GAIAM INC
Form 10-K
March 14, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2006

or

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

For the transition period from to .

Commission File Number 0-27517

GAIAM, INC.
(Exact name of registrant as specified in its charter)

COLORADO	**84-1113527**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

360 INTERLOCKEN BOULEVARD
BROOMFIELD, CO 80021
(Address of principal executive offices)

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

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

Title of Each Class	Name of Each Exchange on Which Registered
Class A Common Stock, $.0001 par value	**NASDAQ Stock Market LLC**

Securities registered pursuant to section 12(g) of the Act:
None

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. **x**

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

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

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

The aggregate market value of the voting common equity held by non-affiliates of the registrant was approximately $234,986,879 as of June 30, 2006, based upon the closing price on the NASDAQ Global Market on that date. The registrant does not have non-voting common equity.

As of March 12, 2007, 19,250,276 shares of the registrant s Class A common stock and 5,400,000 shares of the registrant s Class B common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The following documents (or portions thereof) are incorporated by reference into the Parts of this Form 10-K noted:

Part III incorporates by reference from the definitive proxy statement for the registrant s 2007 Annual Meeting of Shareholders to be filed with the Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Form.

GAIAM, INC.

Annual Report on Form 10-K for the Fiscal Year Ended December 31, 2006

PART I

Item 1. Business

OUR BUSINESS

Gaiam is 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 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 consumers via catalogs, the Internet, direct response television, and broadband and subscription clubs and communities. At the end of 2006, Gaiam s home media was carried by more than 68,000 retail stores in the United States alone, and Gaiam had approximately 7.5 million direct customers.

Gaiam has established itself as a lifestyle media brand, content producer and licensor, information resource and authority in the Lifestyles of Health and Sustainability (LOHAS) market including the emerging Media that Matters (MTM) market. Gaiam seeks to become a unifying symbol of these emerging media and lifestyle genres. Our lifestyle brand is built around our ability to develop and offer media content, products, lifestyle solutions and community to consumers in the LOHAS and MTM markets. Our content forms the basis of our proprietary offerings, on which we realize our highest margins, which then drive demand for parallel product and service offerings. Gaiam s operations are vertically integrated from content creation, through product development and sourcing, to customer service and distribution. We market our products and services across two segments, business and direct-to-consumer. We distribute our products in each of these sales segments from a single fulfillment center.

The LOHAS Market

The LOHAS market, which represented $227 billion in sales according to the 2000 Natural Business Communication study, consists of five main sectors:

- ***Sustainable Economy*****.** Renewable energy, energy conservation, recycled goods, environmental management services, sustainable manufacturing processes and related information and services.
- ***Healthy Living*****.** Natural and organic foods, dietary supplements, personal care products and related information and services.
- ***Alternative Healthcare*****.** Health and wellness solutions and alternative health practices.
- ***Personal Development*****.** Solutions, information, products and experiences relating to mind, body and spiritual development.
- ***Ecological Lifestyles*****.** Environmentally friendly cleaning and household products, organic cotton clothing and bedding, and eco-tourism.

Gaiam participates in all five sectors of the LOHAS market with an emphasis on Personal Development, Ecological Lifestyles and Alternative Healthcare.

The MTM Market

Gaiam considers the MTM market to consist of four distinct sectors:

- ***Childrens.*** Children s entertainment and edutainment with a positive message.
- ***Family Entertainment.*** Entertainment that can be enjoyed by the entire family, containing no violence or profanity.
- ***Documentaries.*** Educational and informational programming (edutainment).
- ***Inspirational Entertainment.*** Entertainment that inspires people to expand their awareness and pursue positive changes in their lives.

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Our Content

Gaiam s business model revolves around content creation, which forms the basis for our proprietary products. We have an in house production team that produces programming, which has won 65 Telly awards and several medals at the International New York Film Festival. We are fully high definition and 5.1 surround sound capable and do the majority of our authoring and editing at our Colorado facility ensuring the quality standards that drives our awards. We also develop children s programming, which have been the recipient of several Parent s Choice and Kids First Awards recognizing new products that help children grow imaginatively, physically, and mentally. During 2006, we produced 45 new titles and added 150 titles to our DVD library through acquisitions and remakes of some of the assets of GoodTimes Entertainment (GoodTimes). Gaiam also develops and markets music and audio CDs and publishes printed content.

Our Products

Our visual media programs represent an integral part of our proprietary product offering. We currently stock approximately 10,000 stock keeping units (SKUs), of which approximately 7,000 are branded proprietary offerings, including media, accessories and soft goods. In 2006, our proprietary products constituted over 70% of our product sales.

Our Sales Channels

We conduct our business across two segments. Our business segment customers are primarily national retailers, corporate accounts and the media. We conduct our direct-to-consumer business through our catalogs, the Internet, direct response television and broadband and subscription clubs and communities.

- *Media*

Gaiam develops, produces and licenses information and programming targeted to consumers who value personal development, wellness, spirituality, inspirational entertainment and a sense of community. Gaiam has an award-winning library of titles that it sells to retailers, licenses to selected distributors operating outside of the United States, and licenses or sublicenses for broadcast and download. Some of our media partners include Google, Comcast, LodgeNet, Blackberry and Entertainment One. All of our licensing arrangements require Gaiam branding to be prominent on the programming and are subject to our royalty agreements with our performing artists. While our licensing of the rights to manufacture and distribute certain of our media lowers recognized revenue, contribution margins and branding are improved.

- *DRTV*

Gaiam uses direct response television (DRTV) marketing to promote LOHAS products and services, particularly those aimed at the fitness/wellness market. DRTV marketing is a highly-scalable distribution channel for segments of our LOHAS product suite, and also provides broad marketing support for our retail partners, as well as creates new direct customers to which we cross-market a wide range of LOHAS products and services via our catalog, Internet, and subscription segments. We capitalize on both long-form DRTV shows as well as leading home shopping channels such as QVC. In 2006, we used the DRTV channel to launch our mass market brand The Firm .

- *Retailers*

Since the inception of our retailer channel in 1998, we have increased its breadth and diversity. As of the end of 2006, Gaiam media titles may be found in over 68,000 stores in the United States from 55,000 at the end of 2005. Gaiam media and other products are currently sold across a variety of leading retailers, including bookstores such as Barnes & Noble and Borders; media stores such as Best Buy and Blockbuster; lifestyle stores such as Discovery Channel Stores and EQ Life; beauty stores such as Ulta; home furnishing stores such as Bed, Bath and Beyond and ABC Carpet and Home; natural food stores such as Whole Foods Market and Wild Oats; sporting goods stores such as Dick s and REI; mass merchants such as WalMart and Target, our largest customer, e-tailers such as Amazon.com and Drugstore.com; and wholesale clubs such as Costco and Sam s Club. Many of these retailers display our products in branded store-within-store lifestyle presentations that may include custom fixtures designed and produced by Gaiam. We implemented our first store-within-store concept late in 2000 and the concept has grown to over 6,000 stores by the end of 2006, up from 4,500 stores at the end of 2005.

Through distributor arrangements and acquisitions, Gaiam branded products may now be found in Canada, Japan, Korea, the United Kingdom and Australia. Our media products are sold to international accounts primarily under licensing agreements and the remaining products are sold through distributor relationships. During 2004, Gaiam entered into a joint venture in Australia to bring Gaiam products to consumers through catalogs, internet and Australian retailers commencing in 2005. Our majority owned UK subsidiary changed its name to Gaiam effective March 1, 2005.

- *Services*

Gaiam, through its Design and Consulting division and eco-travel company, Natural Habitat, provides products and services to businesses, corporate accounts, and schools. Clients of our lifestyle services included The White House, NASA, Fetzer Winery, the U.S. Department of Energy, the Government of Brazil, the Smithsonian Institution, and the World Wildlife Fund.

- *Catalogs*

Gaiam offers a variety of LOHAS products directly to the consumer through our catalogs and through some consumer lifestyle publications. We mailed approximately 20 million catalogs in 2006. Our customer demographics are highly regarded with an average income over $75,000 and over 70% college educated.

- *Internet*

We use the Internet to sell our products and to provide information on the LOHAS lifestyle. We currently offer approximately 7,000 SKUs on our website, www.gaiam.com. We promote our website through our visual media, catalogs, print publications, product packaging and Internet Links. A key component of our Internet approach is to provide customer support for Internet sales from our in-house call center.

- *Subscription Services*

Gaiam offers a variety of subscription paid services. These services include online communities under various brands and subscription clubs. During 2006, we acquired Spiritual Cinema Circle and grew our membership to over 100,000 members. In the fourth quarter of 2006, we also tested a beta site for Gaiam community development.

Our Operations

- *Product Development and Sourcing*

Gaiam branded products are sold across our sales channels. Non-proprietary products are only available through our catalogs and over the Internet. We use our catalog and Internet channels to test products before we develop products under the Gaiam brand and distribute them through our other sales channels. Our products are designed to supply information, enhance customers lifestyles and experiences and provide healthy, natural solutions while being eco-friendly and promoting a sustainable economy. Because we use a multi-channel approach to our business we are able to leverage our product development costs across all channels of our business.

Our proprietary products are designed by our product development team, sourced both domestically and internationally by our merchandisers and produced by third party suppliers to our specifications. We also screen the environmental and social responsibility of our suppliers. In order to minimize risk we often identify an alternate supplier for our products in a separate location.

- *Customer Service*

Gaiam focuses on building and maintaining customer relationships that thrive on loyalty and trust. We maintain a no-risk guarantee policy, whereby a customer is provided a full refund for Gaiam products that are returned at any time, for any reason. We have established a most valued customer program, which extends added benefits to our most loyal catalog and Internet customers. Our in-house customer service department includes product specialists who have specific product knowledge and assist customers in selecting products and solutions that meet their needs. We employ telephone routing software that directs each call to the appropriate representative. Our policy is to ship orders no later than the next business day, which we accomplish by stocking inventory that supports over 92% of our orders. We believe that by offering exceptional customer service we encourage repeat purchases by our customers, enhance our brand identity and reputation and build stronger relationships with our customers.

- *Established Infrastructure*

We operate a 350,000 square foot distribution center near Cincinnati, Ohio, which provides fulfillment for most of our current domestic business needs and has the capacity to support the growth of our business. This central U.S. location allows us to achieve shipping cost efficiencies to most locations. The center is also located within 30 minutes of several major shipping company hubs. We use a supply chain management system that supports our entire operation, including fulfillment, inventory management, and customer service. Our fulfillment center is connected to our other facilities by a state-of-the art voice-over-Internet telecom network that allows us to maintain a high degree of connectivity within our organization.

Our Growth Strategies

- *Expand our Media Offering*

Proprietary and authentic content lies at the core of our business model. Our media offerings introduce customers to Gaiam and help establish Gaiam as an authority in the LOHAS market. Gaiam s primary focus is on leveraging our content with branded lifestyle product offerings through various media, catalogs, the Internet, and national retailers. We believe that the content-centric strategy is a competitive advantage and the multi-channel approach allows us the broadest possible consumer reach. It also provides the optimal context for us to market lifestyle products that are appropriate companions to the media.

We will continue to develop authentic content that caters to the LOHAS lifestyle in DVD, book and audio formats and also accelerate our efforts in the broadcast and online categories. We intend to expand our brand to MTM, which incorporates children s, family, inspirational and edutainment media. We believe we can establish the Gaiam brand as a leading brand in these new media categories.

We have expanded our visual media offerings internationally and plan to continue to expand this opportunity. We also intend to broaden the variety of formats we offer, from our traditional physical media (DVD, CD, etc), to making our content available online to our consumers in both one-shot purchase format and paid monthly/annual subscription services.

- *Capitalize on our market share positioning*

We continue to grow our media market share. Based on Nielsen s Videoscan, Gaiam grew its U.S. DVD market share from 15% in 2004 to 26% in 2005 (pro forma with GoodTimes of over 40%) to 45% in 2006 in the fitness/wellness category. Based on the same Nielsen scanning, Gaiam ended sixth in the non-theatrical U.S. DVD category with 6% market share. We intend to continue to grow our market share in the non-theatrical category through the production and acquisition of titles in the MTM category, focusing on children s and family entertainment. We also plan to line extend into wellness with solution based programming and media based kits building store within store on wellness and continuing to grow our retail presence.

- *Improve our Profit Margins*

We believe we can improve our profit margins with several distinct strategies. We will continue to focus our sales strategy on media that carries over 70% gross margins. Gaiam is establishing itself as a brand in MTM and wellness/fitness media as well as in a genre we call edutainment. By continuing to grow our market share in media, we believe we can attract more media producers to work with the Gaiam brand instead of the traditional studio or distributor model.

We continue to improve margins as we are able to serve the large retailers directly instead of going through third party distributors allowed by the GoodTimes asset acquisition and the increased sales volume of Gaiam media. Since the GoodTimes transaction, we have been able to go directly to retailers like Wal-Mart and Kmart that were serviced by third party distributors prior to the acquisition. During 2006 we implemented a new Vendor Manager Inventory System allowing us to improve store turns and reduce markdowns.

We launched a continuity and subscription club business in second quarter of 2005 which was augmented with certain acquired assets of GoodTimes Entertainment and the acquisition of a majority of Spiritual Cinema in 2006. These businesses carry over 85% gross margins and connect our media content directly to the consumer. We ended 2006 with over 100,000 paying members. We expect to invest in this channel of business. We believe that with the increase in broadband acceptance in the consumer marketplace coupled with our specialized media library and loyal direct customer base, we have an opportunity for strong growth at high margins.

We expect to grow our international business through licensing arrangements that carry low cost of goods. We have a valuable library of branded products that is not being currently monetized with the exception of the UK and Australia. In 2006, we hired personnel familiar with international licensing who will lead this initiative.

- *Strengthen our Lifestyle Brand*

Our goal is to maintain the Gaiam brand as an authority in the LOHAS market (including MTM) and to establish Gaiam as a unifying symbol of the emerging LOHAS lifestyle. We plan to strengthen the Gaiam brand by growing our media, making the Gaiam brand more prominent across our catalog efforts, focusing on category management initiatives, increasing our store-within-store presence across national retailers, increasing our marketing and PR efforts, and aggressively developing and marketing proprietary products while maintaining our high level of customer service. We initiated a branding study in late 2006 that will drive this initiative in 2007.

- *Launch a Mass Market Brand in Fitness*

We launched mass market media and products in fitness under The Firm brand in late 2006. We believe that the aging baby boomers at all income levels will be looking for fitness/wellness products. We do not market the Gaiam brand except in media in certain mass market channels and believe there is growth opportunity for us in those channels under a different brand with the same attention to quality that we have at Gaiam. We supported The Firm brand through DRTV dollars during 2006 and ended the year with over 1,000 doors carrying The Firm brand mainly through a SWIS display.

- *Expand our Proprietary Products*

Our proprietary products, which we introduced in 1997, represented over 70% of our revenues in fiscal year 2006. These products carry a higher margin, provide for branding opportunity and distinguish us from our competitors. We currently offer proprietary products that range from media products to sleep, stress relief, yoga and Pilates accessories to organic cotton bedding and bath products. We have also expanded our exclusive media library to over 2000 titles through our acquisition of the assets of GoodTimes Entertainment. We continue to develop and market proprietary products across the LOHAS sectors. We will continue to look for additional library acquisitions as we expand our content across the MTM market. We are strengthening our supply chain globally by sourcing a greater number of products offshore and leveraging our expanding media sales to acquire lower costs from our replicators. We leverage our product development costs over all sales channels.

- *Capitalize on our Multi-channel Approach*

Our multi-channel strategy affords us the broadest possible customer reach, as well as the ability to allow our customers to buy from us what they want, when they want, where they want to. This approach makes purchasing our lifestyle products convenient regardless of the channel that a customer prefers. It also allows us to migrate segments of our customer base across channels to develop deeper, longer-lasting relationships with them, and to convert them from purchasers of individual media products into subscribers to our continuity programs, whether those are DVD-based, or online access to communities and content on a continuity basis. Additionally, this diversified, strategic approach should provide for continued operating and business stability as we have the ability to cross-market lifestyle products and services regardless of the customer location or the channel to which we are marketing.

In our direct-to-consumer business we are open 24 hours a day, offering over 7,000 products on our Internet site. As we increase the depth of media and community functionality available to our consumers, our Internet presence will transform from being merely a place to order product to a place to consume it, in real-time.

In our business segment, we continue to expand our presence in national retailers and currently have placements in approximately 68,000 retail points in the United States up from 50,000 at the end of 2005 and 25,000 at the end of 2004. We also continue to expand our store-within-store concept in a variety of stores, including Whole Foods Market, Barnes & Noble Bookstores, Borders, Target, Ulta, Dick s Sporting Goods, REI, ABC Carpet and Home and other national retailers. We currently have over 6,000 store within store concepts under the Gaiam and The Firm brands.

- *Complement our Existing Business with Selective Strategic Acquisitions*

Our growth strategy is not dependent on acquisitions. However, we will consider those strategic acquisitions in the LOHAS market that complement our existing business, increase our media and related product offerings, expand our geographical reach, extend our channel distribution, and add to our direct customer base. We especially focus on companies with media content, a strong brand identity and customer and product information databases that augment our existing databases. Gaiam often allows some of the acquired company s management team to retain responsibility for front-end business functions such as creative presentation and marketing, while consolidating operational functions under Gaiam s existing infrastructure when economies of scale can be realized.

- *Establish a lifestyle community*

In 2007, Gaiam plans to expand its community efforts, with specific focus on sustainability, personal development, healthy living, spirituality, alternative healthcare, and responsible media. Gaiam already works with the leading experts in these fields to produce our current suite of media offerings. In 2007, we will launch the online space for our customers to come together with each other and with Gaiam s cadre of experts in these core LOHAS areas, to share ideas, discuss new trends and solutions, and allow our customers have access to world-class resources to deepen their understanding of issues that are central to how they choose to live their lives.

Our Business Segments

We separate our business into two business segments: the business segment which includes sales to businesses, retailers, corporate accounts and media outlets; and the direct-to-consumer segment, which includes DRTV, catalogs, E-commerce, and subscription community services.

The business segment represented 43% of 2006 revenues, while the direct to consumer segment represented 57% of revenues. See Note 11 to our consolidated financial statements for further information on our segments.

Our Intellectual Property

Our tradename Gaiam and various product and Internet domain names are subject to trademark or pending trademark applications of Gaiam or a Gaiam company. We believe these trademarks are significant assets to our business.

Our Competitive Position

We believe that fragmented supplier and distribution networks characterize the LOHAS market, and we are not aware of a dominant leader. Gaiam s goal is to establish itself as the market leader.

Our business is evolving and competitive. Larger and better-established entities may acquire, invest in or form joint ventures with our competitors. Many of these entities have longer operating histories and have greater financial and marketing resources than we have. Increased competition from these or other competitors could reduce our revenue and profits. In addition, the smaller businesses we compete against may be able to more effectively personalize their relationships with customers.

Because Gaiam uses multi-channel distribution for our products, we compete with various producers of similar products and services. Our competitors include Warner Bros., Disney, Paramount, Fox, Anchor Bay, Inspired Entertainment, Goldhill Media, Nike, Reebok, thousands of small, local and regional businesses, and product lines or items offered by large retailers, manufacturers, publishers and media producers.

We believe the principal competitive factors in the LOHAS market are authenticity of information, unique content and distinctiveness of products and services, quality of product, brand recognition and price, and distribution capabilities. We believe we compete favorably on all these relevant factors.

We expect industry consolidation to increase competition. As our competitors grow, they may adopt aggressive pricing or inventory policies, which could result in reduced operating margins and loss of market share.

Our success also depends upon the willingness of consumers to purchase media, goods and services that promote the values we espouse. While we believe our business plan and assumptions are reasonable, the demographic trends on which they are based may change and the current consumption levels may not be sustained. The decrease of consumer interest in purchasing goods and services that promote the values we espouse would materially and adversely affect our customer base and revenues and, accordingly, our financial prospects.

Our Employees

As of March 1, 2007, Gaiam and the Gaiam companies employed approximately 363 individuals. None of our employees are covered by a collective bargaining agreement.

Regulatory Matters

A number of existing and proposed laws restrict disclosure of consumers personal information, which may make it more difficult for Gaiam to generate additional names for its direct marketing, and restrict our ability to send unsolicited electronic mail or printed materials. Although Gaiam believes it is generally in compliance with current laws and regulations and that these laws and regulations have not had a significant impact on our business to date, it is possible that existing or future regulatory requirements will impose a significant burden on us.

The Gaiam companies generally collect sales taxes only on sales to residents of states in which Gaiam has locations. Currently, Gaiam collects sales taxes on sales to residents of California, Colorado, New York and Ohio. A number of legislative proposals have been made at the federal, state and local level, and by foreign governments, that would impose additional taxes on the sale of goods and services over the Internet and certain states have taken measures to tax Internet-related activities. If legislation is enacted that requires Gaiam to collect sales taxes on sales to residents of other states or jurisdictions, sales in our direct-to-consumer businesses may be adversely affected.

Our business is also subject to a number of other governmental regulations, including the Mail or Telephone Order Merchandise Rule and related regulations of the Federal Trade Commission. These regulations prohibit unfair methods of competition and unfair or deceptive acts or practices in connection with mail and telephone order sales and require sellers of mail and telephone order merchandise to conform to certain rules of conduct with respect to shipping dates and shipping delays. We are also subject to regulations of the U.S. Postal Service and various state and local consumer protection agencies relating to matters such as advertising, order solicitation, shipment deadlines and customer refunds and returns. In addition, merchandise imported by Gaiam is subject to import and customs duties and, in some cases, import quotas.

Seasonality

See the Quarterly and Seasonal Fluctuations section of Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, for information pertaining to the seasonal aspects of our business.

Available Information

Our corporate website at www.gaiam.com/corporate provides information about Gaiam, its history, goals and philosophy, as well as certain financial reports and corporate press releases. Our www.gaiam.com website features a library of information and articles on personal development, healthy lifestyles and environmental issues, along with an extensive offering of media, products and services. We believe our website provides us with an opportunity to deepen our relationships with our customers and investors, educate them on a variety of issues, and improve our service. As part of this commitment, we have added a link on our corporate website to our Securities and Exchange Commission filings, including our reports on Form 10-K, 10-Q and 8-K and all amendments to such reports. Those reports are available through our website, free of charge, as soon as reasonably practicable after these reports are filed with the Securities and Exchange Commission.

We have included our website addresses only as inactive textual reference, and the information contained on our website is not incorporated by reference into the Form 10-K.

Item 1A. 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 described below. Additional risks and uncertainties not presently known to us or those we currently deem immaterial also may impair our business operations, and historical results are not necessarily an indication of the future results. The cautionary statements below discuss important factors that could cause our business, financial condition, operating results and cash flows to be materially adversely affected.

Changes in general economic conditions could have a material impact on our business

Our results of operations could be impacted by changes in overall economic conditions that impact consumer spending. Future economic conditions affecting disposable income such as employment levels, consumer confidence, business conditions, stock market volatility, weather conditions, acts of terrorism, threats of war, and interest and tax rates could reduce consumer spending or cause consumers to shift their spending away from our products. If the economic conditions and performance of the retail and media environment worsen, we may experience material adverse impacts on our business, operating results and financial condition.

Increased competition could impact our financial results

We believe that the LOHAS market has thousands of small, local and regional businesses. Some smaller businesses may be able to more effectively personalize their relationships with customers, thereby gaining a competitive advantage. Although we believe that we do not compete directly with any single company that offers our entire range of merchandise, within each merchandise category we have competitors and we may face competition from new entrants. Some of our competitors or our potential competitors may have greater financial and marketing resources and greater brand recognition. In addition, larger, well-established and well-financed entities may acquire, invest in or form joint ventures with our competitors. Increased competition from these or other competitors could negatively impact our business.

Changing consumer preferences may have an adverse effect on our business

Our business is targeted at consumers who assign high value to personal development, healthy lifestyles, responsible media, renewable energy and the environment. A decrease of consumer interest in purchasing goods and services that promote the values we espouse would materially and adversely affect our customer base and sales revenues and, accordingly, our financial prospects. Further, consumer preferences and product trends are difficult to predict. Our future success depends in part on our ability to anticipate and respond to changes in consumer preferences and we may not respond in a timely or commercially appropriate manner to such changes. Failure to anticipate and respond to changing consumer preferences and product trends could lead to, among other things, lower sales of our products, increased merchandise returns and lower margins, which would have a material adverse effect on our business.

Our strategy of offering branded products could lead to inventory risk and higher costs

An important part of our strategy is to feature branded products. These products are sold under our brand names and are manufactured to our specifications. We expect our reliance on branded merchandise to increase. The use of branded merchandise requires us to incur costs and risks relating to the design and purchase of products, including submitting orders earlier and making longer initial purchase commitments.

In addition, the use of branded merchandise limits our ability to return unsold products to vendors, which can result in higher markdowns in order to sell excess inventory. Our commitment to customer service typically results in us keeping a high level of merchandise in stock so we can fill orders quickly. Consequently, we run the risk of having excess inventory, which may also contribute to higher markdowns. Our failure to successfully execute a branded merchandise strategy or to achieve anticipated profit margins on these goods, or a higher than anticipated level of overstocks, may materially adversely affect our revenues.

We offer our customers liberal merchandise return policies. Our consolidated financial statements include a reserve for anticipated merchandise returns, which is based on historical return rates. It is possible that actual returns may increase as a result of factors such as the introduction of new merchandise, changes in merchandise mix or other factors. Any increase in our merchandise returns will correspondingly reduce our revenues.

Acquisitions may harm our financial results

Acquisitions have been part of our growth and may continue to be part of our growth in the future. Our acquisitions may be of entire companies, certain assets of companies, controlling interests in companies or of minority interests in companies where we intend to invest as part of a strategic alliance. If we are not successful in integrating companies that we acquire or are not able to generate adequate sales from the acquired entities, our business could be materially and adversely affected.

The loss of the services of our key personnel could disrupt our business

We depend on the continued services and performance of our senior management and other key personnel, particularly Jirka Rysavy and Lynn Powers. Our strategy of allowing the management teams of some acquired companies to continue to exercise significant management responsibility for those companies makes it important that we retain key employees, particularly the sales and creative teams, of the companies we might acquire.

Our founder and chief executive officer Jirka Rysavy controls Gaiam

Mr. Rysavy holds 100% of Gaiam s 5,400,000 outstanding shares of class B common stock and also owns 1,118,682 shares of class A common stock. The shares of class B common stock are convertible into shares of class A common stock at any time. Each share of class B common stock has ten votes per share, and each share of class A common stock has one vote per share. Consequently, Mr. Rysavy is able to vote a majority of our stock, and will be able to exert substantial influence over Gaiam and to control matters requiring approval by the shareholders of Gaiam, including the election of directors, increasing our authorized capital stock, or a merger or sale of our assets. As a result of Mr. Rysavy s control, no change of control of Gaiam can occur without Mr. Rysavy s consent.

Our success depends on the value of the Gaiam brand

Because of our reliance on sales of proprietary products, our success depends on the Gaiam brand. Building and maintaining recognition of the Gaiam brand are important to attracting and expanding our customer base. If the value of the Gaiam brand were adversely affected, we cannot be certain that we will be able to attract new customers, retain existing customers or encourage repeat purchases, and if the value of our brand were to diminish, our revenues, results of operations and prospects would be adversely affected.

Disputes concerning media content and intellectual property may adversely affect us

Most of our media content is subject to arrangements with third parties pursuant to which we have licensed certain rights to use and distribute media content owned by third parties or have licensed to third parties certain rights to use and distribute media content that we own. In addition, we have a number of agreements with third parties concerning the use of our media content and intellectual property, including agreements regarding royalties, distribution, duplication, etc. Allegations that we do not have rights to use media content and other disputes arising from such arrangements can be costly and may have a material adverse impact on our results.

We are dependent on third party suppliers for the success of our proprietary products

We are dependent on the success of our proprietary products, and we rely on a select group of manufacturers to provide us with sufficient quantities to meet our customers demands in a timely manner, produce these products in a humane and safe environment for both their workers and the planet, maintain quality standards consistent with the Gaiam brand, and meet certain pricing guarantees. Our sourcing of these products overseas continues to increase, and these arrangements carry risks associated with relying on products manufactured outside of the U.S., including political unrest and trade restrictions, currency fluctuations, transportation difficulties, work stoppages, and other uncertainties. In addition, a number of our suppliers are small companies, and some of these vendors may not have sufficient capital, resources or personnel to increase their sales to us or to meet our needs for increased commitments from them. The failure of our suppliers to provide sufficient quantities of our proprietary products could decrease our revenues, increase our costs, and damage our customer service reputation.

We rely on communications and shipping networks to deliver our products

Given our emphasis on customer service, the efficient and uninterrupted operation of order-processing and fulfillment functions is critical to our business. To maintain a high level of customer service, we rely heavily on a number of different outside service providers, such as printers, telecommunications companies and delivery companies. Any interruption in services from our principal outside service providers, including delays or disruptions resulting from labor disputes, power outages, human error, adverse weather conditions or natural disasters, could materially adversely affect our business. In addition, products that we source overseas must be shipped to our distribution center by freight carriers, and a work stoppage or political unrest could adversely affect our ability to fulfill our customer orders.

Information systems upgrades or integrations may disrupt our operations or financial reporting

We continually evaluate and upgrade our management information systems, which are critical to our business. These systems assist in processing orders, managing inventory, purchasing and shipping merchandise on a timely basis, responding to customer service inquiries, and gathering and analyzing operating data by business segment, customer, and SKU (a specific identifier for each different product). We are required to continually update these systems. Furthermore, if we acquire other companies, we will need to integrate the acquired companies systems with ours, a process that could be time-consuming and costly. If our systems cannot accommodate our growth or if they fail, we could incur substantial expenses.

Additionally, our success in E-commerce will depend upon our ability to provide a compelling and satisfying shopping experience. To remain competitive, we must continue to enhance and improve the responsiveness, functionality and features of our online technology.

A material security breach could cause us to lose sales, damage our reputation or result in liability to us

Our computer servers may be vulnerable to computer viruses, physical or electronic break-ins and similar disruptions. We may need to expend significant additional capital and other resources to protect against a security breach or to alleviate problems caused by any breaches. Our relationships with our customers may be adversely affected if the security measures that we use to protect personal information such as credit card numbers are ineffective. We currently rely on security and authentication technology that we license from third parties. We may not prevent all security breaches.

Our systems may fail or limit user traffic, which would cause us to lose sales

We support most of our business through our call center in Broomfield, Colorado. Even though we have back up arrangements, we are dependent on our ability to maintain our computer and telecommunications equipment in this center in effective working order and to protect against damage from fire, natural disaster, power loss, telecommunications failure or similar events. In addition, growth of our customer base may strain or exceed the capacity of our computer and telecommunications systems and lead to degradations in performance or systems failure. We have experienced capacity constraints and failure of information systems in the past that have resulted in decreased levels of service delivery or interruptions in service to customers for limited periods of time. Although we continually review and consider upgrades to our technical infrastructure and provide for system redundancies and backup power to limit the likelihood of systems overload or failure, substantial damage to our systems or a systems failure that causes interruptions for a number of days could adversely affect our business. Additionally, if we are unsuccessful in updating and expanding our infrastructure, including our call center, our ability to grow may be constrained.

Government regulation of the Internet and E-commerce is evolving and unfavorable changes could harm our business

We are subject to general business regulations and laws, as well as regulations and laws specifically governing the Internet and E-commerce. Such existing and future laws and regulations may impede the growth of the Internet or other online services. These regulations and laws may cover taxation, user privacy, pricing, content, copyrights, distribution, consumer protection, the provision of online payment services and quality of products and services. There is lack of clarity on how existing laws governing issues such as property ownership, sales and other taxes and personal privacy apply to the Internet and E-commerce. Unfavorable resolution of these issues may harm our business.

We may face legal liability for the content contained on our website

We could face legal liability for defamation, negligence, copyright, patent or trademark infringement, personal injury or other claims based on the nature and content of materials that we publish or distribute on our website. If we are held liable for damages for the content on our website, our business may suffer. Further, one of our goals is for www.gaiam.com to be a trustworthy and dependable provider of information and services. Allegations of impropriety, even if unfounded, could therefore have a material adverse effect on our reputation and our business.

Relying on our centralized fulfillment center could expose us to losing revenue

Prompt and efficient fulfillment of our customers orders is critical to our business. Our facility in Cincinnati, Ohio handles our fulfillment functions and some customer-service related operations, such as returns processing. A majority of our orders are filled and shipped from the Cincinnati facility. The balance is shipped directly from suppliers. Because we rely on a centralized fulfillment center, our fulfillment functions could be severely impaired in the event of fire, extended adverse weather conditions, transportation difficulties or natural disasters. Because we recognize revenue only when we ship orders, interruption of our shipping would diminish our revenues.

We may face quarterly and seasonal fluctuations that could harm our business

Our revenue and results of operations have fluctuated and will continue to fluctuate on a quarterly basis as a result of a number of factors, including the timing of catalog offerings, timing of orders from retailers, recognition of costs or net sales contributed by new merchandise, fluctuations in response rates, fluctuations in paper, production and postage costs and expenses, merchandise returns, adverse weather conditions that affect distribution or shipping, shifts in the timing of holidays and changes in our merchandise mix. In particular, our net sales and profits have historically been higher during the fourth quarter holiday season. We believe that this seasonality will continue in the future.

Postage and shipping costs may increase and therefore increase our expenses

We ship our products, catalogs, and lifestyle publications to consumers and the cost of shipping is a material expenditure. Postage and shipping prices increase periodically and can be expected to increase in the future. Any inability to secure suitable or commercially favorable prices or other terms for the delivery of our merchandise and catalogs could have a material adverse effect on our financial condition and results of operations.

Our business is subject to reporting requirements that continue to evolve and change, which could continue to require significant compliance effort and resources.

Because our common stock is publicly traded, we are subject to certain rules and regulations of federal, state and financial market exchange entities charged with the protection of investors and the oversight of companies whose securities are publicly traded. These entities, including the Public Company Accounting Oversight Board, the SEC and the NASDAQ, periodically issue new requirements and regulations and legislative bodies also review and revise applicable laws such as the Sarbanes-Oxley Act of 2002. As interpretation and implementation of these laws and rules and promulgation of new regulations continues, we will continue to be required to commit significant financial and managerial resources and incur additional expenses.

Item 1B. Unresolved Staff Comments

Not Applicable.

Item 2. Properties

Our principal executive offices are located in Broomfield, Colorado. Our fulfillment center is located in the Cincinnati, Ohio area. This facility houses most of our fulfillment functions. We selected the Cincinnati site after considering the availability and cost of facilities and labor, proximity to major highways, air delivery hubs and support of local government of new businesses. We also believe that Cincinnati is ideal for providing the low cost shipping available from a single central point to a customer base that conforms to the overall U.S. population.

The following table sets forth certain information relating to our primary facilities:

Primary Locations	**Size**	**Use**	**Lease Expiration**
Broomfield, CO	36,000 sq. ft.	Headquarters and customer service	May 2008
Cincinnati, OH	355,000 sq. ft.	Fulfillment center	September 2007
New York, NY	18,400 sq. ft.	Media office	April 2008
Hopland, CA	12 acres	Renewable energy demo site	Owned

We have options to renew the leases for our headquarters and our fulfillment center. We believe our facilities are adequate to meet our current needs and that suitable additional facilities will be available for lease or purchase when, and as, we need them.

Item 3. Legal Proceedings

From time to time, Gaiam is 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 4. Submission of Matters to a Vote of Security Holders

No matters were brought to a vote of our shareholders in the fourth quarter of the fiscal year ended December 31, 2006.

Part II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Stock Price History

Gaiam s Class A common stock has been quoted on the NASDAQ Global Market under the symbol GAIA since our initial public offering on October 29, 1999. On March 12, 2007, we had 7,991 shareholders of record and 19,250,276 shares of $.0001 par value Class A common stock outstanding. We have 5,400,000 shares of $.0001 par value Class B common stock outstanding, held by one shareholder.

The following table sets forth certain sales price and trading volume data for Gaiam s Class A common stock for the period indicated:

	High Bid	Low Bid	Close	Average Daily Volume
Fiscal 2006:				
Fourth Quarter	$ 15.20	$ 11.98	$ 13.68	144,163
Third Quarter	$ 14.50	$ 9.80	$ 12.91	168,695
Second Quarter	$ 19.98	$ 13.88	$ 14.02	140,701
First Quarter	$ 16.49	$ 12.18	$ 16.11	59,677
Fiscal 2005:				
Fourth Quarter	$ 14.90	$ 9.12	$ 13.51	62,735
Third Quarter	$ 11.05	$ 6.90	$ 10.32	33,038
Second Quarter	$ 7.19	$ 5.35	$ 6.96	4,270
First Quarter	$ 6.25	$ 5.17	$ 5.54	9,587

Dividend Policy

Gaiam has never declared or paid any cash dividends on its capital stock. In addition, our bank line of credit agreement prohibits payment of any dividends to our shareholders. As of December 31, 2006, Gaiam had no outstanding advances under the line of credit agreement.

Sales of Unregistered Securities

During 2006, Gaiam issued 369,724 shares of Class A common stock to Conscious Media, Inc. (CMI) shareholders to purchase shares of CMI. These shares were issued pursuant to an exemption from registration under Section 4(2) of the Securities Act of 1933.

Issuer Purchases of Equity Securities

We did not purchase any of our equity securities during the fiscal year ended December 31, 2006. On February 6, 2007, Gaiam repurchased 2.5 million shares of its Class A common stock from Revolution Living LLC. See Note 13 Subsequent Events.

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by security holders	1,027,740	$ 10.59	1,050,971
Equity compensation plans not approved by security holders			
Total	1,027,740	$ 10.59	1,050,971

Item 6. Selected Financial Data

The selected statement of operations for the years ended December 31, 2006, 2005 and 2004 and balance sheet data as of December 31, 2006 and 2005 set forth below are derived from Gaiam s audited consolidated financial statements which are included elsewhere in this Form 10-K. The selected statement of operations for the years ended December 31, 2003 and 2002 and balance sheet data as of December 31, 2004, 2003 and 2002 set forth below are derived from Gaiam s audited consolidated financial statements which are not included in this Form 10-K. The historical operating results are not necessarily indicative of the results to be expected for any other period. The data set forth below should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and Gaiam s consolidated financial statements and related notes, included elsewhere in this Form 10-K.

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GAIAM, INC.
SELECTED FINANCIAL DATA
(Amounts in thousands, except per share data)

	Year Ended December 31, 2006	2005	2004	2003	2002
Statement of Operations Data					
Net revenues	$ 219,480	$ 142,492	$ 96,657	$ 102,000	$ 111,406
Cost of goods sold	79,150	61,977	48,646	48,927	45,475
Gross profit	140,330	80,515	48,011	53,073	65,931
Selling, operating, general and administrative expenses	134,689	77,429	54,301	54,355	57,180
Operating income (loss)	5,641	3,086	(6,290)	(1,282)	8,751
Other income (loss)	3,905	(175)	109	546	(261)
Income (loss) before income taxes and minority interest	9,546	2,911	(6,181)	(736)	8,490
Income tax expense (benefit)	3,774	974	(2,440)	(461)	3,002
Minority interest in net income of consolidated subsidiary, net of tax	(128)	(601)	(897)	(697)	(40)
Net income (loss)	$ 5,644	$ 1,336	$ (4,638)	$ (972)	$ 5,448
Net income (loss) per share:					
Basic	$ 0.23	$ 0.08	$ (0.32)	$ (0.07)	$ 0.39
Diluted	$ 0.23	$ 0.08	$ (0.32)	$ (0.07)	$ 0.38
Shares outstanding:					
Basic	24,349	17,140	14,684	14,594	14,107
Diluted	24,617	17,354	14,684	14,594	14,489

	December 31, 2006	2005	2004	2003	2002
Balance Sheet Data					
Cash	$ 104,876	$ 15,028	$ 10,439	$ 8,384	$ 11,422
Working capital	140,147	37,216	31,488	29,531	33,944
Total assets	250,968	156,101	88,287	91,860	91,167
Long-term debt (net of current maturities)					55
Stockholders equity	218,606	107,286	66,346	69,485	69,371

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This report contains forward-looking statements that involve risks and uncertainties. When used in this discussion, the words anticipate, believe, plan, estimate, expect, strive, future, intend and similar expressions as they relate to Gaiam or its management are intended to identify such forward-looking statements. Gaiam s 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, 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, acquisitions, new initiatives undertaken by Gaiam, security and information systems, legal liability for website content, merchandise supply problems, failure of third parties to provide adequate service, 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, control of Gaiam by its founder, fluctuations in quarterly operating results, consumer trends, customer interest in our products, the effect of government regulation and other risks and uncertainties included in Gaiam s 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 management s view only as of the date of this report. We undertake no obligation to update any forward-looking information.

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

Overview and Outlook

Gaiam is 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. Gaiam s media brand is built around its ability to develop and offer media content, products, lifestyle solutions and community to consumers in the LOHAS and the emerging MTM markets.

Gaiam offers its 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. Gaiam markets its media and products through a multi-channel approach including traditional media channels, direct to consumers via the Internet, DRTV, subscription clubs, catalog, and through national retailers and corporate accounts.

Gaiam s content forms the basis of its proprietary offerings, which then drive demand for parallel product and service offerings. Gaiam s operations are vertically integrated from content creations, through product development and sourcing, to customer service and distribution. Gaiam markets its products and services across two segments, business and direct-to-consumer. Products are distributed in each of these sales segments from a single fulfillment center.

Gaiam s business segment sells directly to retailers, both domestically and abroad with Gaiam s products now available in over 68,000 retail doors in the United States. In 2005, revenue in this segment was $70.2 million and grew to $93.8 million in 2006 reflecting a 33.7% increase. This increase reflects the sales of media titles acquired through acquisitions and asset purchases combined with internal growth. During the year Gaiam expanded its store-within-store (SWIS) presence to over 6,000 lifestyle presentations, which are custom fixtures designed and produced by Gaiam.

Through its diverse media 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 loyal community, and customer feedback on Gaiam s and the LOHAS industry s focus and future. During 2006, this segment generated revenues of $125.7 million, up from $72.3 million in 2005. This increase reflects growth of 73.8% with the continued investment into branded DRTV, clubs and membership programs.

During 2006, Gaiam completed several acquisitions targeted towards expanding and enhancing its media content and reach. These acquisitions included acquiring the remaining minority interests in CMI, a multimedia company, and Newmark Media, Ltd., a retail distributor in the natural grocery and drug channel. Gaiam also acquired an 85% interest in a DVD subscription club that provides inspirational and spiritual family films.

We believe our growth will be driven by information, media content, products, and community delivered to the consumer via broadcast, catalog, Internet, retailers, international licensing and electronic downloads and subscription systems. Gaiam has increased its focus on its media content creation and distribution, which strategically provides increased branding opportunities, significantly higher operating contribution and greater mainstream penetration. Gaiam plans to invest in its community and membership businesses over the next two years to better capitalize on strong relationships with its loyal consumer audience and growing broadband subscription trends. This will allow Gaiam to focus on better leveraging its content through subscription clubs and community.

Factors that Gaiam believes are important to its long-term success include building its brands, increasing international growth by expanding into new markets primarily through license arrangements, extending its product lines into wellness and children s programs, and enhancing its multimedia platform community through new media opportunities, new club and membership programs, initiatives and acquisitions.

Critical Accounting Policies

Gaiam s consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States, which require management to make judgments, estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Note 1 to the consolidated financial statements in Item 8 of this Form 10-K summarizes the significant accounting policies and methods used in the preparation of Gaiam s consolidated financial statements.

Management believes the following to be critical accounting policies whose application has a material impact on Gaiam s financial presentation, and involve a higher degree of complexity, as they require management to make judgments and estimates about matters that are inherently uncertain.

Provisions for Doubtful Accounts and Returns

Gaiam records a provision for doubtful accounts for all receivables not expected to be collected. Gaiam generally does not require collateral. Gaiam evaluates the collectibility of accounts receivable based on a combination of factors. In circumstances in which Gaiam is aware of a specific customer s inability to meet its financial obligations (e.g. bankruptcy filings), Gaiam records a specific reserve for bad debts against amounts due. For all other instances, Gaiam recognizes reserves based on historical experience and review of individual accounts outstanding.

Gaiam records a provision for product returns to be received in future periods at the time the original sale is recognized. The amount of the returns provision is based upon historical experience and future expectations.

Inventory

Inventory consists primarily of finished goods held for sale and is stated at the lower of cost (first-in, first-out method) or market. Gaiam identifies the inventory items to be written down for obsolescence based on the item s current sales status and condition. If the item is discontinued or slow moving, it is written down based on an estimate of the markdown to retail price needed to sell through its current stock level of the item.

Goodwill

Goodwill represents the excess of the purchase consideration over the fair value of assets acquired less liabilities assumed in a business acquisition. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill is no longer amortized but is reviewed for impairment annually or more frequently if impairment indicators arise, on a reporting unit level. The fair value of a reporting unit is compared with its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired.

If the carrying amount of a reporting unit exceeds its fair value, the goodwill impairment test is performed to measure the amount of impairment loss. Gaiam has allocated goodwill to two reporting units, and uses a market value method for the purposes of testing for potential impairment. The annual review requires extensive use of financial judgment and estimates. Application of alternative assumptions and definitions, such as a change in the composition of a reporting unit, could yield significantly different results.

Investments

Investments in limited liability companies in which Gaiam does have the ability to exercise significant influence or control, or in which it holds a five percent or more membership interest, are accounted for under the equity method. Investments in corporations in which Gaiam does have the ability to exercise significant influence or control, or in which it holds a twenty percent or more ownership, are also accounted for under the equity method. Under the equity method, Gaiam records its share of the income or losses of the investment by increasing or decreasing the carrying value of its investment and recording the income or expense through the consolidated statement of operations. Under the cost method of accounting, investments in private companies are carried at cost and are adjusted only for other-than-temporary declines in fair value.

Purchase Accounting

Gaiam accounts for the acquisition of a controlling interest in a company using the purchase method prescribed by FASB Statement No. 141, *Business Combinations* (SFAS 141). In determining the estimated fair value of certain acquired assets and liabilities, management makes assumptions based upon historical and other relevant information and, in some cases, independent expert appraisers. Assumptions may be incomplete, and unanticipated events and circumstances may occur that could affect the validity of such assumptions, estimates, or actual results. The estimated fair value of assets and liabilities acquired in accordance with SFAS 141 during 2006 are preliminary as of December 31, 2006. We expect to obtain information necessary to finalize the estimated values during 2007.

Media Library

The media library asset represents the fair value of the library of produced videos acquired through business combinations, the purchase price of media rights to both video and audio titles, and the capitalized cost to produce media products marketed by Gaiam to retailers and direct-mail and online customers. The fair value of acquired or purchased media titles and content is amortized on a straight-line basis over succeeding periods on the basis of its estimated useful life. Capitalized production costs are deferred for financial reporting purposes until the media is released and, then, amortized over succeeding periods on the basis of estimated sales. Historical sales statistics are the principal factor used in estimating the amortization rate.

Stock-Based Compensation

Effective January 1, 2006, Gaiam adopted the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), a revision to the previously issued guidance on accounting for stock options and other forms of equity-based compensation issued to employees and others over the their requisite service period (generally the vesting period). The fair value of each grant is estimated as of the grant date using the Black-Scholes option-pricing model. This involves assumptions calculated using management s best estimates at the time of the grant, which impacts the fair value of the option calculated under the Black-Scholes methodology and, ultimately, the expense that will be recognized over the life of the option. Additional information is included in Note 1 of the *Notes to Consolidated Financial Statements*.

Results of Operations

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

	For the Year Ended December 31,					
	2006		**2005**		**2004**	
Net revenue	100.0	%	100.0	%	100.0	%
Cost of goods sold	36.1	%	43.5	%	50.3	%
Gross profit	63.9	%	56.5	%	49.7	%
Expenses:						
Selling and operating	54.6	%	47.5	%	47.7	%
Corporate, general and administrative	6.8	%	6.9	%	8.5	%
Total expenses	61.4	%	54.3	%	56.2	%
Income (loss) from operations	2.5	%	2.2	%	-6.5	%
Other income (expense), net	1.8	%	-0.1	%	0.1	%
Income (loss) before income taxes and minority interest	4.3	%	2.0	%	-6.4	%
Income tax (benefit) expense	1.7	%	0.7	%	-2.5	%
Minority interest in net income of consolidated subsidiary, net of tax		%	-0.4	%	-0.9	%
Net income (loss)	2.6	%	0.9	%	-4.8	%

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Revenue of $219.5 million during 2006 was 54.0% higher than the $142.5 million in revenue generated in 2005. Gaiam s increase in revenue reflects the sales of media titles acquired from GoodTimes Entertainment, coupled with strong performance in our direct marketing programs, continued penetration into existing retail stores, and the addition of new retail distribution outlets. During the year, Gaiam added distribution to over 18,000 new retail doors, bringing the total number of doors in the United States to 68,000. Revenue in Gaiam s direct to consumer segment was $125.7 million in 2006, an increase of $53.4 million or 73.8% over 2005 revenue of $72.3 million, primarily reflecting strong performance in our direct marketing programs and revenue from the SCI acquisition in August 2006. DRTV continues to be a strong revenue source for this segment while providing a test marketing platform for new brands and products. Total revenue generated by Gaiam s business segment, including revenue generated by acquisitions, increased by 33.7% to $93.8 million in 2006 from $70.2 million in 2005.

Gross profit, which consists of revenue less cost of sales (primarily merchandise cost plus inbound freight and duties), increased to $140.3 million for 2006 from $80.5 million during 2005. As a percentage of revenue, gross profit increased 740 basis points to 63.9% in 2006 from 56.5% in 2005. The increase was primarily due to strong sales of media and direct marketing products which carry higher margins, but also carry higher selling and operating expenses. The increased media sales have allowed Gaiam to leverage its purchasing volume to receive improved buying discounts. Gaiam also continued to benefit from the elimination of fees previously paid for third party distribution following the GoodTimes transaction. Additionally, Gaiam s strong cash position allowed the Company to take advantage of prompt pay vendor discounts. The business segment s gross profit increased to 62.5% in 2006 from 57.3% in 2005. The direct to consumer segment s gross profit increased to 65.0% in 2006, up from 55.7% in 2005.

Selling and operating expenses increased to $119.7 million for 2006 compared to $67.6 million in the same period of 2005, primarily resulting from increased sales and operating expenses to support the revenue increases described above and the additional amortization expense associated with GoodTimes media library. As a percentage of revenue, selling and operating expenses increased to 54.6% in 2006 from 47.5% in 2005 reflecting a change in revenue mix toward increased media and direct marketing products which carry higher selling and operating expenses, such as merchandising fees and advertising costs, along with higher gross margins.

Corporate, general and administration expenses increased to $15.0 million in 2006 from $9.8 million in 2005 primarily due to Gaiam s planned investments in its business to support the increased revenue base. As a percent of revenue, corporate general and administration expenses decreased slightly to 6.8% of revenue in 2006 compared to 6.9% of revenue in 2005.

Income from operations was $5.6 million in 2006, up from $3.1 million in 2005, primarily reflecting higher sales and improved gross profit margins, partially offset by higher selling and operating expenses associated with media and direct marketing products, as well as redundant system and operating costs as a result of the GoodTimes acquisition. As a percent of revenue, income from operations improved to 2.5% of revenue during 2006, as compared to 2.2% of revenue in 2005.

Gaiam recorded other income of $3.9 million in 2006 compared to other expense of $0.2 million in 2005. The increase in 2006 other income primarily consisted of interest on cash investments and a gain of $0.5 million on the sale of 19,968 Series A Preferred Units of Life Balance Media Holdings LLC (LIME). This investment was acquired in August 2005 and represented a 19.9% interest in LIME. In 2005, Gaiam recorded a $646 thousand loss on this investment for the period from August 22, 2005 through December 31, 2005, which was partially offset by interest income of $0.4 million. The share of net income associated with minority interest in consolidated subsidiaries was $0.1 million in 2006, compared to the share of net income of $0.6 million for the comparable 2005 period.

Gaiam recorded an income tax expense of $3.8 million in 2006 compared to an income tax expense of $1.0 million in 2005. Gaiam s consolidated effective tax rate fluctuates based upon the distribution of earnings/losses between its domestic and foreign operations.

As a result of the factors described above, Gaiam improved its financial performance over 2005. In 2006, Gaiam produced net income of $5.6 million, or $0.23 per share, as compared to a net income in 2005 of $1.3 million or $0.08 per share.

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Revenue of $142.5 million during 2005 was 47% higher than the $96.7 million in revenue generated in 2004. Gaiam s increase in revenue primarily resulted from increased sales volume from content acquired in the GoodTimes asset acquisition, which was coupled with a 19% internal growth rate. Revenue in Gaiam s direct to consumer segment was $72.3 million in 2005, an increase of $19.9 million or 38% over 2004 revenue of $52.4 million, primarily resulting from the advent of club, membership and DRTV revenue, in addition to a 17% internal growth rate in the core components. Gaiam s business segment generated positive internal growth of 21% for the year, and, including revenue generated by acquisitions, increased the total revenue generated by this segment by 58.6% to $70.2 million in 2005 from $44.2 million in 2004.

Gross profit, which consists of revenue less cost of sales (primarily merchandise cost plus inbound freight and duties), increased to $80.5 million for 2005 from $48 million during 2004. As a percentage of revenue, gross profit increased 680 basis points to 56.5% in 2005 from 49.7% in 2004. This was primarily attributable to a sales mix change favoring media, on which Gaiam generates significantly higher gross margins, and the cessation of markdowns and other costs associated with the format change from VHS to DVD which adversely affected 2004 results. Gross profit was also favorably impacted by improved pricing on DVDs associated with the higher volume, and new direct to retailer access, rather than the use of third party distributors, on several new key accounts. These improvements had the greatest impact on the business segment, as gross profit for this segment improved to 57.3% in 2005 from 45.6% in 2004. The direct to consumer segment also improved, as the gross profit in this segment increased to 55.7% in 2005, up from 53.1% in 2004.

Selling and operating expenses increased to $67.6 million for 2005 compared to $46.1 million in the same period of 2004, primarily resulting from increased sales and operating expenses to support the revenue increases described above, and transition expenses associated with the GoodTimes asset acquisition. As a percentage of revenue, selling and operating expenses decreased to 47.5% in 2005 from 47.7% in 2004 due to higher revenue base.

Corporate, general and administration expenses increased to $9.8 million in 2005 from $8.2 million in 2004, but decreased significantly to 6.9% of revenue in 2005 from 8.5% of revenue in 2004. This expense increase primarily resulted from increased facilities, systems and other infrastructure costs associated with the acquired assets and increased business volume.

As a result of the above factors, Gaiam generated $3.1 in income from operations, or 2.2% of revenue, during 2005, as compared to a $6.3 million operating loss in 2004, which was 6.5% of revenue.

Gaiam recorded $175 thousand in other expense during 2005 and $109 thousand in other income during 2004. In August 2005, Gaiam acquired a 19.9% interest in LIME, and recorded a one-time $646 thousand loss on this investment for the period from August 22, 2005 through December 31, 2005. This loss was partially offset by interest income of $358 thousand for 2005. During 2004, Gaiam generated $160 thousand in interest income. The share of net income associated with minority interest in consolidated subsidiaries was $601 thousand in 2005, compared to the share of net income of $897 thousand for the comparable 2004 period.

Gaiam recorded an income tax expense of $974 thousand for 2005 compared to an income tax benefit of $2.4 million in 2004. Gaiam s consolidated effective tax rate fluctuates based upon the distribution of earnings/losses between its domestic and foreign operations.

As a result of the factors described above, Gaiam improved its financial performance over 2004. In 2005, Gaiam produced net income of $1.3 million, or $0.08 per share, as compared to a net loss in 2004 of $4.6 million or $0.32 per share.

Quarterly and Seasonal Fluctuations

The following table sets forth our unaudited quarterly results of operations for each of the quarters in 2006 and 2005. In management s opinion, this unaudited financial information includes all adjustments, consisting solely of normal recurring accruals and adjustments, necessary for a fair presentation of the results of operations for the quarters presented. This financial information should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this Form 10-K. The results of operations for any quarter are not necessarily indicative of future results of operations. Amounts are in thousands, except per share data.

	Fiscal 2006 First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net revenue	$ 51,752	$ 43,161	$ 51,786	$ 72,781
Gross profit	33,162	26,891	32,629	47,648
Operating income (loss)	1,010	(2,676)	1,010	6,297
Net income (loss)	890	(1,166)	1,653	4,267
Diluted net income (loss) per share	$ 0.04	$ (0.05)	$ 0.06	$ 0.16
Weighted average shares outstanding-diluted	20,795	23,140	26,864	27,211

	Fiscal 2005 First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net revenue	$ 26,324	$ 21,706	$ 30,139	$ 64,322
Gross profit	13,749	10,557	16,713	39,496
Operating income (loss)	287	(1,271)	878	3,193
Net income (loss)	116	(766)	505	1,481
Diluted net income (loss) per share	$ 0.01	$ (0.05)	$ 0.03	$ 0.07
Weighted average shares outstanding-diluted	14,914	14,820	18,892	20,595

Note: The aggregate of certain of the above amounts differs from that reported for the full fiscal year due to the effects of rounding.

Quarterly fluctuations in Gaiam s revenues and operating results are due to a number of factors, including the timing of new product introductions and mailings to customers, advertising, acquisitions (including costs of acquisitions and expenses related to integration of acquisitions), competition, pricing of products by vendors and expenditures on our systems and infrastructure. The impact on revenue and operating results due to the timing and extent of these factors can be significant. Our sales are also affected by seasonal influences. On an aggregate basis, Gaiam generates its strongest revenues and net income in the fourth quarter due to increased holiday spending and retailer fitness purchases.

Liquidity and Capital Resources

Gaiam s capital needs arise from working capital required to fund our 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 Gaiam s infrastructure, and future growth. These capital requirements depend on numerous factors, including the rate of market acceptance of Gaiam s product offerings, the ability to expand Gaiam s customer base, the cost of ongoing upgrades to Gaiam s 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 cannot accurately be predicted. Additionally, Gaiam will continue to pursue opportunities to expand its media libraries, evaluate possible investments in businesses, products and technologies, and increase its sales and marketing programs and brand promotions as needed.

Gaiam has a credit agreement with Wells Fargo that permits borrowings of up to $15 million based upon the collateral value of Gaiam s accounts receivable and inventory. At December 31, 2006, Gaiam had no borrowings outstanding under this agreement; however, $3.0 million was reserved for outstanding letters of credit. Gaiam has complied with all of the financial covenants. This credit agreement expires on July 31, 2007. Should Gaiam choose to borrow under the credit agreement, outstanding advances would bear interest at the lower of prime rate less 50 basis points or LIBO plus 275 basis points. Borrowings are secured by a pledge of Gaiam s assets, and the agreement contains various financial covenants, including covenants prohibiting the payment of cash dividends to Gaiam shareholders and requiring compliance with certain financial ratios.

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Gaiam s operating activities provided net cash of $1.7 million and $6.7 million in 2006 and 2005, respectively. Gaiam s net cash generated from operating activities in 2006 was primarily attributable to net income of $5.6 million, net non-cash expenses of $11.0 million and decreases to accounts receivable of $3.3 million, partially offset by an increase in inventory of $5.4 million, reduced payables and other liabilities of $11.0 million, and net other uses of $1.8 million. The reduction in accounts payable of $6.9 million reflects the Company s decision to buy direct from overseas factories which require payment upon shipment versus going through distributors with payment terms. This change in buying strategy, coupled with other cost saving initiatives, increased Gaiam s gross profit margin to 63.9% in 2006 from 56.5% in 2005. The increase in inventory reflects the additional products necessary to support the increased sales growth. Gaiam s net cash generated from operating activities in 2005 was primarily attributable to net income of $1.3 million and noncash expenses of $6.4 million. The use of cash to fund the growth in accounts receivable resulting from increased sales volume was offset by the growth in accounts payable.

Gaiam s investing and acquisition activities used net cash of $9.7 million and $40.4 million for 2006 and 2005, respectively. In 2006, Gaiam increased its ownership interest in CMI and Newmark Media, Ltd. (Newmark) and acquired an 85% ownership interest in Spiritual Cinema, Inc. (SCI), resulting in net cash outlay of $7.0 million. Additionally, Gaiam acquired or produced additional media content and rights as well as sold other property and equipment for a net cash outlay of $2.7 million. During 2005, Gaiam used cash to acquire assets from GoodTimes and to fund Gaiam s investment in LIME. In 2005 Gaiam used $1.6 million for the purchase of property, equipment and media rights.

Gaiam s financing activities generated net cash of $97.0 million and $38.7 million for 2006 and 2005, respectively. On May 24, 2006, Gaiam sold 5,000,000 shares of Class A common stock and on June 13, 2006 sold 690,000 shares of Class A common stock. The combined sale generated net proceeds of $93.0 million. On July 7, 2005, Gaiam issued and sold 2,821,317 shares of unregistered Class A common stock for an aggregate purchase price of approximately $18.7 million to certain funds advised by Prentice Capital Management, LP. On August 22, 2005, Gaiam issued and sold 2,500,000 shares of unregistered Class A common stock for an aggregate purchase price of $20 million to Revolution Living, LLC. The remaining 2006 and 2005 cash generated by financing activities resulted primarily from the exercise of stock options under Gaiam s 1999 Long Term Incentive Program.

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

In the normal course of our business, Gaiam investigates, evaluates and discusses acquisition, joint venture, minority investment, strategic relationship and other business combination opportunities in the LOHAS and MTM markets. For any future investment, acquisition or joint venture opportunities, Gaiam may consider using then-available liquidity, issuing equity securities or incurring additional indebtedness.

Contractual Obligations

Gaiam has commitments pursuant to lease and debt agreements, but does not have any outstanding commitments pursuant to long-term debt obligations or 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 yrs**
Operating lease obligations	$ 6,153	$ 4,597	$ 1,008	$ 304	$ 244

Off-Balance Sheet Arrangements

Gaiam does not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as special purpose entities (SPEs) or variable interest entities (VIEs), which have been established for the purpose of facilitating off-balance sheet arrangements or other limited purposes. As of December 31, 2006, Gaiam is not involved in any unconsolidated SPEs or VIEs.

Item 7A. 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.

Any borrowings we might make under our bank credit facility would bear interest at the lower of prime rate less 50 basis points or LIBOR plus 275 basis points. Gaiam does not have any amounts outstanding under its credit line, so any unfavorable change in interest rates would not have a material impact on Gaiam s results from operations or cash flows unless Gaiam makes borrowings in the future.

Gaiam purchases a significant amount of inventory from vendors outside of the U.S. in transactions that are primarily U.S. dollar denominated transactions. Because the percentage of our international purchases denominated in currencies other than the U.S. dollar is small, any currency risks related to these transactions are immaterial to Gaiam. A decline in the relative value of the U.S. dollar to other foreign currencies could, however, lead to increased purchasing costs. In order to mitigate this exposure, Gaiam makes virtually all of its purchase commitments in U.S. dollars.

In 2003, Gaiam purchased a 50.1% interest in Gaiam Limited, formerly known as Leisure Systems International Limited, a U.K. based distributor. Because Gaiam Limited s revenues are primarily denominated in foreign currencies, this investment exposes Gaiam to accounting risk associated with foreign currency exchange rate fluctuations. However, we have determined that there was no material market risk exposure to our consolidated financial position, results of operations or cash flows as of December 31, 2006.

Item 8. Financial Statements and Supplementary Data

Index to Financial Statements

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of

Gaiam, Inc.

Broomfield, Colorado

We have audited the accompanying consolidated balance sheets of Gaiam, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedule II for the years ended December 31, 2006, 2005 and 2004. We also have audited management s assessment, included in the accompanying Managements Report on Internal Control over Financial Reporting included in Item 9A, that Gaiam, Inc. and subsidiaries maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO Criteria). The Company s management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these financial statements, an opinion on management s assessment, and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As discussed in Note 1 to the financial statements, in 2006 the Company adopted Statement of Financial Accounting Standard No. 123 (revised 2004), *Share-Based Payment*, effective January 1, 2006.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Gaiam, Inc. and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule II for the years ended December 31, 2006, 2005 and 2004, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein. Also in our opinion, management s assessment that Gaiam, Inc. and subsidiaries maintained effective internal control over financial reporting as of December 31, 2006 is fairly stated, in all material respects, based on the COSO Criteria. Furthermore, in our opinion, Gaiam, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006 based on the COSO Criteria.

Ehrhardt Keefe Steiner & Hottman PC

March 14, 2007
Denver, Colorado

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GAIAM, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	December 31, 2006	2005
Assets		
Current assets:		
Cash and cash equivalents	$ 104,876	$ 15,028
Accounts receivable, net of allowance for doubtful accounts of $1,180 in 2006 and $761 in 2005	25,324	28,067
Inventory, less allowances	24,313	20,792
Deferred advertising costs	3,965	3,917
Deferred tax assets	3,404	3,627
Other current assets	4,965	4,838
Total current assets	166,847	76,269
Property and equipment, net	7,784	9,428
Media library, net	37,201	38,339
Non-current deferred tax assets	5,958	7,282
Goodwill and other intangibles	28,879	17,541
Notes receivable and other assets	4,299	7,242
Total assets	$ 250,968	$ 156,101
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 18,848	$ 25,843
Accrued liabilities	7,437	13,045
Income taxes payable	415	165
Total current liabilities	26,700	39,053
Long-term liabilities		1,663
Total liabilities	26,700	40,716
Minority interest	5,662	8,099
Commitments and contingencies		
Stockholders equity:		
Class A common stock, $.0001 par value, 150,000,000 shares authorized, 21,749,936 and 15,010,736 shares issued and outstanding at December 31, 2006 and 2005, respectively	2	1
Class B common stock, $.0001 par value, 50,000,000 shares authorized, 5,400,000 shares issued and outstanding at December 31, 2006 and 2005	1	1
Additional paid-in capital	200,906	95,840
Accumulated other comprehensive income	873	264
Retained earnings	16,824	11,180
Total stockholders equity	218,606	107,286
Total liabilities and stockholders equity	$ 250,968	$ 156,101

See accompanying notes to the consolidated financial statements.

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GAIAM, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	Years Ended December 31, 2006	2005	2004
Net revenue	$ 219,480	$ 142,492	$ 96,657
Cost of goods sold	79,150	61,977	48,646
Gross profit	140,330	80,515	48,011
Expenses:			
Selling and operating	119,700	67,639	46,060
Corporate, general and administration	14,989	9,790	8,241
Total expenses	134,689	77,429	54,301
Income (loss) from operations	5,641	3,086	(6,290)
Other income (expense)	645	(533)	(51)
Interest income	3,260	358	160
Other income (expense)	3,905	(175)	109
Income (loss) before income taxes and minority interest	9,546	2,911	(6,181)
Income tax expense (benefit)	3,774	974	(2,440)
Minority interest in net income of consolidated subsidiaries, net of income taxes	(128)	(601)	(897)
Net income (loss)	$ 5,644	$ 1,336	$ (4,638)
Net income (loss) per share:			
Basic	$ 0.23	$ 0.08	$ (0.32)
Diluted	$ 0.23	$ 0.08	$ (0.32)
Shares used in computing net income (loss) per share:			
Basic	24,349	17,140	14,684
Diluted	24,617	17,354	14,684

See accompanying notes to the consolidated financial statements.

GAIAM, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
(In thousands, except share data)

	Class A Common Stock Shares	Amount	Class B Common Stock Shares	Amount	Additional Paid-In Capital	Deferred Compensation	Accumulated Other Comprehensive Income	Retained Earnings	Total
Balance at December 31, 2003	9,203,056	$ 1	5,400,000	$ 1	$ 53,831	$ (72)	$ 525	$ 15,199	$ 69,485
Issuance of common stock in conjunction with acquisitions and compensation	208,841				1,102	72			1,174
Comprehensive loss:									
Net loss								(4,638)	(4,638)
Foreign currency translation adjustment, net of income taxes of $75							325		325
Comprehensive loss									(4,313)
Balance at December 31, 2004	9,411,897	1	5,400,000	1	54,933		850	10,561	66,346
Issuance of common stock in conjunction with acquisitions and compensation	5,598,839				40,907				40,907
Retained earnings adjustment to reflect Conscious Media as an equity investment from the date of initial investment through acquisition of a majority interest								(717)	(717)
Comprehensive income:									
Net income								1,336	1,336
Foreign currency translation adjustment, net of income taxes of $(155)							(586)		(586)
Comprehensive income									750
Balance at December 31, 2005	15,010,736	1	5,400,000	1	95,840		264	11,180	107,286
Sale of common stock in underwritten offerings	5,690,000	1			93,601				93,602
Issuance of common stock in conjunction with acquisitions and compensation	1,049,200				11,465				11,465
Comprehensive income:									
Net income								5,644	5,644
Foreign currency translation adjustment, net of income taxes of $393							609		609
Comprehensive income									6,253
Balance at December 31, 2006	21,749,936	$ 2	5,400,000	$ 1	$ 200,906	$	$ 873	$ 16,824	$ 218,606

See accompanying notes to the consolidated financial statements.

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Item 8. Financial Statements and Supplementary Data

GAIAM, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)

	Years ended December 31, 2006	2005	2004
Operating activities			
Net income (loss)	$ 5,644	$ 1,336	$ (4,638)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation	1,926	2,146	2,822
Amortization	5,883	2,555	2,077
Noncash stock-based compensation	623		72
Minority interest in consolidated subsidiaries	128	601	897
Noncash loss on disposal of property and equipment			259
Noncash (gain) loss from equity method investment	(680)	646	
Noncash gain on Gaiam.com stock redemption			(442)
Deferred income tax expense (benefit)	3,210	472	(564)
Changes in operating assets and liabilities, net of effects from acquisitions:			
Accounts receivable	3,319	(11,066)	2,622
Inventory	(5,373)	3,143	304
Deferred advertising costs	(531)	(1,281)	(986)
Other current assets	(1,175)	(1,674)	(30)
Notes receivable and other assets	(238)	(139)	330
Accounts payable	(6,859)	11,399	192
Accrued liabilities and income taxes payable	(4,133)	(1,404)	210
Net cash provided by operating activities	1,744	6,734	3,125
Investing activities			
Purchase of property, equipment, and media rights	(3,412)	(1,589)	(1,649)
Proceeds from sale of property and equipment	668		
Purchase of acquisitions, investments, and stock rights	(6,998)	(38,804)	26
Net cash used in investing activities	(9,742)	(40,393)	(1,623)
Financing activities			
Principal payments on capital leases			(55)
Proceeds from issuance of common stock, net	97,022	38,708	427
Net cash provided by financing activities	97,022	38,708	372
Effects of exchange rates on cash and cash equivalents	824	(460)	181
Net increase in cash and cash equivalents	89,848	4,589	2,055
Cash and cash equivalents at beginning of year	15,028	10,439	8,384
Cash and cash equivalents at end of year	$ 104,876	$ 15,028	$ 10,439
Supplemental cash flow information			
Interest paid	$ 23	$	$ 1
Income taxes paid	949	1,196	679
Common stock issued for acquisitions	4,943	2,150	539

See accompanying notes to the consolidated financial statements.

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GAIAM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Organization and Nature of Operations

Gaiam, Inc. (Gaiam) is 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. Gaiam was incorporated under the laws of the State of Colorado on July 7, 1988.

Principle of Consolidation and Basis of Presentation

The accompanying consolidated financial statements include the accounts of Gaiam and its subsidiaries in which Gaiam s ownership is greater than 50% and the subsidiary is considered to be under Gaiam s control. All material intercompany accounts and transaction balances have been eliminated in consolidation.

Cash and Cash Equivalents

Cash and cash equivalents include demand deposit accounts with financial institutions and highly liquid investments, which mature within three months of date of purchase. The fair value of the cash and cash equivalents approximates their carrying value due to their short maturities.

Provision for Doubtful Accounts and Returns

Gaiam records a provision for doubtful accounts for all receivables not expected to be collected. Gaiam generally does not require collateral. Gaiam evaluates the collectibility of the accounts receivable based on a combination of factors. In circumstances in which Gaiam is aware of a specific customer s inability to meet its financial obligations (e.g. bankruptcy filings), Gaiam records a specific reserve for bad debts against amounts due. For all other instances, Gaiam recognizes reserves based on historical experience and review of individual accounts outstanding.

Gaiam records a provision for product returns to be received in future periods at the time the original sale is recognized. The amount of the returns provision is based upon historical experience and future expectations.

Inventory

Inventory consists primarily of finished goods held for sale and is stated at the lower of cost (first-in, first-out method) or market. Gaiam identifies its inventory items to write down for obsolescence based on the item s current sales status and condition. If the item is discontinued or slow moving, it is written down based on an estimate of the markdown to retail price needed to sell through its current stock level of the item. The reserve for obsolescence was $3.6 million in 2006 and $1.9 million in 2005.

Advertising Costs

Deferred advertising costs relate to the preparation, printing, advertising and distribution of infomercials and catalogs. Such costs are deferred for financial reporting purposes until the catalogs and infomercials are distributed and advertised, then amortized over succeeding periods on the basis of estimated sales. Seasonal catalogs are amortized within seven months, while the amortization period for annual catalogs does not exceed one year. Historical sales statistics are the principal factor used in estimating the amortization rate. Other advertising and promotional costs are expensed as incurred.

In accordance with Emerging Issues Task Force (EITF) Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products)*, Gaiam records sales discounts or other sales incentives as a reduction to revenues. Gaiam identifies and records as expense those cooperative advertising expenses paid by Gaiam, which are for advertisements meeting the separable benefit and fair value tests, as part of selling and operating expense.

Amounts recorded as advertising expense, including those related to Gaiam s catalogs and infomercials were $35.5 million, $17.6 million and $11.6 million for the years ended December 31, 2006, 2005 and 2004, respectively, and are included in selling and operating expense in the consolidated statement of operations.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization, which includes the amortization of assets recorded under capital leases. Included in property and equipment is the cost of internal-use software, including software used in connection with Gaiam s websites. Gaiam expenses all costs related to the development of internal-use software other than those incurred during the application development stage in accordance with AICPA Statement of Position No. (SOP) 98-1, *Accounting for Costs of Computer Software Developed or Obtained for Internal Use*. Costs incurred during the application development stage are capitalized and amortized over the estimated useful life of the software, which is typically three years. Depreciation of property and equipment is computed on the straight-line method over estimated useful lives (generally three to ten years). Property and equipment purchased under capital leases are amortized on a straight-line basis over the lesser of the estimated useful life of the asset or the lease term.

Investments

Investments in limited liability companies in which Gaiam does have the ability to exercise significant influence or control, or in which it holds a five percent or more membership interest, are accounted for under the equity method. Investments in corporations in which Gaiam does have the ability to exercise significant influence or control, or in which it holds a twenty percent or more ownership, are also accounted for under the equity method. Under the equity method, Gaiam records its share of the income or losses of the investment by increasing or decreasing the carrying value of its investment and recording the income or expense through the consolidated statement of operations. Under the cost method of accounting, investments in private companies are carried at cost and are adjusted only for other-than-temporary declines in fair value. Investments under the cost and equity methods are included on the accompanying consolidated balance sheet in Notes receivable and other assets .

Gaiam evaluates its long-lived assets, including investments, on at least an annual basis to test for impairment or valuation issues, and concluded that, as of December 31, 2006 and 2005, no indicators of impairment were present.

Purchase Accounting

Gaiam accounts for the acquisition of a controlling interest in a company using the purchase method prescribed by FASB Statement No. 141, *Business Combinations* (SFAS 141). In determining the estimated fair value of certain acquired assets and liabilities, management makes assumptions based upon historical and other relevant information and, in some cases, independent expert appraisers. Assumptions may be incomplete, and unanticipated events and circumstances may occur that could affect the validity of such assumptions, estimates, or actual results. The estimated fair value of assets and liabilities acquired in accordance with SFAS 141 during 2006 are preliminary as of December 31, 2006. We expect to obtain information necessary to finalize the estimated values during 2007.

Media Library

The media library asset represents the fair value of Gaiam s library of produced videos acquired through business combinations, the purchase price of media rights to both video and audio titles, and the capitalized cost to produce media products marketed by Gaiam to retailers and direct-mail and online customers. The media library is presented net of accumulated amortization of approximately $16.2 million and $10.9 million at December 31, 2006 and 2005, respectively, and it is being amortized over the estimated useful life of the titles, which range from five to fifteen years. Additionally, Gaiam estimates approximately $9.6 million in participation expenses, primarily royalties, on acquired and produced media content during 2007.

In accordance with SOP No. 00-2, *Accounting by Producers or Distributors of Films*, media library costs to produce media content consists of costs incurred to produce the media content, net of accumulated amortization. These costs, as well as participation costs, are recognized as operating expenses on an individual film basis in the ratio that the current year s gross revenues bear to management s estimate of total ultimate gross revenues from all sources to be earned over a seven year period. Capitalized production costs are stated at the lower of unamortized cost or estimated fair value on an individual film basis. Revenue forecasts, based primarily on historical sales statistics, are continually reviewed by management and revised when warranted by changing conditions. When estimates of total revenues and other events or changes in circumstances indicate that a film has a fair value that is less than its unamortized cost, an impairment loss is recognized in the current period for the amount by which the unamortized cost exceeds the film s fair value.

During 2006, capitalized production costs for released films were approximately $248 thousand, and for those films not yet released was approximately $1.1 million. Additionally, as of December 31, 2006, Gaiam estimates that approximately $1.1 million or 21% of the unamortized costs for released films will be amortized during 2007, and approximately 81% of the unamortized costs for released films will be amortized within the next three years. Accumulated amortization for produced media content at December 31, 2006 and 2005 was approximately $8.1 million and $6.8 million, respectively. Amortization expense for produced media content for the years ended December 31, 2006, 2005 and 2004 was $1.4 million, $1.0 million, and $1.4 million, respectively.

The acquired and purchased media rights have $32.2 million of remaining unamortized costs as of December 31, 2006 that will be amortized on a straight-line basis over 7 to 132 months. Amortization expense for acquired and purchased media rights for the years ended December 31, 2006, 2005 and 2004 was $4.1 million, $1.5 million, and $687 thousand, respectively. Based upon the acquired and purchased media and audio titles and rights at December 31, 2006, the annual amortization expense for the next five years is expected to approximate $3.9 million per annum. In 2005, Gaiam added $32.3 million in media assets from its acquisition of content and programming from GoodTimes Entertainment.

Based on total media library costs at December 31, 2006 and assuming no subsequent impairment of the underlying assets or a material increase in the video productions or media acquired, the amortization expense for the next five years is expected to continue to be approximately $5 million or less per annum.

Goodwill and OtherIntangibles

Goodwill represents the excess of the purchase consideration over the estimated fair value of assets acquired less liabilities assumed in a business acquisition. Gaiam s other intangibles mainly consist of customer lists. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill is no longer amortized but is reviewed for impairment annually or more frequently if impairment indicators arise, on a reporting unit level. The estimated fair value of a reporting unit is compared with its carrying amount, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired.

If the carrying amount of a reporting unit exceeds its estimated fair value, the goodwill impairment test is performed to measure the amount of impairment loss. Gaiam has allocated goodwill to two reporting units, and uses a market value method for the purposes of testing for potential impairment. The annual review requires extensive use of financial judgment and estimates. Application of alternative assumptions and definitions, such as a change in the composition of a reporting unit, could yield significantly different results.

Gaiam completed its annual goodwill tests, using comparable company market multiples to establish the estimated fair value of the reporting units, and found no goodwill impairment in either of its reporting units for 2006 and 2005. Gaiam has allocated all of its goodwill balance of $28.3 million at December 31, 2006 to its two reporting units, business and direct to consumer, in the amounts of $17.0 million and $11.3 million, respectively. At December 31, 2005, Gaiam allocated goodwill in the amounts of $11.7 million and $5.7 million, respectively, to its business and direct to consumer reporting units. Goodwill is allocated to reporting units at the time of acquisition. The following table sets forth the changes in goodwill for the period December 31, 2004 through December 31, 2006 by business segment.

	Direct to Consumer Segment (in thousands)	**Business Segment**	**Total**
Balance at December 31, 2004	$ 5,477	$ 4,279	$ 9,756
Additions	231	7,759	7,990
Foreign currency rate change		(351)	(351)
Balance at December 31, 2005	5,708	11,687	17,395
Additions	5,606	4,919	10,525
Foreign currency rate change		429	429
Balance at December 31, 2006	$ 11,314	$ 17,035	$ 28,349

Gaiam s other intangibles gross carrying amount, and related accumulated amortization, at December 31, 2006 and 2005 were $0.7 million and $0.2 million, and $0.1 million and $13 thousand, respectively. The amortization periods range from 17 to 60 months. Amortization expense for the years ended December 31, 2006 and 2005 was $0.1 million and $13 thousand, respectively. Based on the December 31, 2006 balance of other intangibles, the Company estimates amortization expense to be $0.4 million in 2007, $0.1 million in 2008, $32 thousand in 2009, $19 thousand in 2010, and none thereafter.

Long-Lived Assets

Gaiam evaluates impairment of its long-lived assets, other than goodwill, in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* The carrying value of long-lived assets held and used, other than goodwill, is evaluated when events or changes in circumstances indicate the carrying value may not be recoverable. The carrying value of a long-lived asset is considered impaired when the total projected undiscounted cash flows from such asset are separately identifiable and are less than the carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the estimated fair market value of the long-lived asset. Estimated fair market value is determined primarily using the projected cash flows from the asset discounted at a rate commensurate with the risk involved. Losses on long-lived assets held for sale, other than goodwill, are determined in a similar manner, except that fair market values are reduced for disposal costs.

Income Taxes

Gaiam provides for income taxes pursuant to the liability method as prescribed in SFAS No. 109, *Accounting for Income Taxes*. The liability method requires recognition of deferred income taxes based on temporary differences between financial reporting and income tax bases of assets and liabilities, using currently enacted income tax rates and regulations.

Revenues

Revenue from the sale of products is recognized at the time merchandise is shipped to the customer. Revenue for services provided, such as design consultation for solar installations, is recognized when services are rendered. Licensing revenue is recognized upon delivery of the media licensed. Amounts billed to customers for postage and handling are recognized as revenue at the time that the revenues arising from the product being shipped are recognized. Postage and handling costs, which were approximately $13.0 million for 2006, $8.3 million for 2005 and $4.4 million for 2004, are included in selling and operating expense along with other fulfillment costs incurred to warehouse, package and deliver products to customers. Gaiam provides a reserve for expected future returns at the time the sale is recorded based upon historical experience and future expectations.

Fair Value of Financial Instruments

The carrying amounts of Gaiam s financial instruments, including cash, cash equivalents and trade receivables and payables, approximate their fair values.

Use of Estimates

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

Stock-Based Compensation

Prior to January 1, 2006, Gaiam accounted for its stock option program under the recognition and measurement provisions of APB Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees*, and related Interpretations, as permitted by FASB Statement No. 123 (SFAS 123), *Accounting for Stock-Based Compensation*. No stock-based compensation cost was recognized in the Statement of Operations for the year ended December 31, 2005, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant.

During the first quarter of fiscal 2006, Gaiam adopted the provisions of and accounted for stock-based compensation in accordance with FASB Statement No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), which replaced SFAS 123 and supersedes APB 25. Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is from the grant date through the end of the vesting period. Gaiam elected the modified-prospective method, under which prior periods are not revised for comparative purposes. The valuation provisions of SFAS 123R apply to new grants and to grants that were outstanding as of the effective date and are subsequently modified. Estimated compensation for grants that were outstanding as of the effective date will be recognized over the remaining service periods using the compensation cost estimated for the SFAS 123 pro forma disclosures. The adoption of SFAS 123R reduced income from operations and income before income taxes and minority interest by $0.6 million each, decreased net income by $0.4 million, and lowered both basic and diluted earnings per share by $0.01 for the year ended December 31, 2006. The change to SFAS 123R had an immaterial effect on cash flow from operations and cash flow from financing activities for 2006. See Note 10 Share-Based Payments for further information regarding stock option plan assumptions and expenses.

The following table sets forth the pro forma amounts of net income (loss) and net income (loss) per share for the years ended December 31, 2005 and 2004, that would have resulted if Gaiam had accounted for its stock-based compensation plan under the fair value recognition provisions of SFAS 123 and recorded stock-based compensation expense (in thousands, except per share data).

	For the Years Ended December 31,