

GAIAM, INC  
Form 10-Q  
May 10, 2011  
Table of Contents

**United States**  
**Securities and Exchange Commission**  
Washington, D.C. 20549

**Form 10-Q**

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

For the quarterly period ended March 31, 2011

OR

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

Commission File Number 0-27517

**GAIAM, INC.**

(Exact name of registrant as specified in its charter)

Edgar Filing: GAIAM, INC - Form 10-Q

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

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

**833 WEST SOUTH BOULDER ROAD,  
LOUISVILLE, COLORADO 80027**

(Address of principal executive offices)

**(303) 222-3600**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

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

Class	Outstanding at May 9, 2011
Class A Common Stock (\$.0001 par value)	17,909,272
Class B Common Stock (\$.0001 par value)	5,400,000

---

**Table of Contents**

**GAIAM, INC.**

**FORM 10-Q**

**INDEX**

<b><u>PART I. FINANCIAL INFORMATION</u></b>	2
<b>Item 1. <u>Financial Statements (Unaudited):</u></b>	2
<u>Condensed consolidated balance sheets at March 31, 2011 and December 31, 2010</u>	3
<u>Condensed consolidated statements of operations for the Three Months Ended March 31, 2011 and 2010</u>	4
<u>Condensed consolidated statements of cash flows for the Three Months Ended March 31, 2011 and 2010</u>	5
<u>Notes to interim condensed consolidated financial statements</u>	6
<b>Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	9
<b>Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u></b>	13
<b>Item 4. <u>Controls and Procedures</u></b>	13
<b><u>PART II. OTHER INFORMATION</u></b>	13
<b>Item 1. <u>Legal Proceedings</u></b>	13
<b>Item 1A. <u>Risk Factors</u></b>	13
<b>Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	13
<b>Item 3. <u>Defaults Upon Senior Securities</u></b>	13
<b>Item 4. <u>Removed and Reserved</u></b>	13
<b>Item 5. <u>Other Information</u></b>	14
<b>Item 6. <u>Exhibits</u></b>	14
<u>SIGNATURES</u>	15

**Table of Contents**

**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

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

**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements (Unaudited)**

**Unaudited Interim Condensed Consolidated Financial Statements**

We have prepared our unaudited interim condensed consolidated financial statements included herein pursuant to the rules and regulations of the United States Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to these rules and regulations, although we believe that the disclosures made are adequate to make the information not misleading. In our opinion, the unaudited interim condensed financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly, in all material respects, our consolidated financial position as of March 31, 2011, the interim results of operations for the three months ended March 31, 2011 and 2010, and cash flows for the three months ended March 31, 2011 and 2010. These interim statements have not been audited. The balance sheet as of December 31, 2010 was derived from our audited consolidated financial statements included in our annual report on Form 10-K. The interim condensed consolidated financial statements contained herein should be read in conjunction with our audited financial statements, including the notes thereto, for the year ended December 31, 2010.

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

(in thousands, except share and per share data)	March 31, 2011 (Unaudited)	December 31, 2010
<b>ASSETS</b>		
Current assets:		
Cash	\$ 31,085	\$ 28,773
Accounts receivable, net	35,554	50,322
Inventory, less allowances	30,133	33,218
Deferred advertising costs	2,797	2,341
Receivable and deferred tax assets	7,138	8,803
Note receivable and other current assets	10,987	10,220
<b>Total current assets</b>	<b>117,694</b>	<b>133,677</b>
Property and equipment, net	27,699	27,861
Media library, net	15,413	15,596
Deferred tax assets	5,911	3,509
Goodwill	25,861	25,861
Other intangibles, net	747	813
Other assets	462	480
<b>Total assets</b>	<b>\$ 193,787</b>	<b>\$ 207,797</b>
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 17,190	\$ 27,837
Accrued liabilities	8,014	10,834
<b>Total current liabilities</b>	<b>25,204</b>	<b>38,671</b>
Commitments and contingencies		
Equity:		
Gaiam, Inc. shareholders' equity:		
Class A common stock, \$.0001 par value, 150,000,000 shares authorized, 17,909,272 and 17,898,921 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively	2	2
Class B common stock, \$.0001 par value, 50,000,000 shares authorized, 5,400,000 issued and outstanding at March 31, 2011 and December 31, 2010	1	1
Additional paid-in capital	157,950	157,610
Accumulated other comprehensive income	123	114
Accumulated deficit	(6,704)	(5,704)
<b>Total Gaiam, Inc. shareholders' equity</b>	<b>151,372</b>	<b>152,023</b>
Noncontrolling interest	17,211	17,103
<b>Total equity</b>	<b>168,583</b>	<b>169,126</b>
<b>Total liabilities and equity</b>	<b>\$ 193,787</b>	<b>\$ 207,797</b>

See accompanying notes to the interim condensed consolidated financial statements.



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

(in thousands, except per share data)	For the Three Months Ended March 31,	
	2011 (unaudited)	2010
Net revenue	\$ 54,812	\$ 62,183
Cost of goods sold	28,952	29,971
<b>Gross profit</b>	<b>25,860</b>	<b>32,212</b>
Expenses:		
Selling and operating	24,383	29,784
Corporate, general and administration	3,032	2,991
<b>Total expenses</b>	<b>27,415</b>	<b>32,775</b>
Loss from operations	(1,555)	(563)
Interest and other income	46	67
Loss before income taxes and noncontrolling interest	(1,509)	(496)
Income tax benefit	(568)	(177)
Net loss	(941)	(319)
Net (income) loss attributable to noncontrolling interest	(59)	69
Net loss attributable to Gaiam, Inc.	\$ (1,000)	\$ (250)
Net loss per share attributable to Gaiam, Inc. common shareholders:		
Basic	\$ (0.04)	\$ (0.01)
Diluted	\$ (0.04)	\$ (0.01)
Weighted-average shares outstanding:		
Basic	23,301	23,140
Diluted	23,301	23,140

See accompanying notes to the interim condensed consolidated financial statements.

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

(in thousands)	For the Three Months Ended March 31,	
	2011 (unaudited)	2010 (unaudited)
<b>Operating activities</b>		
Net loss	\$ (941)	\$ (319)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	730	776
Amortization	712	1,222
Share-based compensation expense	350	380
Deferred and stock option income tax benefit	(925)	(329)
Changes in operating assets and liabilities:		
Accounts receivable, net	14,776	6,924
Inventory, net	3,100	3,447
Deferred advertising costs	(494)	(564)
Income taxes receivable	178	43
Other current assets	(752)	1,393
Accounts payable	(10,655)	(11,156)
Accrued liabilities	(2,836)	277
Net cash provided by operating activities	3,243	2,094
<b>Investing activities</b>		
Purchase of property, equipment and media rights	(994)	(2,816)
Net cash used in investing activities	(994)	(2,816)
<b>Financing activities</b>		
Net proceeds from issuance of common stock and tax benefits from option exercises	39	538
Net cash provided by financing activities	39	538
Effect of exchange rates on cash	24	
Net change in cash	2,312	(184)
Cash at beginning of period	28,773	48,325
Cash at end of period	\$ 31,085	\$ 48,141
<b>Supplemental cash flow information</b>		
Income taxes paid	\$ 9	\$ 171
See accompanying notes to the interim condensed consolidated financial statements		

## **Table of Contents**

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

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

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

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

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

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

No changes were made to our significant accounting policies during the three months ended March 31, 2011.

We have evaluated events subsequent to March 31, 2011 and concluded that no material event has occurred which would impact either the results reflected in this report or our results going forward.

#### *Use of Estimates and Reclassifications*

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

#### **3. Equity**

During the first three months of 2011, we issued 2,651 of our Class A common shares under our 2009 Long-Term Incentive Plan to our independent directors, in lieu of cash compensation, for services rendered in 2011 and issued 7,700 of our Class A common shares upon exercise of options under our 1999 Long-Term Incentive Plan.

Our subsidiary, Real Goods Solar, Inc. ( Real Goods Solar ), issued 5,661 of its Class A common shares valued at \$15 thousand to compensate independent board members for services rendered during the first quarter of 2011. As of March 31, 2011, we owned 54.6% of Real Goods Solar.

Gaiam and Real Goods Solar both valued the shares issued to their respective independent directors at estimated fair value based on the closing price of their respective stock on the date the shares were issued, which by policy is the last trading day of each quarter in which the services were rendered.

**Table of Contents**

The following is a reconciliation from December 31, 2010 to March 31, 2011 of the carrying amount of total equity, equity attributable to Gaiam, Inc., and equity attributable to the noncontrolling interest.

(in thousands)	Total	Gaiam, Inc. Shareholders					
		Comprehensive Loss	Accumulated Deficit	Comprehensive Income	Class A and Class B Common Stock	Paid-in Capital	Noncontrolling Interest
Balance at December 31, 2010	\$ 169,126	\$	\$ (5,704)	\$ 114	\$ 3	\$ 157,610	\$ 17,103
Issuance of Gaiam, Inc. common stock, including related taxes, and share-based compensation	303					303	
Issuance of subsidiary common stock and share-based compensation	77					37	40
Comprehensive loss:							
Net income (loss)	(941)	(941)	(1,000)				59
Foreign currency translation adjustment, net of taxes of \$8	18	18		9			9
Comprehensive loss	(923)	\$ (923)					
Balance at March 31, 2011	\$ 168,583		\$ (6,704)	\$ 123	\$ 3	\$ 157,950	\$ 17,211

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

(in thousands, except share data)	Three Months Ended	
	March 31, 2011	March 31, 2010
Net loss attributable to Gaiam, Inc.	\$ (1,000)	\$ (250)
Increase in Gaiam, Inc.'s paid-in capital for the issuance of 5,661 and 4,693 Real Goods Solar Class A common shares for the three months ended March 31, 2011 and 2010, respectively, and for share-based compensation	37	33
Change from net loss attributable to Gaiam, Inc. and transfers from the noncontrolling interest	\$ (963)	\$ (217)

**4. Comprehensive Loss**

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

(in thousands)	Three Months Ended	
	March 31, 2011	March 31, 2010
Net loss	\$ (941)	\$ (319)
Other comprehensive income, foreign currency translation, net of related tax	18	
Comprehensive loss	(923)	(319)

Edgar Filing: GAIAM, INC - Form 10-Q

Comprehensive (income) loss attributed to the noncontrolling interest	(59)	69
Comprehensive loss attributable to Gaiam, Inc.	\$ (982)	\$ (250)

**Table of Contents****5. Share-Based Payments**

During the first quarter of 2011, we cancelled 6,300 stock options previously issued under our 1999 and 2009 Long-Term Incentive Plans. Total share-based compensation expense recognized was \$0.4 million for each of the three months ended March 31, 2011 and 2010, and is shown in corporate, general and administration expenses on our condensed consolidated statements of operations.

Also during the first quarter of 2011, Real Goods Solar granted 34,000 new stock options and cancelled 13,000 stock options under the Real Goods Solar 2008 Long-Term Incentive Plan. The new stock options vest 2% per month over 50 months commencing in the eleventh month following the date of grant.

**6. Net Loss Per Share Attributable To Gaiam, Inc. Common Shareholders**

Basic net loss per share attributable to Gaiam, Inc. common shareholders excludes any dilutive effects of options. We compute basic net loss per share attributable to Gaiam, Inc. common shareholders using the weighted average number of common shares outstanding during the period. We compute diluted net loss per share attributable to Gaiam, Inc. common shareholders using the weighted average number of common shares and common stock equivalents outstanding during the period. We excluded common stock equivalents of 469,000 and 596,000 from the computation of diluted net loss per share attributable to Gaiam, Inc. common shareholders for the three months ended March 31, 2011 and 2010, respectively, because their effect was antidilutive.

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

(in thousands, except per share data)	Three Months Ended	
	March 31,	
	2011	2010
Numerator for basic and diluted net loss per share	\$ (1,000)	\$ (250)
Denominator:		
Weighted average share for basic net loss per share	23,301	23,140
Effect of dilutive securities:		
Weighted average of common stock and stock options		
Denominator for diluted net loss per share	23,301	23,140
Net loss per share attributable to Gaiam, Inc. common shareholders basic	\$ (0.04)	\$ (0.01)
Net loss per share attributable to Gaiam, Inc. common shareholders diluted	\$ (0.04)	\$ (0.01)

**7. Segment Information**

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

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

**Table of Contents**

Financial information for our segments is as follows:

(in thousands)	Three Months Ended	
	March 31,	
	2011	2010
Net revenue:		
Direct to consumer	\$ 17,902	\$ 24,610
Business	19,485	22,568
Solar	17,425	15,005
<b>Consolidated net revenue</b>	<b>54,812</b>	<b>62,183</b>
Contribution margin (loss):		
Direct to consumer	(1,067)	(2,157)
Business	(554)	1,566
Solar	66	28
<b>Consolidated contribution loss</b>	<b>(1,555)</b>	<b>(563)</b>
Reconciliation of contribution loss to net loss attributable to Gaiam, Inc.:		
Interest and other income	46	67
Income tax benefit	(568)	(177)
Net (income) loss attributable to noncontrolling interest	(59)	69
<b>Net loss attributable to Gaiam, Inc.</b>	<b>\$ (1,000)</b>	<b>\$ (250)</b>

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

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

**Overview and Outlook**

We are a lifestyle media company providing a broad selection of information, media, products and services to customers who value personal development, wellness, ecological lifestyles, and responsible media.

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.

Our media brand is built around our ability to develop and offer media content, products, and lifestyle solutions to consumers in the LOHAS market. We market our media and products through a multi-channel approach including traditional media channels, direct to consumers via the Internet, direct response marketing, subscriptions, catalogs, and through national retailers, digital partners and corporate accounts.

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

## Edgar Filing: GAIAM, INC - Form 10-Q

Our business segment sells directly to retailers, with our products available in approximately 64,000 retail doors in the United States. During the first quarter of 2011, this segment generated revenue of \$19.5 million, down from \$22.6 million during the first quarter of 2010, primarily attributable to low in-stock levels at our largest retail customer due to the retailer's replenishment delays and reduced sales to Borders resulting from its reorganization. We have been working closely with our retail partner to correct the low in-stock issue and began to see improvements in mid-April. At the end of the first quarter of 2011, we had our store within store presentations, which include custom fixtures that we design, in over 14,600 locations. In 2008, we created a media category management role that is part of our long term strategy and a key step in securing shelf space for media. We have now expanded this strategy to approximately 5,600 doors.

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 subscription base, and customer feedback on us and on the LOHAS industry's focus and future. During the first quarter of 2011, this segment generated revenues of \$17.9 million, down from \$24.6 million during the first quarter of 2010, primarily due to a \$7.7 million sales decline resulting from our previously disclosed plans to lower our direct response television advertising spend, partially offset by positive comparables in our catalog and internet businesses.

**Table of Contents**

Our solar segment offers residential and commercial solar energy integration services. On May 13, 2008, our solar energy integration business consummated an initial public offering and has since been managed as a separate segment. This business has grown its sales and expanded its market territories. During the first quarter of 2011, this segment generated revenues of \$17.4 million, up from \$15.0 million during the first quarter of 2010, due to organic growth, which has been primarily driven by an increase in marketing and sales initiatives. Real Goods Solar has and will continue to use its IPO proceeds to fund its working capital needs and general corporate purposes, which may include future acquisitions of businesses.

We believe our growth will be driven by media content, products, and services delivered to the consumer via Internet, retailers, licensing, electronic downloads and subscriptions. We have increased our focus on fitness media content creation and distribution, and media category management at retailers. Our licensing agreements have expanded our distribution within the non-theatrical media category.

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

**Results of Operations**

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

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2011</b>	<b>2010</b>
Net revenue	100.0%	100.0%
Cost of goods sold	52.8%	48.2%
Gross profit	47.2%	51.8%
Expenses:		
Selling and operating	44.5%	47.9%
Corporate, general and administration	5.5%	4.8%
Total expenses	50.0%	52.7%
Loss from operations	-2.8%	-0.9%
Interest and other income	0.1%	0.1%
Income tax benefit	-1.0%	-0.3%
Net (income) loss attributable to noncontrolling interest	-0.1%	0.1%
Net loss attributable to Gaiam, Inc.	-1.8%	-0.4%

*Three Months Ended March 31, 2011 Compared to Three Months Ended March 31, 2010*

*Net revenue.* Net revenue decreased \$7.4 million, or 11.9%, to \$54.8 million during the first quarter of 2011 from \$62.2 million during the first quarter of 2010. Net revenue in our business segment decreased \$3.1 million, or 13.7%, to \$19.5 million during the first quarter of 2011 from \$22.6 million during the first quarter of 2010, primarily due to low in-stock levels at our largest retail customer as a result of the retailer's replenishment delays and reduced sales to Borders resulting from its reorganization. We have been working closely with our retail partner to correct the low in-stock issue and began to see improvements in mid-April. Net revenue in our direct to consumer segment decreased \$6.7 million to \$17.9 million during the first quarter of 2011 from \$24.6 million during the first quarter of 2010, primarily attributable to a \$7.7 million sales decline resulting from our previously disclosed plans to lower spending for direct response television advertising, partially offset by positive comparables in our catalog and internet businesses. Net revenue in our solar segment increased \$2.4 million to \$17.4 million during the first quarter of 2011 from \$15.0 million during the first quarter of 2010, due to organic growth, which has been primarily driven by an increase in marketing and sales initiatives.

## Edgar Filing: GAIAM, INC - Form 10-Q

*Cost of goods sold.* Cost of goods sold decreased \$1.0 million, or 3.4%, to \$29.0 million during the first quarter of 2011 from \$30.0 million during the first quarter of 2010. As a percentage of net revenue, cost of goods sold increased to 52.8% during the first quarter of 2011 from 48.2% during the first quarter of 2010. Cost of goods sold in our business segment decreased \$1.5 million, or 13.0%, to \$10.2 million during the first quarter of 2011 from \$11.7 million during the first quarter of 2010 and, as a percentage of net revenue, increased slightly to 52.3% during the first quarter of 2011 from 51.9% during the first quarter of 2010, primarily due to a shift in product sales mix. Cost of goods sold in our direct to consumer segment decreased \$0.9 million, or 12.6%, to \$6.4 million during the first quarter of 2011 from \$7.3 million during the first quarter of 2010 and, as a percentage of net revenue, increased to 35.6% during the first quarter of 2011 from 29.6% during the first quarter of 2010, primarily reflecting \$7.7 million of reduced revenues in our lower cost of goods sold direct response television business, partially offset by increased revenues in our higher cost of goods sold catalog and internet businesses. Cost of goods sold in our solar segment increased \$1.4 million, or 13.0%, to \$12.4 million during the

## **Table of Contents**

first quarter of 2011 from \$11.0 million during the first quarter of 2010 and, as a percentage of net revenue, decreased to 71.1% during the first quarter of 2011 from 73.1% during the first quarter of 2010, primarily reflecting a shift towards lower cost of goods sold residential installations.

*Selling and operating expenses.* Selling and operating expenses decreased \$5.4 million, or 18.1%, to \$24.4 million during the first quarter of 2011 from \$29.8 million during the first quarter of 2010. As a percentage of net revenue, selling and operating expenses decreased to 44.5% during the first quarter of 2011 from 47.9% during the first quarter of 2010. This decrease is primarily a result of reducing direct response television advertising to a level we view as more optimal, partially offset by additional costs to develop our GaiamTV and digital delivery strategies.

*Corporate, general and administration expenses.* Corporate, general and administration expenses remained at \$3.0 million during first quarters of both 2011 and 2010. As of percentage of net revenue, corporate, general and administration expenses increased to 5.5% during the first quarter of 2011 from 4.8% during the first quarter of 2010 reflecting the fixed nature of these costs.

*Net (income) loss attributable to noncontrolling interest.* Net (income) loss attributable to noncontrolling interest was income of \$59 thousand during the first quarter of 2011 compared to a loss of \$69 thousand during the first quarter of 2010 primarily as a result of the improved earnings in our solar segment.

*Net loss attributable to Gaiam, Inc.* As a result of the above factors, net loss attributable to Gaiam, Inc. was \$1.0 million during the first quarter of 2011 compared to \$0.3 million during the first quarter of 2010. Net loss per share attributable to Gaiam, Inc. common shareholders was \$0.04 per share during the first quarter of 2011 compared to \$0.01 per share during the first quarter of 2010.

## **Seasonality**

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

## **Liquidity and Capital Resources**

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

We have a revolving line of credit agreement with a financial institution with a current expiration date of October 2, 2011, which we anticipate renewing upon expiration. The credit agreement permits borrowings up to the lesser of \$15 million or our borrowing base which is calculated based upon the collateral value of our accounts receivable, inventory, and certain property and equipment. Borrowings under this agreement bear interest at the prime rate, provided, however, that at no time will the rate be less than 4.25% per annum. Borrowings are secured by a pledge of certain of our assets, and the agreement contains various financial covenants, including covenants requiring compliance with certain financial ratios. At March 31, 2011, we had no amounts outstanding under this agreement; however, \$0.5 million was reserved for outstanding letters of credit. We believe we are in compliance with all of the financial covenants under this credit agreement.

**Table of Contents****Cash Flows**

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

(in thousands)	Three Months Ended March 31,	
	2011	2010
Net cash provided by (used in):		
Operating activities	\$ 3,243	\$ 2,094
Investing activities	(994)	(2,816)
Financing activities	39	538
Effects of exchange rates on cash	24	
Net change in cash	\$ 2,312	\$ (184)

*Operating activities.* Our operating activities provided net cash of \$3.2 million and \$2.1 million during the first quarters of 2011 and 2010, respectively. Our net cash provided by operating activities during the first quarter of 2011 was primarily attributable to decreased accounts receivable, inventory and income taxes receivable of \$18.1 million and noncash adjustments of \$0.9 million to our net loss, partially offset by decreased accounts payable and accrued liabilities of \$13.5 million, increased other current assets and deferred advertising costs of \$1.3 million, and a net loss of \$0.9 million. The reduction in accounts payable reflects payments for inventory purchases of holiday and fitness season shipments. Our net cash provided by operating activities during the first quarter of 2010 was primarily attributable to decreased accounts receivable, inventory and other current assets of \$11.8 million and noncash adjustments of \$2.1 million to our net loss, partially offset by decreased accounts payable of \$11.2 million and increased deferred advertising costs of \$0.6 million.

*Investing activities.* Our investing activities used net cash of \$1.0 million and \$2.8 million during the first quarters of 2011 and 2010, respectively. The net cash used in investing activities during the first quarter of 2011 was used primarily to acquire property and equipment to maintain normal operations for \$0.6 million and media content for \$0.4 million. The net cash used in investing activities during the first quarter of 2010 was used primarily to acquire licensing rights for the Discovery Channel's media catalog and other media content for \$2.4 million, and property and equipment to maintain normal operations for \$0.4 million.

*Financing activities.* Our financing activities provided net cash of \$39 thousand and \$0.5 million during the first quarters of 2011 and 2010, respectively, as a result of stock option exercise issuances and related tax benefits.

On January 11, 2011, we renewed a shelf registration statement on Form S-3 with the Securities and Exchange Commission for the unissued portion of the 5,000,000 shares of our Class A common stock that we originally registered on November 8, 2007. During the quarter ended March 31, 2011, no shares were issued under this shelf registration.

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

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

**Contractual Obligations**

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

(in thousands)	Total	< 1 year	1-3 years	3-5 years	> 5 years
----------------	-------	----------	-----------	-----------	-----------

Operating lease obligations	\$ 6,826	\$ 2,126	\$ 3,470	\$ 1,230	\$
-----------------------------	----------	----------	----------	----------	----

**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 those risks listed in our Annual Report on Form 10-K for the year ended December 31, 2010. Historical results are not necessarily an indication of the future results. Except

## **Table of Contents**

for the historical information contained herein, the matters discussed in this analysis are forward-looking statements that involve risk and uncertainties, including, but not limited to, general economic and business conditions, competition, pricing, brand reputation, consumer trends, and other factors which are often beyond our control. We do not undertake any obligation to update forward-looking statements except as required by law.

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

We are exposed to market risks, which include changes in U.S. interest rates and foreign exchange rates. We do not engage in financial transactions for trading or speculative purposes, but do have on occasion forward contracts for foreign currency transactions, the gains and losses from which historically have been immaterial. In 2010, we acquired controlling financial interest in and, therefore, consolidated Gaiam PTY, an Australian based joint venture. Since Gaiam PTY's functional currency is the Australian dollar, this subsidiary exposes us to risk associated with foreign currency exchange rate fluctuations. However, we have determined that no material market risk exposure to our consolidated financial position, results from operations or cash flows existed as of March 31, 2011.

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

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

### **Item 4. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

Our chief executive officer and chief financial officer conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act. Based upon their evaluation as of March 31, 2011, they have concluded that those disclosure controls and procedures are effective.

#### **Changes in Internal Control over Financial Reporting**

No changes in our internal control over financial reporting occurred during the quarter ended March 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

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

### **Item 1A. Risk Factors**

No material changes.

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

None.

**Item 3. Defaults Upon Senior Securities**  
None.

**Item 4. Removed and Reserved**

**Table of Contents**

**Item 5. Other Information**

None.

**Item 6. Exhibits**

a) Exhibits.

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

**Table of Contents**

**Signatures**

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

Gaiam, Inc.  
(Registrant)  
May 10, 2011

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

(principal executive officer)

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