

AeroGrow International, Inc.  
Form SB-2/A  
May 08, 2007

As filed with the United States Securities and Exchange Commission on May 8, 2007.

Registration No. **333-141689**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**AMENDMENT NO. 1**

**to**

**FORM SB-2**

**REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933**

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**AeroGrow International, Inc.**

(Name of Registrant in its charter)

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**Nevada**

(State or other jurisdiction of  
incorporation or organization)

**3524**

(Primary Standard Industrial  
Classification Code Number)

**46-0510685**

(I.R.S. Employer  
Identification Number)

**6075 Longbow Dr., Suite 200  
Boulder, Colorado 80301  
(303) 444-7755**

(Address and telephone number of principal executive  
offices)

**6075 Longbow Dr., Suite 200  
Boulder, Colorado 80301**

(Address of principal place of business)

W. Michael Bissonnette  
AeroGrow International, Inc.  
6075 Longbow Dr. Suite 200  
Boulder, Colorado 80301  
(303) 444-7755

(Name, address and telephone number of agent for service)

Copies to:

Brian Lane, Esq.  
Gibson, Dunn & Crutcher LLP  
1050 Connecticut Avenue, NW  
Washington, D.C. 20036

**Approximate date of commencement of proposed sale to the public:**

From time to time following the effectiveness of this registration statement.

If any securities being offered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box.

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If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box. "

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**The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.**

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Preliminary Prospectus (Subject to Completion), Dated May 8, 2007

**1,750,140 Shares of Common Stock**

**AeroGrow  
International, Inc.**

This prospectus covers up to 1,750,140 shares of common stock of AeroGrow International, Inc. (“AeroGrow”) that may be offered for resale, or otherwise disposed for the account of, the selling stockholders set forth under the heading “Selling Security Holders” beginning on page 68. The shares of common stock issued and outstanding may be offered at any time. The shares of common stock underlying the outstanding common stock purchase warrants may only be offered for resale after being issued by AeroGrow to the selling stockholders upon exercise.

Our common stock trades on the Over-the-Counter Bulletin Board (“OTC BB”). The Company’s trading symbol is AGWI.OB. No assurance can be made that an active market will develop on the OTC BB. The closing price of our common stock on May 7, 2007 was \$7.30.

AeroGrow will not receive any proceeds from the sale or other disposition of the shares or interests therein by the selling stockholders. To the extent that any of common stock purchase warrants are exercised, we will receive the exercise price paid for the shares of common stock purchased thereunder.

**Investing in our common stock involves a high degree of risk. See “Risk Factors” beginning on page 6 of this prospectus.**

Neither the United States Securities and Exchange Commission (“SEC”) nor any state securities commission has approved or disapproved these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is 2007

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### **Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995**

Information included in this Registration Statement may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). This information may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance, or achievements of AeroGrow International, Inc. ("AeroGrow"), including its predecessor, Wentworth I, Inc. ("Wentworth"), to be materially different from future results, performance, or achievements expressed or implied by any forward-looking statements. Forward-looking statements, which involve assumptions and describe future plans, strategies, and expectations of AeroGrow, are generally identifiable by use of the words "may," "will," "should," "expect," "anticipate," "estimate," "be," "intend," or "project," or the negative of these words or other variations on these words or comparable terminology. These forward-looking statements are based on assumptions that may be incorrect, and there can be no assurance that the projections included in these forward-looking statements will come to pass. Actual results of AeroGrow could differ materially from those expressed or implied by the forward-looking statements as a result of various factors. Except as required by applicable laws, AeroGrow has no obligation, and does not intend, to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

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## PROSPECTUS SUMMARY

*This summary highlights information contained elsewhere in this prospectus. You should read this entire prospectus carefully before making an investment decision, including the “Risk Factors” section beginning on page 5 and our financial statements beginning on page F-1. We refer to AeroGrow International, Inc. as “AeroGrow,” “Company,” “we,” “our” and “us.”*

### **AeroGrow International**

AeroGrow was formed as a Nevada corporation on March 25, 2002. We are in the business of developing, marketing, distributing, and selling advanced indoor aeroponic garden systems. Since formation and through our development stage, which ended in February 2006, our principal activities consisted of product research and development, market research, business planning, and raising the capital necessary to fund these activities. We have completed development of our initial kitchen garden systems and related “bio-grow” seed pods. We have also contracted with a third-party manufacturer who has commenced production activities and a second manufacturer who commenced pilot production in November 2006 and began shipments in January 2007. As of February 15, 2007, we have manufactured and taken delivery of over 100,000 units. We commenced our initial marketing and distribution of our products during March 2006 and have expanded these marketing efforts to encompass retail, home shopping, catalogue, international, and direct to consumer sales channels.

Our principal products are “kitchen garden” indoor growing systems and proprietary seed kits under the brand name AeroGarden™ allowing consumers, with or without gardening experience, the ability to grow cherry tomatoes, cilantro, chives, basil, dill, oregano, mint, flowers, chili peppers, and lettuce throughout the year. Our kitchen garden systems are designed to be simple, consistently successful, and affordable. We believe that our focus on the design and features of our kitchen garden systems made them the first of their kind on the consumer market. We reached this conclusion on the basis of standard methods of market research that we conducted, including focus groups and potential customer interview techniques, review of potentially competitive products offered at all ranges of functionality and price, and testing of products that may be considered competitive in function although not necessarily competitive in market orientation.

We have filed 19 patent applications in the United States to potentially protect our core inventions. To date, no patents have been granted, and there is no assurance such applications will be granted. Although aeroponic technology cannot in and of itself be patented, the patent applications include aeroponic technological advances described below as well as product, nutrient and seed pod inventions designed to enhance plant growth. Many of the patent-pending companion technologies are based on our innovations in the fields of biology, plant physiology, chemistry, and adaptive learning computer science. In addition, we have developed certain trade secrets that simplify, combine and integrate our core technologies into our indoor kitchen garden systems.

In addition, AeroGrow has applied for and has been issued a trademark for AeroGarden™ and six other trademarks and is currently processing 21 other trademark applications for trademarks for its products and product slogans. AeroGrow has also submitted applications to expand its AeroGarden™ trademark in 33 countries, all of which are pending. AeroGrow has also obtained the domain names for AeroGrow.com, AeroGarden.com, AeroGarden.net, AeroGarden.tv, AeroGarden.biz, and Getthegarden.com, among others.

We believe that our inventions and combined technologies will allow almost anyone, from consumers who have no gardening experience to professional gardeners, to produce year-round harvests of herbs, flowers, and vegetables provided in our seed kits regardless of season, weather, or lack of natural light. We believe that our kitchen garden

systems' unique and attractive designs make them appropriate for use in almost any location, including kitchens, bathrooms, living areas, and offices.

Our kitchen garden system retails at approximately \$149 with some variations based on the channel of distribution in which they are sold and the accessory components included with the unit.

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Until March 2006, we were a development stage, start-up company, and we did not generate any revenues. Through March 1, 2006, we funded our operations primarily through the private sale of equity securities. Since commencing sales of our products, we have begun to increase our reliance on revenues generated from such sales for funding our operations. We had an accumulated deficit of \$27,795,605 through December 31, 2006. We expect to incur substantial additional expenses and losses in the further implementation of our business plan. Because we are in the early stages of implementing our business plan, we cannot predict now if we will ever be profitable. Prior to March 2006 when we commenced sales of our aeroponic garden systems, we were considered a Development Stage Enterprise in accordance with Statement of Financial Accounting Standards ("SFAS") SFAS No. 7, Accounting and Reporting by Development Stage Enterprises.

Our principal office is located at 6075 Longbow Drive, Boulder, Colorado 80301. Our telephone number is (303) 444-7755 and our fax number is (303) 444-0406. We maintain a website at [www.aerogrow.com](http://www.aerogrow.com). Information on our website is not part of this prospectus.

## RECENT DEVELOPMENTS

### March 2007 Private Placement

On March 16, 2007, AeroGrow completed a private offering in which AeroGrow sold an aggregate of 833,400 shares of common stock and warrants to purchase 833,400 shares of common stock (the "2007 Investor Warrants") in the form of units consisting of one share of common stock and one warrant per unit (the "2007 Offering"). The units were sold at a price of \$6.00 per unit. In addition, warrants to purchase 83,340 shares of common stock were issued to the placement agent of the 2007 Offering (the "2007 Agent Warrants," and together with the 2007 Investor Warrants, the "2007 Warrants").

Each 2007 Investor Warrant is exercisable for one share of common stock at an exercise price of \$7.50 per share, and each 2007 Agent Warrant is exercisable for one share of common stock at an exercise price of \$8.25 per share. Each 2007 Warrant will be exercisable for five years from the closing of the 2007 Offering. The exercise price and number of shares of common stock underlying the 2007 Warrants is subject to adjustment on certain events, including reverse stock splits, stock dividends and recapitalizations, combinations, and mergers where AeroGrow is not the surviving company. AeroGrow will at all times reserve and keep available, solely for issuance and delivery upon the exercise of the 2007 Warrants, such shares of common stock underlying the 2007 Warrants, as from time to time shall be issuable upon the exercise of the 2007 Warrants.

The Company has the right to require a holder of a 2007 Investor Warrant to exercise the 2007 Investor Warrant if our common stock is quoted on the NASDAQ Capital Market and, for a period of 20 consecutive trading days, the closing bid price of the common stock has been above \$10.00 per share and the daily trading volume has been at least 50,000 shares, in each case on each of the 20 consecutive trading days.

### March 2007 Additional Private Placement

On March 28, 2007, AeroGrow completed an additional private offering in which AeroGrow sold an aggregate of 333,360 shares of common stock and warrants to purchase 333,360 shares of common stock in the form of units consisting of one share of common stock and one warrant per unit. The units were sold at a price of \$6.00 per unit. In addition, warrants to purchase 33,336 shares of common stock were issued to the placement agent of this private offering. The warrants issued to the investors and the placement agent have the same terms as the 2007 Investor Warrants and the 2007 Agent Warrants, respectively.





### SUMMARY FINANCIAL DATA

The following table presents summary financial data for the fiscal years ended December 31, 2005 and 2004, the three month transitional period ended March 31, 2006 and the nine months ended December 31, 2006 and 2005. We derived the summary statement of operations data for the years ended December 31, 2004 and 2005 and the three month transitional period ended March 31, 2006 and the summary consolidated balance sheet data as of December 31, 2005 and 2004 and March 31, 2006 from our audited financial statements. The summary consolidated balance sheet data as of December 31, 2006 and the summary statements of operations data for the nine months ended December 31, 2006 and 2005 are unaudited. We have prepared this unaudited information on the same basis as the audited financial statements and have included all adjustments, consisting only of normal recurring adjustments that we consider necessary for a fair presentation of our financial position and operating results for such periods. The results of operations for the nine months ended December 31, 2006 are not necessarily indicative of the results that may be expected for the full year ending March 31, 2007 or any future period.

You should read the following information together with the more detailed information contained in “Management’s Discussion and Analysis and Plan of Operation,” and our financial statements and accompanying notes included elsewhere in this prospectus.

Statement of Operations Data	Nine months ended December 31		Three months ended	Year ended December 31,	
	2006	2005	March 31, 2006	2005	2004
	(Unaudited)				
Revenue					
Product sales	\$ 6,709,858	\$ -	\$ 35,245	\$ -	\$ -
Operating expenses					
Cost of revenue	4,785,151	-	134,622	-	-
Research and development	1,544,495	1,272,639	978,538	1,578,833	333,038
Sales and marketing	4,285,849	555,622	2,548,583	583,897	79,811
General and administrative	2,671,939	2,408,819	2,010,908	2,923,792	1,983,759
Total operating expenses	13,287,434	4,237,080	5,672,651	5,086,522	2,396,608
Loss from operations	(6,577,576)	(4,237,080)	(5,637,406)	(5,086,522)	(2,396,608)
Total other (income) expense, net	1,812,337	2,638,990	1,905,937	2,631,055	(7,564)
Net loss	\$ (8,389,893)	\$ (6,876,070)	\$ (7,543,343)	\$ (7,717,577)	\$ (2,389,044)
Net loss per share, basic and diluted	\$ (0.90)	\$ (1.39)	\$ (0.84)	\$ (1.55)	\$ (0.56)
Weighted average number of common shares outstanding, basic and diluted	9,304,380	4,958,842	8,956,353	4,971,857	4,252,626

<b>Balance Sheet Data</b>	<b>December 31, 2006</b>	<b>March 31, 2006</b>	<b>December 31, 2005</b>	<b>December 31, 2004</b>
	(Unaudited)			
Cash and cash equivalents	\$ 1,740,327	\$ 8,852,548	\$ 949,126	\$ 1,916,842
Other current assets	3,476,355	435,692	939,200	46,423
Property and equipment, net	873,344	480,771	420,444	30,721
Total other assets	59,134	71,998	234,828	4,484
	\$ 6,149,160	\$ 9,841,009	\$ 2,543,598	\$ 1,998,470
Convertible debentures, net of loan issue discounts	\$ 840,000	\$ 792,539	\$ 2,095,260	\$ -
Mandatorily redeemable common stock	-	310,000	310,000	-
Other current liabilities	2,812,337	821,998	253,740	86,547
Total stockholders' equity (deficit)	2,496,823	7,916,472	(115,402)	1,911,923
	\$ 6,149,160	\$ 9,841,009	\$ 2,543,598	\$ 1,998,470

## RISK FACTORS

*The purchase of shares of our common stock involves a high degree of risk. In addition to the other information contained elsewhere in this prospectus, you should carefully consider the following factors when evaluating an investment in our securities. If any of the adverse events described below actually occur, our business, financial condition and operating results could be materially adversely affected and you may lose part or all of the value of your investment. If you choose to invest in our securities, you should be able to bear a complete loss of your investment.*

### **RISKS RELATED TO OPERATIONS**

**Because AeroGrow has a limited operating history, AeroGrow may not be able to successfully manage its business or achieve profitability.**

AeroGrow has a limited operating history upon which you can base your evaluation of its prospects and the potential value of its common stock. AeroGrow recently has begun to produce its garden systems and seed kits. AeroGrow is confronted with the risks inherent in a start-up company, including difficulties and delays in connection with the production and sales of its kitchen garden systems, reliance on a small number of products, operational difficulties and its potential under-estimation of production and administrative costs. If AeroGrow cannot successfully manage its business, AeroGrow may not be able to generate future profits and may not be able to support its operations. We expect to incur substantial additional expenses and losses in the further implementation of our business plan. Because we are in the early stages of implementing our business plan, we cannot predict now if we will ever be profitable. We may not be able to improve operations and therefore may not become profitable.

**AeroGrow has incurred substantial losses since inception and may never achieve profitability.**

Since AeroGrow commenced its operations in 2002 and through December 31, 2006, AeroGrow has incurred substantial operating losses. For the nine months ended December 31, 2006, AeroGrow had a net loss of \$8,389,893; for the transition period of the three months ended March 31, 2006, AeroGrow had a net loss of \$7,543,343; for the twelve months ended December 31, 2005, AeroGrow had a net loss of \$7,717,577; for the twelve months ended December 31, 2004, AeroGrow had a net loss of \$2,389,044; and for the twelve months ended December 31, 2003, AeroGrow had a net loss of \$1,159,535. Since inception AeroGrow's losses from operations have resulted in an accumulated deficit of \$27,795,605 as of December 31, 2006. AeroGrow expects that its operating expenses will outpace revenues for the near future and result in continued losses. The success of its business will depend on its ability to expand sales and distribution of its AeroGarden™ kitchen garden systems to consumers and develop new product extensions and applications.

AeroGrow is subject to many of the risks common to developing enterprises, including undercapitalization, cash shortages, limitations with respect to financial and other resources, and lack of revenues to be self-sustaining. There is no assurance that AeroGrow will ever obtain profitability, which may lead to the loss of your entire investment.

**If AeroGrow's kitchen garden systems fail to perform properly, its business could suffer with increased costs and reduced income.**

Although AeroGrow has been internally testing its products in its laboratories and with users for three years, its products may fail to meet consumer expectations. AeroGrow has only limited experience with returns and has no meaningful history with respect to warranty claims for its products. AeroGrow may be required to replace or repair products or refund the purchase price to consumers. Failure of AeroGrow's products to meet expectations could:



- damage its reputation,
- decrease sales,
- incur costs related to returns and repairs,
- delay market acceptance of its products,
- result in unpaid accounts receivable, and
- divert its resources to remedy the malfunctions.

The occurrence of any of these events would have an adverse impact on our results of operations.

**AeroGrow will likely need additional capital to fund its growth.**

AeroGrow anticipates that it has sufficient capital to satisfy its requirements for the next 12 months. However, AeroGrow will likely require additional capital to support its growth and cover operational expenses as AeroGrow expands its marketing and product development. It is possible that none of AeroGrow's outstanding warrants will be exercised and the Company will therefore not receive any proceeds therefrom. AeroGrow may need to issue equity, debt or securities convertible into equity which will dilute the current stock ownership in AeroGrow. If AeroGrow cannot obtain additional financing on acceptable terms, AeroGrow may not have sufficient capital to operate its business as planned and would have to modify its business plan or curtail some or all of its operations.

**If the holders of AeroGrow's convertible notes choose repayment instead of conversion or the extension of maturity, AeroGrow will not be able to implement its full plan of operation.**

If holders of AeroGrow's convertible notes choose to demand payment rather than converting their notes to common stock, up to \$720,000 of principal plus related interest may have to be paid after giving effect to the conversions, and instructions to convert, after December 31, 2006. The maturity date of such notes was previously extended to December 31, 2006. The Company's note holders further agreed to extend the maturity of these notes until March 31, 2007. Since December 31, 2006 and as of March 16, 2007, \$580,000 in principal amount of the \$840,000 principal amount of convertible notes has elected to convert, or has instructed us to convert on March 31, 2007, such principal amount of convertible notes to 165,714 shares of common stock. If the holders choose not to convert, AeroGrow would use a portion of its current capital to repay the convertible notes instead of funding its full plan of operations, and AeroGrow may not be able to maximize revenues or profitability.

**AeroGrow's intellectual property and proprietary rights give it only limited protection and can be expensive to defend.**

AeroGrow's ability to produce and sell kitchen garden systems exclusively depends in part on securing patent protection for the components of its systems, maintaining various trademarks and protecting its operational trade secrets. To protect its proprietary technology, AeroGrow relies on a combination of patents pending (and if granted, patents), trade secrets, and non-disclosure agreements, each of which affords only limited protection. AeroGrow owns the rights to 19 United States patent applications. However, these patent applications may not result in issued patents and even issued patents may be challenged. AeroGrow is selling its kitchen garden systems prior to receiving issued patents relating to its patent applications. All of AeroGrow's intellectual property rights may be challenged, invalidated or circumvented. Claims for infringement may be asserted or prosecuted against AeroGrow in the future and AeroGrow may not be able to protect its patents, if any are obtained, and intellectual property rights against others.

AeroGrow's former employees or consultants may violate their non-disclosure agreements with AeroGrow, leading to a loss of proprietary intellectual property. AeroGrow also could incur substantial costs to assert its intellectual property or proprietary rights against others.

**AeroGrow's current or future manufacturers could fail to fulfill AeroGrow's orders for kitchen garden systems which would disrupt its business, increase its costs, and could potentially cause it to lose its market.**

AeroGrow currently depends on two contract manufacturers in China to produce its kitchen garden systems. These manufacturers could fail to produce the kitchen garden system to AeroGrow's specifications or in a workmanlike manner and may not deliver the systems on a timely basis. Our manufacturers must also obtain inventories of the necessary parts and tools for production. AeroGrow owns the tools and dies used by its manufacturers. AeroGrow's manufacturers operate in China and may be subject to business risks that fall outside the control of AeroGrow, including but not limited to, political, currency and regulatory risks, each of which may affect the manufacturer's ability to fulfill AeroGrow's orders for kitchen garden systems. Any change in manufacturers could disrupt our ability to fulfill orders for kitchen garden systems. Any change in manufacturers could disrupt our business due to delays in finding a new manufacturer, providing specifications and testing initial production.

**If we are unable to assimilate our new managers and recruit and retain key personnel necessary to operate our business, our ability to successfully manage our business and develop and market our products may be harmed.**

Several of our executive officers have recently joined us and therefore have limited experience in managing our company. In addition, to expand our business we will also need to attract, retain and motivate highly skilled design, development, management, accounting, sales, merchandising, marketing and customer service personnel. We plan to hire additional personnel in all areas of our business. Competition for many of these types of personnel is intense. As a result, we may be unable to successfully attract or retain qualified personnel. Additionally, any of our officers or employees can terminate their employment with us at any time. The loss of any key employee or our inability to attract or retain other qualified employees could harm our business and results of operations.

**We rely on third parties for a significant portion of our manufacturing, warehouse, distribution, order processing, and fulfillment operations. If these parties are unwilling to continue providing services to us, or are unable to adequately perform such services for us on a cost effective basis, our business could be materially harmed.**

We engage third parties to perform many critical functions. For example, we have outsourced our manufacturing, warehouse, distribution, order processing, and fulfillment operations. Any disruption in our relationship with any of our vendors could cause significant disruption in our business and we may not be able to locate another party that can provide comparable services in a timely manner or on acceptable commercial terms. In addition, no assurance can be made that these relationships will be adequate to support our business as we follow our business plan.

## **RISKS RELATED TO THE RELEVANT MARKET FOR OUR PRODUCT**

**AeroGrow's future depends on the financial success of its kitchen garden systems. Since AeroGrow is introducing entirely new products without comparable sales history, AeroGrow does not know if its kitchen garden systems and seed kits will generate wide acceptance by consumers.**

AeroGrow has introduced its kitchen garden systems and seed kits as new products to consumer markets unfamiliar with their use and benefits. In addition, AeroGrow currently has, and only contemplates having, one product line, indoor garden systems. AeroGrow cannot be certain that its products will generate widespread acceptance. If consumers do not purchase its products in sufficient numbers, AeroGrow will not be profitable and you may lose all of your investment. Investors must consider AeroGrow's prospects in light of the risks, expenses and challenges of



attempting to introduce new products with unknown consumer acceptance.

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**AeroGrow's marketing strategies may not be successful, which would adversely affect its future revenues and profitability.**

AeroGrow's revenues and future depend on the successful marketing of its kitchen garden systems. AeroGrow cannot give assurance that consumers will be interested in purchasing its products. AeroGrow plans to use direct marketing to sell its products via television commercials, infomercials, magazine and newspaper advertising, and the Internet. Its infomercials and commercials may not generate sufficient income to continue to air them. If AeroGrow's marketing strategies fail to attract customers, its product sales will not produce future revenues sufficient to meet its operating expenses or fund its future operations. If this occurs, AeroGrow's business may fail and investors may lose their entire investment.

**We may face significant competition, and if we are unable to compete effectively, our sales may be adversely affected.**

AeroGrow believes that its simplified and complete kitchen garden systems and planned methods of distribution offer significant benefits as compared to the traditional hydroponic industry practices. AeroGrow recognizes, however, that there are companies that are better funded and have greater experience in producing hydroponic products in commercial markets, including, but not limited to, companies such as General Hydroponics and American Hydroponics. These companies could potentially decide to focus on the consumer market with competing products. AeroGrow could also face competition from gardening wholesalers and large and profitable soil-based gardening companies, including, but not limited to, the Burpee Seed Company and Gardener's Supply Company, should they decide to produce a competitive product. In addition, other consumer products companies could develop products to compete with AeroGrow. These companies may use hydroponic technologies, and may have better consumer acceptance. Such companies may be better funded than AeroGrow. If any such competing products are successful, their success may adversely impact AeroGrow.

## **RISKS RELATED TO AEROGROW'S CAPITALIZATION**

**If an exemption from registration on which AeroGrow has relied for any of its past offerings of common stock or warrants were later challenged legally, its principals may have to spend time defending claims, and AeroGrow would then risk paying expenses for defense, rescission and/or regulatory sanctions.**

To raise working capital, AeroGrow offered common stock and warrants in private transactions that AeroGrow believed to be exempt from registration under the Securities Act, as amended, and state securities laws. In 2004 AeroGrow also conducted a state registered offering in Colorado of common stock and warrants intended to be exempt from registration under the Securities Act, as amended, as an intrastate offering. However, because the Company is incorporated in Nevada it did not satisfy all of the requirements for an intrastate offering. This could result in investors or regulators asserting that the Colorado offering and/or the private transactions (if the private transactions were integrated with the Colorado offering) violated the Securities Act. There can be no assurance that investors or regulators will not be successful in asserting a claim that these transactions should not be integrated. In the event that one or more investors seeks rescission, with resulting return of investment funds and interest at a market rate, or that state or federal regulators seeks sanctions against AeroGrow or its principals, AeroGrow would spend time and financial resources to pay expenses for defense, rescission awards or regulatory sanctions. The use of funds would reduce the capital available to implement its full plan of operation. No assurance can be given regarding the outcome of any such actions.



**There may be substantial sales of AeroGrow's common stock by existing stockholders which could cause the price of AeroGrow's stock to fall.**

Future sales of substantial amounts of AeroGrow's common stock in the public market, if one develops, or the perception that such sales might occur, could cause the market price of its common stock to decline and could impair the value of your investment in AeroGrow's common stock and AeroGrow's ability to raise equity capital in the future. As of December 31, 2006, AeroGrow had 9,607,631 shares of common stock outstanding, of which 3,402,237 shares may be sold without restriction. See the following risk factor for discussion of additional shares that are subject to issuance pursuant to outstanding warrants, options and convertible debt. Of the remaining shares, (i) 580,136 shares issued to stockholders of Wentworth I, Inc. ("Wentworth") in the Merger (as defined below in "Merger with Wentworth") have registration rights, but of these shares, 396,813 shares are subject to lockup restrictions for periods of 12 to 18 months from the effective date of the Company's registration statement declared effective on December 22, 2006 (the "2006 Registration Statement") and the holders of such shares have waived their right to be included in that registration statement in exchange for the obligation of the Company to register all such shares as soon as commercially reasonable after the filing of the next quarterly or annual report or after the declaration of effectiveness of the this registration statement, (ii) 332,876 of shares recorded as penalty shares, (iii) 5,578,740 shares issued prior to December 31, 2005 that have been held more than one year and may be transferred and sold, subject to the restrictions under Rule 144 or Rule 701, depending on the status of the holder and the holding period as well as lockup agreements, and (iv) 148,931 shares granted to employees and directors since December 31, 2005 under the company's 2005 Equity Compensation Plan. Of the shares identified in the last two categories above, 4,642,326 shares are subject to lockup agreements for periods of 12 to 18 months from the effective date of the 2006 Registration Statement. The lockup restrictions may be released by the agreement of AeroGrow and Keating Securities, LLC ("Keating Securities"). The shares of AeroGrow's common stock underlying the convertible notes and the warrants issued or to be issued to the holders of convertible notes are required to be registered for resale by AeroGrow and are not subject to lockup restrictions. The sales of AeroGrow common stock by these stockholders having registration rights or even the appearance that such holders may make such sales once a registration statement becomes effective may limit the market for the common stock or depress any trading market volume and price before other investors are able to sell the common stock. Moreover, a number of shareholders have held their investment for a substantial period of time and may desire to sell their shares, which could drive down the price of our common stock.

**AeroGrow's outstanding warrants, options and convertible notes, and additional future obligations to issue AeroGrow securities to various parties, may dilute the value of your investment and may adversely affect AeroGrow's ability to raise additional capital.**

As of December 31, 2006, AeroGrow is committed to issue up to 5,928,155 additional shares of common stock under the terms of outstanding convertible notes, warrants, options and other arrangements, which does not include the 916,740 additional shares of common stock issuable under the terms of the 2007 Warrants. There are warrants and options outstanding issued prior to June 30, 2005 that can be exercised for 818,858 shares of its common stock at exercise prices ranging from \$0.005 to \$15.00 per share. There are 2,143,000 shares of common stock issuable upon exercise of the outstanding warrants issued to investors in the Company's February 2006 private placement offering (the "2006 Offering") exercisable at \$6.25 per share. As of December 31, 2006, there were also 240,006 shares of common stock issuable upon conversion of the convertible notes in the principal amount of \$840,000 at a conversion price of \$3.50 by holders who elected to extend the maturity of their notes to December 31, 2006. Since December 31, 2006 and as of March 16, \$580,000 in principal amount of the \$840,000 principal amount of convertible notes has elected to convert, or has instructed us to convert on March 31, 2007, such principal amount of convertible notes to 165,714 shares of common stock. There are 600,000 shares of common stock issuable upon exercise of outstanding warrants held by the initial holders of the convertible notes with an exercise price of \$5.00 per share. There are

426,000 shares of common stock issuable upon exercise of warrants, at an exercise price of \$6.00 per share, that were issued to holders that elected to convert notes in the principal amount of \$2,130,000. As of December 31, 2006, there are 174,000 shares of common stock issuable upon the exercise of warrants to be issued upon conversion of convertible notes in the principal amount of \$840,000 at an exercise price of \$6.00 per share. There are 60,000 shares of common stock issuable upon exercise of outstanding warrants issued in 2005 to Keating Securities or its designees in connection with the convertible notes offering with exercise price of \$6.00 per share and 214,800 shares of common stock issuable upon exercise of outstanding warrants issued to designees of Keating Securities in the 2006 Offering with an exercise price of \$6.25. As of December 31, 2006, the Company has granted 1,251,491 options to purchase its common stock pursuant to the Company's 2005 Equity Compensation Plan. In connection with the 2007 Offering, which closed in March 2007, the Company issued the 2007 Warrants under which 916,740 additional shares of common stock are issuable pursuant to the terms of the 2007 Warrants.

AeroGrow has historically issued shares of its common stock or granted stock options to employees, consultants and vendors as a means to conserve cash, and AeroGrow may continue to grant additional shares of stock and issue stock options in the future. As of December 31, 2006, there are 129,646 shares of common stock that remain available for issuance under its 2005 Equity Compensation Plan.

For the length of time these notes, warrants, and options are outstanding, the holders will have an opportunity to profit from a rise in the market price of AeroGrow's common stock without assuming the risks of ownership. This may adversely affect the terms upon which AeroGrow can obtain additional capital. The holders of such derivative securities would likely exercise or convert them at a time when AeroGrow would be able to obtain equity capital on terms more favorable than the exercise or conversion prices provided by the notes, warrants or options.

**AeroGrow expects to continue to be subject to the “penny stock” rules for the foreseeable future.**

AeroGrow expects to continue to be subject to the SEC's “penny stock” rules if its common stock sells below \$5.00 per share. Penny stocks generally are equity securities with a price of less than \$5.00. The penny stock rules require broker-dealers to deliver a standardized risk disclosure document prepared by the SEC which provides information about penny stocks and the nature and level of risks in the penny stock market. The broker-dealer must also provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson, and monthly account statements showing the market value of each penny stock held in the customer's account. The bid and offer quotations, and the broker-dealer and salesperson compensation information must be given to the customer orally or in writing prior to completing the transaction and must be given to the customer in writing before or with the customer's confirmation.

In addition, the penny stock rules require that prior to a transaction, the broker and/or dealer must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction. The penny stock rules are burdensome and may reduce purchases of any offerings and reduce the trading activity for AeroGrow's common stock. As long as AeroGrow's common stock is subject to the penny stock rules, the holders of its shares may find it more difficult to sell their securities.

**The market price of the shares may fluctuate greatly. Investors in the company bear the risk that they will not recover their investment.**

Our common stock trades on the OTC BB. The company's trading symbol is AGWI.OB. No assurance can be made that an active market will develop on the OTC BB. Currently, trading in our common stock on the OTC BB is very limited, and the per share price is likely to be influenced by the price at which and the amount of shares the selling stockholders are attempting to sell at any time with the possible effect of limiting the trading price or lowering the price to their offering price. Shares such as those of AeroGrow are also subject to the activities of persons engaged in short selling securities, which generally has the effect of driving the price down. Also, the common stock of emerging growth companies is typically subject to high price and volume volatility. Therefore, the price of AeroGrow's common stock may fluctuate widely. A full and stable trading market for AeroGrow's common stock may never develop in which event any holder of such shares may not be able to sell at the time he elects or at all.

## USE OF PROCEEDS

All of the shares of common stock covered by this prospectus may be sold or otherwise disposed of for the account of the selling stockholders. AeroGrow will not receive any of the proceeds from the sale or other disposition of the shares or interests therein by the selling stockholders.

This prospectus also covers the sale of shares of common stock issuable upon exercise of the 2007 Warrants. Assuming no adjustments to the exercise price for anti-dilution protection, then AeroGrow estimates that it would receive approximately \$6.9 million in gross proceeds in the event that all of the 2007 Warrants are exercised. Any proceeds received from the exercise of the 2007 Warrants will be used for general corporate purposes.

Despite the existence of the 2007 Warrants, it is possible that none will be exercised and the Company will therefore not receive any proceeds therefrom. The 2007 Warrants will be exercised only if the price of the common stock justifies the exercise prior to their expiration.

## DIVIDEND POLICY

The board of directors of AeroGrow has never declared or paid any cash dividends on the common stock. We currently intend to retain any future earnings to finance the growth and development of our business and therefore do not anticipate paying any cash dividends in the foreseeable future. Our board of directors will determine any future payment of cash dividends depending on our financial condition, results of operations, capital requirements, general business condition and other relevant factors. Although we do not anticipate issuing preferred stock, if we do issue preferred stock it is possible that the terms of such stock will prohibit the payment of dividends on our outstanding common stock until all dividends then due on our preferred stock have been paid.

## MARKET DATA

Our common stock trades on the OTC BB. The Company's trading symbol is AGWI.OB. No assurance can be made that an active market will develop on the OTC BB. The closing price of our common stock on May 7, 2007 was \$7.30.

Our common stock may be designated as "penny stock" and thus may be illiquid. The SEC has adopted rules (Rules 15g-2 through 15g-6 of the Exchange Act), which regulate broker-dealer practices in connection with transactions in "penny stocks." Penny stocks generally are any non-NASDAQ equity securities with a price of less than \$5.00, subject to certain exceptions. The penny stock rules require a broker-dealer to deliver each month a standardized risk disclosure document to provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction, account statements showing the market value of each penny stock held in the customer's account, and a special written determination that the penny stock is a suitable investment for the purchaser. A broker-dealer must receive the purchaser's written agreement prior to the transaction. These disclosure requirements may have the effect of reducing the level of trading activity, if any, in the secondary market. Since our common stock is subject to the penny stock rules, persons holding or receiving such shares may find it more difficult to sell their shares. The market liquidity for the shares could be severely and adversely affected by limiting the ability of broker-dealers to sell the shares and the ability of stockholders to sell their stock in any secondary market.

The trading volume in our common stock is extremely limited. The limited nature of the trading market can create the potential for significant changes in the trading price of the common stock as a result of relatively minor changes in the supply and demand for our common stock and without regard to our business activities.

The market price of our common stock may be subject to significant fluctuations in response to numerous factors, including: variations in our annual or quarterly financial results or those of our competitors; conditions in the economy in general; announcements of key developments by competitors; loss of key personnel; unfavorable publicity affecting our industry or us; adverse legal events affecting us; and sales of our common stock by existing stockholders.



We have approximately 850 record holders of our common stock. We believe that in addition to the record ownership there are a limited number of beneficial owners who hold their shares in street name or through other nominees.

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## MANAGEMENT'S PLAN OF OPERATION

The following plan of operation provides information which AeroGrow's management believes is relevant to an assessment and understanding of AeroGrow's business, operations, and financial condition. The discussion should be read in conjunction with the audited financial statements and notes thereto and the unaudited financial statements for the period ending December 31, 2006, both of which are included in this registration statement. This plan of operation contains forward-looking statements that involve risks, uncertainties, and assumptions. AeroGrow's actual results may differ substantially from those anticipated in any forward-looking statements included in this discussion as a result of various factors, including those set forth in "Risk Factors."

### Overview

AeroGrow is in the business of developing, marketing, and distributing advanced indoor aeroponic garden systems. Since formation and through its development stage that ended March 1, 2006, AeroGrow's principal activities have consisted of product research and development, market research, business planning, and raising the capital necessary to fund these activities. AeroGrow has completed development of our initial kitchen garden systems and related "bio-grow" seed pods and has contracted with a third-party manufacturer who has commenced production activities and a second manufacturer who will commence production in the first quarter of calendar 2007. AeroGrow began sales activities as of March 2006. As of February 15, 2006, AeroGrow had manufactured and taken delivery of over 100,000 units. AeroGrow commenced initial marketing and distribution of its products during March 2006, and has expanded these marketing efforts to encompass retail, home shopping, catalogue, international, and direct to consumer sales channels. Prior to March 2006 when AeroGrow commenced sales of its aeroponic garden systems, AeroGrow was considered a Development Stage Enterprise in accordance with Statement of Financial Accounting Standards ("SFAS") SFAS No. 7, Accounting and Reporting by Development Stage Enterprises.

### Liquidity and Capital Resources

As of December 31, 2006, AeroGrow had a cash balance of approximately \$1,740,000. AeroGrow anticipates that existing cash resources will be sufficient for the next 12 months. However, AeroGrow has \$840,000 in convertible notes outstanding for which the original maturity date of December 31, 2006 has been extended until March 31, 2007. AeroGrow does not know at this time whether the holders of these notes intend to convert to common stock at a price of \$3.50 per share or seek repayment of their notes. Since December 31, 2006 and as of March 16, \$580,000 in principal amount of the \$840,000 principal amount of convertible notes has elected to convert, or has instructed us to convert on March 31, 2007, such principal amount of convertible notes to 165,714 shares of common stock. In the event the majority of the holders of the remaining \$720,000 notes request repayment, AeroGrow would need to seek additional debt or equity financing to fund its current business objectives.

AeroGrow anticipates its principal sources of liquidity during the current fiscal year ended March 31, 2007 will be proceeds from sales of our products. AeroGrow intends to use its working capital principally to purchase inventory, fund media advertising, fund product promotion and trade show costs as well as support ongoing product development, overheads and operational costs. In the event retail and/or direct response sales accelerate more rapidly than currently anticipated, AeroGrow would need to support this growth through additional asset-based financing or the raising of additional equity. However, no assurance that such financing will be available on attractive terms or at all.

As of December 31, 2006, AeroGrow has generated net proceeds of \$17,530,437 from the sale of the following securities:

- \$2,279,444 from private placements of 2,040,611 shares of its common stock during 2002, 2003 and 2004,

· \$215,000 from the exercise of its redeemable \$1.25 warrants and \$2.50 warrants for 164,000 shares of common stock in 2003, 2004 and through June 30, 2005,

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- \$2,307,737 from a Colorado registered offering of units consisting of 544,228 shares of common stock and its redeemable \$10.00 warrants and \$15.00 warrants during 2004,
- \$2,591,554 from its debt offering of convertible notes and redeemable 2005 warrants in June, July, August and September 2005,
- \$8,000 from the issuance of 1,600 shares of common stock pursuant to an agreement with an employee at \$5.00 per share during the period June 30, 2005 through September 30, 2005,
- \$85,000 from the issuance of 38,000 shares of common stock pursuant to the exercise of \$1.25 and \$2.50 warrants,
- \$962,500 from the exercise of outstanding \$1.25, \$2.50 and \$5.00 warrants for 395,000 shares of common stock during December 2005;
- \$85,000 from the exercise of 34,000 outstanding \$2.50 warrants and \$31,250 from the exercise of 5,000 outstanding \$6.25 warrants during the six months ended September 30, 2006; and
- \$8,964,952 in net proceeds from the sale of common stock and warrants in the 2006 Offering, consummated February 24, 2006 and March 1, 2006. See “Private Placement in Connection with Merger.”

AeroGrow has used the funds raised to date to:

- complete the research and development of its kitchen garden systems,
- commence manufacturing of one model of our kitchen garden and ten varieties of seed kits.
- develop our direct response marketing advertisements including one 30-minute infomercial and several 60-second television commercials, and
- launch our public relations campaign.

### **Plan of Operation**

Having launched its products through multiple channels including retail, home shopping, catalogue, international and direct to consumer sales, AeroGrow’s objective over the next twelve months will be to expand its marketing efforts in each of these channels for its kitchen garden systems and peripheral products. AeroGrow’s infomercial, a thirty minute video presentation of the product, has been completed and commenced test airings on national cable and local broadcast television stations in September 2006.

In order to transition from the development stage to an operating company, AeroGrow has strengthened its management team with the addition in the last twelve months of a Vice President of Sales, a Vice President of Operations, a Vice President of Engineering and Manufacturing, a new Chief Financial Officer and other marketing, operations and administrative staff.

AeroGrow is also expanding its product development activities to sustain operations beyond its initial product offerings. Development has begun and, in some cases has been completed, for final design and tooling of new models of AeroGrow's AeroGarden kitchen appliances, including models that include additional features and finishes which are designed to retail for higher price points than AeroGrow's current system as well models which will have smaller growing capacities and require smaller counter space designed to retail for lower retail price points. These lower priced products are intended to be introduced into specialty channels of distribution such as children's products (the magic garden), office products (office garden), pet market (the Cat Café for cat grass and catnip), and home beauty and décor market (the scented, wild flower and baby rose gardens). AeroGrow also continues to enhance its offerings of seed kits and accessories, with available seed kits growing from six that were available in March 2006 to over twelve by March 2007, including the sale and distribution of live strawberry plants developed to grow in the AeroGarden system. AeroGrow has also expanded its line of accessories to include the wall garden - shelving units that enable users to mount from one to three AeroGardens systems on the wall vertically in less than 16 inches. Consumers can mount up to three of these wall gardens (a total of nine units) next to each other using only one electrical outlet (collectively know as "The Wall Farm"), allowing consumers to grow a large abundance of fresh homegrown produce year round.

AeroGrow has completed development of many of its marketing materials, including several websites, product brochures, retail packaging, point of purchase displays and other retail collateral materials and public relations kits. We continue to dedicate financial and management resources to the improvement of AeroGrow's marketing and sales materials and processes.

## **Manufacturing**

AeroGrow manufactures its products using contract manufacturing sources that are supervised by its internal engineering and manufacturing teams. Its bio-grow seed pods are manufactured and assembled in its production facilities in Longmont, Colorado.

On September 30, 2005, AeroGrow entered into a manufacturing agreement with Source Plus, Inc. ("Source Plus") an Alabama corporation, and Mingkeda Industries Co., Ltd. ("Mingkeda"), a Chinese company located in the Guangdong Province of China that has primarily manufactured light fixtures in the past. This agreement supersedes a prior agreement with Mingkeda and Source Plus. Under the terms of this agreement, Source Plus advanced monies to Mingkeda for tooling and molds to build AeroGrow's products. To reimburse Source Plus for its advance to Mingkeda, AeroGrow issued 62,000 shares of its common stock to Source Plus in October 2005. AeroGrow recorded a \$310,000 asset for tooling, which AeroGrow will depreciate over a period of three years to reflect the estimated useful life of the tooling. AeroGrow and Source Plus have agreed to certain selling restrictions on its sale of AeroGrow common stock. Further, in return for a \$0.50 per unit price concession from Mingkeda for products AeroGrow purchases, AeroGrow issued 10,000 shares of its common stock to Mingkeda in October 2005. These shares are subject to the same selling restrictions as the stock issued to Source Plus. AeroGrow recorded a \$50,000 expense for inventory which AeroGrow will charge to cost of sales for one year or at a rate of \$0.50 per unit for each unit sold, whichever occurs sooner.

This agreement provides for payment of the purchase price of products manufactured by Mingkeda as follows: 30% paid 25 days prior to shipment, 50% paid upon shipment, and the remaining 20% paid 20 days after shipment. The purchase price is determined based upon a fixed percentage for profit (14% for light bulbs, 29% for all other products); overhead and labor are applied to actual component costs. AeroGrow has also agreed to pay to Source Plus a commission of 2% of the total purchases of the product with such payments to be made using the same proportions as AeroGrow's payments to Mingkeda. In addition, Source Plus is entitled to receive 2% of all purchases by AeroGrow of kitchen gardens, from all sources, for a period of 18 months from the date of the initial shipment from Mingkeda.

Mingkeda will manufacture and ship the products as and when required by AeroGrow and will maintain an agreed level of quality. Currently, Mingkeda has the capacity to produce 15,000 per month and has agreed to develop sufficient capacity to manufacture up to 25,000 kitchen garden systems per month. AeroGrow will have the right to audit Mingkeda's manufacturing performance periodically and maintain an agent in the Mingkeda plant to inspect its production. AeroGrow believes that its products will be manufactured to high quality standards at acceptable costs.

The manufacturing agreement with Mingkeda and Source Plus provides for protection of the intellectual property rights of AeroGrow. Under the agreement, Source Plus is specifically responsible for working as the liaison between AeroGrow and Mingkeda with responsibility for oversight of quality control in the manufacturing of the products, review of specifications and Mingkeda's compliance, monitoring of order fulfillment, and similar tasks related to quality of the finished goods. Source Plus receives a 2% commission for their work. Mingkeda manufactures the product to the specifications of AeroGrow at a predetermined line item component and assembly cost that will not change unless there are changes in exchange rate or cost of raw materials. Changes in cost must be pre-approved by AeroGrow.

In order to diversify its risk from having a single manufacturer, as well as provide for capacity beyond that of Mingkeda, AeroGrow identified and commenced production with an additional contract manufacturing source, Main Power Electrical Factory Ltd (Main Power). AeroGrow has completed its initial set of tooling with Main Power and, in February 2007, authorized the building of a second set of tooling with Main Power which will increase Main Power's capacity to 100,000 per month. During the first calendar quarter of 2007, AeroGrow began receiving delivery of production units built by Main Power. Future production capacity at Main Power is estimated to be 50,000 units per month for each set of tools. Purchasing terms with Main Power are 100% payment upon shipment through commercial bills of exchange. As of December 31, 2006, AeroGrow has recorded \$203,845 in tooling costs related to tooling at Main Power for two models of its AeroGarden. AeroGrow has paid Main Power \$8,032 in deposits toward tooling costs, with an additional \$195,813 due as of December 31, 2006 payable in lump sum payments of \$51,632 with the balance of \$144,581 to be amortized at the rate of \$0.20 per unit. Additional tooling cost of approximately \$100,000 will be recorded in the first calendar quarter of 2007 related to the additional tooling discussed previously. These costs will be paid with approximately \$14,000 in a lump sum payment with the balance to be amortized at the rate of \$0.20 per unit

In addition, we are increasing research and development and AeroGrow production capacity for AeroGrow seed kits for AeroGrow kitchen garden systems at AeroGrow's facility in Longmont, Colorado. We expect to continue to dedicate financial and management resources to the improvement of operating efficiencies and production capacity at this facility.

### **Retail Marketing and Sales**

AeroGrow began testing various direct marketing advertisements during the third and fourth calendar quarter of 2006 including:

- 60-second television commercials,
- 30-minute infomercials,
- home shopping networks, and
- Internet advertising.

AeroGrow has completed the initial test airings of the infomercial it produced and has increased the frequency of the infomercial airings through March 2007, with target monthly media expenditures of \$500,000 to \$750,000 per month during this period. AeroGrow expects that the exposure for its products and services that will be generated from the infomercial and other direct response marketing advertising will broaden the AeroGarden™ brand and product recognition in all channels of distribution.

In July 2006, the AeroGarden was featured on QVC, the world's largest television retailer, and have had four additional airings since that time, with further times scheduled through April 2007, including a scheduled airing which will feature a new model of AeroGarden throughout QVC's broadcast day, a promotion known as "Today's Special Value" or "TSV".

AeroGrow has expanded its presence in catalogues from its catalogue launch partner, Frontgate, to multiple catalogues including Brookstone, Plow and Hearth, Improvements and others, all of which AeroGrow believes add to the growing consumer recognition of their products. AeroGrow also continues to expand its retail distribution with over

650 retail stores to date carrying AeroGarden products nationwide in multiple channels including housewares, culinary, lawn and garden and department stores. Included in the foregoing is an initiative launched in September 2006 which focused on generating a high level of awareness and product visibility in the New York metropolitan market. This initiative included securing high profile merchandising for AeroGrow's products from leading retailers in the New York area such as Macy's, Bed, Bath and Beyond, Linens 'n Things and others for the 2006 holiday season. This initiative was promoted in New York using AeroGrow's infomercial and other television media to promote sales at the participating retail locations and has resulted in several of these major retailers electing to continue merchandising AeroGrow's products after the holiday season, as well as increasing the number of storefronts carrying the AeroGarden product line. The AeroGarden has received recognition from retailers such as Amazon.com whose customers voted the AeroGarden the "Most Wished For" home and garden product of 2006, the media, including features in nationally recognized television shows such as the "Today Show" and the "Ellen Degeneres" show and the housewares industry, with the AeroGarden receiving "Best in Category" from the International Housewares Association in the "Food Preparation" category based upon the AeroGarden's innovative technology, user benefits and market response.



AeroGrow has developed a nationwide network of manufacturer sales representative organizations with experience in each of these retail categories to manage sales activities for these channels. These sales representatives are independent contractors compensated by commission based on the sales they generate. Although AeroGrow's gross profit margins will be lower when selling through retail channels, AeroGrow will not incur the relatively higher advertising costs associated with its direct response marketing. AeroGrow's ability to continue to expand and maintain sales through retail channels will depend on the success of its public relations and direct marketing campaigns in generating awareness for its products, the retailers' ability and willingness to merchandise its products, and continued consumer acceptance for its kitchen garden systems.

### **Distribution**

AeroGrow had contracted with a third party service provider in Reno, Nevada to fulfill, store and ship its products through December 31, 2006. As of January 1, 2007, AeroGrow terminated its relationship with the company in Reno, Nevada and relocated its warehousing and fulfillment to a new third party facility in Chino Hills, California. AeroGrow anticipates this change will reduce inbound and outbound freight costs as well as fulfillment and handling charges and reduce time to market as a result of its location near the major sea ports of Los Angeles and Long Beach California. This third party service provider provides warehousing, order packing, and shipping for the products sold (through both direct response channels and retail channels) on primarily a variable cost basis. Costs for warehousing, order packing, and shipping for the products sold through direct response channels are included in the shipping and handling charge paid by the direct response purchaser. For retail distribution, the costs for warehousing, order packing, and shipping are lower because of the efficiencies gained in shipping larger quantities per order. Freight costs will vary significantly depending upon quantity ordered and destination, but they are projected to range from 3% to 5% of sales net of reimbursement from customers. A different third party service provider also provides payment processing, database management, and customer support services for the direct response sales. AeroGrow manages the majority of its consumer and retailer customer support from its own facilities.

AeroGrow has contracted with two telemarketing companies, InPulse Response Group, Inc. and LiveOps, Inc. to provide operators who will take calls from consumers responding to its direct response marketing. Both contracts may be cancelled upon 30 days notice. These orders and the orders received on its website are provided to our third party service provider daily to be fulfilled. Telemarketing costs per order are approximating 4% of direct response sales.

### **International Sales**

AeroGrow has begun to build its international distributor network and has entered into agreements to date with distributors in Mexico and Canada. On September 1, 2006, AeroGrow retained the services of a consultant in London to assist in developing AeroGrow's international distributor network in Europe and Asia. AeroGrow anticipates finalizing distribution agreements in key markets such as Japan, Germany and the United Kingdom by the end of March 2007 and having models of AeroGrow kitchen garden products, compatible with European and Asian regulatory and electrical requirements, completed and available for distribution during the early part of the second calendar quarter of 2007.

## Inflation and Seasonality

AeroGrow does not expect inflation to have a significant effect on its operations in the foreseeable future. Because its kitchen garden systems are designed for an indoor gardening experience, it is possible that AeroGrow may experience slower sales in the United States during April through September when its consumers may tend to garden outdoors. In addition, AeroGrow has had increased sales during the holiday season in the fourth calendar quarter. With regard to its international distribution, AeroGrow intends to sell to its international distributors in US Dollars thereby minimizing effects from currency fluctuations. AeroGrow's purchases from China may be effected by changes in valuation of the US Dollar as compared to the Chinese Yuan.

## Results of Operations

The nine months ended December 31, 2006 represented our first nine months of revenues from operations. Initial shipments of our products began in March 2006. During our first holiday selling season, we experienced higher than anticipated demand for our products and accordingly were unable to fully meet customer demands both from retailers ("Retail Sales") as well as direct sales to consumer ("Direct Sales"). As a result, we had orders from retailers totaling \$305,000 and direct orders from consumers totaling \$205,000 that we were unable to ship by December 31, 2006. Further, during the months of November and December 2006, we elected to expedite shipping of 9,615 units of our AeroGarden units from our factory in China by air rather than by sea in order to satisfy customer demands at an incremental airfreight cost of \$27 per unit, or a total additional freight cost of \$259,600, which was included in Cost of Revenue for the three and nine months ended December 31, 2006.

For the three and nine months ended December 31, 2006, net sales totaled \$4,857,604 and \$6,709,858, respectively. There were no sales in the prior year. Direct Sales are generated as a result of airings of our infomercial, our websites and other direct to consumer advertisements. Retail Sales are generated through sales to "brick and mortar" retailers, catalogues and home shopping companies who in turn sell to consumers. In regard to our Direct Sales, we offer our direct customers thirty days to evaluate the product paying only the shipping and handling costs for such products before making the required installment payments after the expiration of the thirty day trial period. Accordingly, we have not recorded \$354,050 of revenue as of December 31, 2006 related to the unpaid balance due for such orders shipped prior to December 31, 2006. We also deferred recognition of \$102,480 of product costs associated with the foregoing revenue in as much as the customer is required to return the product to us and we are able to recover these costs through resale of the goods. An analysis of our sales is as follows:

	Three months ended December 31, 2006	Nine months ended December 31, 2006
Direct Sales, net	\$ 1,314,174	\$ 1,673,483
Retail Sales, net	3,543,430	5,036,375
	\$ 4,857,604	\$ 6,709,858

During the nine months ended December 31, 2006, we had two retail customers who accounted for 19% (\$1,303,949) and 15% (\$1,019,629), respectively, of our net sales. During the three months ended December 31, 2006, the same two retail customers accounted for 19% (\$929,544) and 12% (\$562,733), respectively, of our net sales.

Cost of revenues for the three and nine months ended December 31, 2006 totaled \$3,282,291 and \$4,785,151, representing 68% and 71% of revenues, respectively. Cost of revenues include product costs for purchased and manufactured products, freight costs for inbound freight from manufacturers and outbound freight to customers, costs related to warehousing and the shipping of products to customers and duties and customs applicable to products imported. Included in cost of revenues for the three months ended December 31, 2006, is approximately \$140,000 in incremental airfreight costs for the initial shipments of our products and approximately \$259,600 in incremental airfreight costs related to expediting deliveries resulting from higher than expected demand for our products during the holiday season. This shipping practice is not expected to be a recurring method of transportation for our products. During the nine months ended December 31, 2006, product costs were also impacted by the worldwide increasing costs of plastics and copper. We have seen improvement in the costs of plastics in recent months and as a result have realized a 4% reduction in our product cost subsequent to December 31, 2006. Further, in as much as inbound freight from our manufacturers as well as outbound freight to our customers both are included in our cost of sales, we have determined that our third party warehouse and fulfillment facility based in Reno, Nevada was not efficient in minimizing such freight costs. Effective January 1, 2007, we terminated our agreement with the facility in Reno and entered into a new agreement with a warehouse facility near Los Angeles, California. We anticipate this change will result in savings of 10% to 15% in our freight and distribution costs. We also experienced higher than anticipated costs in the startup of our seed kit manufacturing operations which we anticipate will decline in future periods as efficiencies in manufacturing seed kits due to improvements in both process and volume are realized.

Gross margins will vary based upon the ratio of Direct Sales, where we recognize as revenue the full purchase price for the product as opposed to Retail Sales, where we recognize as revenue the wholesale price for the product charged to the retailer. Media costs associated with Direct Sales are included in Sales and Marketing costs. Gross margins for the three and nine months ended December 31, 2006 were \$1,575,313 and \$1,924,707 representing 32% and 29% of revenues, respectively. Affecting gross margins for the three and nine months ended December 31, 2006, as discussed above, were airfreight costs of \$259,600 and \$399,600, respectively, reducing gross margins by 5% and 6%, respectively. With the addition of the new manufacturing capability, we expect to have sufficient manufacturing capacity to avoid such airfreight costs in the future. Also affecting gross margins were increases in the manufactured costs due to costs associated with plastics of our AeroGarden as discussed above which have improved by 4% of current product cost manufactured in China from that which was incurred during the three and nine months ended December 31, 2006. Further reductions in manufacturing cost are anticipated for the next twelve months based upon new integrated microprocessors which would reduce the cost of current electronic components. There are further reductions possible from obtaining regulatory approval to produce selected seed kits in China to be shipped with the AeroGarden which would result in 60% cost savings for such seed kits as compared to current manufacturing costs in Colorado.

During the three and nine months ended December 31, 2006 we incurred \$700,111 and \$1,544,495 in research and development costs as compared to \$584,074 and \$1,272,639 for the three and nine months ended December 31, 2005, an increase of \$116,037 and \$271,856, or 20% and 21%, respectively. We continue to allocate additional resources to the development, design and technology of various new prototype models as well as expansion of our greenhouse and laboratory to measure the success of various seeds, cuttings and nutrients under different conditions and testing new plant varieties for additional seed kits. A significant component of the increase for the nine months ended December 31, 2006 over the nine months ended December 31, 2005 is \$329,595 in non-cash compensation expense recognized as a result of stock options granted and common stock issued during the period to personnel engaged in our research and development activities. Partially offsetting this increase is the cost savings associated with research and development resources available to us through our new manufacturer including resources for design, prototyping and regulatory approvals.

Sales and marketing costs for the three and nine months ended December 31, 2006 totaled \$1,965,578 and \$4,285,849 as compared to \$203,822 and \$555,622 for the three and nine months ended December 31, 2005, an increase of \$1,761,756 and \$3,730,227, or 864% and 671%, respectively. Sales and marketing costs for the nine months ended December 31, 2006 include all costs associated with the media cost for airings of our infomercial and other direct response advertisements which totaled \$630,714, \$687,241 in costs associated with the production of our infomercial, \$176,981 in advertising and other promotional allowances granted to our retail customers, \$161,699 in public relations costs, \$311,592 in commissions to sales representatives for sales to our retail customers and \$167,897 in other advertising and promotional costs. Further, a significant component of the increase on sales and marketing for the nine months ended December 31, 2006 over the nine months ended December 31, 2005 is \$237,488 in non-cash compensation expense recognized as a result of stock options granted and common stock issued during the period to personnel engaged in our sales and marketing activities.

General and administrative costs for the three months ended December 31, 2006 totaled \$1,042,537 as compared to \$976,234 for the three months ended December 31, 2005, an increase of \$66,303 or 7%. For the nine months ended December 31, 2006, general and administrative costs totaled \$2,671,939 as compared to \$2,408,819 for the nine months ended December 31, 2005, an increase of \$263,120 or 11%. Contributing to the increases for the three and nine months ended December 31, 2006 are approximately \$176,000 in legal and consulting costs associated with our efforts to complete the registration of the 6,700,900 shares of common stock and the shares of common stock underlying warrants and convertible debt associated with our 2005 convertible debt offering and our 2006 private placement offering. Also impacting general and administrative costs during the three months ended December 31, 2006 were approximately \$50,000 in moving and related costs as a result of our relocation to our new 21,012 square foot corporate headquarters.

In the next twelve months, we intend to continue researching and developing new product designs and product extensions including, but not limited to, product line extensions targeted at both higher and lower retail price points, nutrient delivery systems and additional seed varieties for our seed kits. We also will dedicate research and development resources to the improvement, expansion and automation of our in-house seed kit manufacturing capabilities.

On July 27, 2006, we entered into a lease with Pawnee Properties, LLC, an unrelated company, to consolidate our operations, other than our seed kit manufacturing operations, into a 21,012 square foot office space at 6075 Longbow Drive, Boulder, Colorado 80301, commencing November 2006. The initial rent is \$15,759 per month, plus our proportionate share of building taxes, insurance, and operating expenses. The initial term continues until January 31, 2012, unless modified under specified circumstances. The lease contains other standard office lease provisions.

Future cash payments under such operating lease for the upcoming five years are as follows:

<b>Year Ended</b>	<b>Rent</b>
March 31, 2007	\$ 48,877
March 31, 2008	\$296,848
March 31, 2009	\$316,253
March 31, 2010	\$325,152
March 31, 2011	\$327,047

### **Off-Balance Sheet Arrangements**

AeroGrow has certain current commitments under operating leases and has not entered into any capital leases or contracts for financial derivative instruments such as futures, swaps and options.

### *Critical Accounting Policies and Estimates*

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

### *Research and Development*

The costs incurred to develop products to be sold or otherwise marketed are currently charged to expense. When a product is ready for general release, its capitalized costs will be amortized using the straight-line method of

amortization over a reasonable period.

*Inventory*

Inventories are valued at the lower of cost, determined by the first-in, first-out method, or market. Included in inventory costs where we are the manufacturer are raw materials, labor and manufacturing overhead. We record the raw materials at delivered cost. Standard labor and manufacturing overhead costs are applied to the finished goods based on normal production capacity. A majority of our products are manufactured overseas and are recorded at delivered cost.

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### *Stock Based Compensation*

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123R, "Share-Based Payment." Subsequently, the Securities and Exchange Commission ("SEC") provided for a phase-in implementation process for SFAS No. 123R, which required adoption of the new accounting standard no later than January 1, 2006. SFAS No. 123R requires accounting for stock options using a fair-value-based method as described in such statement and recognize the resulting compensation expense in the Company's financial statements. Prior to January 1, 2006, the Company accounted for employee stock options using the intrinsic value method under APB No. 25, "Accounting for Stock Issued to Employees" and related Interpretations, which generally results in no employee stock option expense. AeroGrow adopted SFAS No. 123R on January 1, 2006 and does not plan to restate financial statements for prior periods. AeroGrow plans to continue to use the Black-Scholes option valuation model in estimating the fair value of the stock option awards issued under SFAS No. 123R. The adoption of SFAS No. 123(R) has increased net loss by \$404,965 for the nine months ended December 31, 2006 as compared to using our prior method under APB 25.

### *Revenue Recognition*

AeroGrow recognizes revenue from product sales, net of estimated returns, when persuasive evidence of a sale exists: that is, a product is shipped under an agreement with a customer; risk of loss and title has passed to the customer; the fee is fixed or determinable; and collection of the resulting receivable is reasonably assured. The liability for sales returns is estimated based upon historical experience of return levels.

AeroGrow records estimated reductions to revenue for customer and distributor programs and incentive offerings, including price markdowns, promotions, other volume-based incentives and expected returns. Future market conditions and product transitions may require the Company to take actions to increase customer incentive offerings, possibly resulting in an incremental reduction of revenue at the time the incentive is offered. Additionally, certain incentive programs require the Company to estimate based on industry experience the number of customers who will actually redeem the incentive. AeroGrow also records estimated reductions to revenue for end user rebate programs, returns and costs related to warranty services.

### *Warranty and Return Reserves*

AeroGrow records warranty liabilities at the time of sale for the estimated costs that may be incurred under its basic warranty program. The specific warranty terms and conditions vary depending upon the product sold but generally include technical support, repair parts, labor for periods up to one year. Factors that affect the Company's warranty liability include the number of installed units currently under warranty, historical and anticipated rates of warranty claims on those units, and cost per claim to satisfy the Company's warranty obligation.

AeroGrow reserves for potential returns from customers and associated refunds or credits related to such returns based upon historical experience.

### *Shipping and Handling Costs*

Shipping and handling costs associated with inbound freight are recorded in cost of sales. Shipping and handling costs associated with freight out to customers are also included in cost of sales. Shipping and handling charges to customers are included in sales.

### *Beneficial Conversion Feature of convertible notes*

In accordance with Emerging Issues Task Force No. 98-5, “Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios”, and Emerging Issues Task Force No. 00-27, “Application of Issue No. 98-5 to Certain Convertible Instruments”, the Company recognizes the advantageous value of conversion rights attached to convertible debt. Such rights gives the debt holder the ability to convert debt into shares of common stock at a price per share that is less than the fair market value of the common stock on the day the loan is made to the Company. The beneficial value is calculated as the intrinsic value (the fair market value of the stock at the commitment date in excess of the conversion rate) of the beneficial conversion feature of the notes and the related accrued interest and is recorded as a discount to the related debt and an addition to additional paid in capital. The discount is subsequently amortized to interest expense over the remaining outstanding period of the related debt using the interest method.



*Registration Rights Penalties*

The holders of securities issued in the Company's 2006 Offering and 2005 Offering (see Note 3 to the Company's Condensed Financial Statements) have registration rights for the common stock and for the common stock underlying the convertible debt and the warrants held by them. Liquidated damages for failure to register and maintain registration for such common stock are payable in common stock of the Company under certain circumstances and are limited to 1% of the amount of the outstanding convertible debt up to a maximum of 24% and 1% of the amount of the investment in the 2006 Offering up to a maximum of 18%. In each case, the amount is payable in shares of the Company's common stock valued at a rate of \$2.00 per share. The Company has elected to recognize the impact of such registration rights penalties as incurred, which commenced after July 23, 2006 (see Note 3 and Note 6). The Company completed the registration of the foregoing securities on December 22, 2006 and recognized five months of penalty, resulting in the recording of 332,876 shares of common stock to be issued at a value of \$5.00 for a total of \$1,664,380. On December 21, 2006, the FASB Financial Statement Publication ("FSP") EITF 00-19-2 that addresses the accrual and accounting for registration rights penalties becomes effective for the year beginning December 15, 2006. The Company is assessing this FSP and will adopt it for fiscal 2007. The Company does not expect the adoption to have a significant difference in its current policy.

## **BUSINESS**

### **Overview**

AeroGrow was formed as a Nevada corporation on March 25, 2002. AeroGrow's principal business is developing, marketing, distributing, and selling advanced indoor aeroponic garden systems designed and priced to appeal to the gardening, cooking and small kitchen appliance, healthy eating, and home and office décor markets worldwide. AeroGrow's principal activities since its formation through February 2006 have consisted of product research and development, market research, business planning, and raising the capital necessary to fund these activities. AeroGrow currently has 19 patent applications pending in the United States, and 28 trademark applications, 7 of which have been allowed, (25 in the United States and 3 international). To date, AeroGrow has completed the development of two proprietary growing systems and nine proprietary seed kits. These development activities included an iterative process of experimentation, consumer testing, and adjustment in consultation with scientists familiar with the technology. AeroGrow's experimentation included more than 500 internal tests on nutrients, lighting, water quality, and seed varieties in our greenhouses and labs performed between August 2002 and December 2005. Often, these tests were combined with in-home use of our systems by sample consumers picked from our employees and investors. User feedback from these tests was often incorporated in next generation products and development.

During 2006 AeroGrow completed development of its initial kitchen garden systems and related "bio-grow" seed pods. AeroGrow contracted with a third-party manufacturer who commenced production activities and a second manufacturer who will commence production in the first quarter of calendar 2007. In March 2006, AeroGrow began sales activities. As of February 15, 2007, AeroGrow had manufactured and taken delivery of over 100,000 units of its AeroGarden™ kitchen garden units. AeroGrow commenced initial marketing and distribution of its products during March 2006 and has expanded these marketing efforts to encompass retail, home shopping, catalogue, international, and direct to consumer sales channels.

AeroGrow's principal products are "kitchen garden" indoor growing systems and proprietary seed kits that allow consumers, with or without gardening experience, the ability to grow cherry tomatoes, cilantro, chives, basil, dill, oregano, mint, flowers, chili peppers, and lettuce throughout the year. AeroGrow's kitchen garden systems are designed to be simple, consistently successful, and affordable. AeroGrow believes that its focus on the design and features of its kitchen garden systems made them the first of their kind on the consumer market. This conclusion was reached on the basis of standard means of market research, including focus groups and potential customer interview techniques, review of potentially competitive products offered at all ranges of functionality and price, and testing of products that may be considered competitive in function although not necessarily competitive in market orientation.

AeroGrow believes that its products will allow almost anyone, from consumers who have no gardening experience to professional gardeners, to produce year-round harvests of a variety of herbs, vegetables, and flowers, which are provided in its seed kits, regardless of season, weather, or lack of natural light. AeroGrow believes that its kitchen garden systems' unique and attractive designs make them appropriate for use in almost any location including kitchens, bathrooms, living areas and offices.

AeroGrow's kitchen garden system currently on the market retails at approximately \$149 with variations based on the channel of distribution in which they are sold and the accessory components included with the unit.

### **Hydroponics Industry - Background and Opportunity**

Hydroponics is the science of growing plants in water instead of soil. Used commercially worldwide, hydroponics is considered an advanced and often preferred crop production method. Hydroponics is typically used inside greenhouses to give growers the ability to better regulate and control nutrient delivery, light, air, water, humidity, pests and temperature. Hydroponic growers benefit by producing crops faster and enjoying higher crop yields per acre

than traditional soil-based growers.

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Aeroponic technology is derived from hydroponics and occurs when plant roots are suspended in an air chamber and bathed at regular intervals with nutrient solution. AeroGrow believes that the aeroponic technology used in its kitchen garden systems is a technological advance over hydroponics because plant roots are suspended in a near 100% humidity enclosed air chamber and bathed in a nutrient-rich solution. We believe aeroponic methods ensure the plants not only have sufficient water, nutrients and oxygen, but the temperature inside the root chamber can be easily controlled, ensuring temperature stress of the plant does not limit growth. For this reason, we believe the use of a well designed and maintained aeroponic system can yield increases in growth rate and plant survival when compared to hydroponics systems.

From August 2002 through July 2005, AeroGrow conducted research with approximately 500 individuals who were identified either because they (i) signed-up on our website to pre-order the basic AeroGrow product, (ii) agreed to be beta testers of the basic product, (iii) came to preview meetings concerning the company, or (iv) were friends of employees and consultants of the Company. Persons found the AeroGrow's website through referrals, web searches, or as a result of fund raising and hiring activities. The research consisted of face-to-face and internet interviews/surveys with potential consumers and standard focus group experiences. From some of the contacts, AeroGrow obtained a ten page questionnaire and in other instances the responses were taped for later review. Persons from approximately 35 states responded to the surveys and focus groups. A professional market research consultant assisted with the design, implementation and analysis of the focus groups, individual interviews, and surveys. From this research, AeroGrow believes that there is a potential, sizeable national market for its countertop soil-less kitchen garden systems for use indoors in homes and offices. Until the development of AeroGrow's kitchen garden systems, significant barriers have prevented hydroponic or aeroponic technology from being incorporated into mainstream, mass-marketed consumer products, including:

- Consumers generally lack the specialized knowledge required to select, set up, operate and maintain the various components for a typical hydroponic or aeroponic system, including growing trays, irrigation channels, growing media nutrient reservoirs, and nutrient delivery systems consisting of electronic timers, pumps, motors, tubing and nozzles.
- Consumers generally do not possess the specialized knowledge required to select, set up, operate and maintain the varied indoor lighting systems that are necessary to grow plants in the absence of adequate indoor natural light.
- Consumers are required to properly mix and measure complex hydroponic nutrient formulas, which change depending on the plant variety and the stage of plant growth. In addition, consumers must deal with the problem of nutrient spoilage.
- Federally-mandated water quality reports show that the water in many large cities is not suitable for hydroponic or aeroponic growing and requires chemical treatments. Consumers generally are unaware of how to adjust the water for healthy plant growth.

AeroGrow believes that these complexities have been accepted in existing hydroponic market channels because its research has indicated that hydroponic manufacturers have generally focused their product development and marketing efforts on satisfying the needs of the commercial greenhouse and dedicated hobbyist markets. AeroGrow's research has indicated that the hydroponic growing equipment currently available in these markets is bulky, expensive and comprised of many parts. These users are motivated to gain the specialized knowledge, equipment and experience currently required to successfully grow plants with these products.

AeroGrow believes that the complexities of currently available commercial hydroponic products fail to address the needs and wants of the mass consumer market, leaving that market unserved. AeroGrow further believes that its trade secrets, patent-pending inventions and companion technologies have simplified and improved hydroponic and aeroponic technologies and enabled it to create the first indoor aeroponic gardening system appropriate for the mass consumer market.

## **Our Proprietary Technology**

AeroGrow has spent almost four years innovating, simplifying, combining and integrating numerous proprietary technologies and inventions into a family of “plug and grow” aeroponic kitchen garden systems and related seed kits specifically designed and priced for the mass consumer market. AeroGrow has filed 19 patent applications in the United States to protect its inventions. Following is a description of AeroGrow’s proprietary technologies and inventions, which are used together in its kitchen garden system and seed kits. The inventions under the patent applications have not been granted patents, and there can be no assurance that patents will be granted. See “Risk Factors - AeroGrow’s intellectual property and proprietary rights give it only limited protection and can be expensive to defend.”

**Rainforest Nutrient Delivery System.** AeroGrow’s “rainforest” nutrient delivery system combines its patent-pending technologies with features from several hydroponic or aeroponic methodologies into a proprietary system designed to provide aeroponic plant growth. These hydroponic or aeroponic methodologies include:

- *Drip Technologies.* Drip systems create nutrient irrigation by pumping nutrient solution from a reservoir up to the base of the plant and saturating a soil-less growing medium. The growing medium delivers nutrients and moisture to plant roots which is similar to rainwater as it drips through the soil and past plant roots.
- *Ein Gedi Aeroponic Technologies.* Plant roots in aeroponic systems are suspended in an air chamber and bathed at regular intervals with nutrient solution. In the Ein Gedi variation of aeroponics, plant roots are allowed to grow directly into nutrient solution after passing through an air space.

AeroGrow’s rainforest technology suspends plant roots into a 2 to 4 inch air chamber above an oxygenated nutrient solution. Nutrients are pumped from the nutrient reservoir to the base of each plant where a regulated flow of nutrients drips down through plant roots.

**Pre-Seeded Bio-Grow Seed Pods.** AeroGrow’s proprietary bio-grow seed pods include pre-implanted seeds, a bio-sponge growing medium, removable bio-dome covers and a grow basket to assist with the proper distribution of moisture. AeroGrow’s seed pods were designed to be used in its kitchen garden systems. AeroGrow believes consumers may use seeds purchased from other sources for use in its kitchen garden system, although AeroGrow cannot provide any assurances on germination and growth in such cases.

AeroGrow selected the seeds to pre-implant in its initial bio-grow seed pods after two years of extensive research, which included:

- analyzing thousands of seed varieties,
- growing and testing several hundred varieties of plants in its greenhouse and grow laboratories, and
- testing the taste and appearance of its grown vegetables, herbs and flowers with consumers.

AeroGrow implants its selected seeds in a bio-sponge growing medium that, based upon research by AeroGrow, facilitates rapid germination and enhanced root growth in comparison to other mediums tested as well as supporting plant roots from germination through maturity and harvest. AeroGrow’s bio-grow domes create a mini-greenhouse environment by covering the grow surface to create a near-100% humidity air chamber, which is optimal for most plant germination and initial growth. Bio-grow domes help regulate moisture and temperature to levels optimal for

plant germination.

AeroGrow's proprietary bio-grow seed pods are a vital component of its kitchen garden system. AeroGrow's bio-grow seed pods will be packaged along with nutrients in its proprietary seed kits to be used in its kitchen garden systems. These seed kits currently include seeds for cherry tomatoes, salad greens, cilantro, chives, basil, dill, oregano, mint, chili peppers and flowers as well as a variety of international herbs for Italian, Japanese, and French cooking. In addition to pre-seeded pods, AeroGrow also plans to allow consumers to purchase unseeded pods to give them the opportunity to grow their own seeds in AeroGrow's kitchen garden systems. Not all plants, however, are appropriate to grow in the kitchen garden system.

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AeroGrow has also begun development of methodology to cultivate and ship live “starter” plants in the grow pod mediums that will be able to grow in AeroGrow’s kitchen garden systems. AeroGrow has started market testing this process with strawberries during the first quarter of calendar 2007

**Microprocessor-Based Control Panel and Nutrient Cycle Delivery System.** AeroGrow believes that certain common problems face both experienced gardeners and beginning gardeners, including:

- improperly watering plants,
- improperly feeding plants, and
- failing to provide plants with sufficient light needed for healthy growth.

To assist consumers, especially inexperienced gardeners, AeroGrow has developed two patent-pending microprocessor-based technologies that address these common problems. These technologies are designed to:

- regulate the lighting system,
- automatically alert users when it is time to add water and nutrients,
- help simplify and reduce consumers’ time and involvement in caring for plants,
- reduce the variables and errors often made by consumers in plant care, and
- enhance plant growth.

AeroGrow has developed two kitchen garden systems with different control systems which are described below at “AeroGrow’s Kitchen Garden Systems.” AeroGrow’s microprocessor-based control panel will be available as an accessory for its basic kitchen garden system and is included as a standard feature on its deluxe kitchen garden system. This control panel includes an electronic nutrient and water reminder system and microprocessor-controlled lights that alert consumers to add water and nutrients when needed and help ensure that plants are properly fed and receive the proper lighting. Without the microprocessor control panel, the user is required to track the time since the last nutrient tablets were added and must monitor the system visually as to when to add water.

In addition, AeroGrow’s deluxe kitchen garden system includes its microprocessor-based nutrient cycle delivery system as a standard feature. With its nutrient cycle delivery system, the consumer selects from four plant types (lettuce, herbs, tomatoes or flowers) and the system then automatically adjusts and optimizes the nutrient, water and lighting cycles based on the plant variety selected.

**Time-Release Nutrient Tablets.** Plants require a balanced mixture of nutrients for optimal growth. Certain nutrient combinations, including calcium nitrate and magnesium sulphate, generally cannot be combined, mixed, or stored in the same container due to specific chemical reactions that bind them together and renders them useless to plants. Hydroponic growers seek to solve this problem by packaging various nutrient concentrations in up to four separate containers, which are individually measured and added as needed by the consumer. These nutrient complexities require consumers using hydroponic systems to:

- understand the blends of nutrient fertilizer that are best suited for the specific variety of plants they are growing,



- understand the nutrient requirements for the specific plant variety at each of three stages of its growth and maturity,
- measure and blend nutrients from up to four different concentrated solutions and add them to specific measured quantities of water, and

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· monitor, adjust and re-mix nutrient fertilizers over time.

AeroGrow believes that current plant nutrition processes required for successful hydroponic growing have created barriers to mass consumer use and acceptance because they are cumbersome and complex. To help overcome these barriers, AeroGrow has spent nearly three years developing time-release nutrient tablets designed specifically to deliver the proper nutrients to the plants, while offering consumers a user-friendly nutrient system. The consumer simply adds the plant-specific nutrient tablets to the kitchen garden systems when instructed by the microprocessor-based nutrient cycle delivery system, usually once every two weeks. The nutrient tablets eliminate the need for measuring and mixing multi-part nutrient formulas and storing various nutrients in separate containers. The nutrient tablets customize multiple nutrients and minerals such as calcium, magnesium and iron for specific plant varieties at different stages of their growth.

**Water Quality.** Tap water as supplied by local municipalities often is not conducive to aeroponic or hydroponic growth. To address these problems, most hydroponic growers monitor and chemically adjust the water they use on a daily or weekly basis.

AeroGrow believes that the problems associated with the wide range of water chemistry found throughout the United States (and possibly internationally), as well as the complexities involved in monitoring water chemistry, are significant barriers which limit the use of hydroponic gardening by the general public. AeroGrow has developed a patent-pending formula that automatically adjusts and balances the water to a level capable of sustaining healthy plant growth in an aeroponic environment. This formula is pre-mixed into AeroGrow's time-release nutrient tablet described above, which eliminates the need for consumers to understand water chemistry.

**Integrated and Automated Lighting System.** Hydroponic systems typically do not incorporate built-in lighting systems. Lighting systems must typically be purchased as separate components and assembled by the consumers. Hydroponic lighting systems generally consist of a ballast, reflector hood, lights and an electronic timer. The consumer must suspend the lighting system over the hydroponic unit and then continually raise the lights as the plants grow. Complete lighting systems often cost hundreds of dollars, which is considerably more than the cost of AeroGrow's entire kitchen garden system.

AeroGrow's kitchen garden systems include built-in adjustable grow lights with ballast, reflector hood, lights and an electronic timer. AeroGrow's integrated lighting systems include high-output compact fluorescent light bulbs that deliver a spectrum and intensity of light designed to help optimize plant growth without natural light. In addition, AeroGrow's lighting system is fully automated and controlled by its microprocessor-based control panel described above.

**Adaptive Growth Software.** Through research and testing in AeroGrow's grow laboratory, AeroGrow's plant scientists have determined that better plant growth can be achieved if nutrients, moisture and lighting are adapted and customized to the specific stages of the plants' growth: germination, initial growth and advanced growth. AeroGrow has developed a proprietary software technology entitled "adaptive growth technology" which automatically analyzes and adjusts the nutrient delivery schedules based on plant maturity. AeroGrow intends to introduce this technology into an upgraded kitchen garden system to be introduced in the second calendar quarter of 2007 as an added feature for specialty retailers in the future.

### **AeroGrow's Kitchen Garden Systems**

AeroGrow has developed two kitchen garden systems and has commenced marketing one of these models. The marketed model features the rainforest nutrient delivery system and an integrated lighting system (including the microprocessor-based control panel), and a microprocessor-based nutrient cycle delivery system. This kitchen garden system retails at approximately \$149 with variations based on the channel of distribution in which it is sold and the accessory components included with the unit.

AeroGrow plans to introduce two new models of its kitchen garden systems in the second half of calendar 2007. One new model will feature an upgraded unit with a stainless steel accented design and the adaptive growth technology discussed above. This model is expected to retail for \$169 to \$199 based on the channel of distribution in which it is sold and the accessory components included with the unit. In addition, AeroGrow plans to introduce a smaller version of its current kitchen garden system targeted to retail for a price of \$99-\$119 based on the channel of distribution in which it is sold and the accessory components included with the unit.

AeroGrow is in the process of modifying its current units for compatibility with Asian and European electrical requirements for international distribution. AeroGrow anticipates continued development of new models of its kitchen garden systems to meet the demands of its customers and price points as required by market conditions.

### **AeroGrow's Seed Kits**

AeroGrow has developed and is producing a variety of seed kits to be used in its kitchen garden systems. These seed kits include pre-seeded bio-grow seed pods and a three- to six-month supply of nutrients, including its formula for adjusting water quality. AeroGrow expects its seed kits to retail at prices ranging from \$14.99 to \$19.99. Currently developed seed kits include:

- cherry tomato garden,
- chili pepper garden,
- gourmet herb garden,
- salad greens garden,
- grandiflora petunia garden,
- international basil garden,
- Japanese herbs,
- French Herbs, and
- Italian herbs.

AeroGrow's seed kits, time-release nutrient tablets, and replacement light bulbs are also sold to consumers for use with its kitchen garden system. Additionally, seed pods are available for use by consumers who wish to try to grow their own seeds, but no assurance can be given that all varieties of plants will grow with the AeroGrow kitchen garden system.

### **Other Accessories**

To compliment and expand the functionality of its kitchen garden systems, AeroGrow has developed a variety of accessory products. AeroGrow has developed an Herb Appeal Collection, consisting of an internally produced video and guidebook on the care and uses of herbs and a set of cutting boards. We have also developed two wall bracket systems designed to hold two or more kitchen garden systems for consumers who wish to grow more than one seed kit at a time. AeroGrow is also developing its own design of a battery operated herb blender and salad dressing maker. These products will be sold individually and will be used as premium "gifts with purchases" to enhance AeroGrow's direct to consumer and retail offerings.

### **Additional Future Products**

In addition to its kitchen garden systems, AeroGrow is developing and plans to market in the future companion products designed to provide a successful gardening experience for consumers of all experience levels while providing a potentially continuing and profitable revenue stream for it. AeroGrow's development and production of the following additional products will depend in large part on the revenues generated from future product sales and the availability of additional financings.

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*Magic Garden.* AeroGrow's children's magic garden is designed for simplicity and ease of use. AeroGrow anticipates introducing this garden system in the toy market.

*Decorator Office Garden.* AeroGrow is developing a garden system designed specifically for use in offices and work stations to introduce decorative and fragrant living flowers into the workplace.

*Professional System.* A larger-scale garden system is planned for small businesses, florists, restaurants, large families and gardening enthusiasts who want to grow large quantities of vegetables, herbs and flowers.

*Future Seed Kits.* AeroGrow plans to complete development and begin production of additional seed kits in 2007. AeroGrow currently anticipates that these seed kits could include a cilantro garden, sunny flower garden, baby bell peppers, Asian hot peppers, and a salsa garden with cherry tomatoes, jalapenos, and cilantro, as well as new varieties of salad greens for international markets. AeroGrow has also begun development of methodology to cultivate and ship live "starter" plants in the grow pod mediums that will be able to grow in AeroGrow's kitchen garden systems. AeroGrow anticipates market testing this process with strawberries during the first quarter of calendar 2007.

Development of these products are included in the budgeted research and development expenses for the future. For other product expansions and new products, AeroGrow has not budgeted amounts for their research and development at this time, and in connection therewith may need to raise additional capital. However, no assurance can be given that such products will be successful.

## **Markets**

Based on AeroGrow's informal market research, consisting of individual consumer interviews, focus groups and Internet survey responses, AeroGrow believes that its kitchen garden systems will appeal to a broad spectrum of the people in the United States and internationally, including Europe and Japan. AeroGrow believes that its products will appeal to at least four major market segments:

- experienced gardeners,
- novice and "want-to-be" gardeners,
- the kitchen products and small appliances market, and
- the office and home décor markets.

Further, based on its discussions with potential distributors, AeroGrow believes that its kitchen garden systems also present opportunities in the specialized toy, educational, gift and hydroponic hobbyist markets.

**Gardener Market.** The 2002 National Gardening Survey conducted by the National Gardening Association states that gardening was America's number one hobby with more than 70 million active gardeners. Based upon this survey, there were estimated to be 27 million vegetable gardeners with one out of every four households having a vegetable garden, over 15 million fresh herb gardeners and over 20 million flower gardeners. AeroGrow believes that its kitchen garden systems and related products can offer both expert and novice gardeners several major benefits not readily available through traditional gardening methods, including:

- the ability to grow fresh herbs, lettuces, vegetables, tomatoes and flowers year-round, regardless of indoor light levels or seasonal weather conditions,
- the ability to easily start plants indoors during colder months and then transplant them outdoors at the onset of the outdoor growing season,
- the ability to use stem cuttings to propagate multiple reproductions of the desired plants in AeroGrow's kitchen garden systems,

- the reasonable assurance that crops can grow successfully by significantly reducing potential obstacles such as uncertain weather and garden pests,
- the ease of growing hydroponically in contrast to the toil associated with traditional gardening, including preparing the soil, planting, thinning, weeding and watering.

**“Want-to-be” Gardener Market.** AeroGrow believes that many people have an interest in gardening but lack the knowledge, confidence, available space, equipment, or time to garden. AeroGrow has observed the following barriers to beginning to garden:

- gardening requires an ongoing time commitment,
- apartment, high-rise and condominium dwellers often lack the land needed for a traditional garden,
- gardening requires physical work which can be a significant barrier to older people or people with limited mobility or health issues,
- buying the necessary equipment to garden can be expensive, and
- gardening requires knowledge and expertise.

AeroGrow believes that its kitchen garden systems overcome many of these barriers and provide a simple, convenient way for many current non-gardeners to begin to garden.

**Kitchen Products and Small Appliances Market.** AeroGrow believes that many Americans now enjoy cooking as a form of entertainment or hobby and that these people repeatedly purchase new kitchen appliances and will be motivated to purchase AeroGrow’s kitchen garden systems and related seed kits. Consumers in this potential market include:

- people interested in cooking who would appreciate the convenience and satisfaction of having a readily available supply of fresh-cut herbs and basil to flavor soups, salads and other dishes,
- people who prefer the distinctive texture and taste of freshly picked, vine-ripened tomatoes, basil, lettuce and other vegetables over days-old supermarket produce, and
- people interested in healthy, pesticide-free foods for themselves and their families, reflecting both the rapidly growing interest in naturally and organically grown foods and the increasing number of people who, for health or weight concerns, include salads and fresh vegetables as part of their families’ diets.

AeroGrow believes that its kitchen garden systems will be embraced in this market by people who understand the value of having an ongoing supply of fresh herbs and vine-ripened produce throughout the year.

**Office and Home Decor Market.** Flowers are frequently used to brighten homes and offices around the world. It is difficult to readily grow flowers indoors due to a lack of sufficient light and growing knowledge. As a result, people often use cut flowers, which are expensive, short-lived and require ongoing maintenance. AeroGrow’s kitchen garden systems enable colorful and fragrant flowers to be easily grown indoors year-round. Flowers grown with its kitchen garden systems will last for months with minimal care and maintenance. Flowers can be grown in a wide variety of



indoor locations, including kitchen and bathroom countertops, living rooms, bedrooms, family rooms, offices, work stations, waiting rooms and lobbies. In addition, professional plant caretakers may be motivated to include AeroGrow's kitchen garden systems among their traditional plant options because of the relatively low cost and ease of maintenance of AeroGrow's systems.

**Specialty Markets.** We believe that several specialized markets potentially exist for AeroGrow's kitchen garden systems in the future, including:

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- toy market for a children's "root-viewing" garden,
- classroom market for student education relating to plant growth,
- gift market,
- hydroponic enthusiast market, and
- international markets, particularly in large cities with limited outdoor garden space.

### **Marketing and Sales Strategy**

AeroGrow began launching its kitchen garden system in the United States during the first quarter of 2006 with a nationwide public relations campaign. Initial test marketing shipments to retail launch partners, including Sur La Table, Frontgate, and others commenced in March 2006. As launch partners, the Company had agreed to feature Sur La Table and Frontgate in the Company's public relations efforts. In addition, the Company agreed to pay to Sur La Table a \$30,000 fee for full page advertisement in Sur La Table's catalogue distributed to over one million consumers. The Company granted exclusive rights to Frontgate as a catalogue retailer through December 1, 2006, in exchange for Frontgate's agreement to provide full page advertisements within their catalogues for the AeroGarden through the end of 2006. To date, AeroGrow has developed many of its marketing materials, including its website, product brochures, retail packaging and other retail collateral materials, public relations kits, in-store point of purchase supplies, infomercial, and short-form television show. AeroGrow's planned marketing strategy is to follow its initial launch with sales of its products through direct marketing vehicles and then expanded distribution through retail channels. AeroGrow plans to expand its marketing and distribution internationally in the second calendar quarter of 2007. AeroGrow's planned direct marketing activities include 30-minute infomercials, 60-second television spots, home shopping networks, print advertising, and Internet-based advertising. AeroGrow's plan is designed to educate prospective customers while creating widespread awareness of its kitchen garden systems and generating direct sales in four key target markets: the experienced gardener market, the "want-to-be" gardener market, the kitchen products and small appliances markets, and the office and home décor market.

### **Competition**

Aeroponic and hydroponic technologies have historically been limited to ardent hobbyists and commercial growing facilities worldwide. AeroGrow believes that it is the first company to develop and offer a simple soil-less indoor growing system for the mass consumer market.

Typical hydroponic manufacturers offer a range of equipment and accessories through distributors or small independent "hydro-shops" in a trade-oriented manner similar to plumbing or electrical suppliers. Purchasers typically mix and match equipment from various suppliers in an "a la carte" fashion to individually customize a large system that they then assemble on their premises. AeroGrow believes that these products are substantially more expensive than the proposed selling prices of the Company's products.

AeroGrow believes that its simplified and complete kitchen garden systems and planned methods of distribution offer significant benefits from these traditional hydroponic industry practices. However, AeroGrow recognizes that there are companies that are better funded and have greater experience in producing hydroponic products in commercial markets, including, but not limited to, companies such as General Hydroponics and American Hydroponics. These companies could potentially decide to focus on the consumer market with competing products. AeroGrow could also

potentially face competition from gardening wholesalers and large and profitable soil-based gardening companies, including, but not limited to, the Burpee Seed Company and Gardener's Supply Company, should they decide to produce a competitive product. These companies may have better consumer acceptance and may be better funded than AeroGrow.

## **Manufacturing**

AeroGrow manufactures its products using contract manufacturing sources that are supervised by its internal engineering and manufacturing teams. Its bio-grow seed pods will initially be produced and assembled in its laboratory facilities in Longmont, Colorado.

AeroGrow has signed a tri-party manufacturing agreement with Source Plus, Inc. (“Source Plus”), an Alabama corporation, and Mingkeda Industries Co., Ltd. (“Mingkeda”), a Chinese company, for the initial manufacture of its kitchen garden systems and accessories. Source Plus assisted AeroGrow in identifying companies in China that had the capability to manufacture AeroGrow’s kitchen garden systems. Source Plus advanced monies to Mingkeda for tooling and molds to build AeroGrow’s products. To reimburse Source Plus for its advances to Mingkeda for tooling, AeroGrow issued 62,000 shares of its common stock to Source Plus in October 2005. AeroGrow recorded a \$310,000 asset for tooling. Source Plus is also obligated to provide quality control inspection services at Mingkeda’s factory for AeroGrow. Mingkeda has informed AeroGrow that it can currently produce 15,000 kitchen garden systems per month and will eventually be able to produce approximately 25,000 kitchen garden systems per month with its existing set of tools. To date, AeroGrow has received approximately 85,000 units from Mingkeda with over 20,000 additional units in process. Mingkeda estimates that it can add the additional set of tools and presses within 60 to 90 days following AeroGrow’s notification. There is no assurance that Mingkeda will be able to meet the projected estimated deliveries. If it is not able to meet the orders, the Company's sales will be adversely affected. In addition to the Mingkeda plant, AeroGrow is exploring relationships with other manufacturers located in China as an alternative supply source should sales volumes require added production. In the event Mingkeda is unable to meet its anticipated production capacity before AeroGrow is able to develop additional contract manufacturing sources, sales could be adversely affected if sales demand exceed production capacity.

AeroGrow’s manufacturing costs for its initial model of the AeroGarden are anticipated to allow AeroGrow to achieve gross margins before selling expenses from wholesale sales ranging from 40% to 50% once manufacturing volumes are at a sufficient level to enable AeroGrow to: (i) achieve economies of scale in its seed kit production; (ii) obtain volume discounts for parts and components related to the manufacture of its kitchen garden systems; and (iii) minimize transportation and logistics costs. However, no assurance can be given that the price of our products will not be subject to downward price pressure, or that our margins will be attained or maintained.

AeroGrow has completed its initial set of tooling and in February 2007 authorized the building of a second set of tooling with a second contract manufacturer, Main Power Electrical Factory Ltd., which is located in China (“Main Power”). During the first calendar quarter of 2007, AeroGrow began receiving delivery of production units built by Main Power. Production capacity at Main Power is estimated to be 50,000 units per month for each set of tools.

AeroGrow produces and assembles its bio-grow seed pods in its laboratory facilities in Longmont, Colorado. The seed pods and kitchen garden systems are shipped to a fulfillment center in Reno, Nevada. A third party service provider provides warehousing, order fulfillment, and shipping for AeroGrow’s products. See also “Distribution” above.

## **Product Returns and Warranties**

AeroGrow has had limited sales to date and thus has limited experience dealing with returns. AeroGrow currently processes returns at a third party distribution center, but intends to allow products to be returned to its facilities in Longmont, Colorado in the near future. AeroGrow anticipates that it will send unopened returned products to back into inventory and repair defective products to sell as refurbished products. Mingkeda will provide AeroGrow with replacement part assemblies for products which are deemed defective due to materials or manufacturing

complications. The Company records warranty liabilities at the time of sale for the estimated costs that may be incurred under its basic warranty program. The specific warranty terms and conditions vary depending upon the product sold but generally include technical support, repair parts, labor for periods up to one year. Factors that affect the Company's warranty liability include the number of installed units currently under warranty, historical and anticipated rates of warranty claims on those units, and cost per claim to satisfy the Company's warranty obligation.

## Intellectual Property

AeroGrow has filed 19 patent applications in the United States to protect its technologies and products. These applications are for:

- seed germination pods that transport, support and germinate seedlings in aeroponic or hydroponic devices and support the growth of the plant to maturity, filed in November 2003, application serial number 10/714,786, and responded to examiner's second action,
- use of infrared beams to measure plant roots which creates a basis for the regulation of nutrients, oxygen and plant growth, filed in December 2003, application serial number 10/748,321, and responding to examiner's second action,
- PONDS (passive, osmotic nutrient delivery system) technology, which is a nutrient delivery system using no moving parts, filed in March 2005, application serial number 11/079,054,
- RAIN (rain-aerated ionized nutrient) system technology, which hyper-oxygenates and ionizes plant roots in AeroGrow's kitchen garden systems, filed in March 2005, application serial number 10/528,110,
- rainforest growing dome for maximizing germination, filed in April 2005, application serial number 11/098,176, and responded to examiner's second action,
- growing basket for optimizing liquid and nutrient delivery, filed in April 2005, application serial number 11/111,553, and responding to examiner's second action,
- methods for growing plants using seed germination pods, filed in April 2005, application serial number 11/112,269, and responding to examiner's second action,
- devices and methods for growing plants by measuring liquid or nutrient usage rate, the adaptive growth learning technologies, filed in December 2005, application serial number 11/321,368,
- time-release oxygen generating nutrient compositions and methods for growing plants, filed in December 2005, application serial number 11/321,910,
- pH buffered plant nutrient compositions and methods for growing plants, filed in December 2005, application serial number 11/321,023,
- apparatus and methods for delivering photoradiation to plants, filed in June 2006, application serial number 60/814,853,
- smart garden devices and methods for hydroponic gardens, filed in June 2006, application serial number 11/455,364,
- indoor gardening appliance, filed in August 2005, application serial number 29/235,880,
- master gardener baskets and methods for growing plants, filed in August 2006, application serial number 60,840,575,
- devices and methods for growing plants, filed in January 2007, application serial number 11/653,121,



- indoor gardening appliance, filed in January 2007, application serial number 29/271,260,
- indoor gardening appliance, filed January 2007, application serial number 29/271,259, and
- systems and methods for controlling liquid delivery and distribution to plants, filed January 2007, application serial number 11/654,164.

AeroGrow believes that these patent applications do not infringe on issued patents owned by others. AeroGrow believes that if it fails to receive patents for any one of these patent applications, its operations will not be substantially, adversely affected. AeroGrow believes that failure to obtain patents, however, will make it easier for competitors to bring competitive products to market. If such competitive products performed better and/or were marketed by companies with greater financial and distribution resources than AeroGrow, such competitive products may adversely affect AeroGrow's operations. In addition to the patents being sought, AeroGrow maintains some crucial information about its products as trade secrets, which information is closely guarded. The inventions under the patent applications have not been granted patents, and there can be no assurance that patents will be granted.

AeroGrow has filed 28 trademark applications in the United States (7 of which have been allowed) and three trademark applications designating 33 countries, which it intends to prosecute to protect its products and brand equity. The applications are for:

- Farmers Market Fresh, filed in July 2005, application serial number 78671280, and allowed,
- Kitchen Harvest filed in December 2005, application serial number 78781094,
- AeroGarden filed in December 2005, application serial number 78781935, and allowed,
- Farmer's Market in Your Kitchen, filed in March 2006, application serial number 78836826, and allowed,
- Off the Plant and Into the Pot, filed in March 2006, application serial number 78836758, and allowed,
- Cut & Cook, filed in March 2006, application serial number 78836736, and allowed,
- Bio-Dome, filed in March 2006, application serial number 78836718, and allowed,
- AeroPod, filed in March 2006, application serial number 78836577, and allowed,
- AeroGarden, filed in Mexico in June 2006, application serial number 790722, and responding to examiner's action,
- AeroGarden, filed in 31 countries under the Madrid Protocol in June 2006, application serial number A0005030,
- AeroGarden, filed in Canada in June 2006, application serial number 1,305,822,
- International Gourmet, filed in May 2006, application serial number 78874379, and about to publish,
- Farmer's Market Fresh, filed in May 2006, application serial number 78882877, and responding to examiner's action,





- AeroGrow, filed in April 2005, application serial number 78614573, responded to examiners first action and suspended,
- MiniGarden, filed in August 2006, application serial number 78955672,
- GrowNow, filed in August 2006, application serial number 78955692, and responding to examiner's action,
- Green Thumb Guarantee, filed in September 2006, application serial number 77007729,
- BioTransport, filed in September 2006, application serial number 77009465,
- Herb Appeal, filed November 2006, application serial number 77045636,
- Strawberry Patch, filed November 2006, application serial number 77045993
- Sweet Rubies, filed December 2006, application serial number 77058522,
- Plug & Grow, filed December 2006, application serial number 77058534,
- Even Better Than Organic, filed December 2006, application serial number 77070519, and responding to examiner's action,
- AeroGarden, filed December 2006, application serial number 77073259, and responding to examiner's first action,
- AeroGarden, filed December 2006, application serial number 77073339, and responding to examiner's first action,
- AeroGarden, filed December 2006, application serial number 77073345, and responding to examiner's first action,
- AeroGarden, filed December 2006, application serial number 77073362,
- AeroGarden, filed December 2006, application serial number 77073424,
- AeroGarden, filed December 2006, application serial number 77073448, and
- Herb `n Serve, filed January 2007, application serial number 77095536.

Each of AeroGrow's employees, independent contractors and consultants has executed assignment of application agreements and nondisclosure agreements. The assignment of application agreements grant to AeroGrow the right to own inventions and related patents which may be granted in the United States. The nondisclosure agreements generally provide that these people will not disclose AeroGrow's confidential information to any other person without its prior written consent. AeroGrow has also obtained the domain names for AeroGrow.com, AeroGarden.com, AeroGarden.net, AeroGarden.tv, AeroGarden.biz, and Getthegarden.com, among others.

### **Governmental Regulation and Certification**

To the best of its knowledge, AeroGrow believes that it is complying with United States regulations concerning the shipping and labeling of seeds and nutrients. Currently, the components for the kitchen garden system are UL

certified. AeroGrow has filed initial applications for UL certification and ETL certification for the kitchen garden system as a whole. These certifications confirm that the products have been tested and conform to a recognized level of fire and other safety standards for consumers. Such independent third party certification is required for sales of products through many major retailers.

AeroGrow believes that its costs and effects of compliance with environmental laws will not be material.

### **Personnel**

As of January 31, 2007, AeroGrow employed approximately 68 persons - 56 full-time and 12 part-time. In addition, AeroGrow contracts for the services of part-time and project consultants on an "as needed" basis. AeroGrow believes that its employee relations are good. AeroGrow believes that it will hire additional employees and/or consultants in the future as its operations grow. AeroGrow is planning to outsource some activities, in whole or part, such as manufacturing, telemarketing, public relations, infomercial production, fulfillment, and shipping.

### **Facilities**

On July 27, 2006 the Company entered into a lease with Pawnee Properties, LLC to consolidate its operations, other than its seed kit manufacturing operations, into a 21,012 square foot office space at 6075 Longbow Drive, Boulder, Colorado 80301. Pawnee Properties, LLC, and its controlling persons, are not affiliates of the Company. The initial rent is \$15,759 per month, plus the Company's proportionate share of building taxes, insurance and operating expenses. The initial term continues until January 31, 2012, unless modified under specified circumstances. The agreement contains other standard office lease provisions

AeroGrow also rents 1,800 square feet of laboratory, prototyping and manufacturing space in Longmont, Colorado, pursuant to a month-to-month rental agreement. The rental agreement requires AeroGrow to pay monthly rent in the amount of \$1,200. AeroGrow use this space to manufacture its seed pods.

While its facilities appear adequate for the foreseeable future, AeroGrow may add space to meet future growth as needed. Upon expiration of its current leases, AeroGrow believes that it will be able to either renew its existing leases or arrange new leases in nearby locations on acceptable terms. AeroGrow believes that these properties are adequately covered by insurance.

### **Legal Proceedings**

AeroGrow is not a party in any bankruptcy, receivership or other legal proceeding, and to the best of AeroGrow's knowledge, no such proceedings by or against AeroGrow have been threatened.

## MERGER WITH WENTWORTH

### History of Wentworth

Wentworth I, Inc., a Delaware corporation (“Wentworth”), and AeroGrow entered into an Agreement and Plan of Merger (the “Merger Agreement”) on January 12, 2006, which was consummated on February 24, 2006. Under the Merger Agreement, Wentworth merged with and into AeroGrow, and AeroGrow was the surviving corporation (“Merger”). The certificate of incorporation and by-laws of AeroGrow prior to the Merger are now those of the surviving company, and the surviving company is governed by the corporate law of the State of Nevada.

Wentworth was organized under the laws of the State of Delaware on March 6, 2001. Its business plan was to seek, investigate and, if such investigation warranted, enter into a business combination with a target operating company that primarily desired to seek the perceived advantages of a U.S. reporting company under the Securities Exchange Act of 1934, as amended (“Exchange Act”). Wentworth’s principal business objective was to seek long-term growth potential through the acquisition of a business rather than immediate, short-term earnings. Its search was not restricted to any specific business, industry, or geographical location. Wentworth was one of a number of shell companies with nominal assets and operations owned, in part, by Keating Securities and its affiliates.

Wentworth filed a registration statement on Form SB-2 with the SEC in order to undertake a public offering of 50,000 shares of its common stock at a purchase price of \$1.00 per share, which registration statement was declared effective on August 12, 2001. Wentworth successfully completed the offering and, pursuant to Rule 419 of the Securities Act, the offering proceeds, less 10%, (which was retained by Wentworth to cover its expenses), were placed in an escrow account together with the shares of common stock issued in the public offering.

In February 2003, when Wentworth determined that it was unable to consummate a business combination within the 18 month time period from the date of the effectiveness of its registration statement as required by Rule 419(e)(2)(iv), all funds held in escrow were returned to the investors who had purchased common stock in the offering and the 50,000 shares of common stock held in the escrow account were returned as treasury stock. A post-effective amendment to the registration statement was filed on March 25, 2003, to remove from registration all shares of common stock that were sold in the offering and to confirm the withdrawal of the registration statement.

Wentworth was dormant after March 2003, but management elected to continue the implementation of its original business plan and sought a business combination with an operating company. On August 4, 2004, Wentworth filed Form 10-SB to register its shares of common stock under Section 12(g) of the Exchange Act. At the time of the Merger, Wentworth was a reporting company under Section 12(g) of the Exchange Act and was current in its reporting under the Exchange Act.

Wentworth and ENECO, Inc., a Utah corporation (“Eneco”), entered into an Agreement and Plan of Merger (the “Eneco Merger Agreement”) on October 28, 2005, by which Wentworth agreed to merge with and into Eneco, with Eneco being the surviving corporation. Effective January 3, 2006, Wentworth terminated the Eneco Merger Agreement due to the failure of the transactions contemplated thereunder to have been consummated by January 1, 2006. It was only after termination of the Eneco Merger Agreement that Wentworth was available as a vehicle for AeroGrow. The decision to negotiate a merger between Wentworth and AeroGrow was made after the termination of the Eneco Merger Agreement.

### Certain Transactions by Wentworth

During 2002, Wentworth borrowed a total of \$8,500 from Kevin R. Keating, its then president. The amount loaned plus interest at 6% was due and payable upon the completion of a business combination. For the years ended

December 31, 2005 and 2004, interest on this loan of \$510 each year is included in operations. At December 31, 2005, the principal balance of this loan together with accrued interest totaled \$10,290.

Wentworth's president, with two other shareholders, granted Keating Reverse Merger Fund, LLC ("KRM Fund") an option to acquire an aggregate of 1,000,000 shares of Wentworth, owned by them, until January 30, 2005, at a total purchase price of \$125,000. This option expired unexercised.

On April 9, 2003 and August 7, 2003 Timothy Keating paid invoices on behalf of Wentworth in an aggregate of \$1,861. Timothy Keating is the managing member of Keating Investments, LLC (“Keating Investments”).

On June 10, 2004, Wentworth entered into a contract with Vero Management, L.L.C. (“Vero Management”) for managerial and administrative services. Vero Management was not engaged to provide, and did not render, legal, accounting, auditing, investment banking, or capital formation services. Kevin R. Keating is the manager of Vero Management. The term of the contract was for one year. In consideration of the services provided, Vero Management was paid \$1,000 for each month in which services were rendered. For the years ended December 31, 2005 and 2004, a total of \$12,000 and \$7,000, respectively, was included in results of operations as a result of the agreement.

Wentworth entered into a financial advisory services agreement with Keating Securities, an affiliate of Keating Investments, the managing member of Wentworth’s controlling stockholder, and engaged Keating Investments to act as a financial advisor in connection with the business combination between Wentworth and AeroGrow for which it earned an advisory fee of \$350,000 upon completion of the Merger. The \$350,000 was in addition to the sale price of Wentworth. The services included introduction of Wentworth to AeroGrow and advising Wentworth on the Merger. The advisory fee was paid at the closing of the Merger. Keating Securities made no assurances regarding completion of the private placement or the merger.

Keating Securities filed a Form 211 with the NASD to cause the common stock to be traded on the OTC BB. We have received confirmation that our stock has been cleared for trading on the OTC BB. As part of that filing, Keating Securities has indicated that it will act as a market maker in the common stock at the time of its initial trading. There can be no assurance that Keating Securities will continue to act as a market maker for the common stock of the Company. To the knowledge of the Company, Keating Securities does not intend to provide any other after market support to the common stock of the Company.

### Ownership of Wentworth prior to Merger

Immediately prior to the Merger, the stock ownership of Wentworth was as set forth below in the table of ownership. The number of shares includes those that were issued and outstanding and not adjusted for the conversion formula to be applied at the consummation of the Merger.

Name	Number of Shares of Wentworth Common Stock Beneficially Owned	Percent of Shares
Kevin R. Keating 936A Beachland Blvd., Suite 13 Vero Beach, Florida 32963 (1), (2)	743,000	19.8%
Keating Investments, LLC c/o Timothy J. Keating, Manager 5251 DTC Parkway, Suite 1090 Greenwood Village, Colorado 80111	565,000	15.1%
Bertrand T. Ungar 1362 South Elizabeth Denver, Colorado 8023 (4)	192,000	5.1%
Garisch Financial, Inc.	250,000	6.7%

c/o Frederic M. Schweiger, President 1753 Park Ridge Pointe Park Ridge, Illinois 60068 (5)		
Keating Reverse Merger Fund, LLC c/o Timothy J. Keating, Manager 5251 DTC Parkway, Suite 1090 Greenwood Village, Colorado 80111 (6)	2,000,000	53.3%



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- (1) Kevin R. Keating was the President, Secretary, Treasurer and sole director of Wentworth.
  - (2) Kevin R. Keating is not affiliated with and has no equity interest in Keating Reverse Merger Fund, LLC or Keating Investments, LLC and disclaims any beneficial interest in the shares of Wentworth's common stock owned by Keating Reverse Merger Fund, LLC or Keating Investments, LLC.
  - (3) Timothy J. Keating exercises voting and dispositive power of the shares held by Keating Investments, LLC. Keating Investments, LLC is not owned by or affiliated with Kevin R. Keating and disclaims any beneficial interest in the shares of Wentworth's common stock owned by Kevin R. Keating.
  - (4) Held in the name of PG Ventures, LLC (153,600 shares) and Carmel Capital, LLC (38,400 shares), both of which are owned and controlled by Mr. Ungar.
  - (5) Frederic M. Schweiger is the sole officer, director and stockholder of Garisch Financial, Inc. and exercises voting and dispositive power of such shares held by Garisch Financial, Inc.
  - (6) Timothy J. Keating exercises voting and dispositive power of the shares held by Keating Reverse Merger Fund, LLC. Keating Reverse Merger Fund, LLC is not owned by or affiliated with Kevin R. Keating and disclaims any beneficial interest in the shares of Wentworth's common stock owned by Kevin R. Keating.

### **Effect of Merger**

As a result of the Merger, AeroGrow became a "successor issuer" to Wentworth within the meaning of Rule 12(g)-3 under the Exchange Act. As a "successor issuer," AeroGrow is a Section 12(g) reporting company under the Exchange Act. As a result, the shares of common stock of AeroGrow are now registered securities under Section 12(g) of the Exchange Act.

In the Merger, each of the Wentworth's 3,750,000 shares of outstanding common stock ("Wentworth common stock") was converted into the right to receive 0.154703 shares of AeroGrow common stock resulting in the issuance of 580,136 shares of AeroGrow's common stock to the Wentworth stockholders representing 6.5% of the issued and outstanding common stock of AeroGrow immediately after the Merger, the 2006 Offering, and the Note Conversion (as defined below).

Each share of AeroGrow common stock issued to the Wentworth's stockholders in the Merger is restricted stock, and the holder may not sell, transfer, or otherwise dispose of such shares without registration under the Securities Act or an available exemption therefrom. The Merger Agreement contains piggy-back registration rights that allow each Wentworth stockholder to include his, her, or its shares in any registration statement filed for the public offering or resale of its securities in the future. This registration right is required to satisfy certain positions taken by the SEC in connection with shares issued to persons that may be considered promoters. The SEC's position is that the shares held by promoters may not be publicly sold pursuant to Rule 144, but may only be publicly sold by the promoter pursuant to an effective resale registration statement. It has been determined by the Company that KRM Fund, Kevin R. Keating, and Keating Investments are promoters under this definition. The other shareholders of Wentworth, Garisch Financial, Inc., and Bertrand T. Unger are not promoters. As part of the 2006 Offering, AeroGrow agreed to register for resale the shares of AeroGrow's common stock issued to the investors in the 2006 Offering (together with the shares of AeroGrow's common stock underlying the warrants issued in the 2006 Offering) on a registration statement to be filed with and declared effective by the SEC. The holders of 396,813 of such shares have waived their right to be included in this registration statement in exchange for the obligation of the company to register all such shares as soon

as commercially reasonable after the filing of the next quarterly or annual report after the declaration of effectiveness of the this registration statement, and the Company has agreed to use its commercially reasonable efforts to have such replacement registration statement declared effective as soon as practicable.

Pursuant to the Merger Agreement, KRM Fund entered into a lockup agreement respecting 309,406 shares of common stock under which it will be prohibited from selling or otherwise transferring: (i) any of its shares of AeroGrow's common stock for a period of 12 months following the effective date of the resale registration statement that includes the common stock issued in 2006, and (ii) 50% of its shares of AeroGrow's common stock for a period of 18 months following the effective date of such registration statement. Approximately 87,407 shares of AeroGrow's common stock held by Keating Investments, the managing member of KRM Fund and the 90% owner of Keating Securities, are also subject to lockup restrictions similar to those that apply to the KRM Fund shares. The foregoing lockup restrictions may be released by the mutual agreement of AeroGrow and Keating Securities, the exclusive placement agent for the 2006 Offering.

As post-closing covenants to the Merger Agreement, AeroGrow agreed that, unless it has the consent of KRM Fund, it will not issue any securities until February 28, 2007 to its officers and directors or 10% or greater stockholders, consultants, service providers, or other parties, except for issuances with respect to outstanding options, warrants, and convertible securities and pursuant to existing obligations, grants pursuant to stock option and similar plans approved by the board and stockholders, capital raising requirements approved by the board, or third party, arms-length transactions. AeroGrow is also obligated to: (i) remain a 12(g) reporting company and comply with the reporting requirements under the Exchange Act, (ii) use its commercially reasonable efforts to obtain and maintain a quotation of its shares of AeroGrow common stock on the OTC BB or Nasdaq, and (iii) within 30 days following the Closing, procure key man life insurance policies on certain officers of AeroGrow. AeroGrow also was obliged to satisfy the independence, audit, and compensation committee and other corporate governance requirements under the Sarbanes-Oxley Act of 2002, the rules and regulations promulgated by the SEC, and the requirements of either Nasdaq or American Stock Exchange ("AMEX") (as selected by AeroGrow), whether or not AeroGrow's common stock is listed or quoted, or qualifies for listing or quotation, on Nasdaq or AMEX. On March 28, 2006, AeroGrow elected to use the requirements of Nasdaq for its corporate governance standards.

### **Accounting Treatment for Merger**

The Merger, for accounting and financial reporting purposes, was accounted as an acquisition of Wentworth by AeroGrow. As such, AeroGrow was the accounting acquirer in the Merger, and the historical financial statements of AeroGrow before the merger will continue to be the financial statements for AeroGrow following the Merger.

### **Private Placement in Connection with Merger**

In its 2006 Offering, AeroGrow conducted a private placement offering of its common stock and common stock purchase warrants (the "2006 Warrants") to institutional investors and other high net worth individuals on a best efforts \$5,000,000 minimum, \$12,000,000 maximum basis as a condition to consummation of the Merger.

The 2006 Offering was commenced February 6, 2006, and there were closings on February 24, 2006, and March 1, 2006. AeroGrow received gross proceeds of \$10,740,000. Pursuant to investor subscription agreements, AeroGrow sold 2,148,000 shares of its common stock and warrants to purchase 2,148,000 shares of its common stock. Each unit in the offering consisted of 1 share of common stock and a warrant to purchase 1 share of common stock expiring February 2011, at an exercise price of \$6.25 per share. The price per unit was \$5.00. AeroGrow received net proceeds of \$8,964,952 after commissions and offering expenses.

Keating Securities was the exclusive placement agent for the 2006 Offering. For their services, they were paid a fee of 10% of the gross proceeds, or \$1,074,000. AeroGrow also paid Keating Securities a non-accountable expense allowance of 3% of the gross proceeds, or \$322,200. In addition, AeroGrow issued to Keating Securities and its

designees warrants to purchase an aggregate of 214,800 shares of common stock expiring February 2011, at an exercise price of \$6.25 per share (“Agent Warrants”). The Agent Warrants are fully vested and may be exercised on a cashless or net issuance basis. The holders of the Agent Warrants were granted the same registration rights as the investors in the 2006 Offering (see below).

AeroGrow is required to register its shares of common stock issued to the investors in the 2006 Offering and the shares of common stock underlying the Warrants and Agent Warrants for resale by the investors pursuant to a registration statement declared effective by the SEC under the Securities Act. If AeroGrow does not have an effective registration statement under the Securities Act that registers for resale the above listed common shares within 150 days of the closing date, then AeroGrow must pay each of the investors (but not the holders of 2006 Warrants or Agent Warrants) 1% of the purchase price paid by such investor for the common stock for each month thereafter that the investor cannot publicly sell the shares of common stock pursuant to an effective registration statement or other exemptions from the federal securities laws. This penalty is payable in shares of common stock at a deemed price of \$2.00 per share. The Company filed the required registration statement within the 45 days. Through September 30, 2006, the Company has recorded penalties for untimely registration of 161,100 shares of common stock issued in the 2006 Offering and booked a corresponding expense of \$805,500. The holders of 85,000 shares of our common stock issued in the 2006 Offering have waived their right to be included in this registration statement in exchange for the obligation of the company to register all such shares as soon as commercially reasonable after the filing of the next quarterly or annual report after the declaration of effectiveness of the this registration statement, and the Company has agreed to use its commercially reasonable efforts to have such replacement registration statement declared effective as soon as practicable.

Copies of the form of Subscription Agreement, Placement Agreement, Form of Common Stock Purchase Warrant, and Form of Agent Warrant are filed as exhibits to this registration statement.

The issuance of shares of AeroGrow's common stock and the 2006 Warrants to the investors in the 2006 Offering was completed pursuant to an exemption from registration contained in Regulations D and S, only to accredited investors. The shares of AeroGrow's common stock, the 2006 Warrants, and the shares of common stock underlying the 2006 Warrants may not be offered or sold in the United States unless they are registered under the Securities Act, or an exemption from the registration requirements of the Securities Act is available.

### **Modification of Convertible Notes**

In connection with the Merger, AeroGrow sought to modify the terms of the outstanding convertible notes issued in the private placement conducted from July to September 2005. The convertible notes were sold as part of 300 units offered at a price of \$10,000 per unit, consisting of a 10% unsecured convertible note ("Convertible Note") and 2,000 warrants with an exercise price of \$5.01 per share and an expiration date of September 13, 2010 ("Debt Warrant"). The notes were originally due and payable on June 30, 2006. The outstanding principal amount of notes originally issued was \$3,000,000. The note holders of this debt were offered the opportunity to convert the principal and interest at a reduced conversion rate, extend the maturity for a lesser reduced conversion rate than immediate conversion, or maintain the current terms unchanged.

Holders of convertible notes representing \$2,130,000 in principal amount converted their notes into AeroGrow common stock at a conversion price of \$3.00 per share, a reduction from the original conversion price of \$4.00 per share. Accordingly, at the closing of the Merger and 2006 Offering, AeroGrow issued 710,009 shares of its common stock (rounded up for fractional shares) to converting note holders ("Note Conversion"). The converting note holders also were issued, pursuant to the terms of the note offering, additional warrants to purchase 426,000 shares of AeroGrow's common stock expiring February 2011, at an exercise price of \$6.00 per share ("Conversion Warrants"). Each share of AeroGrow's common stock and each Debt Warrant and Conversion Warrant is a restricted security and the holder thereof may not sell, transfer or otherwise dispose of such securities without registration under the Securities Act or an available exemption therefrom. AeroGrow agreed to file a registration statement with the SEC under the Securities Act to register for resale the shares of AeroGrow's common stock issued to converting note

holders (together with the shares of common stock underlying the Debt Warrants and Conversion Warrants).

Holder of convertible notes representing \$840,000 in principal amount agreed to extend the maturity under their notes from June 30, 2006 to December 31, 2006 in exchange for a reduction in their conversion price from \$4.00 per share to \$3.50 per share. The Company's note holders further agreed to extend the maturity of these notes until March 31, 2007. The remaining holders of convertible notes, representing \$30,000 in principal amount, did not elect to convert or extend the maturity of their notes and were paid in cash on June 30, 2006. Since December 31, 2006 and as of March 16, \$580,000 in principal amount of the \$840,000 principal amount of convertible notes has elected to convert, or has instructed us to convert on March 31, 2007, such principal amount of convertible notes to 165,714 shares of common stock. We do not know at this time whether the holders of the remaining \$260,000 of convertible notes intend to convert to common stock at a price of \$3.50 per share or seek repayment of their convertible notes.

For those holders of convertible notes who elected to convert or extend the maturity of their notes as described above, (i) AeroGrow eliminated the 180 day lockup provisions on the shares of common stock underlying the convertible notes, Debt Warrants, and Conversion Warrants; (ii) AeroGrow eliminated the redemption provisions of the Debt Warrants; and (iii) the holders of the Convertible Note waived any registration penalties that they had in connection with any late filing or absence of effectiveness under the registration rights provisions of their original subscription for the notes.

Liquidated damages resulting from AeroGrow's failure to file and have declared effective a registration statement that would include the common stock issued as a result of the convertible notes and the shares of common stock underlying the Debt Warrants and Conversion Warrants must be settled through the issuance of additional common stock valued at a price of \$2.00 per share. AeroGrow has recorded penalties for an Effectiveness Default with regard to the convertible notes through December 31, 2006, of 332,876 shares of common stock and booked a corresponding expense of \$1,664,048.

Keating Securities acted as the placement agent for the offering of the convertible notes and related warrants. Keating Securities did not provide any services and did not receive any fees in connection with the modification of the convertible notes.

## MANAGEMENT

### Directors and Officers

The following table shows the names and ages of our directors and executive officers and the positions they hold with AeroGrow. Our bylaws provide that directors are generally elected at our annual shareholders meeting and hold office until the next annual shareholders meeting and until their successors are elected and qualified. Our bylaws provide that the board of directors shall consist of such number of members as the board may determine from time to time, but not less than one and not more than fifteen. Our board of directors currently consists of five individuals. Executive officers are selected by the board of directors and serve at its discretion.

Name	Age	Position with AeroGrow	Serving as a Director Since
W. Michael Bissonnette	58	Chief Executive Officer, President and Director	2002
Richard A. Kranitz	62	Director	2002
Wayne Harding	52	Director	2005
Jack J. Walker	72	Director	2006
Kenneth Leung	62	Director	2006
Mitchell B. Rubin	52	Chief Financial Officer	n/a
Randall Lee Seffren	49	Chief Marketing Officer	n/a

**W. Michael Bissonnette** is our founding shareholder and has served as chief executive officer, president and a director of AeroGrow since July 2002. Concurrently, he has served as chief executive officer, president, and a director of our former parent company, Mentor Capital Consultants, Inc. since March 2000. Mentor Capital currently has no active operating business. From 1994 through 2000, Mr. Bissonnette was a private investor. From 1989 to 1994, he was the founder, chief executive officer, president, and a director of Voice Powered Technology International, Inc., an international consumer electronics company. From 1977 to 1989, Mr. Bissonnette was the founder, chief executive officer and president of Knight Protective Industries, Inc., an international consumer security products company. Prior to 1977, he was founder, chief executive officer and president of Shagrila Carpets, Inc., a multi-store retailer of commercial and home carpeting. Both Voice Powered Technology International, Inc. and Knight Protective Industries, Inc. specialized in the funding, development, and marketing of technology-based consumer products.

**Richard A. Kranitz** has been a director of AeroGrow since July 2002. He has also served as a director of Mentor Capital since March 2000. Mr. Kranitz has been an attorney in private practice since 1970, emphasizing securities, banking and business law. From 1990 to the present he has been an attorney in Kranitz & Philipp in Grafton, Wisconsin. Previously, following the death of a partner in 1976, he formed the Law Offices of Richard A. Kranitz. From 1982 to 1983 he also was a member of Fretty & Kranitz and from 1977 to 1978 he was also a member of Habush, Gillick, Habush, Davis, Murphy, Kraemer & Kranitz. He was a member of McKay, Martin & Kranitz from 1973 to 1976, and was employed by Reinhart, Boerner, Van Deuren, Norris & Reiselbach, s.c. from 1970 to 1973. Mr. Kranitz served as Law Clerk to the Honorable Myron L. Gordon in the U.S. District Court (E.D. Wisconsin) from 1969 to 1970. Mr. Kranitz has served as a director of the Grafton State Bank from 1990 to present. He served as a venture capital consultant to, and director of, various companies, and he has served at various times as a director of various professional, civic, or charitable organizations.

**Wayne Harding** has been a director since October 2005. He has served as vice president business development of Rivet Software since December 2004. From August 2002 to December 2004 Mr. Harding was owner and President of Wayne Harding & Company CPAs and from 2000 until August 2002 he was director-business development of CPA2Biz. He provided consulting services for AeroGrow from December 2003 through March 2004. Mr. Harding is a certified public accountant licensed in Colorado. He is past president of the Colorado Society of CPAs and past



member of the Governing Council for the American Institute of CPAs.

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**Jack J. Walker** has been a director since the February 23, 2006, annual meeting of shareholders. He has served as president of English & Continental Properties, Inc., a real estate investment and development company, since 1980 to present. From 1976 to 1985, Mr. Walker was president of March Trade & Finance, Inc., a private investment company. From 1974 to 1976, Mr. Walker acquired control of Charles Spreckly Industries, Town & Commercial Properties and Associated Development Holdings. In 1961 he started English & Continental Property Company, and became joint Managing Director of this commercial development company until 1976. Mr. Walker began his career in 1957 as a lawyer in London, England specializing in real estate, financing, international tax, and corporate affairs. Mr. Walker has served as a director of Megafoods Stores Inc. from 1984 to 1993. In addition, since 1975 through the present, he has served as a venture capital consultant to companies on financial and pre-IPO strategies. In addition, he created the Walker Foundation for Charitable Activities and he has served at various times as a director of various professional, civic, and charitable organizations.

**Kenneth Leung** has been a director since the February 23, 2006, annual meeting of shareholders. From 1995 to the present he has been Managing Director of Investment Banking-Environmental and the Chief Investment Officer of the Environmental Opportunities Fund at Sanders Morris Harris. Previously Mr. Leung served as Managing Director Research-Environmental at Smith Barney from 1978 to 1994. He was Vice President Research-Environmental with F. Eberstadt & Co. from 1974 to 1978. From 1968-1974 he was an Assistant Treasurer with Chemical Bank. Mr. Leung served on the boards of American Ecology since February 2005, Caprius, Inc. since December, 2006, and SystemOne Technologies since June 2000, all of which are public companies. He has served at various times as a director of various civic and charitable organizations.

#### **Description of Other Executive Officers of the Corporation**

All of the officers of the corporation are appointed by the board of directors to serve until their termination or resignation or appointment of a successor. The current officers, in addition to Mr. Bissonette, are:

**Mitchell Rubin** was elected chief financial officer and treasurer of AeroGrow on February 23, 2006. Prior to joining AeroGrow, from January 2003 through February 2006, Mr. Rubin was an independent financial consultant. From July 1999 to December 2002, Mr. Rubin was the Chief Financial Officer of Web-Ideals LLC, a privately owned application service provider that offered a web-based application for managing direct to consumer commerce. From January 1994 to June 1999, Mr. Rubin held various positions including Chief Financial Officer, Chief Executive Officer, and director with Voice Powered Technology International Inc., a publicly held developer and manufacturer of consumer electronic products. From July 1991 to December 1993, Mr. Rubin served as Executive Vice President and Chief Operating Officer of Regal Group, Inc., a television direct-response company. Mr. Rubin began his career as a certified public accountant.

**Randy Seffren** has been chief marketing officer of AeroGrow since April 2004 on a consulting basis through Prometheus Communications Group, a company of which he is the principal owner, and through which he has billed AeroGrow and as an employee since July 2006. From 1999 to 2004, Mr. Seffren headed the marketing efforts for healthcare communications companies, including Orbis Broadcast Group and MedEd Architects. From 1993 to 1999, he was executive vice president with Reebok Home Fitness/DP Fitness/Body By Jake Fitness/Kent & Spiegel Direct. From 1989 to 1993, Mr. Seffren led the marketing, communications and product development efforts as director of marketing communications with Life Fitness, a fitness equipment company.

#### **Board Committees and Meetings**

AeroGrow has established two standing committees so that some matters can be addressed in more depth than may be possible in a full board meeting: an audit committee and a governance, compensation and nominating committee. These two committees each operate under a written charter. The board has affirmatively determined that Mr. Channer, who was elected by the board and appointed Chairman of these two committees on April 16, 2007, is independent as defined by applicable securities law and NASDAQ corporate governance guidelines. As of March 28, 2006, AeroGrow elected to comply with the corporate governance requirements of NASDAQ which satisfied its obligation pursuant to the Merger Agreement. Following is a description of both of these committees.

**Audit Committee.** The current members of our audit committee are Mr. Channer (chairman), Mr. Jack Walker and Mr. Kenneth Leung. Mr. Channer is considered a financial expert and Messrs Walker and Leung are considered financially literate under the rules of the SEC for audit committee members. Each of these persons is an independent director. As AeroGrow adds additional independent members to our board of directors as required by applicable securities law or exchange listing guidelines, such independent directors may be appointed to our audit committee or the membership of the committee may be changed. This committee's charter provides that the committee shall:

- oversee the accounting and financial reporting processes and audits of the financial statements,
- assist the board with oversight of the integrity of our financial statements, the company compliance with legal and regulatory requirements, its independent auditors' qualifications and independence and the performance of the independent auditors, and
- provide the board with the results of its monitoring.

**Governance, Compensation and Nominating Committee.** The current members of the governance, compensation and nominating committee are Mr. Channer (chairman) and Mr. Jack Walker and Mr. Kenneth Leung. Each of these persons is an independent director. This committee's charter provides that the committee shall:

- recommend to the board the corporate governance guidelines to be followed,
- review and recommend the nomination of board members,
- set the compensation for the chief executive officer and other officer, and
- administer the equity performance plans of AeroGrow.

**Meetings.** During fiscal year ended March 31, 2007 the board of directors met 8 times. Each director attended all of the meetings held by the board during the period that he served as a director of AeroGrow

**Code of Ethics.** We have adopted a Code of Ethics that applies to each of our employees, executive officers and directors. A copy is available free of charge in the "Investor" section at [www.aerogrow.com](http://www.aerogrow.com). Any amendment to or waiver of the Code of Ethics will be disclosed promptly following the date of such amendment or waiver in a Current Report on Form 8-K filing with the SEC.

## **Director Compensation**

### *Current and Historical Compensation Program*

In 2004 and 2005 each director received 2,000 shares of common stock for his service as director. Mr. Bissonnette has agreed to forgo any future stock-based compensation for serving as a director of AeroGrow. AeroGrow compensates directors \$500 for attending meetings and reimburses them for their out-of-pocket expenses for attending meetings. On March 28, 2006, AeroGrow granted to each of its four outside directors 2,500 shares of the Company's common stock at a value of \$5.00 per share for a total of \$12,500 for each director, or an aggregate total of \$50,000, and 10,000 fully vested five-year options to purchase AeroGrow common stock at an exercise price of \$5.00 per share for services for the fiscal year ending March 31, 2007. In addition, Messrs. Walker, Harding and Leung received grants of 1,250 shares for service on the Audit Committee and 750 shares for service on the Governance Committee. On March 22, 2007, AeroGrow granted to three of its four outside directors, Messrs. Leung, Walker and Kranitz, 2,500 shares of the Company's common stock at a market value of \$5.90 per share for a total of \$14,750 for each director, or an aggregate total of \$59,000, and 10,000 fully vested five-year options to purchase AeroGrow common stock at an exercise price

of \$5.90 per share, the price per share equal to the fair market value of the Common Stock on the date of the option grant, for services on the board for the calendar year ending December 31, 2007. In addition, on March 22, 2007, Messrs. Walker and Leung received grants of 1,250 shares for service on the Audit Committee and 750 shares for service on the Governance Committee. Also, Mr. Harding, the previous Chairman of the audit and governance committees, received a grant on March 22, 2007 for services rendered of 3,500 shares of the Company's common stock at a market value of \$5.90 per share for a total of \$20,650 and 5,000 fully vested five-year options to purchase AeroGrow common stock at an exercise price of \$5.90 per share, the price per share equal to the fair market value of the Common Stock on the date of the option grant. Mr. Harding resigned from the board effective April 16, 2007.

*Director Compensation Table*

The following table sets forth information regarding all forms of compensation received by directors of the Company during the fiscal year ended March 31, 2007:

Name	Directors Fees Earned				All Other Compensation	Total
	or Paid in Cash	Stock Awards	Option Awards			
Michael Bissonnette (Chairman)	\$ -	\$ -	-	\$ -	\$ -	
Wayne E. Harding, III, Director	\$ 2,000	\$ 30,650	\$ 25,850 (1)	\$ 69,650 (2)	\$ 128,150	
Richard A. Kranitz, Director	\$ 2,000	\$ 14,750	\$ 51,700 (1)	\$ 24,000 (3)	\$ 92,450	
Kenneth Leung, Director	\$ 2,000	\$ 36,550	\$ 51,700 (1)	-	\$ 90,250	
Jack J. Walker, Director	\$ 2,000	\$ 36,550	\$ 51,700 (1)	-	\$ 90,250	

- (1) Valued using the Black Scholes option pricing model using the following assumptions: no dividend yield; expected volatility rate of 132%; risk free interest rate of 5% and an average life of 5 years resulting in a value of \$5.17 per option granted.
- (2) Represents consulting fees paid to Wayne Harding & Co. for various projects including oversight of a pilot kiosk sales program, investigation of international sales prospects and other new business opportunities.
- (3) Represents fees for legal services paid to Kranitz and Philip, a law firm of which Mr. Kranitz is a partner.

**Executive Compensation***Executives and Employment Arrangements*

The following discussion and table relates to compensation arrangements on behalf of, and compensation paid by the Company to Mr. Bissonnette, our chief executive officer, Mr. Rubin, our Chief Financial Officer, Mr. Brainard, our Vice President of Sales, Mr. Seffren, our Chief Marketing Officer, Mr. Wolfe, our Vice President of Operations and Mr. Robertson, our Vice President of Engineering and Manufacturing for the fiscal year ended March 31, 2007.

*Employment Contracts*

AeroGrow has entered into employment agreements with W. Michael Bissonnette, Mitchell B. Rubin, Randall (Randy) L. Seffren, Jeff Brainard, W. Terry Robertson Jr. and J. Michael Wolfe.

*W. Michael Bissonnette*

The employment agreement of Mr. Bissonnette, dated as of March 1, 2006, provides that he will be employed as the chief executive officer of AeroGrow for an initial term of 24 months, renewable automatically for successive one year terms. He will be paid a base salary of \$225,000. Mr. Bissonnette will also be able to participate in equity compensation plans as determined by the compensation committee. Mr. Bissonnette will be reimbursed car and home office expenses at the rate of \$2,500 per month and participate in regular employee benefit plans as provided by the Company. If Mr. Bissonnette is terminated without cause by the Company or Mr. Bissonnette terminates under certain circumstances constituting a breach of the agreement by the Company, he will be paid his base salary, medical benefits, and pro rata portion of the bonus for one year. If he terminates his employment without cause, he will be paid his salary to the end of the month of such notice. Mr. Bissonnette has agreed to regular confidentiality provisions and

agreed not to compete with AeroGrow in the area of aeroponics products and business for two years after the termination of employment. Any inventions, including modifications, are assigned to the Company by the terms of the agreement.

*Mitchell B. Rubin*

The employment agreement of Mr. Rubin, dated as of March 1, 2006, provides that he will be employed as the chief financial officer of the Company. He will devote his entire business time to the affairs of the Company, provided that for the first four months of his employment he was permitted to devote a limited amount of time to non-competitive business activities during the work day in transition from his prior consulting business. The initial term is two years and renewable for successive one year terms. Mr. Rubin shall receive base compensation of \$200,000 per year and a bonus per fiscal year of not less than 1.5% of EBITDA. If Mr. Rubin is terminated without cause by the Company or Mr. Rubin terminates under certain circumstances constituting a breach of the agreement by the Company, Mr. Rubin shall be entitled to receive severance compensation equivalent to six months base salary and the pro rata bonus. In addition, in the event of a change in control of AeroGrow, including a change in chief executive officer, Mr. Rubin shall be entitled to receive severance for one year. The agreement also provides for medical, vacation and other benefits commensurate with the policies and programs as adopted by AeroGrow for its senior executives. Further, the agreement provides for Mr. Rubin to receive a grant of options to purchase 125,000 shares of AeroGrow's common stock under AeroGrow's 2005 Plan at an exercise price of not greater than \$5.00, which was granted on March 28, 2006. These options shall: (i) were fully vested on the grant date; (ii) shall not expire in less than five years from the date of grant; (iii) be subject to other standard terms and conditions under the 2005 Plan. (iii) be subject to other standard terms and conditions under the 2005 Plan; and; (iv) have other terms and conditions no less favorable than that granted to other senior executives of the Company. Mr. Rubin has agreed to regular confidentiality and inventions assignment provisions and agreed not to compete with AeroGrow for two years after the termination of employment.

*Randall (Randy) L. Seffren*

The employment agreement of Mr. Seffren provides that he will be employed as Chief Marketing Officer of the Company. He will devote all of his business time to the affairs of the Company working half time from an office in Chicago, Illinois and the balance of his time traveling on Company business. The initial term is two years ending July 31, 2008, and renewable for successive one year terms. Mr. Seffren will receive base compensation of \$200,000 per year and a bonus per fiscal year in an amount not less than 1.5% of the EBITDA of the Company, as determined by the Company's annual financial statements and pro rated for any portion of such annual period covered under this Agreement. The bonus is subject to adjustment so that it is no less favorable than granted to other senior executives. The agreement also provides for medical, vacation, and other benefits commensurate with the policies and programs as adopted by AeroGrow for its senior executives. Further, the agreement confirms the option grant awarded to Mr. Seffren as of March 28, 2006, consisting of an option to purchase 125,000 shares of AeroGrow's common stock under AeroGrow's 2005 Equity Compensation Plan at an exercise price of \$5.00 per share, which were fully vested as of that grant date and are subject to other standard terms and conditions under the 2005 Equity Compensation Plan. Mr. Seffren has agreed to regular confidentiality and inventions assignment provisions and agreed not to compete with AeroGrow during employment and for 24 months thereafter. If his employment is terminated, he will be entitled to receive severance pay equal to six months of his base salary as in effect immediately before his termination, and the payment by the Company of medical benefits until the 12th month following termination, and the pro rata portion of his bonus as of the nearest quarter end financial statements of the Company.

*Jeff Brainard*

The employment agreement of Mr. Brainard, dated as of March 31, 2006, provides that he will be employed as the vice president, sales of the Company. He will devote his entire business time to the affairs of the Company, working from his home office in Lexington, Massachusetts. The initial term is two years and renewable for successive one year terms. Mr. Brainard shall receive base compensation of \$150,000 per year and a bonus per fiscal year in an amount not less than the greater of: (i) \$50,000; (ii) 0.5 per cent of retail net sales, net of all customer deductions including but not limited to returns, allowances, bad debts and other deductions; or (iii) 1.5% of the EBITDA of the Company as determined by the Company's annual financial statements and pro rated for any portion of such annual period covered under this Agreement. Such bonus shall be payable for the initial year in two installments, \$25,000 to be paid six months following the initial date of the agreement, an additional \$25,000 12 months following the date of the agreement, and the balance not later than 120 days after the end of the each of the Company's fiscal years covered under the agreement. The agreement also provides for medical, vacation, and other benefits commensurate with the policies and programs adopted by AeroGrow for its senior executives. Further, the agreement provides for Mr. Brainard to receive a grant of 125,000 options to purchase AeroGrow's common stock under AeroGrow's 2005 Plan at an exercise price of not greater than \$5.00. The options shall: (i) vest pursuant to a schedule that provides for vesting of at least of 33% of the amount of the grant at the date granted and 33% per each 12-month period from the date of grant; (ii) not expire in less than five years from the date of grant; and (iii) be subject to other standard terms and conditions under the 2005 Plan. The agreement also required that Mr. Brainard be granted shares of AeroGrow common stock equal in value to \$25,000 semi-annually until such time as the salary is at a rate of \$200,000 annually. The first 5,000 shares (valued at a price of \$5.00 per share) were granted immediately upon Mr. Brainard's joining AeroGrow, with 5,000 additional shares six months thereafter. Effective March 31, 2007, the salary was increased to \$200,000 annually. Mr. Brainard has agreed to regular confidentiality and inventions assignment provisions and agreed not to compete with AeroGrow for a period equal to the term employed after the termination of employment. If Mr. Brainard is terminated without cause by the Company or Mr. Brainard terminates under certain circumstances constituting a breach of the agreement by the Company, Mr. Brainard shall be entitled to receive severance compensation equivalent to six months base salary and the pro rata bonus. In addition, in the event of a change in control of AeroGrow, including a change in chief executive officer, Mr. Brainard shall be entitled to receive severance for one year.

*W. Terry Robertson Jr.*



The employment agreement of Mr. Robertson, dated as of April 15, 2006, provides that he will be employed as the Vice President of Engineering, Manufacturing and Quality of the Company. He will devote his entire business time to the affairs of the Company. The initial term is two years and renewable for successive one year terms. Mr. Robertson shall receive base compensation of \$150,000 per year, a bonus of 5,000 shares of the Company's common stock upon Employee's relocation to the Boulder, Colorado area, and a bonus per fiscal year of not less than 1.5% of EBITDA. If Mr. Robertson is terminated without cause by the Company or Mr. Robertson terminates under certain circumstances constituting a breach of the agreement by the Company, Mr. Robertson shall be entitled to receive severance compensation equivalent to six months base salary and the pro rata bonus. The agreement also provides for medical, vacation and other benefits commensurate with the policies and programs adopted by AeroGrow for its senior executives. Further, the agreement provides for Mr. Robertson to receive a grant of 125,000 options to purchase AeroGrow's common stock under AeroGrow's 2005 Plan at an exercise price of not greater than \$5.00. The options, which were granted on March 28, 2006, shall: (i) vest 50% 12 months from the anniversary date hereof and an additional 12.5% per each three-month period thereafter until fully vested; (ii) not expire in less than five years from the date of grant; and (iii) be subject to other standard terms and conditions under the 2005 Plan. Mr. Robertson has agreed to regular confidentiality and inventions assignment provisions and agreed not to compete with AeroGrow for a period equal to the term employed after the termination of employment. In addition, in the event of a change in control of AeroGrow, including a change in chief executive officer, Mr. Robertson shall be entitled to receive severance for one year. On November 15, 2006, Mr. Robertson's annual salary was increased to \$165,000 per year and he received a retroactive salary adjustment of \$10,000.

*J. Michael Wolfe*

The employment agreement of Mr. Wolfe, dated as of March 15, 2006, provides that he will be employed as the Vice President of Operations of the Company. He will devote his entire business time to the affairs of the Company. The initial term is two years and renewable for successive one year terms. Mr. Wolfe initially received base compensation of \$135,000 per year and a bonus per fiscal year of not less than 0.5% of EBITDA. If Mr. Wolfe is terminated without cause by the Company or Mr. Wolfe terminates under certain circumstances constituting a breach of the agreement by the Company, Mr. Wolfe shall be entitled to receive severance compensation equivalent to six months base salary and the pro rata bonus. The agreement also provides for medical, vacation and other benefits commensurate with the policies and programs adopted by AeroGrow for its senior executives. Further, the agreement provides for Mr. Wolfe to receive a grant of options to purchase 125,000 shares of AeroGrow's common stock under AeroGrow's 2005 Plan at an exercise price of not greater than \$5.00, which was granted on March 28, 2006. These options: (i) were fully vested on the grant date; (ii) shall not expire in less than five years from the date of grant; (iii) be subject to other standard terms and conditions under the 2005 Plan. Mr. Wolfe has agreed to regular confidentiality and inventions assignment provisions and agreed not to compete with AeroGrow for a period equal to the term employed after the termination of employment. In addition, in the event of a change in control of AeroGrow, including a change in chief executive officer, Mr. Wolfe shall be entitled to receive severance for one year. Effective April 7, 2007, Mr. Wolfe's annual salary was increased to \$175,000 per year and the bonus to 1.5% of EBITDA.

Except as set forth above, the other employees of AeroGrow are employed on an "at will" basis subject to varying lengths of severance agreements and, to the extent specific agreements exist; such agreements are not deemed material.

*Summary Compensation Table*

The following table sets forth information regarding all forms of compensation received by the named executive officers during the fiscal year ended March 31, 2007:

Name and Principal Position	Year	Salary	Bonus	Stock Awards	Option Awards	All Other Compensation	Total
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W. Michael Bissonnette, CEO, President and Director(1)	2007	\$ 225,000	\$ --	\$ --	\$ --	23,063(1)	\$ 248,063
Mitchell B. Rubin, Chief Financial Officer	2007	\$ 200,000	\$ 5,000	\$ (2)	\$ --	--	\$ 230,000
Randy Seffren, Chief Marketing Officer	2007	\$ 150,000	\$ --	\$ --	\$ --	53,828 (3)	\$ 203,528
Jeff Brainard, Vice President Sales	2007	\$ 150,000	\$ 63,462	\$ (4)	\$ 9,604(4)	--	\$ 248,066
W. Terry Robertson Jr., Vice President of Engineering, Manufacturing and Quality	2007	\$ 159,375	\$ (5)	\$ (5)	\$ (5)	--	\$ 699,375
J. Michael Wolfe Vice President, Operations	2007	\$ 157,500	\$ --	\$ --	\$ --	--	\$ 157,500

- (1) In accordance with the employment agreement entered into as of March 1, 2006, Mr. Bissonnette has a non-accountable expense allowance of \$2,500 per month as reimbursement for his auto expenses, home office expenses and other expenses.
- (2) Represents 5,000 shares of the Company's common stock granted to Mr. Rubin in December 2006 valued by the Company at \$5.00 per share.
- (3) Represents consulting fees paid to Prometheus Communications Group, LLC ("PCG") of which Mr. Seffren is the 100% owner and managing member prior to the effective date of Mr. Seffren's employment agreement.
- (4) In accordance with Mr. Brainard's employment agreement, the Company issued 5,000 shares of the Company's common stock on January 3, 2007 valued by the Company at \$5.00 per share. In addition, in December 2006, Mr. Brainard was granted five year options to purchase the Company's common stock at an exercise price of \$5.00 per share which will vest monthly pro-rata over a two year period. The Company valued the foregoing options using the Black Scholes option pricing model using the following assumptions: no dividend yield; expected volatility rate of 129.67%; risk free interest rate of 5% and an average life of 4 years, resulting in a value of \$4.12 per option granted.
- (5) The Company issued 5,000 shares of the Company's common stock on January 3, 2007 valued by the Company at \$5.00 per share. In accordance with Mr. Robertson's employment agreement, the Company granted in June 2006 125,000 options to purchase the Company's common stock at an exercise price of \$5.00 per share, which will vest 50% during the initial twelve months from