |
| Denominators for diluted net income (loss) per share attributable to Gaiam, Inc. common shareholders          | 23,352                              | 23,167  | 23,361                             | 23,370     |
| Net income (loss) per share attributable to Gaiam, Inc. common shareholders - basic                           | \$ 0.04                             | \$ 0.02 | \$ 0.00                            | \$ (0.16)  |
| Net income (loss) per share attributable to Gaiam, Inc. common shareholders - diluted                         | \$ 0.04                             | \$ 0.02 | \$ 0.00                            | \$ (0.16)  |

**9. Segment Information**

We manage our business and aggregate our operational and financial information in accordance with three reportable segments. The direct to consumer segment contains direct response marketing programs, catalogs, Internet, and subscription community sales channels; the business segment comprises retailers, media and corporate account channels; and the solar segment reflects solar energy businesses.

Although we are able to track revenues by sales channel, the management, allocation of resources, and analysis and reporting of expenses is presented on a combined basis, at the reportable segment level. Contribution margin is defined as net revenue less cost of goods sold and total operating expenses.

Financial information for our segments is as follows:

| (in thousands)                          | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|-----------|------------------------------------|-----------|
|   | 2010                                | 2009      | 2010                               | 2009      |
| Net revenue:                            |                                     |           |                                    |           |
| Direct to consumer                      | \$ 26,686                           | \$ 30,971 | \$ 72,304                          | \$ 85,673 |
| Business                                | 21,016                              | 20,502    | 61,471                             | 59,954    |
| Solar                                   | 24,626                              | 22,966    | 57,162                             | 45,210    |
| Consolidated net revenue                | 72,328                              | 74,439    | 190,937                            | 190,837   |
| Contribution margin (loss):             |                                     |           |                                    |           |
| Direct to consumer                      | (1,220)                             | (279)     | (5,472)                            | (5,228)   |
| Business                                | 1,118                               | 966       | 3,237                              | 704       |
| Solar                                   | 1,175                               | 258       | 1,625                              | (2,933)   |
| Consolidated contribution margin (loss) | 1,073                               | 945       | (610)                              | (7,457)   |

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| Reconciliation of contribution margin (loss) to net income (loss) attributable to Gaiam, Inc.: |        |        |       |            |
|--|--------|--------|-------|------------|
| Interest and other income  | 1,058  | 86     | 1,197 | 221        |
| Income tax expense (benefit)   | 801    | 388    | 71    | (2,699)    |
| Net (income) loss attributable to noncontrolling interest                                      | (478)  | (278)  | (457) | 803        |
| Net income (loss) attributable to Gaiam, Inc.  | \$ 852 | \$ 365 | \$ 59 | \$ (3,734) |

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**Item 2. Management's discussion and analysis of financial condition and results of operations**

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with the condensed consolidated financial statements and related notes included elsewhere in this document. This section is designed to provide information that will assist in understanding our condensed consolidated financial statements, changes in certain items in those statements from period to period, the primary factors that caused those changes and how certain accounting principles, policies and estimates affect the condensed consolidated financial statements.

**Overview and Outlook**

We are a lifestyle media company providing a broad selection of information, media, products and services to customers who value personal development, wellness, ecological lifestyles, and responsible media. Our media brand is built around our ability to develop and offer media content, products, and lifestyle solutions to consumers in the LOHAS market.

We offer our customers the ability to make purchasing decisions and find responsible content based on these values while providing quality offerings at a price comparable to mainstream alternatives. We market our media and products through a multi-channel approach including traditional media channels, direct to consumer via the Internet, direct response marketing, subscriptions and catalogs, and through national retailers and corporate accounts.

Our business model revolves around content creation, which forms the basis of our proprietary offerings. Our operations are vertically integrated from content creation, utilizing our in-house production studio, through product development and sourcing, to customer service and distribution. We market our products and services across three segments: business, direct to consumer, and solar. We distribute the majority of our products in our business and direct to consumer segments from our fulfillment center or drop-ship products directly to customers. We also utilize a third party replication and fulfillment center for media distribution in our business segment.

Our business segment sells directly to retailers, with our products available in approximately 65,000 retail doors in the United States. During the third quarter of 2010, this segment generated revenue of \$21.0 million, up from \$20.5 million during the third quarter of 2009, an increase of 2.5%. This increase primarily reflects increased store within store presentations, our continued success as media category manager and the consolidation of a new business, partially offset by a modest weakening in the consumer environment. During the third quarter of 2010, we expanded our store within store presentations, which include custom fixtures that we design, to over 14,500 locations. Our media category management role, which is part of our long term strategy and a key step in securing shelf space for media, expanded to approximately 4,600 doors, up from 4,000 at the end of the third quarter of 2009.

Through its diverse marketing reach, the direct to consumer segment provides an opportunity to launch and support new media releases, a sounding board for new product testing, promotional opportunities, a growing subscription base, and customer feedback on us and the LOHAS industry's focus and future. During the third quarter of 2010, this segment generated revenues of \$26.7 million, down from \$31.0 million during the third quarter of 2009. This decrease reflects planned reductions to our catalog circulation of 16% and to media spend for direct response television of 17%, as well as the closure of unprofitable businesses.

Our solar segment offers residential and small commercial solar energy integration services. On May 13, 2008, our solar energy integration business consummated an initial public offering and has since been a separate segment. This business has grown its sales and expanded its market territories. During the third quarter of 2010, this segment generated revenues of \$24.6 million, up from \$23.0 million during the third quarter of 2009. We have and will continue to use the solar segment's IPO proceeds to fund this segment's working capital needs and general corporate purposes, which may include future acquisitions of businesses.

We believe our growth will be driven by media content, products, and services delivered to the consumer via Internet, retailers, licensing, electronic downloads and subscriptions. We have increased our focus on media content creation and distribution, media category management, and branded store within store presentations at retailers. Our recent licensing agreements with The Discovery Channel and The Travel Channel will expand our distribution within the non-theatrical media category. In addition, our new licensing of the Reebok name for fitness media and accessories will result in a significant expansion of our product offerings at Target stores in the fourth quarter of 2010.

We believe a number of factors are important to our long-term success, including increasing our branded store within a store presence, expanding category management into new retailers and genres, increasing international growth by expanding into new markets primarily through license arrangements, extending our product lines and enhancing our multimedia platform community through new media opportunities, new membership programs, initiatives and acquisitions.





**Table of Contents****Results of Operations**

The following table sets forth certain financial data as a percentage of revenue for the periods indicated:

|   | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |         |
|---|-------------------------------------|---------|------------------------------------|---------|
|   | 2010                                | 2009    | 2010                               | 2009    |
| Net revenue   | 100.0 %                             | 100.0 % | 100.0 %                            | 100.0 % |
| Cost of goods sold  | 54.1 %                              | 51.9 %  | 50.6 %                             | 48.5 %  |
| Gross profit  | 45.9 %                              | 48.1 %  | 49.4 %                             | 51.5 %  |
| Expenses:   |                                     |         |                                    |         |
| Selling and operating                                     | 40.3 %                              | 42.5 %  | 45.0 %                             | 50.5 %  |
| Corporate, general and administration                     | 4.1 %                               | 4.3 %   | 4.7 %                              | 4.9 %   |
| Total expenses  | 44.4 %                              | 46.8 %  | 49.7 %                             | 55.4 %  |
| Income (loss) from operations                             | 1.5 %                               | 1.3 %   | (0.3)%                             | (3.9)%  |
| Interest and other income                                 | 1.5 %                               | 0.1 %   | 0.6 %                              | 0.1 %   |
| Income tax expense (benefit)                              | 1.1 %                               | 0.5 %   | 0.0 %                              | (1.4)%  |
| Net (income) loss attributable to noncontrolling interest | (0.7)%                              | (0.4)%  | (0.3)%                             | 0.4 %   |
| Net income (loss) attributable to Gaiam, Inc.             | 1.2 %                               | 0.5 %   | 0.0 %                              | (2.0)%  |

*Three Months Ended September 30, 2010 Compared to Three Months Ended September 30, 2009*

*Net revenue.* Net revenue decreased \$2.1 million, or 2.8%, to \$72.3 million during the third quarter of 2010 from \$74.4 million during the third quarter of 2009. Net revenue in our business segment increased \$0.5 million, or 2.5%, to \$21.0 million during the third quarter of 2010 from \$20.5 million during the third quarter of 2009, primarily reflecting increased store within store presentations, our continued success as media category manager and the consolidation of a new business, partially offset by a modest weakening in the consumer environment. Net revenue in our direct to consumer segment decreased \$4.3 million to \$26.7 million during the third quarter of 2010 from \$31.0 million during the third quarter of 2009. This 13.8% decrease in the direct to consumer segment net revenue primarily reflects our decisions to further reduce catalog circulation by 16%, decrease media spend for our direct response television by 17% and close unprofitable businesses. Net revenue in our solar segment increased \$1.7 million, or 7.2%, to \$24.6 million during the third quarter of 2010 from \$23.0 million during the third quarter of 2009, due to organic growth.

*Gross profit.* Gross profit decreased \$2.6 million, or 7.4%, to \$33.2 million during the third quarter of 2010 from \$35.8 million during the third quarter of 2009. As a percentage of net revenue, gross profit decreased to 45.9% during the third quarter of 2010 from 48.1% during the third quarter of 2009. The decrease in gross profit percentage primarily reflects increased revenue from our lower margin solar segment and a higher mix of fitness product and accessory sales.

*Selling and operating expenses.* Selling and operating expenses decreased \$2.5 million, or 7.8%, to \$29.2 million during the third quarter of 2010 from \$31.6 million during the third quarter of 2009. As a percentage of net revenue, selling and operating expenses decreased to 40.3% during the third quarter of 2010 from 42.5% during the third quarter of 2009. This decrease is primarily a result of reducing payroll and infrastructure costs, optimizing television advertising and reducing catalog prospecting.

*Corporate, general and administration expenses.* Corporate, general and administration expenses decreased \$0.3 million, or 9.1%, to \$2.9 million during the third quarter of 2010 from \$3.2 million during the third quarter of 2009. As of percentage of net revenue, corporate, general

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and administration expenses decreased to 4.1% during the third quarter of 2010 from 4.3% during the third quarter of 2009 primarily as a result of reductions in payroll and related expenses.

*Interest and other income.* Interest and other income increased \$1.0 million to \$1.1 million during the third quarter from \$0.1 million during the third quarter of 2009 as a result of a gain from adjusting an equity investment to its estimated fair value.

*Net income attributable to noncontrolling interest.* Net income attributable to noncontrolling interest increased \$0.2 million to \$0.5 million during the third quarter of 2010 from \$0.3 million during the third quarter of 2009 primarily as a result of the improved earnings in our solar segment.

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*Net income attributable to Gaiam, Inc.* As a result of the above factors, net income attributable to Gaiam, Inc. was \$0.9 million during the third quarter of 2010 compared to \$0.4 million during the third quarter of 2009. Net income per share attributable to Gaiam, Inc. common shareholders was \$0.04 per share during the third quarter of 2010 compared to \$0.02 per share during the third quarter of 2009.

*Nine Months Ended September 30, 2010 Compared to Nine Months Ended September 30, 2009*

*Net revenue.* Net revenue increased \$0.1 million, or 0.1%, to \$190.9 million during the nine months ended September 30, 2010 from \$190.8 million during the nine months ended September 30, 2009. Net revenue in our business segment increased \$1.5 million, or 2.5%, to \$61.5 million during the nine months ended September 30, 2010 from \$60.0 million during the nine months ended September 30, 2009, primarily reflecting improvement in our domestic business, including increased store within store presentations, our continued success as media category manager, and the addition of several new media and accessory brands, partially offset by a modest weakening in the consumer environment. Net revenue in our direct to consumer segment decreased \$13.4 million to \$72.3 million during the nine months ended September 30, 2010 from \$85.7 million during the nine months ended September 30, 2009. This 15.6% decrease in the direct to consumer segment net revenue primarily reflects our decision to reduce catalog circulation, reduce media spend for our direct response television and close unprofitable businesses. Net revenue in our solar segment increased \$12.0 million, or 26.4%, to \$57.2 million during the nine months ended September 30, 2010 from \$45.2 million during the nine months ended September 30, 2009, due to organic growth.

*Gross profit.* Gross profit decreased \$3.9 million, or 4.0%, to \$94.3 million during the nine months ended September 30, 2010 from \$98.2 million during the nine months ended September 30, 2009. As a percentage of net revenue, gross profit decreased to 49.4% during the nine months ended September 30, 2010 from 51.5% during the nine months ended September 30, 2009. The decrease in gross profit percentage primarily reflects increased revenue from our lower margin solar segment.

*Selling and operating expenses.* Selling and operating expenses decreased \$10.3 million, or 10.7%, to \$85.9 million during the nine months ended September 30, 2010 from \$96.3 million during the nine months ended September 30, 2009. As a percentage of net revenue, selling and operating expenses decreased to 45.0% during the nine months ended September 30, 2010 from 50.5% during the nine months ended September 30, 2009. This decrease is primarily a result of reducing payroll and infrastructure costs, optimizing television advertising expenses and reducing catalog prospecting.

*Corporate, general and administration expenses.* Corporate, general and administration expenses decreased \$0.5 million, or 4.9%, to \$9.0 million during the nine months ended September 30, 2010 from \$9.4 million during the nine months ended September 30, 2009. As of percentage of net revenue, corporate, general and administration expenses decreased to 4.7% during the nine months ended September 30, 2010 from 4.9% during the nine months ended September 30, 2009 primarily as a result of reductions in payroll and related expenses.

*Interest and other income.* Interest and other income increased \$1.0 million to \$1.2 million during the nine months ended September 30, 2010 from \$0.2 million during the nine months ended September 30, 2009 as a result of a gain from adjusting an equity investment to its estimated fair value.

*Income tax expense (benefit).* Income tax expense (benefit) as a percentage of income (loss) before income taxes and noncontrolling interest decreased to 12.1% during the nine months ended September 30, 2010 from 37.3% during the nine months ended September 30, 2009 primarily due to benefits resulting from enhanced charitable donation deductions and other permanent differences.

*Net income (loss) attributable to noncontrolling interest.* Net income attributable to noncontrolling interest was \$.05 million during the nine months ended September 30, 2010 compared to a net loss attributable to noncontrolling interest of \$0.8 million during the nine months ended September 30, 2009 primarily as a result of the improved earnings in our solar segment.

*Net income (loss) attributable to Gaiam, Inc.* As a result of the above factors, net income attributable to Gaiam, Inc. was \$0.1 million during the nine months ended September 30, 2010 compared to a net loss of \$3.7 million during the nine months ended September 30, 2009. Net income per share attributable to Gaiam, Inc. common shareholders was \$0.00 per share during the nine months ended September 30, 2010 compared to a net loss of \$0.16 per share during the nine months ended September 30, 2009.

**Seasonality**

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Our sales are affected by seasonal influences. On an aggregate basis, we generate our strongest revenues and net income in the fourth quarter due to increased holiday spending and retailer fitness purchases.

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

Our capital needs arise from working capital required to fund operations, capital expenditures related to acquisition and development of media content, development of our Internet and community platforms and new products, acquisitions of new businesses, replacements, expansions and improvements to our infrastructure, and future growth. These capital requirements depend on numerous factors, including the rate of market acceptance of our product offerings, our ability to expand our customer base, the cost of ongoing upgrades to our product offerings, the level of expenditures for sales and marketing, the level of investment in distribution systems and facilities and other factors. The timing and amount of these capital requirements are variable and we cannot accurately predict them. Additionally, we will continue to pursue opportunities to expand our media libraries, evaluate possible investments in businesses, products and technologies, and increase our sales and marketing programs and brand promotions as needed.

We have a revolving line of credit agreement with a financial institution with a current expiration date of October 2, 2011. The credit agreement permits borrowings up to the lesser of \$15 million or our borrowing base which is calculated based upon the collateral value of our accounts receivable, inventory, and certain property and equipment. Borrowings under this agreement bear interest at the prime rate, provided, however, that at no time will the rate be less than 4.25% per annum. Borrowings are secured by a pledge of certain of our assets, and the agreement contains various financial covenants, including covenants requiring compliance with certain financial ratios. At September 30, 2010, we had no amounts outstanding under this agreement; however, \$0.5 million was reserved for outstanding letters of credit. We believe we are in compliance with all of the financial covenants under this credit agreement.

**Cash Flows**

The following table summarizes our primary sources (uses) of cash during the periods presented:

| (in thousands)  | Nine Months Ended<br>September 30, |           |
|---|------------------------------------|-----------|
|   | 2010                               | 2009      |
| Net cash provided by (used in):                       |                                    |           |
| Operating activities                                  | \$ 1,988                           | \$ 20,935 |
| Investing activities                                  | (6,797)                            | (5,613)   |
| Financing activities                                  | (2,690)                            | (2,850)   |
| Effect of exchange rates on cash and cash equivalents | 9                                  |           |
| Net change in cash and cash equivalents               | \$ (7,490)                         | \$ 12,472 |

*Operating activities.* Our operating activities provided net cash of \$2.0 million and \$20.9 million during the nine months ended September 30, 2010 and 2009, respectively. Our net cash provided by operating activities during the nine months ended September 30, 2010 was primarily attributable to decreased accounts receivable of \$9.3 million, noncash adjustments to net income of \$5.6 million, and net income of \$0.5 million, partially offset by decreased accounts payable of \$3.8 million, reduced accrued liabilities of \$3.5 million, increased inventory of \$3.1 million and increased deferred advertising costs and other current assets of \$3.1 million. The reduction in accounts payable reflects payments for inventory purchases. Our net cash provided by operating activities during the nine months ended September 30, 2009 was primarily attributable to decreased accounts receivable and inventory of \$17.1 million, noncash adjustments to the net loss of \$3.6 million, increased accounts payable and accrued liabilities of \$3.2 million and refunded income taxes of \$3.2 million, partially offset by the net loss of \$4.5 million and increased deferred advertising costs of \$1.7 million.

*Investing activities.* Our investing activities used net cash of \$6.8 million and \$5.6 million during the nine months ended September 30, 2010 and 2009, respectively. The net cash used in investing activities during the nine months ended September 30, 2010 was used primarily to acquire licensing rights for the Discovery Channel's media catalog and other media content for \$4.9 million and property and equipment to maintain normal operations for \$1.9 million. The net cash used in investing activities during the nine months ended September 30, 2009 was used primarily to acquire property and equipment for \$3.4 million, of which \$1.5 million was acquired to maintain normal operations, and for media productions of \$2.2 million.

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*Financing activities.* Our financing activities used net cash of \$2.7 million and \$2.9 million during the nine months ended September 30, 2010 and 2009, respectively. Our net cash used in financing activities during the nine months ended September 30, 2010 was the result of dividend payments of \$3.5 million or \$0.15 per share, partially offset by cash provided by stock option exercise issuances and their related tax benefits of \$0.8 million. Our net cash used in financing activities during the nine months ended September 30, 2009 was used primarily to repurchase 932,000 shares of our Class A common stock.

We believe our available cash, cash expected to be generated from operations, cash generated by the sale of our stock, and borrowing capabilities should be sufficient to fund our operations on both a short-term and long-term basis. However, our projected cash needs may change as a result of acquisitions, product development, unforeseen operational difficulties or other factors.

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In the normal course of our business, we investigate, evaluate and discuss acquisition, joint venture, minority investment, strategic relationship and other business combination opportunities in the LOHAS market. For any future investment, acquisition or joint venture opportunities, we may consider using then-available liquidity, issuing equity securities or incurring additional indebtedness.

**Contractual Obligations**

We have commitments pursuant to lease agreements, but have no outstanding commitments pursuant to purchase obligations. The following table shows our commitments to make future payments under operating leases:

| (in thousands)              | Total    | < 1 year | 1-3 years | 3-5 years | > 5 years |
|-----------------------------|----------|----------|-----------|-----------|-----------|
| Operating lease obligations | \$ 7,179 | \$ 2,092 | \$ 3,496  | \$ 1,591  | \$        |

**Risk Factors**

We wish to caution you that there are risks and uncertainties that could cause our actual results to be materially different from those indicated by forward looking statements that we make from time to time in filings with the Securities and Exchange Commission, news releases, reports, proxy statements, registration statements and other written communications as well as oral forward looking statements made from time to time by our representatives. These risks and uncertainties include, but are not limited to, those risks listed in our Annual Report on Form 10-K for the year ended December 31, 2009. Additional risks and uncertainties that we currently deem immaterial may also impair our business operations, and historical results are not necessarily an indication of the future results. Except for the historical information contained herein, the matters discussed in this analysis are forward-looking statements that involve risk and uncertainties, including, but not limited to, general economic and business conditions, competition, pricing, brand reputation, consumer trends, and other factors which are often beyond our control. We do not undertake any obligation to update forward-looking statements except as required by law.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to market risks, which include changes in U.S. interest rates and foreign exchange rates. We do not engage in financial transactions for trading or speculative purposes, but do have on occasion forward contracts for foreign currency transactions, the gains and losses from which historically have been immaterial. On July 1, 2010, we acquired controlling financial interest in and, therefore, consolidated Gaiam PTY, an Australian based joint venture. Since Gaiam PTY's functional currency is the Australian dollar, this subsidiary exposes us to accounting risk associated with foreign currency exchange rate fluctuations. However, we have determined that no material market risk exposure to our consolidated financial position, results from operations or cash flows existed as of September 30, 2010.

Any borrowings we might make under our bank credit facility would bear interest at the prime rate, provided, however, that at no time may the rate be less than 4.25% per annum. We do not have any amounts outstanding under our credit line, so any unfavorable change in interest rates would not have a material impact on our results from operations or cash flows unless we make borrowings in the future.

We purchase a significant amount of inventory from vendors outside of the U.S. in transactions that are primarily U.S. dollar denominated transactions. A decline in the relative value of the U.S. dollar to other foreign currencies has and may continue to lead to increased purchasing costs.



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**Item 4. Controls and Procedures**  
**Evaluation of Disclosure Controls and Procedures**

Our chief executive officer and chief accounting officer conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act. Based upon their evaluation as of September 30, 2010, they have concluded that those disclosure controls and procedures are effective.

**Changes in Internal Control over Financial Reporting**

No changes in our internal control over financial reporting occurred during the three and nine months ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

From time to time, we are involved in legal proceedings that we consider to be in the normal course of business. We do not believe that any of these proceedings will have a material adverse effect on our business.

**Item 1A. Risk Factors**

No material changes.

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

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. (Removed and Reserved)**

**Item 5. Other Information**

None.

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**Item 6. Exhibits**

a) Exhibits.

| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 31.1               | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 (filed herewith).  |
| 31.2               | Certification of the Chief Accounting Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 (filed herewith).   |
| 32.1               | Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).  |
| 32.2               | Certification of the Chief Accounting Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith). |

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**Signatures**

In accordance with the requirements of the Securities and Exchange Act, the registrant caused this report to be signed on its behalf, by the undersigned, thereunto duly authorized.

Gaiam, Inc.  
(Registrant)  
November 8, 2010

By: /s/ Lynn Powers  
Lynn Powers  
Chief Executive Officer

(principal executive officer)

By: /s/ Stephen J. Thomas  
Stephen J. Thomas  
Chief Accounting Officer  
(principal financial and accounting officer)