

AeroGrow International, Inc.
Form 10-K
June 26, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended March 31, 2012

or

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

For the transition period from _____ to _____

(Commission File No.) 001-33531

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

Nevada
(State or other jurisdiction of
incorporation or organization)

46-0510685
(I.R.S. Employer
Identification No.)

6075 Longbow Drive, Suite 200
Boulder, Colorado 80301

(303) 444-7755

(Address, including zip code and telephone number, including area code, of registrant's of principal executive office)

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

None

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

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Title of each class:
Common Stock, par value \$0.001 per share

Name of each exchange on which registered:
OTCQB

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

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

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

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

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

The aggregate market value of the voting common stock held by non-affiliates of the registrant as of September 30, 2011 was \$376,698, the last day of our most recent second quarter. For the purpose of the foregoing calculation only, all directors and executive officers of the registrant and owners of more than 5% of the registrant's common stock are assumed to be affiliates of the registrant. This determination of affiliate status is not necessarily conclusive for any other purpose.

The number of shares of the registrant's common stock outstanding as of June 15, 2012 is 576,294,744.

DOCUMENTS INCORPORATED BY REFERENCE

None

Table of Contents

AeroGrow International Inc.
Annual Report on Form 10-K
Year Ended March 31, 2012

		Page
PART I		
Item 1.	<u>Business</u>	1
Item 1A.	<u>Risk Factors</u>	8
Item 1B.	<u>Unresolved Staff Comments</u>	14
Item 2.	<u>Description of Property</u>	14
Item 3.	<u>Legal Proceedings</u>	14
Item 4.	<u>Mine Safety Disclosures</u>	14
PART II		
Item 5.	<u>Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	15
Item 6.	<u>Selected Financial Data</u>	16
Item 7.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
Item 7A.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	38
Item 8.	<u>Financial Statements</u>	39
Item 9.	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	39
Item 9A.	<u>Controls and Procedures</u>	40
Item 9B.	<u>Other Information</u>	41
PART III		
Item 10.	<u>Directors, Executive Officers and Corporate Governance</u>	41
Item 11.	<u>Executive Compensation</u>	46
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	52
Item 13.	<u>Certain Relationships and Related Transactions, and Director Independence</u>	54
Item 14.	<u>Principal Accountant Fees and Services</u>	55
PART IV		
Item 15.	<u>Exhibits, Financial Statement Schedules</u>	58
	<u>Signatures</u>	

This Annual Report on Form 10-K (“Annual Report”) for AeroGrow International, Inc. (“AeroGrow,” the “Company,” “we,” “our” or “us”), including the “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” contains forward-looking statements regarding future events and our future results that are based on current expectations, estimates, forecasts, and projections about the industry in which we operate and the beliefs and assumptions of our management. Words such as “expects,” “anticipates,” “targets,” “goals,” “projects,” “may,” “will,” “would,” “intends,” “plans,” “believes,” “seeks,” “estimates,” variations of such words, and similar expressions are intended to identify such forward-looking statements. These forward looking statements may include, among others, statements concerning our expectations regarding our business, growth prospects, revenue trends, operating costs, working capital requirements, access to funding, competition, results of operations and other statements of expectations, beliefs, future plans and strategies, anticipated events or trends, and similar expressions concerning matters that are not historical facts. These forward-looking statements are only predictions that are subject to risks, uncertainties, and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those

expressed in any forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in this Report under the section entitled “Risk Factors” in Item 1A of Part I and elsewhere, and in other reports we file with the SEC, including the most recent quarterly reports on Form 10-Q and current reports on Form 8-K. While forward-looking statements are based on reasonable expectations of our management at the time that they are made, you should not rely on them. We undertake no obligation to revise or update publicly any forward-looking statements for any reason.

Table of Contents

PART I

ITEM 1. BUSINESS

Our Business

AeroGrow is a developer, marketer, direct-seller, and wholesaler of advanced indoor garden systems designed for consumer use and priced to appeal to the gardening, cooking, and healthy eating, and home and office décor markets. To date, we have launched multiple lines of proprietary indoor gardens, more than 40 corresponding proprietary seed kits, and various cooking, gardening and décor accessories, both nationally and internationally.

As of March 31, 2012, we had manufactured and shipped approximately 1.1 million AeroGarden® units and approximately 2.5 million seed kits to consumer and retailers worldwide. We commenced initial marketing and distribution of our products in March 2006 and now focus our sales and marketing efforts on the direct-to-consumer sales channels, which principally comprise our own in-house direct mail catalogue, e-mail marketing, and internet marketing. In addition, we sell to a limited number of retailers and international third-party distributors.

Our principal products are indoor gardens and proprietary seed kits that allow consumers, with or without gardening experience, to grow: (i) vegetables, such as tomatoes, chili peppers and salad greens; (ii) fresh herbs, including cilantro, chives, basil, dill, oregano, and mint; and (iii) flowers, such as petunias, snapdragons, pink geraniums and phlox. Consumers can also plant and grow their own seeds using our proprietary “grow anything” kits, or use their AeroGardens as seed starters for their outdoor gardens with our “garden starter” systems.

Our indoor gardens are designed to be simple, consistently successful, and affordable. We believe that our products 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, regardless of season, weather, or availability of natural light. We believe that our indoor gardening products’ unique and attractive designs make them appropriate for use in almost any location, including kitchens, living areas, and offices.

Our indoor gardening units are sold through different channels designed to match customer needs and interests with the appropriate garden unit features and benefits at list prices ranging from approximately \$90 to \$200, depending on size, design elements, light intensity and other automated features. As is customary in the direct-to-consumer channels, we frequently offer temporary discounts and targeted promotions that reduce the net price a consumer pays for our gardens.

Corporate History

AeroGrow International, Inc. (“AeroGrow”) was formed as a Nevada corporation on March 25, 2002. AeroGrow merged with Wentworth I, Inc., a Delaware corporation on February 24, 2006, and AeroGrow was the surviving corporation.

After more than three years of initial research and product development, we began sales activities in March 2006. Since that time, we have expanded our operations and currently distribute our products through multiple sales channels. We have developed direct sales channels, including web sales and a direct mail catalogue business, with approximately 0.9 million catalogues mailed in our fiscal year ended March 31, 2012 (“Fiscal 2012”). In prior years, we have also utilized direct television sales, including infomercials and 60 and 120 second television commercials, mall kiosks, and print and radio advertisement to generate consumer sales. We also sell through approximately 500 retail storefronts in North America, and in seven countries internationally. We have expanded our product lines, and now offer four different indoor garden models, with each model available in different colors and trim styles, more than 40

seed kits, and various gardening and kitchen accessories.

1

Table of Contents

Hydroponics Industry - Background

Hydroponics is the science of growing plants using nutrients suspended 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 with higher crop yields per acre than traditional soil-based growers.

Aeroponic technology is derived from hydroponics and occurs when plant roots are suspended in an air chamber and bathed with a nutrient solution. We believe that the aeroponic technology used in our indoor gardening products is a technological advance over most hydroponic growing systems because plant roots are partially suspended in air and allowed direct access to oxygen, while being bathed in a highly oxygenated, nutrient rich solution. For these reasons, we believe the use of a well-designed and maintained aeroponic system can yield increases in growth rates and plant survival when compared to most hydroponic or soil-based systems.

Until the development of our indoor gardening products, certain barriers 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 indoors in the absence of adequate natural light;
- Consumers are often unable to properly mix and measure complex hydroponic nutrient formulas, which change depending on the plant variety and the stage of plant growth;
 - Consumers are unable to deal with the problem of nutrient spoilage; and
- Federally mandated water quality reports show that the water in many large cities is not suitable for hydroponic or aeroponic growing and requires treatments in order to sustain growth.

Our research leads us to believe that these complexities have been accepted in existing hydroponic market channels because these manufacturers have generally focused their product development and marketing efforts on satisfying the needs of the commercial greenhouse and dedicated hobbyist markets. These users are motivated to gain the specialized knowledge, equipment and experience currently required to successfully grow plants with these products. Our research also indicates that the hydroponic growing equipment currently available in these markets is bulky, expensive and comprised of many, often unintegrated, parts.

We believe that the complexities of currently available commercial hydroponic and aeroponic products fail to address the needs and wants of the mass consumer market, leaving that market unserved. We further believe that our patented and patent-pending inventions, companion technologies, and trade secrets have simplified and improved hydroponic and aeroponic technologies and have enabled us to create an indoor hydroponic and aeroponic gardening system appropriate for the mass consumer market.

Our Proprietary Technology

Since our inception in 2002, we have been innovating, simplifying, and integrating our proprietary technologies and inventions into a family of “plug and grow” indoor gardening products and related seed kits specifically designed and priced for the mass consumer market. We have used this technology platform to develop four different models of indoor gardens, each with different features and technology groupings, with list prices ranging from approximately \$90 to \$200. We have filed multiple patent applications in the United States and internationally to protect our inventions, and seven patents have been issued (four in the United States and three internationally). Following is a description of our proprietary technologies and inventions that are used in our indoor garden system and seed kits.

Table of Contents

Rainforest Nutrient Delivery System. Our “rainforest” nutrient delivery system combines our technologies with features from several hydroponic and aeroponic methodologies into a proprietary system that leaves plant roots suspended in an air gap. Plant roots take oxygen directly out of the air and, in testing of aeroponic systems by multiple different sources, including lettuce studies by NASA Small Business Innovation Research, plants grow faster as a result.

Advanced Growing System. Our Advanced Growing System (“AGS”) is available on several of our indoor gardens and combines features from our rainforest delivery system with technologies that deliver increased nutrient oxygenation, faster and healthier root growth, decreased consumer maintenance requirements, and increased product reliability. With AGS, plant roots are suspended in air in a 100% humid aeroponic chamber and then grow into a continuously oxygenated nutrient bath.

Pre-Seeded Bio-Grow Seed Pods. Our proprietary bio-grow seed pods include pre-implanted, specially selected seeds, a growing medium, removable bio-dome covers, and a grow basket.

Microprocessor-Based Control Panel and Nutrient Cycle Delivery System. Our microprocessor-based controls include automated grow lights to ensure that plants receive the proper amount of lighting, and feature nutrient and water reminder systems that alert consumers to add water and nutrients when needed. In addition, some systems allow consumers to select from multiple plant types (for example, lettuce, herbs, tomatoes, or flowers) and the system then automatically adjusts the nutrient, water and lighting cycles to optimize growth. In addition, some systems take into account stage of growth of the specific plants when optimizing these factors.

Custom Nutrients and Automatic pH Adjustment. We have developed patented nutrient solutions designed specifically to deliver the proper nutrients to plants, while offering consumers a user-friendly application methodology. Plant specific nutrients are included with each seed kit, and consumers simply add them when instructed by the microprocessor-based nutrient reminder. The pre-measured and mixed nutrients eliminate the need for measuring and mixing multi-part nutrient formulas and storing various nutrients in separate containers. We also formulate a proprietary buffer into the nutrients that automatically adjusts tap water from around the country to the right pH ranges for plant growth. Without this adjustment, tap water from many areas in the country will severely limit or inhibit plant growth in most aeroponic and hydroponic systems.

Integrated and Automated Lighting System. Hydroponic systems typically do not incorporate built-in lighting systems. Our indoor gardening products include built-in adjustable grow lights with ballast, reflector hood, grow bulbs and an electronic timer. Our integrated lighting systems include proprietary high-output compact fluorescent light bulbs that deliver a spectrum and intensity of light designed to optimize plant growth without natural light. In addition, our lighting system is fully automated and controlled by our microprocessor-based control panel described above. Variations in lighting are a differentiator in our product lines, and we have several gardens on the market with “50% more light and twice the height” of our initial gardens, allowing consumers to grow larger plants such as full-sized tomatoes in our indoor gardens, and deliver higher yields.

New Technologies in Development. We continue to develop improvements in lights, nutrients, oxygenation, seed variety selection, and style and design innovations, each of which are applied to our products on an ongoing basis.

Markets

Based on our sales experience to date and our existing channels of distribution, and supplemented by our own formal and informal market research consisting of individual consumer interviews, focus groups, blog monitoring, customer modeling, and Internet survey responses, we believe that our indoor gardening products appeal to a broad spectrum of consumers across multiple areas of interest. We believe that our products appeal to at least four major market segments:

Table of Contents

Gardener Market. The 2010 National Gardening Survey conducted by the National Gardening Association states that gardening is America's number one hobby with more than 81 million households active in gardening. Based upon this survey, there were estimated to be 36 million households participating in food gardening and 13 million households participating in fresh herb gardening. We believe that our indoor gardening products and related products 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 our indoor gardening products; and
- the ease of growing in our indoor gardens, in contrast to the toil associated with traditional gardening, including preparing the soil, planting, thinning, weeding, watering, and removing pests.

“Want-to-be” Gardener Market. We believe that many people have an interest in gardening but lack the knowledge, confidence, available space, equipment, or time to garden. We have observed the following barriers that often prevent people from gardening:

- 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 people with limited mobility or health issues;
 - buying the necessary equipment to garden can be expensive; and
 - gardening requires knowledge and expertise.

We believe that our indoor gardening products overcome many of these barriers and provide a simple, convenient way for many current non-gardeners to begin to garden.

Cooking and Healthy Eating Market. Many Americans enjoy cooking as a hobby. Consumers in this market include:

- people interested in cooking who would appreciate the convenience and satisfaction of having a readily available supply of fresh-cut herbs to flavor soups, salads, and other dishes,
- people who prefer the distinctive texture and taste of freshly picked, vine-ripened tomatoes, basil, lettuces, 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.

We believe that our indoor gardening products are embraced in this market by people who understand the value of having an ongoing supply of fresh herbs and fresh produce throughout the year.

Table of Contents

Home and Office Décor Market. Flowers are frequently used to brighten homes and offices worldwide. 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. Our indoor gardening products enable colorful and fragrant flowers to be easily grown indoors year round. Flowers grown with our indoor gardening products 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.

Products

AeroGarden Indoor Gardens. We currently offer four different indoor garden models with list prices ranging from approximately \$90 to \$200 and differentiated based on size, design, light intensity, degree of automation, inclusion of Adaptive Growth Technology or Advanced Growing Systems, height potential of light hoods, and inclusion of plant support systems.

Currently, our AeroGarden product line is divided into three main categories:

1. AeroGarden 3 Series – The AeroGarden 3 series features the Advanced Growing System, grow lights, a smaller footprint, and an attractive, stylish design that makes it suitable for use as a decorative feature throughout the home or office. AeroGarden 3s fit easily on kitchen counters, night stands, and end tables. Some models include upgraded trim and new finish designs such as the “Ladybug” garden targeted at all-family usage. List prices range from \$90 to \$100.
2. AeroGarden Classic Series – Includes our original products which feature the rainforest nutrient delivery system, automated lights, and reminder systems. List prices range from \$150 to \$170.
3. AeroGarden Extra Series – AeroGarden 7 with extended lamp arms and greater light output for growing larger vegetables. Some models also include stainless steel trim. List prices range from \$180 to \$200.

AeroGarden Seed Kits. We currently offer more than 40 seed kits for use in our indoor gardening products. These seed kits include pre-seeded bio-grow seed pods and a three-to-six-month supply of nutrients, including our patented formula for adjusting water quality. Our seed kits have list prices ranging from \$13 to \$20, and include:

- Vegetable Gardens: cherry tomato, chili pepper, and salsa garden.
- Herb Gardens: gourmet herbs, Italian herbs, and pesto basil.
- Flower Gardens: cascading petunias, English cottage, scented blooms, and mountain meadow.
- Salad Gardens: salad greens, romaine lettuce.

Our seed kits are sold to consumers for use with our indoor gardening products. Individual seed kits are grown by consumers for three to six months and then new seed kits may be purchased for replanting.

AeroGarden Seed-Starting Kits. Our line of Garden Starter Systems and Grow Anything Kits are designed to allow consumers to plant and grow their own seeds in the AeroGarden. With our Garden Starter Systems, consumers can start up to 66 seedlings in our indoor gardens for transplant into their outdoor gardens when weather allows. With the Grow Anything Kits, consumers can grow their own seeds to maturity in the AeroGarden, or transplant seeds outdoors when weather allows.

Other Accessories. To complement and expand the functionality of our indoor gardening products, we have developed a variety of accessory products.

Future Products. Our core technology platform can be leveraged by bundling different components into new products with a wide variety of features and price points that then can be sold through a variety of direct and retail channels for use in different settings around the home or office. Examples include a desk garden series, a professional system for larger plants and vegetables, patio and deck gardens, home décor and air freshening gardens, and additional seed kits and accessories.

Table of Contents

Integrated Marketing and Sales Channel Strategy

We consider our products to be an entirely new product category. A primary objective since launch has been to maximize the exposure of the product and educate consumers on the benefits of indoor gardening through an integrated marketing and distribution strategy. We launched with a nationwide public relations campaign in 2006, and received extensive media exposure, with multiple features on national talk shows as well local television coverage, local and national print articles and blog and Internet pieces. We combined the public relations launch with a retail and direct strategy focusing on high visibility partners and media, including product sales through retailers, national cataloguers, home shopping channels, direct television commercials, our own in-house direct response catalogue, internet sales, and inbound and outbound telemarketing.

Shift in Channel Strategy. During the fiscal year ended March 31, 2010 (“Fiscal 2010”) we determined that broad distribution through the retail channel was not appropriate for a company at our stage of development because of relatively low profit margins, high capital requirements, and the operational requirements of our retailer customers. As a result, we terminated our relationships with certain retailers and re-focused our efforts on building our direct-to-consumer business. During the fiscal year ended March 31, 2011 (“Fiscal 2011”) and Fiscal 2012, we further reduced our presence in the retail channel. As of March 31, 2012, our products were being offered in approximately 500 storefronts in North America (down from approximately 7,500 during the fiscal year ended March 31, 2009, as well as through select online retailers).

To further our strategic shift towards direct-to-consumer selling, we began investigating the network marketing channel of distribution during Fiscal 2011 and Fiscal 2012. Network marketing, which is also known as direct selling or multi-level marketing, involves person-to-person selling through independent distributors, which we believe represents a logical potential next step in our stated strategy to move the marketing and selling of AeroGrow products closer to the end consumer. In April 2011, we entered into a Licensing Agreement with Cyrano Partners, LLC (“Cyrano”) under which Cyrano began to offer our products in the network marketing sales channel. Simultaneously we entered into a Transaction Agreement with Cyrano to form a joint venture to pursue the network marketing sales channel, subject to the achievement of certain conditions precedent, including an obligation on the part of Cyrano to raise the capital necessary to fund the joint venture. Cyrano was unable to satisfy the funding condition precedent and, in August 2011, the Licensing Agreement and the Transaction Agreement were terminated. (For further information on the Cyrano transactions, please refer to Item 9B. Other Information of our Annual Report on Form 10-K for the year ended March 31, 2011.) We believe that network marketing may represent a viable sales channel for our products and we are continuing to investigate potential strategies for entering this channel of distribution.

Direct Response Sales. In the fall of 2006, we launched an infomercial advertising campaign that began with 30-minute programming and was subsequently supplemented with 60-second and 120-second television commercials. Since the fall of 2006, overall spending on television advertising has decreased as a percentage of the overall marketing budget, as we have been cash constrained and therefore focused our spending on the most efficient media channels. Although we did not spend any funds on television advertising in Fiscal 2012, we may resume television advertising in the future.

In 2007, we produced and began mailing our own in-house, direct mail product catalogue, which tested successfully with a mailing of approximately 60,000 catalogues. In Fiscal 2012 we mailed approximately 900,000 catalogues. With our catalogue sales we focus on remarketing to current customers and also prospecting for new customers using database marketing techniques.

We established our first consumer product website in the fall of 2006 and supplemented this website in late 2007 with search engine advertising, banner advertising, email campaigns and web affiliate programs. In the fall of 2008 we took on in-house management of many of these programs from third-party providers and have seen resulting increases

in efficiency.

A key focus of our web and catalogue marketing is to maximize the lifetime value of AeroGrow customers through repeat sales of our seed kits, light bulbs and accessories.

During Fiscal 2012, direct response sales represented 89.8% of our total net sales.

6

Table of Contents

Retail Sales. Initial shipments to retailers commenced in March 2006. Over the next several years, we rapidly grew our retail distribution and as of March 31, 2009 our products were being sold through approximately 7,500 stores in North America. In Fiscal 2010 through Fiscal 2012, we reduced our sales to retailers as discussed above, and as of March 31, 2012 our products were being sold through approximately 500 stores in North America. During Fiscal 2012, sales to retailers represented 8.6% of our total net sales. Approximately 88.4% of our total sales to retailers represented sales to Canadian Tire Corporation in Fiscal 2012.

International Sales. We began testing international sales opportunities in the UK and Japan in late 2007, and have since expanded internationally into Australia, South Korea, Mexico, France and several other countries. During Fiscal 2012, we sold products to third-party distributors in seven international markets, and international sales represented 1.6% of our total net sales. International efforts in Fiscal 2012 were limited to supporting distribution in existing markets. Material incremental expansion into new countries is not anticipated in the immediate future, but we plan to pursue international growth in future years as and when resources allow.

Competition

Aeroponic and hydroponic technologies have historically been limited to ardent hobbyists and commercial growing facilities. We believe that we are the first company to develop and offer a simple dirt-free 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. We believe that these products are substantially more expensive than our products.

We believe that our simplified and complete indoor gardening products and current and planned methods of distribution offer significant benefits from these traditional hydroponic industry practices. To date, we have discovered a kitchen design firm that has tried to introduce an indoor growing system into the market. In our laboratory tests, these systems have performed at levels far below our own systems in terms of germination success, longevity, speed-of-growth and overall yields.

However, we recognize that there are other companies that are better funded and have greater experience in producing hydroponic products in commercial markets, or that have been more successful in manufacturing or selling consumer products or soil-based gardening products.

Manufacturing and Operations

We source our AeroGarden products and accessory items from contract manufacturing companies that manufacture products using tooling we own, in accordance with our specifications, and subject to our intellectual property rights. We have three Chinese manufacturers of our garden products. Each is capable of manufacturing multiple garden models. We believe the existing production capacity of these manufacturers is more than sufficient to meet our garden requirements for the short-to-medium term. In addition, capacity expansion is available in a reasonable period of time with a nominal tooling investment. We also try to have multiple, dual-sourced manufacturers of our many component parts and accessories.

In July 2008 we opened a company-operated distribution center in Indianapolis, Indiana where we also produced and assembled our seed kits. In May 2011, we closed this facility and moved all our North American distribution and seed kit assembly operations to a third-party logistics facility in Mexico, Missouri. Indoor gardening products are shipped

from China to the third-party fulfillment center in Missouri, as well as to third-party distribution facilities in countries outside North America.

Product Returns and Warranties

To date, product returns have been within our expectations for both retail and direct-to-consumer sales. At retail, we generally use a “destroy in field” methodology as the cost of shipping a used product back to us often does not justify the value of the recovered unit. Our manufacturers provide us with replacement parts at no charge for products that are deemed defective due to materials or manufacturing complications. We record warranty liabilities at the time of sale for the estimated costs that may be incurred under our basic warranty program. The specific warranty terms and conditions vary depending upon the product sold but generally include technical support, repair parts, and labor for periods up to one year. Factors that affect our 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 our warranty obligation.

Table of Contents

Intellectual Property

Our success and ability to compete are substantially dependent upon our internally developed technology and expertise. While we rely on patent, copyright, trade secret, and trademark law to protect our technology, we also believe that factors such as the technological and creative skills of our personnel, new product developments, product enhancements, and reliable product maintenance are essential to establishing and maintaining a technology leadership position. There can be no assurance that others will not develop technologies that are similar or superior to our technology. As of March 31, 2012, we have filed multiple patent applications in the United States and internationally to protect our inventions, and of these, four United States and three international patents have been issued. In addition to patents, we maintain critical information about our products as trade secrets.

In addition, we have filed, and from time to time will file, trademark applications in the United States and internationally, a number of which have been registered or allowed. We have also obtained, both domestically and internationally, domain names for AeroGrow.com, AeroGarden.com, AeroGarden.net, AeroGarden.tv, AeroGarden.biz, and Getthegarden.com, among others.

Each of our employees, independent contractors, interns, and consultants has executed assignment of rights to intellectual property agreements and nondisclosure agreements. The assignment of application rights to intellectual property agreements grant us the right to own inventions and related patents which may be granted in the United States and throughout the world. The nondisclosure agreements generally provide that these people will not disclose our confidential information to any other person without our prior written consent.

We intend to prosecute to protect our products and brand equity, when necessary and as we deem appropriate.

Governmental Regulation and Certification

We believe that we are in compliance with regulations in the United States and Canada concerning the shipping and labeling of seeds and nutrients. Currently, the components for the indoor garden system are ETL certified. 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.

We believe that our costs of compliance with environmental laws will not be material.

Personnel

As of March 31, 2012, AeroGrow employed 21 employees with 16 full-time and five part-time. In addition, we contract the services of part-time and project consultants on an “as needed” basis. We believe that our employee relations are good. Historically, our outsourced business also included manufacturing, some telemarketing, infomercial production, fulfillment and shipping. Additional employees and/or consultants may be hired in the future as our operations merit.

ITEM 1A. RISK FACTORS

Our business, future performance and forward-looking statements are affected by general industry and market conditions and growth rates, general economic and political conditions in the United States, Canada and worldwide, competition, interest rate and currency exchange rate fluctuations and other events. The following items are representative of the risks, uncertainties and other conditions that may impact our business.

Table of Contents

Risks Related to our Business, Products and Markets

We have incurred substantial net losses since inception and may never achieve profitability.

Since we commenced operations in 2002, and through March 31, 2012, we incurred substantial losses, including a net loss of \$3,551,034 for the twelve month period ended March 31, 2012. As of March 31, 2012, our losses have resulted in an accumulated deficit of \$67,745,576. The future success of our business will depend on our ability to profitably expand sales of our AeroGarden indoor garden systems, seed kits and accessory products, and develop new product extensions and applications.

We are subject to many of the risks common to developing enterprises, including undercapitalization, cash shortages, limited financial and other resources, and insufficient scale to be self-sustaining. There is no assurance that we will ever attain profitability.

Our financial condition may limit our ability to borrow funds or to raise additional equity as may be required to fund our future operations.

Our ability to borrow funds or raise additional equity may be limited by our financial condition. In addition, a failure to obtain additional funding to support our working capital and operating requirements could prevent us from making expenditures that are needed to allow us to maintain our operations. We anticipate raising additional capital in the form of equity, or by renewing our current working capital facility at its maturity, in order to support our inventory and other operating requirements during the fiscal year ending March 31, 2013. In the event we cannot raise this additional funding, we will have to scale back on our operating plans for the current and future fiscal years. There can be no assurance that we will be able to secure the additional capital in an amount and in time to support all of our operating plans.

We have shifted the focus of our business strategy toward the direct-to-consumer sales channels. Failure to successfully develop our position in these channels could have an adverse impact on our future results of operations.

During Fiscal 2010, we announced a strategic shift to increase our focus on the direct-to-consumer business channels. Since then we have dedicated a larger proportion of our capital and human resources to develop these channels. Successfully growing these channels will require that we invest in revenue-generating media to attract new customers, effectively target our marketing messages to consumers, and develop ongoing relationships with consumers through excellence in our fulfillment, shipping and customer service operations. There is no assurance that we will be successful in achieving these requirements, or that we can do so on a timely basis. In the event we do not succeed in developing the direct-to-consumer channels as we intend, there could be a material adverse impact on our business, prospects, results of operations, and financial condition.

We have effectively transitioned our business away from the retail distribution channel. Unless our direct-to-consumer strategy is successful, this change in channel strategy could have a material adverse impact on our business.

In the fiscal year ended March 31, 2012, approximately 8.6% of our net sales were to retailer customers. As a result of our transition to a direct-to-consumer business model, we have discontinued sales to all but one of our former retail chain store customers. Unless the direct-to-consumer distribution model is successful, this change could have a material adverse effect on our business, prospects, results of operations, and financial condition.

We currently sell to only one major “brick and mortar” retail chain store customer, Canadian Tire Corporation (“CTC”). The loss of this customer could have a material adverse impact on our business.

In Fiscal 2012, our net sales to CTC totaled \$627,730, representing 7.6% of our total net sales. The loss of CTC as a customer, or a significant decline in orders from CTC could materially affect our sales of indoor garden systems, seed kits and accessories, and therefore have a material adverse effect on our business, prospects, results of operations, and financial condition.

Table of Contents

Because we have a limited operating history under our current direct-to-consumer-focused strategy, we may not be able to successfully manage our business or achieve profitability.

We have a limited operating history subsequent to our change in strategy to focus on the direct-to-consumer channels of distribution. Since commencing operations in 2002, and including the fiscal years following our shift in strategy, we have not achieved profitability in any fiscal year. We continue to face the challenges inherent in smaller and/or early stage companies, including difficulties and delays in connection with the production and sales of our indoor garden systems, reliance on a small number of products and manufacturers, operational difficulties, and difficulty in estimating future sales, production requirements and costs, and administrative costs. If we cannot successfully manage our business, we may not be able to generate future profits and may not be able to support our operations. We may incur additional expenses and losses in the further implementation of our business plan. We may not be able to improve operations and therefore may never become profitable.

A worsening of the economy, particularly in the United States and Canada, could materially adversely affect our business.

The success of our business operations depends significantly on consumer confidence and spending, which deteriorated during the recently experienced worldwide economic downturn. A re-occurrence of the economic downturn and the consequent impact on consumer spending, particularly in the United States and Canada, could adversely impact our revenue, ability to market our products, build customer loyalty, or otherwise implement our business strategy. In such a scenario, we would experience a material adverse effect on our business, prospects, results of operations, and financial condition.

Our future success is completely dependent on our ability to market our indoor garden systems, seed kits and accessory products and generate consumer acceptance on a broader scale.

We have introduced our indoor garden systems and seed kits as new products to consumer markets unfamiliar with their use and benefits. Although we believe that we have penetrated only a small portion of the potential market for our products, our marketing efforts may not generate widespread consumer adoption. If our marketing strategies fail to attract customers, our product sales may not produce future revenue sufficient to meet our operating expenses or fund our future operations. Our business, prospects, results of operations, and financial condition will be materially and adversely affected.

If we are unable to recruit, train 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.

To maintain our business position, we will need to attract, retain, and motivate highly skilled design, development, management, accounting, sales, merchandising, marketing, and customer service personnel. Competition for many of these types of personnel can be intense, depending on general economic conditions, alternative employment options, and job location. 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 have a material adverse effect on our business, prospects, results of operations, and financial condition.

As a result of the economic downturn, decline in consumer spending and the consequent impact on the sales of our products, we restructured our operations and implemented a substantial workforce reduction. These actions could adversely impact the morale and performance of our remaining employees and our ability to hire new personnel.

Our business was adversely impacted by the deterioration in the global economy and the consequent impact on our various channels of distribution. We restructured our business operations in order to re-size our overhead costs and streamline our distribution, fulfillment, and manufacturing operations. This resulted in a substantial decrease in the number of our full-time employees. In addition, during Fiscal 2012 we instituted a temporary furlough program that impacted most employees, and instituted a salary deferral program for our senior management. In total, these actions could have unintended impact on our remaining employees, could lead to a decline in employee morale, and could lead to a loss of additional personnel over and above the level desired by the Company. In the event of such employee attrition, we may not be able to replace the lost personnel on a timely basis, or with individuals having the same level of skills. In either case, our business prospects, results of operations and financial condition could be materially and adversely affected.

Table of Contents

Our current or future manufacturers could fail to fulfill our orders for indoor garden systems, which would disrupt our business, increase our costs, and could potentially cause us to lose our market.

We currently depend on three contract manufacturers in China to produce our indoor garden systems. These manufacturers could fail to produce the indoor garden system to our 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. Although we own the tools and dies used by our manufacturers, our manufacturers operate in China. As a result, our manufacturers may be subject to business risks that fall outside our control, including but not limited to, political, currency, and regulatory risks, each of which may affect the manufacturer's ability to fulfill our orders for indoor garden systems. In addition, weather or natural disasters in China could disrupt our supply of product. Any change in manufacturers could disrupt or delay our ability to fulfill orders for indoor garden systems while we search for alternative supply sources, provide specifications, and test initial production. Our business prospects, results of operations and financial condition would be materially and adversely affected.

Our revenue and level of business activity are highly seasonal, requiring us to staff our operations, incur overhead and marketing costs, purchase and manufacture inventory, and incur other operating costs in advance of having firm customer orders for our products. A material variance in actual orders relative to anticipated orders could have an adverse impact on our business.

For the fiscal year ended March 31, 2012, approximately 49.0% of our total net sales occurred during four consecutive calendar months (November through February). We must therefore estimate sales in advance of the anticipated peak months and operate our business during the balance of the year in such a way as to insure that we can meet the demand for our products during the peak months. This requires us to incur significant operating, marketing, and overhead expenses, and to utilize cash and other capital resources to invest in inventory in advance of having certainty as to the ultimate level of demand for our product during the peak months. Shortfalls in actual demand for our products, relative to our forecast, could result in a significant loss of revenue due to lack of adequate product inventory. Alternatively, a shortfall in actual demand for our products during peak months could cause us to liquidate excess inventory at a loss or at substantially lower margins. In any of these cases, we may not generate enough revenue to cover expenses incurred throughout the balance of the year. Our business prospects, results of operations and financial condition would be materially and adversely affected.

We are highly reliant upon a single distribution and assembly facility. Any material disruption to the operation of this facility could adversely affect our business.

All of our North American fulfillment and distribution operations, and the entirety of our seed kit assembly operations are located in a third-party-managed facility based in Mexico, Missouri. Any material disruption to the operation of this facility, whether caused by internal or external factors could have a material adverse effect on our business prospect s, results of operations and financial condition.

We rely on third-party providers in 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 certain critical functions supporting our business operations. Any disruption in our relationship with any of our vendors could cause significant disruption to our business and we may not be able to locate another party that can provide comparable services in a manner that is timely, consistent with our business plan, or on acceptable commercial terms. Our business prospects, results of operations and financial condition would be materially and adversely affected.

Our intellectual property and proprietary rights give us only limited protection, and can be expensive to defend.

Our ability to produce and sell indoor garden systems exclusively depends in part on securing patent protection for the components of our systems, maintaining various trademarks, and protecting our operational trade secrets. To protect our proprietary technology, we rely on a combination of patents pending (and if granted, patents), trade secrets, and non-disclosure agreements, each of which affords only limited protection. We own the rights to four patents which have been issued in the United States and three patents which have issued internationally. All of our intellectual property rights may be challenged, invalidated, or circumvented. Claims for infringement may be asserted or prosecuted against us in the future and we may not be able to protect our patents, if any more are obtained, and intellectual property rights against others. Our former employees or consultants may violate their non-disclosure agreements, leading to a loss of proprietary intellectual property. We could also incur substantial costs to assert our intellectual property or proprietary rights against others and our business prospects, results of operations and financial condition would be materially and adversely affected..

Table of Contents

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

We believe that our complete indoor garden systems offer significant benefits over traditional hydroponic industry products. There are companies in a variety of related markets including but not limited to, consumer electronics, commercial hydroponics, gardening wholesale, and soil-based gardening that are larger, better funded, have more recognizable brand names, and have experience in our channels of distribution. These companies could potentially decide to develop products to compete with our products. These companies could use hydroponic technologies, and could achieve better consumer acceptance. The success of any competing products may have a material adverse effect on our business prospects, results of operations and financial condition.

Increases in energy prices, resulting from general economic conditions, or other factors, may raise our cost of goods sold and adversely affect our business, results of operations and financial condition.

Energy costs, especially gasoline and fuel costs, are significant expenses in the delivery of our products. Increased costs resulting from general economic conditions, war, acts of nature, or other factors, may result in declining margins and operating results if market conditions prevent us from passing these increased costs on to our customers through timely price increases on our products. Our business prospects, results of operations and financial condition would be materially and adversely affected.

Our current AeroGarden manufacturers are located in China and therefore our product costs may be subject to fluctuations in the value of the dollar against the Chinese currency.

Although we purchase our AeroGarden products in U.S. dollars, the prices charged by our factories are predicated upon their cost for components, labor and overhead. Therefore, changes in the valuation of the U.S. dollar in relation to the Chinese currency may cause our manufacturers to raise prices of our products which could reduce our profit margins and have a material adverse effect on our business prospects, results of operations and financial condition.

If our indoor garden systems fail to perform properly, our business could suffer with increased costs and reduced income.

From our inception through March 31, 2012, we have sold approximately 1.1 million AeroGardens and have provided a limited warranty with each garden sold. In addition, our indoor garden systems are “guaranteed to grow.” We therefore may be required to replace or repair products or refund the purchase price to consumers. Failure of our products to meet expectations could damage our reputation, decrease sales, increase costs related to returns and repairs, delay market acceptance of our products, result in unpaid accounts receivable, and divert our resources to remedy the malfunctions. The occurrence of any of these events would have a material adverse effect on our business prospects, results of operations and financial condition.

From time to time, we may be subject to litigation that, if decided adversely to us, could have a material adverse impact on our financial condition.

From time to time, we are a party to various litigation matters, in most cases involving ordinary and routine claims incidental to our business. We cannot estimate with certainty our ultimate legal and financial liability with respect to such litigation. Although we do not believe that any current litigation poses a material threat to our business, defense of any lawsuits or proceedings, even if successful, may require management to spend a substantial time and attention on the part of our management personnel that otherwise would be spent on other aspects of our business, and may require the expenditure of significant amounts for legal fees and other related costs. Settlement of lawsuits also may result in significant payments and modifications to our operations. In addition, we also may be subject to adverse

publicity as a result of litigation. Any of these events could have a material adverse effect on our business, prospects, results of operations, and financial condition.

Table of Contents

Risks Related to the Market for our Securities

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

Currently, trading in our common stock is limited, and the price per share is likely to be influenced by the price at which and the amount of shares the selling security holders are attempting to sell at any time. This could have the effect of limiting the trading price or lowering the market price to the selling security holders' offering prices. Common stock such as ours may be subject to the activities of persons engaged in short selling securities, which generally has the effect of driving the price down. In addition, the common stock of emerging growth companies is typically subject to high price and volume volatility. Therefore, the price of our common stock has fluctuated, and may continue to fluctuate, widely. A full and stable trading market for our common stock may never develop and, as a result, stockholders may not be able to sell their shares at the time they elect, if at all.

There may be substantial sales of our common stock by existing security holders which could cause the price of our stock to fall.

Future sales of substantial amounts of our common stock in the public market or the perception that such sales might occur, could cause the market price of our common stock to decline and could impair the value of an investment in our common stock and our ability to raise equity capital in the future.

As of March 31, 2012, we had 20,994,160 common shares issued and outstanding. On April 11, 2012, we completed a restructuring of our debt and equity accounts that involved the conversion of secured debt and preferred equity into 392,854,704 shares of common stock. As a result, there was a substantial increase in the number of our common shares outstanding. In addition, during the period May 10, 2012 through May 31, 2012, we temporarily reduced the exercise price on all of our common stock warrants to \$0.01 per share to incent the holders to exercise the warrants. As a result of this program, we issued 162,445,880 shares of common stock pursuant to the exercise of warrants. As of June 15, 2012, we had 576,294,744 common shares issued and outstanding. (Please refer to Note 8 "Subsequent Events" to our consolidated financial statements for additional information regarding the restructuring and the temporary reduction in the exercise prices of our warrants.)

Sales of our common stock by security holders, or even the appearance that such holders may make such sales, may limit the market for our 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.

We can issue debt securities and shares of preferred stock without stockholder approval, which could adversely affect the rights of common stockholders.

Our Articles of Incorporation allow our Board of Directors to approve the terms and conditions of debt securities and preferred stock for issuance by the Company, including but not limited to voting rights, conversion privileges and liquidation preferences, without the approval of common stockholders. The rights of the holders of our common stock may be adversely impacted as a result of the rights that could potentially be granted to holders of debt securities or preferred stock that we may issue in the future. In addition, there could be an impact on the price of our common stock because of the potential impact on the rights of common shareholders resulting from future issuances of debt or preferred stock.

Our outstanding warrants, options and any additional future obligations to issue our securities to various parties, may dilute the value of an investment in AeroGrow. In addition, the terms and conditions of these securities could

significantly impact the price of our common shares, and could adversely impact our ability to raise additional equity capital.

As of March 31, 2012, we had reserved for issuance up to approximately 222 million additional shares of common stock under the terms of outstanding convertible notes, warrants, options, conversion of Series A Convertible Preferred and other arrangements.

Table of Contents

On April 11, 2012, we completed a restructuring of our debt and equity accounts that involved the conversion of all of our outstanding secured convertible debt and all of the Series A Convertible Preferred shares into 392,854,704 shares of common stock. In addition, during the period May 10, 2012 through May 31, 2012, 162,445,880 common stock warrants were exercised pursuant to a program under which we temporarily reduced the exercise price on all of our common stock warrants to \$0.01 per share. (Please refer to Note 8 “Subsequent Events” to our consolidated financial statements for additional information regarding the restructuring and the temporary reduction in the exercise prices of our warrants.) As of May 31, 2012, we had reserved for issuance up to approximately 63.5 million additional shares of common stock under the terms of the remaining warrants and options to purchase our common stock.

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

Further, future sales of substantial amounts of these shares, or the perception that such sales might occur, could cause the market price of our common stock to decline and could impair the value of an investment in our common stock and our ability to raise equity capital in the future.

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

To raise working capital, we offered common stock and warrants in private transactions that we believed to be exempt from registration under the Securities Act and state securities laws. In 2004, we conducted a state-registered offering in Colorado of common stock and warrants, intended to be exempt from registration under the Securities Act as an intrastate offering. However, because we are incorporated in Nevada, the offering 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 private offerings subsequent to the Colorado offering (if the private offerings 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 us or our principals, we 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 operate our business. No assurance can be given regarding the outcome of any such actions.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. DESCRIPTION OF PROPERTY

We lease a 9,868 square foot office space in, Boulder, Colorado, with a current monthly rent of \$9,046, which is subject to 3.5% annual increases. We also pay our proportionate share of building taxes, insurance and operating expenses. The lease term continues until September 30, 2014, unless modified under specified circumstances. The agreement contains other standard office lease provisions.

During the first two months of Fiscal 2012 (April and May of 2011), we also rented approximately 90,400 square feet of warehouse and manufacturing space in Indianapolis, Indiana at the rate of \$16,950 per month. We closed this

facility and terminated the lease in May 2011.

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

ITEM 3. LEGAL PROCEEDINGS

From time to time, we are party to various litigation matters, in most cases involving ordinary and routine claims incidental to our business. We cannot estimate with certainty our ultimate legal and financial liability with respect to any such pending litigation matters. However, we believe, based on our examination of such matters, that our ultimate liability, if any, will not have a material adverse effect on our financial position, results of operations or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

Table of Contents

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Our common stock is listed on the OTCQB market tier under the symbol AERO.

Price Range of Common Stock

The following table sets forth, for the periods indicated, the high and low daily closing prices of our common stock for the two most recently completed fiscal years while trading on the markets noted above.

	Fiscal Year Ended 3/31/12		Fiscal Year Ended 3/31/11	
	High	Low	High	Low
1st Quarter -				
Ended June 30	\$ 0.060	\$ 0.020	\$ 0.190	\$ 0.130
2nd Quarter -				
Ended Sept 30	\$ 0.030	\$ 0.010	\$ 0.160	\$ 0.050
3rd Quarter -				
Ended Dec 31	\$ 0.100	\$ 0.010	\$ 0.100	\$ 0.050
4th Quarter -				
Ended Mar 31	\$ 0.030	\$ 0.010	\$ 0.090	\$ 0.035

Holders

As of June 15, 2012, we had approximately 606 holders of record of our common stock. A substantially greater number of stockholders are "street name" or beneficial holders, whose shares are held of record by banks, brokers and other financial institutions. See "Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters," for additional information about holders of our common stock.

Dividends

We have never declared or paid cash dividends on our common stock. We currently intend to retain all available funds and any future earnings for use in the operation of our business and do not anticipate paying any cash dividends in the foreseeable future. Any future determination to declare cash dividends will be made at the discretion of our board of directors, subject to compliance with covenants under any existing financing agreements, which may restrict or limit our ability to declare or pay dividends, and will depend on our financial condition, results of operations, capital requirements, general business conditions, and other factors that our board of directors may deem relevant.

Equity Compensation Plan Information

The equity compensation plan information called for by Item 201(d) of Regulation S-K is set forth in Item 12 "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters" of Part III of this Annual Report under the heading "Equity Compensation Plan Information."

Issuer Purchases of Equity Securities

We did not repurchase any shares of our common stock during the quarter ended March 31, 2012.

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA

Consolidated Statements of Operations Data	Fiscal Years ended March 31,		
	2012	2011	2010
Revenues	\$ 8,230,424	\$ 11,313,212	\$ 17,251,347
Cost of revenue	4,164,676	7,928,687	11,846,399
Gross profit	4,065,748	3,384,525	5,404,948
Operating Expenses			
Research and development	48,669	187,178	424,741
Sales and marketing	2,031,043	3,760,290	6,104,742
General and administrative	2,278,491	3,116,446	5,112,647
Total operating expenses	4,358,203	7,063,914	11,642,130
Loss from operations	(292,455)	(3,679,389)	(6,237,182)
Other (income) expense	3,258,579	4,242,351	94,023
Net loss	\$ (3,551,034)	\$ (7,921,740)	\$ (6,331,205)
Net loss per share, basic and diluted	\$ (0.18)	\$ (0.56)	\$ (0.50)
Weighted average number of common shares outstanding, basic and diluted	19,516,701	14,240,761	12,564,140
Consolidated Balance Sheet Data		March 31,	
	2012	2011	2010
Cash and cash equivalents	\$ 501,577	\$ 355,781	\$ 249,582
Total assets	\$ 4,379,004	\$ 6,234,896	\$ 6,843,780
Total liabilities	\$ 9,501,046	\$ 8,086,171	\$ 10,170,710
Total stockholders' equity (deficit)	\$ (5,122,042)	\$ (1,851,275)	\$ (3,326,930)

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Annual Report on Form 10-K ("Annual Report"), including the "Management's Discussion and Analysis of Financial Condition and Results of Operations," contains forward-looking statements regarding future events and our future results that are based on current expectations, estimates, forecasts, and projections about the industry in which we operate and the beliefs and assumptions of our management. Words such as "expects," "anticipates," "targets," "goals," "projects," "may," "will," "would," "could," "intends," "plans," "believes," "seeks," "estimates," variations of such words, and

expressions are intended to identify such forward-looking statements. These forward looking statements may include, among others, statements concerning our expectations regarding our business, growth prospects, revenue trends, operating costs, working capital requirements, access to funding, competition, results of operations and other statements of expectations, beliefs, future plans and strategies, anticipated events or trends, and similar expressions concerning matters that are not historical facts. These forward-looking statements are only predictions that are subject to risks, uncertainties, and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in this Report under the section entitled “Risk Factors” in Item 1A of Part I and elsewhere, and in other reports we file with the SEC, specifically the most recent reports on Form 10-Q. While forward-looking statements are based on reasonable expectations of our management at the time that they are made, you should not rely on them. We undertake no obligation to revise or update publicly any forward-looking statements for any reason.

Table of Contents

Executive Overview

We are in the business of developing, marketing, and distributing advanced indoor aeroponic and hydroponic garden systems. After several years of initial research and product development, we began sales activities in March 2006. Since that time we have expanded our operations and currently offer four different indoor garden models, more than 50 seed kits, and various gardening and kitchen accessories. Although our business is focused on the United States and Canada, our products are available in seven other countries.

Beginning in the fiscal year ended March 31, 2010 (“Fiscal 2010”), and continuing through the fiscal year ended March 31, 2012 (“Fiscal 2012”), we scaled back our operations as a result of the general economic downturn and the resulting decline in consumer confidence and spending. We also determined that broad distribution through retail channels was not appropriate for a company at our stage of development because of relatively low profit margins, high capital requirements, and the operational requirements of our retailer customers. As of March 31, 2012, our products were offered in approximately 500 storefronts in North America, as compared to approximately 575 stores as of March 31, 2011. Going forward, we plan to continue selling through our largest retailer customer that comprised approximately 88.4% of our sales to retailers during Fiscal 2012.

Beginning in late Fiscal 2010 and continuing through Fiscal 2012, we re-focused our efforts towards building our direct-to-consumer business, which carries higher margin opportunity. To position our business for the future, we increased the depth and breadth of our direct sales distribution channels to include a direct mail catalogue business with approximately 0.9 million catalogues mailed in Fiscal 2012, significantly increased our web-selling presence and developed a robust e-mail marketing program. In addition, we have tested print ads in national magazines, infomercials, mall kiosks, and long-form and short-form infomercials, and may increase our use of these marketing vehicles in the future. In Fiscal 2012, approximately 89.8% of our total sales were to direct customers.

To further our strategic shift towards direct-to-consumer selling, we began investigating the network marketing channel of distribution during Fiscal 2011. Network marketing, which is also known as direct selling or multi-level marketing, involves person-to-person selling through independent distributors, which we believe represents a potential next step in our stated strategy to move the marketing and selling of AeroGrow products closer to the end consumer. In April 2011, we entered into a Licensing Agreement with Cyrano Partners, LLC (“Cyrano”) under which Cyrano began to offer our products in the network marketing sales channel. Simultaneously we entered into a Transaction Agreement with Cyrano to form a joint venture to pursue the network marketing sales channel, subject to the achievement of certain conditions precedent, including an obligation on the part of Cyrano to raise the capital necessary to fund the joint venture. Cyrano was unable to satisfy the funding condition precedent and, in August 2011, the Licensing Agreement and the Transaction Agreement were terminated. We believe that network marketing may represent a viable sales channel for our products, and are continuing to investigate potential strategies for entering this channel of distribution.

During Fiscal 2010 we began the process of restructuring our balance sheet and began efforts to re-capitalize the Company to address cash and liquidity constraints that were severe, at times, and had a material impact on the operations of the business. During Fiscal 2010 we issued approximately \$6.7 million of convertible preferred stock, restructured the amounts and payment timing of certain of our accounts payable, and reduced the amount of interest-bearing debt outstanding. During the fiscal year ended March 31, 2011 (“Fiscal 2011”), we issued \$7.0 million in Subordinated Secured Convertible Notes and \$1.5 million in short-term working capital debt (see additional detail under the caption “Liquidity and Capital Resources”). In Fiscal 2012, we restructured the amounts and payment timing of certain of our accounts payable, issued \$1.6 million in short-term working capital debt, restructured the payment schedule for a \$2.1 million note payable to a supplier, and received approval from our shareholders and affected creditors to convert our Series A Preferred Stock and Subordinated Secured Convertible Notes into common stock (see additional detail on these transactions under the caption “Liquidity and Capital Resources” and in Note 8

“Subsequent Events” to our consolidated financial statements). The conversions of our convertible securities were completed on April 11, 2012 (the first month of the fiscal year ended March 31, 2013). In addition, during May 2012, we offered our warrant holders the opportunity to exercise their warrants at a reduced price, resulting in \$1.59 million of new common equity capital from warrant exercises.

As a result, of these efforts, we believe we can meet our cash requirements for the next twelve months. We do intend to seek additional capital, however, to provide a cash reserve against contingencies, address the seasonal nature of our working capital needs, and to enable us to invest further in trying to increase the scale of our business. There can be no assurance we will be able to raise this additional capital, that we will be able to increase the scale of our business, or that our existing resources will be sufficient to meet all of our cash requirements. In such an event, we would reduce the scale of our operations and take such actions as are available to us to reduce our cash requirements. However, there can be no assurance that such actions would be successful.

Table of Contents

Our Critical Accounting Policies

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 cost.

	March 31, 2012	March 31, 2011
Finished goods	\$ 913,267	\$ 1,351,245
Raw materials	871,157	1,196,325
	\$ 1,784,424	\$ 2,547,570

We determine an inventory obsolescence reserve based on management's historical experience and establishes reserves against inventory according to the age of the product. As of March 31, 2012 and 2011, the Company had reserved \$103,401 and \$848,794, respectively, for inventory obsolescence.

Revenue Recognition

We recognize 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.

We record estimated reductions to revenue for customer and distributor programs and incentive offerings, including promotions and other volume-based incentives. Certain incentive programs require the Company to estimate based on industry experience the number of customers who will actually redeem the incentive. At March 31, 2012 and March 31, 2011, the Company had accrued \$37,955 and \$23,889 respectively, as its estimate for the foregoing deductions and allowances.

Warranty and Return Reserves

We record 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 and labor for periods up to one year. Factors that affect our 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 our warranty obligation. Based upon the foregoing, we have recorded as of March 31, 2012 and March 31, 2011 a provision for potential future warranty costs of \$8,304 and \$22,105, respectively.

We reserve for known and potential returns and associated refunds or credits related to such returns based upon historical experience. In certain cases, customers are provided a fixed allowance, usually in the 1% to 2% range, to cover returned goods. This allowance is deducted from payments made to us by such retailers. As of March 31, 2012 and March 31, 2011, the Company has recorded a reserve for customer returns of \$27,258 and \$44,315, respectively.

Shipping and Handling Costs

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

by customers are included in product sales.

18

Table of Contents

Stock Based Compensation

We account for share-based payments in accordance with ASC 710-10-55 (prior authoritative guidance: FASB Statement 123(R) Shared-Based Payment). We use the Black-Scholes option valuation model to estimate the fair value of stock option awards issued under ASC 710-10-55. For the years ended March 31, 2012, March 31, 2011, and March 31, 2010, equity compensation in the form of stock options and grants of restricted stock that vested totaled \$258,892, \$138,804, and \$452,393, respectively, and is included in the accompanying Statements of Operations in the following categories:

	Years ended		
	March 31, 2012	March 31, 2011	March 31, 2010
General and administrative	\$ 168,560	\$ 69,295	\$ 319,673
Research and development	-	-	6,644
Sales and marketing	90,332	69,509	126,076
Total	\$ 258,892	\$ 138,804	\$ 452,393

Advertising and Production Costs

We expense all production costs related to advertising, including, print, television, and radio advertisements when the advertisement has been broadcast or otherwise distributed. We record media costs related to its direct-to-consumer advertisements, inclusive of postage and printing costs incurred in conjunction with mailings of direct response catalogues, and related direct response advertising costs, in accordance with ASC 340-20-25 (prior authoritative guidance: Statement of Position, "No. SOP 93-7" Reporting on Advertising Costs). In accordance with ASC 340-20-25, direct response advertising costs incurred should be reported as assets and should be amortized over the estimated period of the benefits, based on the proportion of current period revenue from the advertisement to probable future revenue. As of March 31, 2012 and March 31, 2011, the Company had deferred \$2,524 and \$3,386, respectively, related to such media costs. Advertising expenses for the years ended March 31, 2012, March 31, 2011 and March 31, 2010 were \$751,456, \$1,542,939, and \$2,299,431, respectively.

Research and Development

Research, development, and engineering costs are expensed as incurred. Research, development, and engineering expenses primarily include payroll and headcount related costs, contractor fees, infrastructure costs, and administrative expenses directly related to research and development support.

Deferred Debt Issuance Costs

We capitalize debt issuance costs that are directly attributable to realizing the proceeds of the debt issued and these costs are amortized over the contractual life of the debt using the effective interest method.

New Accounting Pronouncements

In May 2011, the FASB issued ASC Update 2011-04 (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. This ASC update results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between U.S. GAAP and International Financial Reporting Standards ("IFRS"). The new guidance includes changes to how and when the valuation premise of highest and best use applies, clarification on the application of blockage factors and other premiums and discounts, as well as new and revised disclosure requirements. This ASC update is effective for interim

and annual periods beginning after December 15, 2011. The adoption of this guidance did not have a material effect on our financial statements.

In September 2011, the FASB issued updated guidance on the periodic testing of goodwill for impairment. This guidance will allow companies to assess qualitative factors to determine if it is more-likely-than-not that goodwill might be impaired and whether it is necessary to perform the two-step goodwill impairment test required under current accounting standards. This new guidance is effective for us beginning July 1, 2012, with early adoption permitted. This new guidance will not have a material impact on our consolidated financial statements.

Table of Contents

Inflation and Seasonality

We do not currently expect inflation to have a significant effect on our operations. Because our indoor garden systems are designed for an indoor gardening experience, we experience slower sales in the United States and Canada during the late spring and summer months when our consumers may tend to garden outdoors. In addition, we have experienced increased sales during the holiday season in the fourth calendar quarter (the third quarter of our fiscal year). We sell to our international distributors in U.S. Dollars thereby minimizing effects from currency fluctuations. We purchase our gardens and other accessory products from Chinese manufacturers, and these purchases are denominated in U.S. Dollars. However, over time, the cost of the products we procure from China may be affected by changes in the value of the U.S. Dollar relative to the Chinese currency and/or by labor and material cost increases faced by our Chinese manufacturers.

Results of Operations

The following table sets forth, as a percentage of sales, our financial results for the last three fiscal years:

	Fiscal Years Ended March 31,					
	2012		2011		2010	
Net revenue						
Direct-to-consumer	89.8	%	79.3	%	57.5	%
Retail	8.6	%	19.1	%	40.1	%
International	1.6	%	1.6	%	2.4	%
Total net revenue	100.0	%	100.0	%	100.0	%
Cost of revenue	50.6	%	70.1	%	68.7	%
Gross profit	49.4	%	29.9	%	31.3	%
Operating expenses						
Research and development	0.6	%	1.7	%	2.5	%
Sales and marketing	24.7	%	33.2	%	35.4	%
General and administrative	27.7	%	27.5	%	29.6	%
Total operating expenses	53.0	%	62.4	%	67.5	%
Loss from operations	-3.6	%	-32.5	%	-36.2	%
Total other (income)/expense, net	39.6	%	37.5	%	0.4	%
Net loss	-43.2	%	-70.0	%	-36.7	%

Fiscal Years Ended March 31, 2012 and March 31, 2011

Summary Overview

For the fiscal year ended March 31, 2012 (“Fiscal 2012”), our net sales totaled \$8,230,424, a decrease of 27.2% from the fiscal year ended March 31, 2011 (“Fiscal 2011”).

Our sales to retailer customers declined by 67.1% to \$710,471, representing almost half of the overall sales decrease we experienced during Fiscal 2012. The reduction in sales to retailers reflected a combination of factors, but principally reflected our decision to de-emphasize sales to retailers because of the higher risk and lower margins associated with these sales. In addition, due to severe cash constraints experienced during Fiscal 2012, we were unable to procure inventory to meet demand from our retailer customers, which had a significant adverse effect on our sales to retailers in Fiscal 2012. As of March 31, 2012, our products were being carried in approximately 500 retail storefronts, as compared to approximately 575 a year earlier.

Table of Contents

Our direct-to-consumer sales also declined, by 17.7% to \$7,386,847, principally because of a 51.3% decrease in our spending on revenue-generating advertising, reflecting our increased utilization of electronic marketing media, the impact of cash constraints we experienced in our first and second fiscal quarters, and the impact of an initiative to test the network marketing sales channel that began in late April 2011 and continued through the first week of August 2011. As part of that test we increased the average pricing on our products and reduced our promotional activity in other channels, which resulted in reduced demand for our products through our direct response and retail channels during that time period. Nonetheless, we did deliver a 68.9% year-over-year increase in the efficiency of our marketing efforts during Fiscal 2012, as measured by dollars of direct-to-consumer sales per dollar of advertising expense, which partially offset the impact on sales of the decline in advertising spending. Sales per dollar of advertising expense totaled \$9.83 during Fiscal 2012, as compared to \$5.82 per dollar of advertising expense in Fiscal 2011. Sales to international distributors also fell in Fiscal 2012, by 25.8% to \$133,106, as we did not promote international sales and relied exclusively on reorders from our existing customers.

The combination of these factors resulted in a year-over-year decline in total net sales of 27.2% to \$8,230,424 in Fiscal 2012.

Our gross margin for Fiscal 2012 was 49.4%, up from 29.9% in the prior year. The increase in percentage margin reflected a variety of factors experienced during Fiscal 2012, including a greater mix of higher-margin direct-to-consumer and seed kit and accessory revenue, higher average pricing, and efficiencies achieved in our assembly, fulfillment, and distribution operations.

Operating expenses for Fiscal 2012 totaled \$4,358,203, 38.3% or \$2,705,711 lower than the prior fiscal year. This decrease reflected a variety of cost saving initiatives, staffing reductions, and lower spending on advertising and promotion. Sales and marketing costs were reduced by 46.0%, including a \$791,483, or 51.3% reduction in advertising spending caused in large part by the cash constraints we experienced during the first and second fiscal quarters of Fiscal 2012, as well as by a shift in our spending toward less expensive electronic media. General and administrative expense totaled \$2,278,491 during Fiscal 2012, and was down 26.9%, or \$837,955, from Fiscal 2011. The lower general and administrative expense primarily reflected the impact of lower headcount and a furlough program we implemented in the second fiscal quarter of Fiscal 2012, as well as spending reductions in all areas, including legal expenses, administration, and facility and office-related expenses. Research and development costs also declined year-over-year, by \$138,509 in Fiscal 2012, reflecting lower headcount and reduced product development activity relative to the prior fiscal year.

Our loss from operations totaled \$292,455 for Fiscal 2012, as compared to a loss of \$3,679,389 in the prior year. The lower loss reflected the impact of margin improvements, cost savings initiatives and lower media spending which offset the impact of lower sales during Fiscal 2012.

Other expense for Fiscal 2012 totaled \$3,258,579 as compared to \$4,242,351 in the prior year. The net other expense in Fiscal 2012 included \$2,918,040 in non-cash expense related to: (i) the amortization of deferred financing costs, and (ii) the amortization of a calculated debt discount (including amounts accelerated because of the conversion of convertible debt into common stock during the period). The vast majority of these charges related to convertible notes issued during Fiscal 2011. These notes were considered to have been issued at a discount because they had a conversion price lower than the market price of our stock at the time of issuance, and because the notes were issued with warrants to purchase our common stock. The resulting discount is being amortized to expense over the three-year life of the notes, as are the related financing costs. In addition, current year other expense included \$415,405 in net gains related to negotiated discounts on accounts payable and debt balances. In Fiscal 2011, other expense included the impact of \$3,267,566 in non-cash expense related to deferred financing costs and debt discount amortization.

Our net loss for Fiscal 2012 totaled \$3,551,034, down \$4,370,706 from the prior year due to the reduced operating loss and the year-over-year reduction in net other expense.

Table of Contents

Revenue

The table set forth below shows quarterly revenues by sales channel for the fiscal years ended March 31, 2012, and March 31, 2011:

	Quarters ended				Year ended
	30-Jun-10	30-Sep-10	31-Dec-10	31-Mar-11	31-Mar-11
Sales – direct-to-consumer	\$1,546,935	\$1,071,606	\$3,563,597	\$2,794,396	\$8,976,534
Sales – retail	191,578	287,373	1,366,060	312,200	2,157,211
Sales – international	79,506	20,638	73,214	6,109	179,467
	\$1,818,019	\$1,379,617	\$5,002		