

AeroGrow International, Inc.  
Form SB-2/A  
December 15, 2006

As filed with the United States Securities and Exchange Commission on December 15, 2006.

Registration No. 333-133180

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

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**AMENDMENT NO. 1**  
**to**  
**FORM SB-2**  
**REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933**

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**AEROGROW INTERNATIONAL, INC.**  
(Name of Registrant in its charter)

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

**3524**  
(Primary Standard Industrial  
Classification Code Number)

**46-0510685**  
(I.R.S. Employer  
Identification Number)

**6075 Longbow Dr. Suite 200**  
**Boulder, Colorado 80301**  
**(303) 444-7755**  
(Address and telephone number of principal executive  
offices)

**6075 Longbow Dr. Suite 200**  
**Boulder, Colorado 80301**  
(Address of principal place of business)

W. Michael Bissonnette  
AeroGrow International, Inc.  
6075 Longbow Dr. Suite 200  
Boulder, Colorado 80301  
(303) 444-7755  
(Name, address and telephone number of agent for service)

Copies to:

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

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

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

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

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

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

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

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

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

**AEROGROW INTERNATIONAL, INC.**  
**Registration Statement on Form SB-2**  
**under the**  
**Securities Act of 1933, as amended**

**CALCULATION OF REGISTRATION FEE**

Title of each class of securities to be registered	Amount to be registered(1)	Proposed maximum offering price per security	Proposed maximum aggregate offering price	Amount of registration fee
Common stock	3,171,264	\$ 5.00 <sup>(2)</sup>	\$ 15,856,320	\$ 1,696.63
Common stock underlying 2006 Warrants	2,163,345	\$ 6.25 <sup>(3)</sup>	\$ 13,520,906	\$ 1,446.74
Common stock underlying 2005 Convertible Notes	214,291	\$ 3.50 <sup>(3)</sup>	\$ 750,019	\$ 80.26
Common stock underlying 2005 Debt Warrants	726,000	\$ 5.00 <sup>(3)</sup>	\$ 3,630,000	\$ 388.41
Common stock underlying 2005 Conversion Warrants	426,000	\$ 6.00 <sup>(3)</sup>	\$ 2,556,000	\$ 273.49
Total Registration Fee				\$ 3,885.53
Total Previously Paid				\$ 4,250.92

(1) Pursuant to Rule 416(a) under the Securities Act, there are also being registered such indeterminable number of shares of common stock as may be issued pursuant to the anti-dilution provisions of such warrants, stock splits, stock dividends or similar transactions.

(2) Estimated solely for the purpose of calculating the registration fee under Rule 457 under the Securities Act.

(3) Pursuant to Rule 457(g) under the Securities Act, the registration fee has been calculated on the basis of the proposed maximum price at which the warrants may be exercised or notes may be converted.

The information in this prospectus is not complete and may be changed. The selling shareholders may not sell these securities until the registration statement filed with the SEC is effective. This prospectus is not an offer to sell these securities and we are not soliciting offers to buy these securities in any state where the offer or sale is not permitted.

**Preliminary Prospectus (Subject to Completion), Dated December \_\_, 2006**

**6,700,900 Shares of Common Stock**

**AEROGROW  
INTERNATIONAL, INC.**

This prospectus covers up to 6,700,900 shares of common stock of AeroGrow International, Inc. (“AeroGrow”) that may be offered for resale, or otherwise disposed for the account of, the selling stockholders set forth under the heading “Selling Security Holders” beginning on page 61. The shares of common stock issued and outstanding may be offered at any time. The shares of common stock underlying the outstanding common stock purchase warrants and issuable on conversion of outstanding debt instruments may only be offered for resale after being issued by AeroGrow to the selling stockholders upon exercise or conversion.

An application has been filed to cause the shares of our common stock to be traded on the Over-the-Counter Bulletin Board (“OTC BB”) under the symbol \_\_. [The last sale price of the common stock on December \_\_, 2006 was \$\_\_.]

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

Investing in our common stock involves a high degree of risk. See “Risk Factors” beginning on page 3 of this prospectus.

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

The date of this prospectus is December \_\_, 2006

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

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

## PROSPECTUS SUMMARY

*This summary highlights information contained elsewhere in this prospectus. You should read this entire prospectus carefully before making an investment decision, including the “Risk Factors” section beginning on page 3 and our financial statements beginning on page F-1. We refer to AeroGrow International, Inc. as “AeroGrow,” “Company,” “we,” “our” and “us.”*

### **AeroGrow International**

AeroGrow was formed as a Nevada corporation on March 25, 2002. We are in the business of developing, marketing, and distributing advanced indoor aeroponic garden systems. Since formation and through our development stage, which ended in February 2006, our principal activities consisted of product research and development, market research, business planning, and raising the capital necessary to fund these activities. We have completed development of our initial kitchen garden systems and related “bio-grow” seed pods. We have also contracted with a third-party manufacturer who has commenced production activities and a second manufacturer who will commence production in the first quarter of calendar 2007. As of December 7, 2006, we have manufactured and taken delivery of over 65,000 units. We commenced our initial marketing and distribution of our products during March 2006 and have expanded these marketing efforts to encompass retail, home shopping, catalogue, international, and direct to consumer sales channels.

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

We have filed 14 patent applications in the United States to potentially protect our core inventions. To date, no patents have been granted, and there is no assurance such applications will be granted. Although aeroponic technology cannot in and of itself be patented, the patent applications include aeroponic technological advances described below as well as product, nutrient and seed pod inventions designed to enhance plant growth. Many of the patent-pending companion technologies are based on our innovations in the fields of biology, plant physiology, chemistry, and adaptive learning computer science. In addition, we have developed certain trade secrets which simplify, combine and integrate our core technologies into our indoor kitchen garden systems.

In addition, AeroGrow has applied for and has been issued a trademark for AeroGarden™ and six other trademarks and is currently processing 12 other trademark applications for trademarks for its products and product slogans. AeroGrow has also submitted applications to expand its AeroGarden™ trademark in 33 countries, all of which are pending. AeroGrow has also obtained the domain names for AeroGrow.com and AeroGarden.com, AeroGarden.net, AeroGarden.tv, AeroGarden.biz, and Getthegarden.com among others.

We believe that our inventions and combined technologies will allow almost anyone, from consumers who have no gardening experience to professional gardeners, to produce year-round harvests of herbs, flowers, and vegetables provided in our seed kits regardless of season, weather, or lack of natural light. We believe that our kitchen garden systems’ unique and attractive designs make them appropriate for use in almost any location, including kitchens, bathrooms, living areas, and offices.

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

Until March 2006, we were a development stage, start-up company, and we did not generate any revenues. Through March 1, 2006, we funded our operations primarily through the private sale of equity securities. Since commencing sales of our products, we have begun to increase our reliance on revenues generated from such sales for funding our operations. We had an accumulated deficit of (\$24,937,367) through September 30, 2006. We expect to incur substantial additional expenses and losses in the further implementation of our business plan. Because we are in the early stages of implementing our business plan, we cannot predict now if we will ever be profitable. Prior to March 2006 when we commenced sales of our aeroponic garden systems, we were considered a Development Stage Enterprise in accordance with Statement of Financial Accounting Standards ("SFAS") SFAS No. 7, Accounting and Reporting by Development Stage Enterprises.

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



## RISK FACTORS

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

### RISKS RELATED TO OPERATIONS

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

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

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

Since AeroGrow commenced its operations in 2002 and through September 30, 2006, AeroGrow has incurred substantial operating losses. For the six months ended September 30, 2006, AeroGrow had a net loss of \$5,531,655; for the transition period of the three months ended March 31, 2006, AeroGrow had a net loss of \$7,543,343; for the twelve months ended December 31, 2005, AeroGrow had a net loss of \$7,717,577; for the twelve months ended December 31, 2004, AeroGrow had a net loss of \$2,389,044; and for the twelve months ended December 31, 2003, AeroGrow had a net loss of \$1,159,535. Since inception AeroGrow's losses from operations have resulted in an accumulated deficit of \$24,937,367. AeroGrow expects that its operating expenses will outpace revenues for the near future and result in continued losses. The success of its business will depend on its ability to expand sales and distribution of its AeroGarden™ kitchen garden systems to consumers and develop new product extensions and applications.

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

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

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

damage its reputation,

· decrease sales,

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

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

**AeroGrow may need additional capital to fund its growth.**

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

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

AeroGrow's convertible notes with an aggregate principal amount of \$30,000 were re-paid on June 30, 2006. In addition, \$840,000 of principal amount will be due on December 31, 2006, unless converted. The Company has offered to these holders to extend the maturity of their notes until March 31, 2007. No assurance can be given that such offer will be accepted. If these holders choose to demand payment rather than converting their notes to common stock, up to \$840,000 of principal plus related interest may have to be paid. If such holders choose not to convert or extend the maturity, AeroGrow would use a portion of its current capital to repay the convertible notes instead of funding its full plan of operations, and AeroGrow may not be able to maximize revenues or profitability.

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

AeroGrow's ability to produce and sell kitchen garden systems exclusively depends in part on securing patent protection for the components of its systems, maintaining various trademarks and protecting its operational trade secrets. To protect its proprietary technology, AeroGrow relies on a combination of patents pending (and if granted, patents), trade secrets, and non-disclosure agreements, each of which affords only limited protection. AeroGrow owns the rights to 14 United States patent applications. However, these patent applications may not result in issued patents and even issued patents may be challenged. AeroGrow is selling its kitchen garden systems prior to receiving issued patents relating to its patent applications. All of AeroGrow's intellectual property rights may be challenged, invalidated or circumvented. Claims for infringement may be asserted or prosecuted against AeroGrow in the future and AeroGrow may not be able to protect its patents, if any are obtained, and intellectual property rights against others. AeroGrow's former employees or consultants may violate their non-disclosure agreements with AeroGrow, leading to a loss of proprietary intellectual property. AeroGrow also could incur substantial costs to assert its intellectual property or proprietary rights against others.

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

AeroGrow currently depends on one contract manufacturer in China to produce its kitchen garden systems. This manufacturer may fail to produce the kitchen garden system to AeroGrow's specifications or in a workmanlike manner and may not deliver the systems on a timely basis. Such manufacturer must also obtain an inventory of necessary parts and tools for production. AeroGrow owns the tools and dies used by its manufacturer. AeroGrow's manufacturer operates in China and may be subject to business risks that fall outside the control of AeroGrow including but not limited to, political, currency and regulatory risks each of which may affect the manufacturer's ability to fulfill AeroGrow's orders for kitchen garden systems. Any change in manufacturers could disrupt our ability to fulfill orders for kitchen garden systems. Any change in manufacturers could disrupt its business due to delays in finding a new manufacturer, providing specifications and testing initial production. Although AeroGrow has begun to work with a second manufacturer, no assurance can be given when or if production will be available from that manufacturer. This manufacturer is also located in China and is subject to the same risks as our current manufacturer.

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

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

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

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

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

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

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

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

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

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

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

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

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

To raise working capital, AeroGrow offered common stock and warrants in private transactions that AeroGrow believed to be exempt from registration under the 1933 Act, as amended, and state securities laws. In 2004 AeroGrow also conducted a state registered offering in Colorado of common stock and warrants intended to be exempt from registration under the 1933 Act, as amended, as an intrastate offering. However, because the Company is incorporated in Nevada it did not satisfy all of the requirements for an intrastate offering. This could result in investors or regulators asserting that the Colorado offering and/or the private transactions (if the private transactions were integrated with the Colorado offering) violated the 1933 Act. There can be no assurance that investors or regulators will not be successful in asserting a claim that these transactions should not be integrated. In the event that one or more investors seeks rescission, with resulting return of investment funds and interest at a market rate, or that state or federal regulators seeks sanctions against AeroGrow or its principals, AeroGrow would spend time and financial resources to pay expenses for defense, rescission awards or regulatory sanctions. The use of funds would reduce the capital available to implement its full plan of operation. No assurance can be given regarding the outcome of any such actions.

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

Future sales of substantial amounts of AeroGrow's common stock in the public market, if one develops, or the perception that such sales might occur, could cause the market price of its common stock to decline and could impair the value of your investment in AeroGrow's common stock and AeroGrow's ability to raise equity capital in the future. As of September 30, 2006, AeroGrow had 9,421,343 shares of common stock outstanding, of which 544,228 shares may be sold without restriction. In addition, see the following risk factor for discussion of additional shares that are subject to issuance pursuant to warrants, options and convertible debt. Of the remaining shares, (i) 710,009 shares issued upon conversion of the Convertible Notes (as defined below in "Modification of Convertible Notes") in the principal amount of \$2,130,000 at a conversion price of \$3.00 per share are subject to registration rights and are not subject to lock up restrictions, (ii) 2,148,000 shares issued in the 2006 Offering (as defined below) are subject to registration rights and are not subject to lock up restrictions, (iii) 580,136 shares issued to stockholders of Wentworth I, Inc. ("Wentworth") in the Merger (as defined below in "Merger with Wentworth") have registration rights, but of these shares, 396,813 shares are subject to lock up restrictions for periods of 12 to 18 months from the effective date of this registration statement and the holders of such shares have waived their right to be included in this registration statement in exchange for the obligation of the company to register all such shares as soon as commercially reasonable after the filing of the next quarterly or annual report after the declaration of effectiveness of the this registration

statement, and the Company has agreed to use its commercially reasonable efforts to have such replacement registration statement declared effective as soon as practicable, (iv) 811,391 shares were issued during 2005 and are considered “restricted” shares under Rule 144, (v) 4,285,121 shares have been held more than one year and may be transferred and sold, subject to the restrictions under Rule 144 or Rule 701 depending on the status of the holder and the holding period, and (vi) 66,235 shares granted to employees and directors on March 30, 2006 under the company’s 2005 Equity Compensation Plan. Of the shares identified in the last two categories above, 4,642,326 shares are subject to lock up agreements for periods of 12 to 18 months from the effective date of this registration statement. The lock up restrictions may be released by the agreement of AeroGrow and Keating Securities, LLC (“Keating Securities”). The shares of AeroGrow’s common stock underlying the Convertible Notes and the warrants issued or to be issued to the holders of Convertible Notes are required to be registered for resale by AeroGrow and are not subject to lock up restrictions. As part of the 2006 Offering, AeroGrow agreed to register for resale the shares of common stock issued to investors in the 2006 Offering (together with the shares of common stock underlying the 2,148,000 warrants issued in the 2006 Offering) on a registration statement to be filed with the SEC. There can be no assurance that the shares of common stock subject to registration rights, and not covered by this Registration Statement, will become registered under the Securities Act. The sales of AeroGrow common stock by these stockholders having registration rights or even the appearance that such holders may make such sales once a registration statement becomes effective may limit the market for the common stock or depress any trading market volume and price before other investors are able to sell the common stock. Moreover, a number of shareholders have held their investment for a substantial period of time and may desire to sell their shares, which could drive down the price of our common stock.

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

As of September 30, 2006, AeroGrow is committed to issue up to 5,992,155 additional shares of common stock under the terms of outstanding convertible notes, warrants, options and other arrangements. There are warrants and options outstanding issued prior to June 30, 2005 that can be exercised for 882,858 shares of its common stock at exercise prices ranging from \$0.005 to \$15.00 per share. There are 2,143,000 shares of common stock issuable upon exercise of the outstanding warrants issued to investors in the 2006 Offering exercisable at \$6.25 per share. There are also 240,006 shares of common stock issuable upon conversion of the Convertible Notes in the principal amount of \$840,000 at a conversion price of \$3.50 by holders who have elected to extend the maturity of their notes to December 31, 2006. The Company has offered to these holders to extend the maturity of their notes until March 31, 2007. There are 600,000 shares of common stock issuable upon exercise of outstanding warrants held by the initial holders of the Convertible Notes with an exercise price of \$5.00 per share. There are 426,000 shares of common stock issuable upon exercise of warrants, at an exercise price of \$6.00 per share, that were issued to holders that elected to convert notes in the principal amount of \$2,130,000. There are 168,000 shares of common stock issuable upon the exercise of warrants to be issued upon conversion of Convertible Notes in the principal amount of \$840,000 at an exercise price of \$6.00 per share. There are 60,000 shares of common stock issuable upon exercise of outstanding warrants issued in 2005 to Keating Securities or its designees in connection with the Convertible Notes offering with exercise price of \$6.00 per share and 214,800 shares of common stock issuable upon exercise of outstanding warrants issued to designees of Keating Securities in the 2006 Offering with an exercise price of \$6.25. As of September 30, 2006, the Company has granted an 1,251,491 options to purchase its common stock pursuant to the Company's 2005 Equity Compensation Plan.

AeroGrow has historically issued shares of its common stock or granted stock options to employees, consultants and vendors as a means to conserve cash, and AeroGrow may continue to grant additional shares of stock and issue stock options in the future. As of September 30, 2006, there are 201,871 shares of common stock available for issuance under its 2005 Equity Compensation Plan.

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

**If AeroGrow's common stock is traded, AeroGrow expects to be subject to the "penny stock" rules for the foreseeable future.**

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



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

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

An application has been made to cause the Company's common stock to be traded on the OTC BB, and therefore there is no established market for AeroGrow's shares at this time. If a public market develops, the price is likely to be influenced by the price at which and the amount of shares the selling stockholders are attempting to sell at any time with the possible effect of limiting the trading price or lowering the price to their offering price. Shares such as those of AeroGrow are also subject to the activities of persons engaged in short selling securities, which generally has the effect of driving the price down. Also, common stock of emerging growth companies is subject to high price and volume volatility. Therefore, the price of AeroGrow's common stock may fluctuate widely. A full and stable trading market for AeroGrow's common stock may never develop in which event any holder of such shares may not be able to sell at the time he elects or at all.

#### **USE OF PROCEEDS**

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

This prospectus also covers the sale of shares of common stock issuable upon exercise of common stock purchase warrants and conversion of outstanding debt. In the event those common stock purchase warrants are exercised for cash, assuming no adjustments to the exercise price for anti-dilution protection, then AeroGrow estimates that it would receive approximately \$19,706,906 in gross proceeds. Any proceeds received from the exercise of the warrants will be used for general corporate purposes.

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

#### **DIVIDEND POLICY**

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

## MARKET DATA

An application has been filed to cause the shares of our common stock to be traded on the OTC BB under the symbol \_\_\_\_\_. [The last sale price of the common stock on December \_\_, 2006 was \$\_\_\_\_.]

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

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

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

[The high and low sales prices for the common stock for the period \_\_\_\_, 2006, the initial trading date, until \_\_\_\_, 2006, were \$\_\_\_\_ and \$\_\_\_\_ respectively (such prices being stated without retail mark-up, mark-down, or commissions).]

We have approximately 756 record holders of our common stock. We believe that in addition to the record ownership there are a limited number of beneficial owners who hold their shares in street name or through other nominees.

## MANAGEMENT'S PLAN OF OPERATION

The following plan of operation provides information which AeroGrow's management believes is relevant to an assessment and understanding of AeroGrow's business, operations, and financial condition. The discussion should be read in conjunction with the audited financial statements and notes thereto and the unaudited financial statements for the period ending September 30, 2006, both of which are included in this registration statement. This plan of operation contains forward-looking statements that involve risks, uncertainties, and assumptions. AeroGrow's actual results may differ substantially from those anticipated in any forward-looking statements included in this discussion as a result of various factors, including those set forth in "Risk Factors."

### Overview

AeroGrow is in the business of developing, marketing, and distributing advanced indoor aeroponic garden systems. Since formation and through its development stage that ended March 1, 2006, AeroGrow's principal activities have consisted of product research and development, market research, business planning, and raising the capital necessary to fund these activities. AeroGrow has completed development of our initial kitchen garden systems and related "bio-grow" seed pods and has contracted with a third-party manufacturer who has commenced production activities and a second manufacturer who will commence production in the first quarter of calendar 2007. AeroGrow began sales activities as of March 2006. As of September 30, 2006, AeroGrow had manufactured and taken delivery of over 45,000 units. AeroGrow commenced initial marketing and distribution of its products during March 2006, and has expanded these marketing efforts to encompass retail, home shopping, catalogue, international, and direct to consumer sales channels. Prior to March 2006 when AeroGrow commenced sales of its aeroponic garden systems, AeroGrow was considered a Development Stage Enterprise in accordance with Statement of Financial Accounting Standards ("SFAS") SFAS No. 7, Accounting and Reporting by Development Stage Enterprises.

### Liquidity and Capital Resources

As of September 30, 2006, AeroGrow had a cash balance of approximately \$3,374,710. AeroGrow anticipates that existing cash resources will be sufficient for the next 12 months. However, AeroGrow has \$840,000 in convertible debentures that become due as of December 31, 2006. AeroGrow does not know at this time whether the holders of these debentures intend to convert to common stock at a price of \$3.50 per share or seek repayment of their debentures. To date, no notices of conversion have been received. In the event the majority of the holders of these debentures request repayment, AeroGrow would need to seek additional debt or equity financing to fund its current business objectives.

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

As of September 30, 2006, AeroGrow has generated net proceeds of \$17,439,187 from the sale of the following securities:

- \$2,279,444 from private placements of 2,040,611 shares of its common stock during 2002, 2003 and 2004,
- \$215,000 from the exercise of its redeemable \$1.25 warrants and \$2.50 warrants for 164,000 shares of common stock in 2003, 2004 and through June 30, 2005,

- \$2,307,737 from a Colorado registered offering of units consisting of 544,228 shares of common stock and its redeemable \$10.00 warrants and \$15.00 warrants during 2004,

- \$2,591,554 from its debt offering of convertible notes and redeemable 2005 warrants in June, July, August and September 2005,
- \$8,000 from the issuance of 1,600 shares of common stock pursuant to an agreement with an employee at \$5.00 per share during the period June 30, 2005 through September 30, 2005,
- \$85,000 from the issuance of 38,000 shares of common stock pursuant to the exercise of \$1.25 and \$2.50 warrants,
- \$962,500 from the exercise of outstanding \$1.25, \$2.50 and \$5.00 warrants for 395,000 shares of common stock during December 2005;
- \$25,000 from the exercise of 10,000 outstanding \$2.50 warrants and \$31,250 from the exercise of 5,000 outstanding \$6.25 warrants during the nine months ended September 30, 2006; and
- \$8,964,952 in net proceeds from the sale of common stock and warrants in the 2006 Offering, consummated February 24, 2006 and March 1, 2006 (see "Private Placement in Connection with Merger.")

AeroGrow has used the funds raised to date to:

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

### **Plan of Operation**

During the next 12 months, AeroGrow intends to continue to expand its efforts in manufacturing, marketing, distributing, and selling its AeroGarden™ kitchen garden systems. Manufacturing activities began in January 2006 for production and production capacity has been expanded in an attempt to meet the demands of our customers, both in terms of capacity at our current contract manufacturer as well as establishment of an additional contract manufacturer. AeroGrow produced its infomercial in September 2006 and has completed the initial test airings of the infomercial in December, 2006. AeroGrow plans to increase the frequency of the infomercial airings through March 2007. AeroGrow has expanded its presence in catalogues from our catalogue launch partner, Frontgate, to multiple catalogues including Brookstone, Plow and Hearth, Improvements, and others. AeroGrow also plans to continue to expand its retail distribution and already has over 450 retail stores carrying the AeroGarden™ products nationwide. In order to transition from its development stage to an operating company, AeroGrow has strengthened its management team with the addition of a vice president of sales, a vice president of operations, a chief financial officer, and other operations and administrative staff. AeroGrow also is expanding its new product development activities to sustain operations beyond its initial product offerings.

During 2006, AeroGrow has completed development of many of its marketing materials, including its infomercial, website, product brochures, retail packaging, point of purchase displays, and other retail collateral materials and public relations kits. AeroGrow continues to dedicate financial and management resources to the improvement of its marketing and sales materials and processes.

During the six months ended September 30, 2006, AeroGrow incurred \$844,384 in research and development. During the year ended December 31, 2005, AeroGrow incurred \$1,578,833 in research and development costs. During the year ended December 31, 2004, AeroGrow incurred \$333,038 in research and development costs. During the year ended December 31, 2003, AeroGrow incurred \$344,164 in research and development costs. AeroGrow initially focused its efforts on determining if an aeroponic product could be developed for consumer use in the home at attractive prices. AeroGrow then focused on developing the design, technology and various prototype models. In addition, AeroGrow set up a greenhouse and laboratory to measure the success of growing herbs, vegetables and flowers with various seeds, cuttings, and nutrients under different lighting conditions. Finally, AeroGrow filed patent applications for the technology used in its kitchen garden systems.

In the next 12 months AeroGrow intends to continue researching and developing new product designs and product extensions including, but not limited to, nutrient delivery systems and additional seed varieties for its seed kits.

AeroGrow's plan of operation for the balance of the fiscal years ended March 31, 2007 and 2008 will depend, in part, on whether the assumptions used to develop its business plan were accurate or need to be changed to respond to different business needs or objectives. Any changes could cause the working capital to be insufficient to fund its operations and AeroGrow could be required to seek additional financing sooner than AeroGrow currently anticipates.

## **Manufacturing**

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

On September 30, 2005, AeroGrow entered into a manufacturing agreement with Source Plus, Inc. ("Source Plus") an Alabama corporation, and Mingkeda Industries Co., Ltd. ("Mingkeda"), a Chinese company located in the Guangdong Province of China that has primarily manufactured light fixtures in the past. This agreement supersedes a prior agreement with Mingkeda and Source Plus. Under the terms of this agreement, Source Plus advanced monies to Mingkeda for tooling and molds to build AeroGrow's products. To reimburse Source Plus for its advance to Mingkeda, AeroGrow issued 62,000 shares of its common stock to Source Plus in October 2005. AeroGrow recorded a \$310,000 asset for tooling which AeroGrow will depreciate over a period of three years to reflect the estimated useful life of the tooling. AeroGrow and Source Plus have agreed to certain selling restrictions on its sale of AeroGrow common stock. Because certain capital raising and the listing and trading of the Company's securities was not completed by June 1, 2006, Source Plus may have the ability to require AeroGrow to repay the \$155,000 in exchange for its return of AeroGrow stock. To date, Source Plus has not made such request. If the market value of AeroGrow common stock issued to Source Plus is less than \$155,000 one year after the closing of the 2006 Offering, then AeroGrow has agreed to pay such difference to Source Plus in cash within 60 days following the one year date, plus interest at 5% per annum. Further, in return for a \$0.50 per unit price concession from Mingkeda for products AeroGrow purchases, AeroGrow issued 10,000 shares of its common stock to Mingkeda in October 2005. These shares are subject to the same selling restrictions as the stock issued to Source Plus. AeroGrow recorded a \$50,000 expense for inventory which AeroGrow will charge to cost of sales for one year or at a rate of \$0.50 per unit for each unit sold, whichever occurs sooner.

This agreement provides for payment of the purchase price of products manufactured by Mingkeda as follows: 30% paid 25 days prior to shipment, 50% paid upon shipment, and the remaining 20% paid 20 days after shipment. The purchase price is determined based upon a fixed percentage for profit (14% for light bulbs, 29% for all other products); overhead and labor are applied to actual component costs. AeroGrow has also agreed to pay to Source Plus a commission of 2% of the total purchases of the product with such payments to be made using the same proportions as AeroGrow's payments to Mingkeda. In addition, Source Plus is entitled to receive 2% of all purchases by AeroGrow of kitchen gardens, from all sources, for a period of 18 months from the date of the initial shipment from Mingkeda. Mingkeda will manufacture and ship the products as and when required by AeroGrow and will maintain an agreed level of quality. Currently, Mingkeda has the capacity to produce 15,000 per month and has agreed to develop sufficient capacity to manufacture up to 25,000 kitchen garden systems per month. AeroGrow will have the right to audit Mingkeda's manufacturing performance periodically and maintain an agent in the Mingkeda plant to inspect its production. AeroGrow believes that its products will be manufactured to high quality standards at acceptable costs.

The manufacturing agreement with Mingkeda and Source Plus provides for protection of the intellectual property rights of AeroGrow. Under the agreement, Source Plus is specifically responsible for working as the liaison between AeroGrow and Mingkeda with responsibility for oversight of quality control in the manufacturing of the products, review of specifications and Mingkeda's compliance, monitoring of order fulfillment, and similar tasks related to

quality of the finished goods. Source Plus receives a 2% commission for their work. Mingkeda manufactures the product to the specifications of AeroGrow at a predetermined line item component and assembly cost that will not change unless there are changes in exchange rate or cost of raw materials. Changes in cost must be pre-approved by AeroGrow.



In order to diversify its risk from having a single manufacturer, as well as provide for capacity beyond that of Mingkeda, AeroGrow is seeking additional contract manufacturing sources. AeroGrow has completed its initial set of tooling with a second contract manufacture, Main Power Electrical Factory Ltd., which is located in China (“Main Power”). AeroGrow anticipates first production units to be built by Main Power during the first quarter of calendar 2007. Production capacity at Main Power is estimated to be 50,000 units per month for each set of tools. Purchasing terms with Main Power will be 100% payment upon shipment through commercial bills of exchange. AeroGrow has paid 5% of the tooling costs to Main Power with an additional 5% of the tooling cost due upon the initial shipment. The remainder of the tooling cost will be amortized as an additional charge of \$0.20 per unit purchased from Main Power.

### **Public Relations Program**

During the first calendar quarter of 2006, AeroGrow initiated a public relations program designed to gain a wide exposure for AeroGrow and its kitchen garden systems through news stories:

- on radio and television,
- in food and gardening sections of newspapers,
- in food and gardening magazines, and
- on the Internet.

AeroGrow’s products were sent to selected major food and gardening editors, other recognized gardening and cooking authorities, and celebrities, to familiarize them with the products. The public relations program to date has yielded placements in newspapers such as the New York Times, magazines such as Readers Digest and Time, and television shows such as Good Morning America. AeroGrow signed a letter agreement with Patrice Tanaka & Company, Inc. (“Tanaka”) in June 2005 to manage its public relations activities. This agreement is cancelable by either party at any time. AeroGrow agreed that, through March 2006, 25% of Tanaka’s hourly compensation will be paid in shares of its common stock at the then current market or fair value. The total stock compensation payable to Tanaka is 11,354 shares, and AeroGrow recorded a corresponding expense of \$56,770. AeroGrow expects Tanaka to execute a lock up agreement with restrictions similar to those agreed to by Keating Reverse Merger Fund, LLC. Through September 30, 2006, cash compensation to Tanaka was \$350,023. AeroGrow anticipates continuing to have Tanaka manage public relations activities through March 2007.

### **Retail Marketing and Sales**

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

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

AeroGrow has completed the initial test airings of the infomercial it produced and plans to increase the frequency of the infomercial airings through March 2007, with target monthly media expenditures of \$600,000 to \$1,000,000 per

month during this period. AeroGrow expects that the exposure for its products and services that will be generated from the infomercial and other direct response marketing advertising will broaden the AeroGarden™ brand and product recognition in all channels of distribution. In July the AeroGarden™ was featured on QVC. There have been three additional airings since that time. AeroGrow has expanded its presence in catalogues from our catalogue launch partner, Frontgate, to multiple catalogues including Brookstone, Plow and Hearth, Improvements, and others. AeroGrow also continues to expand its retail distribution with over 450 retail stores to date carrying the AeroGarden™ products nationwide. Included in the foregoing is an initiative launched in September 2006 which focuses on generating a high level of awareness and product visibility in the New York metropolitan market. This initiative included securing high profile merchandising for our products from leading retailers in the New York area such as Macy's, Bed, Bath and Beyond, Linens 'n Things, and others for the 2006 holiday season. This initiative will be promoted in New York using the infomercial and other television media to promote sales at the participating retail locations.

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

### **Distribution**

AeroGrow's kitchen garden systems will be shipped from its manufacturers in China primarily via ocean cargo to a fulfillment center in Reno, Nevada. Initial shipments were shipped via airfreight to meet customer delivery dates and allow for additional quality inspection during the early stages of production. AeroGrow's seed pods are shipped from its manufacturing facility in Longmont, Colorado, to the fulfillment center. AeroGrow has contracted with Innotrac Corporation ("Innotrac"), a Georgia corporation, to fulfill, store and ship its products. Innotrac provides warehousing order packing, and shipping for the products sold (through both direct response channels and retail channels) on primarily a variable cost basis. Costs for warehousing, order packing, and shipping for the products sold through direct response channels are approximately \$1.50 to \$2.00 per unit, plus actual freight costs of \$5.00 to \$10.00 per order. These costs are included in the shipping and handling charge paid by the direct response purchaser. For retail distribution, the costs for warehousing, order packing, and shipping are estimated to be between \$.50 and \$1.00 per unit because of the efficiencies gained in shipping larger quantities per order. Freight costs will vary significantly depending upon quantity ordered and destination, but they are projected to range from 2% to 4% of sales net of reimbursement from customers. Innotrac also provides payment processing, database management, and customer support services for the direct response sales. These costs are approximately 2.5% of sales for payment processing and database management costs. AeroGrow manages the majority of its consumer and retailer customer support from its own facilities. The contract with Innotrac is for an initial term of three years, but provides for termination by either party on 90 days written notice. AeroGrow is presently exploring alternative fulfillment, warehousing, and order processing solutions to reduce costs and improve operational efficiency.

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

### **International Sales**

AeroGrow has begun to build its international distributor network and has entered into agreements to date with distributors in Mexico and Canada. On September 1, 2006, AeroGrow retained the services of a consultant in London to assist us in developing our international distributor network in Europe and Asia. AeroGrow anticipates having models of the AeroGarden™ kitchen garden products compatible with European and Asian regulatory and electrical requirements completed and available for distribution beginning in March 2007.

## **Inflation and Seasonality**

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

## **Results of Operations**

The six months ended September 30, 2006, included our first six months of revenues from operations. Initial shipments of our products began in March 2006. For the three and six months ended September 30, 2006, net sales totaled \$1,030,316 and \$1,852,254, respectively. For the six months ended September 30, 2006, one customer represented 24% of revenues. In accordance with our policy regarding revenue recognition, we deferred recognition of \$247,512 in sales to the following period for one customer, a television retailer, due to return rights granted to this customer in the event our products did not meet sales expectations.

Cost of revenues for the three and six months ended September 30, 2006, totaled \$827,165 and \$1,502,860, representing 80% and 81% of revenues, respectively. Included in cost of revenues for the three months ended September 30, 2006, is approximately \$170,000 in airfreight costs for the initial shipments of our products at a cost of approximately of \$140,000 over standard ocean freight costs. This shipping practice is not expected to be a recurring method of transportation for our products. We also experienced higher than anticipated costs in the startup of our seed kit manufacturing operations. As we begin to increase seed kit production volume, costs for seed kit production are anticipated to improve in future periods as economies of scale and manufacturing efficiencies are achieved.

During the three and six months ended September 30, 2006, we incurred \$409,453 and \$844,384 in research and development costs as compared to \$380,352 and \$688,565 for the three and six months ended September 30, 2005, an increase of \$29,101 and \$155,819, or 8% and 23%, respectively. We continue to allocate additional resources to the development, design and technology of various new prototype models as well as expansion of our greenhouse and laboratory to measure the success of various seeds, cuttings, and nutrients under different conditions and testing new plant varieties for additional seed kits. A significant component of the increase for the six months ended September 30, 2006 over the six months ended September 30, 2005 is \$121,562 in compensation expense recognized as a result of stock options granted during the period to personnel engaged in our research and development activities.

Sales and marketing costs for the three and six months ended September 30, 2006, totaled \$1,359,797 and \$2,320,271 as compared to \$257,307 and \$351,800 for the three and six months ended September 30, 2005, an increase of \$1,102,490 and \$1,968,471, or 429% and 560%, respectively. Sales and marketing costs include all costs associated with the marketing and distribution of our products and, for the six months ended September 30, 2006, include \$642,000 in personnel costs, \$590,000 in costs associated with the production of our infomercial, \$124,000 in public relations costs, and \$160,000 in other advertising and promotional costs.

General and administrative costs for the three months ended September 30, 2006 totaled \$773,362 as compared to \$774,631 for the three months ended September 30, 2005, a decrease of \$1,269. For the six months ended September 30, 2006, general and administrative costs totaled \$1,629,402 as compared to \$1,432,585 for the six months ended September 30, 2005, an increase of \$196,817. The increases for the six months ended September 30, 2006 are due to salaries for additional administrative and finance personnel as well as increases in legal and audit fees.

Net losses for the three months ended September 30, 2006 increased to \$3,408,766 compared to \$3,284,599 for the three months ended September 30, 2005. Net losses for the six months ended September 30, 2006 increased to \$5,531,655 from \$4,338,821. The increases in net loss during the three and six months ended September 30, 2006 of \$124,167 and \$1,192,834 are related to overall increases in operating expenses as discussed above.

In the next 12 months, we intend to continue researching and developing new product designs and product extensions including, but not limited to, product line extensions targeted at both higher and lower retail price points, nutrient delivery systems and additional seed varieties for our seed kits. We also will dedicate research and development resources to the improvement, expansion and automation of our in-house seed kit manufacturing capabilities.

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

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

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

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

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

### **Critical Accounting Policies and Estimates**

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

### **Research and Development**

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

### **Stock Based Compensation**

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

on our results of operations.

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### Revenue Recognition

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

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

### Warranty and Return Reserves

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

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

### Shipping and Handling Costs

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

### Beneficial Conversion Feature of Debentures

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



Registration Rights Penalties

The holders of securities issued in the Company's February 2006 private placement offering and the convertible debt offering in 2005 (Note 3) have registration rights for the common stock and for the common stock underlying the convertible debt and the warrants held by them. Liquidated damages for failure to register and maintain registration for such common stock are payable in common stock of the Company under certain circumstances and are limited to 1% of the amount of the outstanding convertible debt up to a maximum of 24% and 1% of the amount of the investment in the 2006 Offering up to a maximum of 18%. In each case, the amount is payable in shares of the Company's common stock valued at a rate of \$2.00 per share. Until such time as there has been a consensus reached on Emerging Issues Task Force Issue No. 05-4, "The Effect of a Liquidated Damages Clause on a Freestanding Financial Instrument Subject to EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock' ", the Company has elected to recognize the impact of such registration rights penalties as incurred, which commenced after July 22, 2006.

## **BUSINESS**

### **Overview**

AeroGrow was formed as a Nevada corporation on March 25, 2002. AeroGrow's principal business is developing, marketing and selling advanced indoor aeroponic garden systems designed and priced to appeal to the gardening, cooking and small kitchen appliance, healthy eating, and home and office décor markets worldwide. AeroGrow's principal activities since its formation through March 2006 have consisted of product research and development. AeroGrow currently has 14 patent applications pending in the United States, and 21 trademark applications (19 in the United States and 3 international). To date, AeroGrow has completed the development of two proprietary growing systems and nine proprietary seed kits, research into the markets for AeroGrow's products and the best channels through which to sell them, product engineering, business planning, and raising the capital necessary to fund these activities. These development activities included an iterative process of experimentation, consumer testing, and adjustment, in consultation with scientists familiar with the technology. AeroGrow's experimentation included more than 500 internal tests on nutrients, lighting, water quality and seed varieties in our greenhouses and labs between August 2002 and December 2005. Often, these tests were combined with in-home use of our systems by sample consumers picked from our employees and investors. User feedback from these tests was often incorporated in next generation products and development.

During 2006 AeroGrow completed development of its initial kitchen garden systems and related "bio-grow" seed pods. AeroGrow has contracted with a third-party manufacturer who commenced production activities and a second manufacturer who will commence production in the first quarter of calendar 2007. In March 2006, AeroGrow actively began sales activities. As of September 30, 2006, AeroGrow has manufactured and taken delivery of over 45,000 units of its AeroGarden™ kitchen garden units. AeroGrow commenced initial marketing and distribution of its products during March 2006 and has expanded these marketing efforts to encompass retail, home shopping, catalogue, international and direct to consumer sales channels.

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

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

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

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

Hydroponics is the science of growing plants in water instead of soil. Used commercially worldwide, hydroponics is considered an advanced and often preferred crop production method. Hydroponics is typically used inside greenhouses to give growers the ability to better regulate and control nutrient delivery, light, air, water, humidity,

pests and temperature. Hydroponic growers benefit by producing crops faster and enjoying higher crop yields per acre than traditional soil-based growers.

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

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

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

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

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

### **Our Proprietary Technology**

AeroGrow has spent more than three years innovating, simplifying, combining and integrating numerous proprietary technologies and inventions into a family of "plug and grow" aeroponic kitchen garden systems and related seed kits specifically designed and priced for the mass consumer market. AeroGrow has filed 14 patent applications in the United States to protect its inventions. Following is a description of AeroGrow's proprietary technologies and inventions, which are used together in its kitchen garden system and seed kits. The inventions under the patent

applications have not been granted patents, and there can be no assurance that patents will be granted. See "Risk Factors - Aerogrow's intellectual property and proprietary rights give it only limited protection and can be expensive to defend."

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

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

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

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

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

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

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

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

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



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

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

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

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

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

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

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

- understand the blends of nutrient fertilizer that are best suited for the specific variety of plants they are growing,
- understand the nutrient requirements for the specific plant variety at each of three stages of its growth and maturity,
- measure and blend nutrients from up to four different concentrated solutions and add them to specific measured quantities of water, and
- monitor, adjust and re-mix nutrient fertilizers over time.



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

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

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

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

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

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

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

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

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

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



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

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

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

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

### **Other Accessories**

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

### **Additional Future Products**

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

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

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

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

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

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

## **Markets**

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

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

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

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

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

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

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

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

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

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

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

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

**Office and Home Decor Market.** Flowers are frequently used to brighten homes and offices around the world. It is difficult to readily grow flowers indoors due to a lack of sufficient light and growing knowledge. As a result, people often use cut flowers, which are expensive, short-lived and require ongoing maintenance. AeroGrow’s kitchen garden systems enable colorful and fragrant flowers to be easily grown indoors year-round. Flowers grown with its kitchen garden systems will last for months with minimal care and maintenance. Flowers can be grown in a wide variety of indoor locations, including kitchen and bathroom countertops, living rooms, bedrooms, family rooms, offices, work stations, waiting rooms and lobbies. In addition, professional plant caretakers may be motivated to include AeroGrow’s kitchen garden systems among their traditional plant options because of the relatively low cost and ease of maintenance of AeroGrow’s systems.

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

- toy market for a children’s “root-viewing” garden,



- classroom market for student education relating to plant growth,
- gift market,

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- hydroponic enthusiast market, and
- international markets, particularly in large cities with limited outdoor garden space.

### **Marketing and Sales Strategy**

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

### **Competition**

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

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

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

### **Manufacturing**

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

laboratory facilities in Longmont, Colorado.

AeroGrow has signed a tri-party manufacturing agreement with Source Plus, Inc. (“Source Plus”), an Alabama corporation, and Mingkeda Industries Co., Ltd. (“Mingkeda”), a Chinese company, for the initial manufacture of its kitchen garden systems and accessories. Source Plus assisted AeroGrow in identifying companies in China that had the capability to manufacture AeroGrow’s kitchen garden systems. Source Plus advanced monies to Mingkeda for tooling and molds to build AeroGrow’s products. To reimburse Source Plus for its advances to Mingkeda for tooling, AeroGrow issued 62,000 shares of its common stock to Source Plus in October 2005. AeroGrow recorded a \$310,000 asset for tooling. Source Plus is also obligated to provide quality control inspection services at Mingkeda’s factory for AeroGrow. Mingkeda has informed AeroGrow that it can currently produce 15,000 kitchen garden systems per month and will eventually be able to produce approximately 25,000 kitchen garden systems per month with its existing set of tools. To date, AeroGrow has received approximately 65,000 units from Mingkeda with over 30,000 additional units in process. Mingkeda estimates that it can add the additional set of tools and presses within 60 to 90 days following AeroGrow’s notification. In addition to the Mingkeda plant, AeroGrow is exploring relationships with other manufacturers located in China as an alternative supply source should sales volumes require added production. In the event Mingkeda is unable to meet its anticipated production capacity before AeroGrow is able to develop additional contract manufacturing sources, sales could be adversely affected if sales demand exceed production capacity.

AeroGrow's manufacturing costs for its initial model of the AeroGarden are anticipated to allow AeroGrow to achieve gross margins before selling expenses from wholesale sales ranging from 40% to 50% once manufacturing volumes are at a sufficient level (in excess of 10,000 per month) to enable AeroGrow to: (i) achieve economies of scale in its seed kit production; (ii) obtain volume discounts for parts and components related to the manufacture of its kitchen garden systems; and (iii) minimize transportation and logistics costs. However, no assurance can be given that the price of our products will not be subject to downward price pressure, or that our margins will be attained or maintained.

AeroGrow has begun tooling with a second contract manufacturer, Main Power Electrical Factory Ltd., which is located in China. AeroGrow anticipates first production units to be built by Main Power during the first quarter of calendar 2007. Production capacity at Main Power is estimated to be 50,000 units per month for each set of tools.

AeroGrow produces and assembles its bio-grow seed pods in its laboratory facilities in Longmont, Colorado. The seed pods and kitchen garden systems are shipped to a fulfillment center in Reno, Nevada. Innotrac Corporation provides warehousing, order fulfillment, and shipping for AeroGrow's products. AeroGrow's agreement with Innotrac is described above at "Distribution."

### **Product Returns and Warranties**

AeroGrow has had limited sales to date and thus has limited experience dealing with returns. AeroGrow currently processes returns at Innotrac, its third party distribution center, but intends to allow products to be returned to its facilities in Longmont, Colorado in the near future. AeroGrow anticipates that it will send unopened returned products to back into inventory and repair defective products to sell as refurbished products. Mingkeda will provide AeroGrow with replacement part assemblies for products which are deemed defective due to materials or manufacturing complications. The Company records warranty liabilities at the time of sale for the estimated costs that may be incurred under its basic warranty program. The specific warranty terms and conditions vary depending upon the product sold but generally include technical support, repair parts, labor for periods up to one year. Factors that affect the Company's warranty liability include the number of installed units currently under warranty, historical and anticipated rates of warranty claims on those units, and cost per claim to satisfy the Company's warranty obligation.

### **Intellectual Property**

AeroGrow has filed 14 patent applications in the United States to protect its technologies and products. These applications are for:

- seed germination pods that transport, support and germinate seedlings in aeroponic or hydroponic devices and support the growth of the plant to maturity, filed in November 2003, application serial number 10/714,786, and responded to examiner's second action,
- use of infrared beams to measure plant roots which creates a basis for the regulation of nutrients, oxygen and plant growth, filed in December 2003, application serial number 10/748,321, and responding to examiner's second action,

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

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

AeroGrow has filed 19 trademark applications in the United States (7 of which have been allowed) and three trademark applications designating 33 countries, which it intends to prosecute to protect its products and brand equity. The applications are for:

- Farmers Market Fresh, filed in July 2005, application serial number 78671280, and allowed,

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- Kitchen Harvest filed in December 2005, application serial number 78781094,
- AeroGarden filed in December 2005, application serial number 78781935, and allowed,
- Farmer's Market in Your Kitchen, filed in March 2006, application serial number 78836826, and allowed,
- Off the Plant and Into the Pot, filed in March 2006, application serial number 78836758, and allowed,
- Cut & Cook, filed in March 2006, application serial number 78836746, and allowed,
- Bio-Dome, filed in March 2006, application serial number 78836718, and allowed,
- AeroPod, filed in March 2006, application serial number 78836577, and allowed,
- AeroGarden, filed in Mexico in June 2006, application serial number 790722, and responding to examiner's action,
- AeroGarden, filed in 31 countries under the Madrid Protocol in June 2006, application serial number A0005030,
- AeroGarden, filed in Canada in June 2006, application serial number 1,305,822,
- International Gourmet, filed in May 2006, application serial number 78874379, and about to publish,
- Farmer's Market Fresh, filed in May 2006, application serial number 78882877, and responding to examiner's action,
- AeroGrow, filed in April 2005, application serial number 78614573, and responded to examiners first action,
- MiniGarden, filed in August 2006, application serial number 78955675,
- GrowNow, filed in August 2006, application serial number 78955695, and responding to examiner's action,
- Green Thumb Guarantee, filed in September 2006, application serial number 77007729,
- BioTransport, filed in September 2006, application serial number 77009465,
- Herb Appeal, filed November 2006, application serial number 77045636,
- Strawberry Patch, filed November 2006, application serial number 77045993
- Sweet Rubies, filed December 2006, application serial number 77058522, and
- Plug & Grow, filed December 2006, application serial number 77058534.

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



## **Governmental Regulation and Certification**

To the best of its knowledge, AeroGrow believes that it is complying with United States regulations concerning the shipping and labeling of seeds and nutrients. Currently, the components for the kitchen garden system are UL certified. AeroGrow has filed initial applications for UL certification and ETL certification for the kitchen garden system as a whole. These certifications confirm that the products have been tested and conform to a recognized level of fire and other safety standards for consumers. Such independent third party certification is required for sales of products through many major retailers.

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

## **Personnel**

As of December 1, 2006, AeroGrow employs approximately 65 persons, 45 full-time and 20 part-time. In addition, AeroGrow contracts for the services of part-time and project consultants on an "as needed" basis. AeroGrow believes that its employee relations are good. AeroGrow believes that it will hire additional employees and/or consultants in the future as its operations grow. AeroGrow is planning to outsource some activities, in whole or part, such as manufacturing, telemarketing, public relations, infomercial production, fulfillment, and shipping.

## **Facilities**

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

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

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

## **Legal Proceedings**

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



## MERGER WITH WENTWORTH

### *History of Wentworth*

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

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

Wentworth filed a registration statement on Form SB-2 with the SEC in order to undertake a public offering of 50,000 shares of its common stock at a purchase price of \$1.00 per share, which registration statement was declared effective on August 12, 2001. Wentworth successfully completed the offering and, pursuant to Rule 419 of the Securities Act of 1933, as amended (“1933 Act”), the offering proceeds, less 10%, (which was retained by Wentworth to cover its expenses), were placed in an escrow account together with the shares of common stock issued in the public offering.

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

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

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

### *Certain Transactions by Wentworth*

During 2002, Wentworth borrowed a total of \$8,500 from Kevin R. Keating, its then president. The amount loaned plus interest at 6% was due and payable upon the completion of a business combination. For the years ended December 31, 2005 and 2004, interest on this loan of \$510 each year is included in operations. At December 31, 2005,

the principal balance of this loan together with accrued interest totaled \$10,290.

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

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

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

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

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

*Ownership of Wentworth prior to Merger*

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

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

c/o Frederic M. Schweiger, President  
1753 Park Ridge Pointe  
Park Ridge, Illinois 60068 (5)

Keating Reverse Merger Fund, LLC  
c/o Timothy J. Keating, Manager  
5251 DTC Parkway, Suite 1090  
Greenwood Village, Colorado 80111 (6)

2,000,000

53.3%

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(1) Kevin R. Keating was the President, Secretary, Treasurer and sole director of Wentworth.

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

#### *Effect of Merger*

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

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

Each share of AeroGrow common stock issued to the Wentworth's stockholders in the Merger is restricted stock, and the holder may not sell, transfer, or otherwise dispose of such shares without registration under the 1933 Act or an available exemption therefrom. The Merger Agreement contains piggy-back registration rights that allow each Wentworth stockholder to include his, her, or its shares in any registration statement filed for the public offering or resale of its securities in the future. This registration right is required to satisfy certain positions taken by the SEC in connection with shares issued to persons that may be considered promoters. The SEC's position is that the shares held by promoters may not be publicly sold pursuant to Rule 144, but may only be publicly sold by the promoter pursuant to an effective resale registration statement. It has been determined by the Company that KRM Fund, Kevin R. Keating, and Keating Investments are promoters under this definition. The other shareholders of Wentworth, Garisch Financial, Inc., and Bertrand T. Unger are not promoters. As part of the 2006 Offering, AeroGrow agreed to register for resale the shares of AeroGrow's common stock issued to the investors in the 2006 Offering (together with the shares of AeroGrow's common stock underlying the warrants issued in the 2006 Offering) on a registration statement to be filed with and declared effective by the SEC. The holders of 396,813 of such shares have waived their right to be included in this registration statement in exchange for the obligation of the company to register all such shares as soon as commercially reasonable after the filing of the next quarterly or annual report after the declaration of effectiveness of the this registration statement, and the Company has agreed to use its commercially reasonable efforts to have such replacement registration statement declared effective as soon as practicable.

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

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

#### *Accounting Treatment for Merger*

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

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

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

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

Keating Securities was the exclusive placement agent for the 2006 Offering. For their services, they were paid a fee of 10% of the gross proceeds, or \$1,074,000. AeroGrow also paid Keating Securities a non-accountable expense allowance of 3% of the gross proceeds, or \$322,200. In addition, AeroGrow issued to Keating Securities and its designees warrants to purchase an aggregate of 214,800 shares of common stock expiring February 2011, at an exercise price of \$6.25 per share (“Agent Warrants”). The Agent Warrants are fully vested and may be exercised on a cashless or net issuance basis. The holders of the Agent Warrants were granted the same registration rights as the investors in the 2006 Offering (see below).

AeroGrow is required to register its shares of common stock issued to the investors in the 2006 Offering and the shares of common stock underlying the Warrants and Agent Warrants for resale by the investors pursuant to a registration statement declared effective by the SEC under the 1933 Act. If AeroGrow does not have an effective registration statement under the 1933 Act that registers for resale the above listed common shares within 150 days of the closing date, then AeroGrow must pay each of the investors (but not the holders of 2006 Warrants or Agent Warrants) 1% of the purchase price paid by such investor for the common stock for each month thereafter that the investor cannot publicly sell the shares of common stock pursuant to an effective registration statement or other exemptions from the federal securities laws. This penalty is payable in shares of common stock at a deemed price of

\$2.00 per share. The Company filed the required registration statement within the 45 days. Through September 30, 2006, the Company has recorded penalties for untimely registration of 161,100 shares of common stock issued in the 2006 Offering and booked a corresponding expense of \$805,500. The holders of 85,000 shares of our common stock issued in the 2006 Offering have waived their right to be included in this registration statement in exchange for the obligation of the company to register all such shares as soon as commercially reasonable after the filing of the next quarterly or annual report after the declaration of effectiveness of the this registration statement, and the Company has agreed to use its commercially reasonable efforts to have such replacement registration statement declared effective as soon as practicable.



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

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

### **Modification of Convertible Notes**

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

Holders of Convertible Notes representing \$2,130,000 in principal amount converted their notes into AeroGrow common stock at a conversion price of \$3.00 per share, a reduction from the original conversion price of \$4.00 per share. Accordingly, at the closing of the Merger and 2006 Offering, AeroGrow issued 710,009 shares of its common stock (rounded up for fractional shares) to converting note holders ("Note Conversion"). The converting note holders also were issued, pursuant to the terms of the note offering, additional warrants to purchase 426,000 shares of AeroGrow's common stock expiring February 2011, at an exercise price of \$6.00 per share ("Conversion Warrants"). Each share of AeroGrow's common stock and each Debt Warrant and Conversion Warrant is a restricted security and the holder thereof may not sell, transfer or otherwise dispose of such securities without registration under the Securities Act or an available exemption therefrom. AeroGrow agreed to file a registration statement with the SEC under the 1933 Act to register for resale the shares of AeroGrow's common stock issued to converting note holders (together with the shares of common stock underlying the Debt Warrants and Conversion Warrants).

Holders of Convertible Notes representing \$840,000 in principal amount agreed to extend the maturity under their notes from June 30, 2006 to December 31, 2006 in exchange for a reduction in their conversion price from \$4.00 per share to \$3.50 per share.

The remaining holders of Convertible Notes, representing \$30,000 in principal amount, did not elect to convert or extend the maturity of their notes and were paid in cash on June 30, 2006.

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

Liquidated damages resulting from AeroGrow's failure to file and have declared effective a registration statement that would include the common stock issued as a result of the Convertible Notes and the shares of common stock underlying the Debt Warrants and Conversion Warrants must be settled through the issuance of additional common stock valued at a price of \$2.00 per share. AeroGrow has recorded penalties for an Effectiveness Default with regard to the Convertible Notes through September 30, 2006, of 44,550 shares of common stock and booked a corresponding expense of \$222,750.

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

## MANAGEMENT

### Directors and Officers

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

Name	Age	Position with AeroGrow	Serving as a Director Since
W. Michael Bissonnette	57	Chief Executive Officer, President and Director	2002
Richard A. Kranitz	62	Director	2002
Wayne Harding	51	Director	2005
Jack J. Walker	71	Director	2006
Kenneth Leung	61	Director	2006
Mitchell B. Rubin	51	Chief Financial Officer	n/a
Randall Lee Seffren	49	Chief Marketing Officer	n/a

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

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

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

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

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

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

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

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

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

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

#### **Board Committees, Meetings and Compensation**

Our board of directors considers all major decisions. AeroGrow has established two standing committees so that some matters can be addressed in more depth than may be possible in a full board meeting: an audit committee and a governance, compensation and nominating committee. These two committees each operate under a written charter. The board has affirmatively determined that Mr. Harding is independent as defined by applicable securities law and

NASDAQ corporate governance guidelines. As of March 28, 2006, AeroGrow elected to comply with the corporate governance requirements of NASDQ which satisfied its obligation pursuant to the Merger Agreement. Following is a description of both of these committees.

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

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

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

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

**Meetings.** During fiscal year ended December 31, 2005, the board of directors met 15 times. Each director attended all of the meetings held by the board during the period that he served as a director of AeroGrow.

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

### **Director Compensation**

In 2004 and 2005 each director received 2,000 shares of common stock for his service as director. Mr. Bissonnette has agreed to forego any future stock-based compensation for serving as a director of AeroGrow. AeroGrow compensates directors \$500 for attending meetings and reimburses them for their out-of-pocket expenses for attending meetings. On March 28, 2006, AeroGrow granted to each of its four outside directors 2,500 shares of the Company's common stock at a value of \$5.00 per share for a total of \$12,500 for each director, or an aggregate total of \$50,000, and 10,000 fully vested five-year options to purchase AeroGrow common stock at an exercise price of \$5.00 per share for services for the fiscal year ending December 31, 2005.

The following table provides information concerning compensation earned by Mr. Bissonnette, our chief executive officer, Mr. Gutterman, our former chief financial officer, Mr. Rubin, our current Chief Financial Officer, Mr. Brainard, our Vice President of Sales, and Mr. Seffren, our chief marketing officer during 2004, 2005 and the transition period from January 1, 2006 through March 31, 2006 (the "Transition Period"). As of March 31, 2006, no other executive officer of AeroGrow was paid in excess of \$100,000 in 2005 or is anticipated to earn in excess of \$100,000 in the current fiscal year.

## Summary Compensation Table Annual

Name and Principal Position	Year	Compensation		All Other Compensation
		Salary	Bonus	
	Transition Period			(1)
	2005	\$ 39,583	\$ 0	(1)
W. Michael Bissonnette, CEO, President and Director(1)	2005	\$ 156,954	\$ 0	4,500(2)
	2004	\$ 134,428	\$ 0	10,000(1)
	2004	\$ 134,428	\$ 0	10,000(2)
	Transition Period			
	2005	\$ 0	\$ 0	99,167(3)
	2004	\$ 0	\$ 0	404,653(3)
Randy Seffren, CMO	2004	\$ 0	\$ 0	215,566(3)
	Transition Period			
	2005	\$ 0	\$ 0	277,005(4)
Jerry L. Gutterman, Former, CFO (through February 24, 2006)	2004	\$ 0	\$ 0	56,723(4)
	Transition Period			
	2005	\$ 16,667	\$ 0	10,072(5)
	2004	\$ 0	\$ 0	29,937(5)
Mitchell Rubin, CFO	2004	\$ 0	\$ 0	0
	Transition Period			
	2005	\$ 0	\$ 0	6,656(6)
Jeff Brainard, Vice President Sales	2004	\$ 0	\$ 0	0

(1) Mr. Bissonnette also received perquisites and other personal benefits totaling \$31,954 in 2005, \$24,504 in 2004, and \$4,500 for the three months ended March 31, 2006. In accordance with the employment agreement entered into as of March 1, 2006, Mr. Bissonnette has a non-accountable expense allowance of \$2,500 per month as reimbursement for Employee's auto expenses, home office expenses and other expenses.

(2) Other compensation reflects the value at the time of grant of shares of our common stock received by Mr. Bissonnette in each year.

(3) Other compensation for 2005 and 2004 reflects consulting fees of \$164,153 and \$84,466 and the value at the time of grant of shares of our common stock received by Prometheus Communications Group, LLC ("PCG") of which Mr. Seffren is the 100% owner and managing member, in 2005 and 2004, respectively. For the three months ended March 31, 2006, \$49,167 of consulting fees were paid to PCG. On March 28, 2006, Mr. Seffren was granted



10,000 shares of common stock which are shown above at fair value deemed to be \$5.00 per share. Also on March 28, 2006, Mr. Seffren was granted 125,000 five year options to purchase the Company's common stock at an exercise price of \$5.00 that were fully vested upon grant and which are not included in the above table.

(4) Other compensation reflects consulting fees of \$139,330 and the value at the time of grant of shares of our common stock received by Mr. Gutterman in 2005. Also reflected are 2,000 shares valued at \$1.00 per share in 2004. Other Compensation also includes \$46,723 of consulting fees paid in 2004. In 2004, Mr. Gutterman received options to purchase 19,922 shares of our common stock at an exercise price of \$1.25 per share. The values of these stock options are not included in the above table.

(5) Other compensation reflects consulting fees of \$10,072 for the three months ended March 31, 2006 prior to the commencement of Mr. Rubin's employment and \$29,937 in consulting fees for 2005. During 2005, Mr. Rubin was granted 3,768 five year options to purchase the Company's common stock at an exercise price of \$0.50 that were fully vested upon grant and which are not included in the above table. On March 28, 2006, Mr. Rubin was granted 125,000 five year options to purchase the Company's common stock at an exercise price of \$5.00 that were fully vested upon grant and 5,000 shares of restricted common stock in December 2006, both of which are not included in the above table.

(6). Other compensation reflects consulting fees of \$6,656 for the three months ended March 31, 2006, prior to the commencement of Mr. Brainard's employment. On March 28, 2006, Mr. Brainard was granted 125,000 five year options to purchase the Company's common stock at an exercise price of \$5.00 that will vest 33% of the amount of the grant at the date granted and 33% per each 12 month period from the date of grant and which are not included in the above table.

The following table provides information with respect to the named executive officers concerning unexercised stock options held by them at March 31, 2006. All options granted to date are unexercised and, in as much as there is no trading market in the Company's common stock, are considered not to be "in the money".

Name and Principal Position	Number of Securities Underlying Options Granted	% of Total Options Granted through 30-Sep-06	Exercise Price per Share	Expiration Date
Randy Seffren, CMO	125,000	9.99%	\$ 5.00	27-Mar-2011
Mitchell Rubin, CFO	3,768	0.30%	\$ 0.50	31-Dec-2010
Mitchell Rubin, CFO	125,000	9.99%	\$ 5.00	27-Mar-2011
Terry Robertson, Vice President Manufacturing and Engineering	125,000	9.99%	\$ 5.00	27-Jun-2011
Jeff Brainard, Vice President Sales	125,000	9.99%	\$ 5.00	27-Mar-2011

### Compensation Plans

**Amended 2003 Stock Option Plan.** On January 3, 2003, the board of directors adopted a stock option plan for key employees (including key employees who are directors), non-employee directors, consultants and investors which provided that an aggregate of 400,000 shares of our common stock may be granted under the plan ("2003 Plan"). As of December 31, 2005, there were options for 204,869 shares outstanding and the remaining options of 195,131 were merged into the 2005 Equity Compensation Plan and the 2003 Plan no longer separately exists. Vesting schedules are determined individually for each grant and were all fully vested as of December 2005.

*Administration.* The plan is administered by our Governance, Compensation and Nominating Committee, and in the past was administered by the board. The plan provides that it may be administered by either the committee or board, and in its administration it may:

- select participants,
- determine the date of grant, exercise price and other terms of options,
- establish rules and regulations to administer the plan,
- amend, suspend, or discontinue the plan subject to applicable shareholder approval,
- interpret the rules relating to the plan, and
- otherwise administer the plan.

*Stock Options.* The plan provides that the committee may grant both incentive stock options, which can result in potentially favorable tax treatment to the participant, and non-qualified stock options. The committee determines the terms and vesting provisions, including the exercise price. The maximum term of each option and the times at which

each option will be exercisable generally are fixed by the committee, except that no option may have a term exceeding ten years. Shares subject to options that expire or otherwise terminate remain available for awards under the plan. Shares issued under the plan may be either newly issued shares or shares which AeroGrow has reacquired.

**2005 Equity Compensation Plan.** In August 2005 AeroGrow adopted the 2005 Equity Compensation Plan (“2005 Plan”) to promote the interests of AeroGrow and our shareholders by attracting, retaining, and motivating our key officers, employees, directors, and consultants. A total of 1,505,000 shares of our common stock were available for grant under this plan pursuant to stock options or awards of shares of restricted stock. As of December 31, 2005, 28,401 options and 157,192 shares of restricted stock had been granted under this plan and 1,319,407 remained available for grant. Our 2003 stock option plan was merged into this plan in August 2005, which modification was approved by the stockholders in February 23, 2006; the 2003 Plan no longer separately exists. The options for the 204,869 shares issued under the 2003 Plan continue to be governed by their grant agreements but are administered under the 2005 Plan. The 2005 Plan was approved by our stockholders at the annual meeting of stockholders held February 23, 2006. As of March 28, 2006, AeroGrow granted an additional 888,153 options and 83,737 shares of its common stock pursuant to the 2005 Plan. As of that date, there were 351,671 unallocated shares that may be the subject of awards in the future. On June 28, 2006, the Company granted to Terry Robertson an option to purchase 125,000 shares of the Company’s common stock at an exercise price of \$5.00 per share under the 2005 Plan which will vest 50% on the 12 month anniversary of the grant and 12.5% for each of the next four three-month periods. On September 25, 2006, the Company granted to one employee an option to purchase 10,000 shares of the Company’s common stock at an exercise price of \$5.00 per share under the 2005 Plan which will vest pro rata over a two year period. The Company valued the foregoing options using the Black Scholes option pricing model using the following assumptions: no dividend yield; expected volatility rate of 129.67%; risk free interest rate of 5% and an average life of 4 years resulting in a value of \$4.12 per option granted.

*Shares Available for Awards.* Shares subject to an award that is cancelled, expired unexercised, forfeited, settled in cash or otherwise terminated remain available for awards under the plan. Shares issued under the 2005 Plan may be either newly issued shares or shares which AeroGrow has reacquired. The plan imposes individual limitations on the amount of certain awards in order to comply with Section 162(m) of the Internal Revenue Code of 1986. Under these limitations no single participant may generally receive awards in any calendar year that relate to more than \$1 million. Awards may generally be adjusted to prevent dilution or enlargement of benefits when certain events occur such as a stock dividend, reorganization, recapitalization, stock split, combination, merger, or consolidation.

*Eligibility.* Our employees, directors and consultants may be granted awards under the plan. As of September 30, 2006, approximately 59 individuals were eligible to participate.

*Administration.* The plan is administered by the Governance, Compensation and Nominating Committee. Awards to directors serving on the committee are determined and administered by the full board of directors. The committee may:

- select participants,
- determine the type and number of awards to be granted,
- determine the exercise or purchase price, vesting periods and any performance goals,
- determine and later amend the terms and conditions of any award,
- interpret the rules relating to the plan, and
- otherwise administer the plan.

*Stock Options.* The committee may grant both incentive stock options, which can result in potentially favorable tax treatment to the participant, and non-qualified stock options. The committee determines the terms and individual vesting schedules for each grant including the exercise price which may not be less than the fair market value of a

share of common stock on the date of the grant.

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*Restricted Shares.* The committee may grant restricted shares of common stock. Restricted shares are shares of common stock with transfer restrictions. These restrictions lapse on the basis of performance and/or continued employment as determined in advance by the committee. They may be forfeited by participants as specified by the committee in the award agreement. A participant who has received a grant of restricted shares will be eligible to receive dividends and have the right to vote those shares. Restricted shares may not be transferred, encumbered or disposed of during the restricted period or until after the restrictive conditions are met.

*Other Terms.* All outstanding awards vest, become immediately exercisable or payable, and have all restrictions lifted immediately when AeroGrow experiences a change in control. The Board may amend or terminate the plan subject to applicable stockholder approval. The committee may not amend the terms of previously granted options to reduce the exercise price or cancel options and grant substitute options with a lower exercise price than the cancelled options. The committee also may not adversely affect the rights of any award holder without the award holder's consent.

Mr. Gutterman was granted 69,429 stock options at an exercise price of \$1.25 per share stock options under the 2003 Plan. Mr. Rubin was granted 1,366 stock options at an exercise price of \$0.50 per share stock options under the 2003 Plan. They are the only executive officers who have been granted stock options under the 2003 Plan.

Mr. Bissonnette, Mr. Gutterman and Mr. Seffren were granted 2,000, 24,710, and 28,520 restricted shares of common stock, respectively, under the 2005 Plan. Mr. Rubin was granted 2,402 stock options at an exercise price of \$0.50 per share stock options under the 2005 Plan.

#### **Equity Compensation Plan Information.**

Information regarding employee stock options outstanding as of September 30, 2006 is as follows:

Exercise price range	Options Outstanding		Options Exercisable	
	Options	Weighted-average Exercise Price	Weighted-average Remaining Contractual Life (years)	Options
Over \$0.00 to \$0.50	30,618	\$ 0.08	2.42	30,618
Over \$0.50 to \$2.50	137,259	\$ 1.57	2.22	137,259
\$5.00	1,083,614	\$ 5.00	4.47	953,818
	1,251,491	\$ 4.50	3.99	1,121,695

In addition to option grants, during the six months ended September 30, 2006, the Company granted under the 2005 Plan a total of 31,400 shares of common stock at a fair value of \$5.00 per share, consisting of 6,000 shares granted and issued to employees, 19,400 shares granted to consultants for services, 1,250 shares granted to each of three directors for service on the Audit Committee and 750 shares granted to each of three directors for service on the Governance Committee. All of the foregoing were charged to operating expenses for the six months ended September 30, 2006 resulting in a total charge of \$157,000.

Information regarding the Company's equity compensation plans at September 30, 2006 is as follows:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance
Equity compensation plans approved by security holders	1,251,491	\$ 4.51	208,171
Equity compensation plans not approved by security holders	-	\$ -	-
<b>Total</b>	<b>1,251,491</b>	<b>\$ 4.51</b>	<b>208,171</b>

At September 30, 2006, the Company has granted options for 129,796 of the Company's common stock that are unvested that will result in \$534,760 of compensation expense in future periods if fully vested.

This table does not reflect 86,436 and 358,008 shares of common stock issued through December 31, 2005 and 2004, respectively, to employees and consultants as compensation and not as part of a plan.

### ***Employment Contracts***

AeroGrow has entered into employment agreements with W. Michael Bissonnette, Mitchell Rubin, Randy Seffren, Jeff Brainard, and Terry Robertson.

The employment agreement of Mr. Bissonnette, dated as of March 1, 2006, provides that he will be employed as the chief executive officer of AeroGrow for an initial term of 24 months, renewable automatically for successive one year terms. He will be paid a base salary of \$225,000. Mr. Bissonnette will also be able to participate in equity compensation plans as determined by the compensation committee. Mr. Bissonnette will be reimbursed car and home office expenses at the rate of \$2,500 per month and participate in regular employee benefit plans as provided by the Company. If Mr. Bissonnette is terminated without cause by the Company or Mr. Bissonnette terminates under certain circumstances constituting a breach of the agreement by the Company, he will be paid his base salary, medical benefits, and pro rata portion of the bonus for one year. If he terminates his employment without cause, he will be paid his salary to the end of the month of such notice. Mr. Bissonnette has agreed to regular confidentiality provisions and agreed not to compete with AeroGrow in the area of aeroponics products and business for two years after the termination of employment. Any inventions, including modifications, are assigned to the Company by the terms of the agreement.

The employment agreement of Mr. Rubin, dated as of March 1, 2006, provides that he will be employed as the chief financial officer of the Company. He will devote his entire business time to the affairs of the Company, provided that for the first four months of his employment he was permitted to devote a limited amount of time to non-competitive business activities during the work day in transition from his prior consulting business. The initial term is two years and renewable for successive one year terms. Mr. Rubin shall receive base compensation of \$200,000 per year and a bonus per fiscal year of not less than 1.5% of EBITDA. If Mr. Rubin is terminated without cause by the Company or Mr. Rubin terminates under certain circumstances constituting a breach of the agreement by the Company, Mr. Rubin shall be entitled to receive severance compensation equivalent to six months base salary and the pro rata bonus. The agreement also provides for medical, vacation and other benefits commensurate with the policies and programs as adopted by AeroGrow for its senior executives. Further, the agreement provides for Mr. Rubin to receive a grant of options to purchase 125,000 shares of AeroGrow's common stock under AeroGrow's 2005 Plan at an exercise price of not greater than \$5.00, which was granted on March 28, 2006. The options, which were granted in shall: (i) vest pursuant to a schedule that provides for vesting of at least 50% of the amount of each grant within 12 months from the

grant date; (ii) not expire in less than five years from the date of grant; (iii) be subject to other standard terms and conditions under the 2005 Plan; and; (iv) have other terms and conditions no less favorable than that granted to other senior executives of the Company. Mr. Rubin has agreed to regular confidentiality and inventions assignment provisions and agreed not to compete with AeroGrow for two years after the termination of employment.



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

The employment agreement of Mr. Brainard, dated as of March 31, 2006, provides that he will be employed as the vice president, sales of the Company. He will devote his entire business time to the affairs of the Company, working from his home office in Lexington, Massachusetts. The initial term is two years and renewable for successive one year terms. Mr. Brainard shall receive base compensation of \$150,000 per year and a bonus per fiscal year in an amount not less than the greater of: (i) \$50,000; (ii) 0.5 per cent of retail net sales, net of all customer deductions including but not limited to returns, allowances, bad debts and other deductions; or (iii) 1.5% of the EBITDA of the Company as determined by the Company's annual financial statements and pro rated for any portion of such annual period covered under this Agreement. Such bonus shall be payable for the initial year in two installments, \$25,000 to be paid six months following the initial date hereof, an additional \$25,000 12 months following the date hereof, and the balance not later than 120 days after the end of the each of the Company's fiscal years covered under this agreement. The agreement also provides for medical, vacation and other benefits commensurate with the policies and programs adopted by AeroGrow for its senior executives. Further, the agreement provides for Mr. Brainard to receive a grant of 125,000 options to purchase AeroGrow's common stock under AeroGrow's 2005 Plan at an exercise price of not greater than \$5.00. The options shall: (i) vest pursuant to a schedule that provides for vesting of at least of 33% of the amount of the grant at the date granted and 33% per each 12 month period from the date of grant; (ii) not expire in less than five years from the date of grant; and (iii) be subject to other standard terms and conditions under the 2005 Plan. Mr. Brainard has agreed to regular confidentiality and inventions assignment provisions and agreed not to compete with AeroGrow for a period equal to the term employed after the termination of employment. In addition, in the event of a change in control of AeroGrow, including a change in chief executive officer, Mr. Brainard shall be entitled to receive severance for one year.

The employment agreement of Mr. Robertson, dated as of April 15, 2006, provides that he will be employed as the vice president of Engineering, Manufacturing and Quality of the Company. He will devote his entire business time to the affairs of the Company. The initial term is two years and renewable for successive one year terms. Mr. Robertson shall receive base compensation of \$150,000 per year, a bonus of 5,000 shares of the Company's common stock upon Employee's relocation to the Boulder, Colorado area, and a bonus per fiscal year of not less than 1.5% of EBITDA. If Mr. Robertson is terminated without cause by the Company or Mr. Robertson terminates under certain circumstances constituting a breach of the agreement by the Company, Mr. Robertson shall be entitled to receive severance compensation equivalent to six months base salary and the pro rata bonus. The agreement also provides for medical, vacation and other benefits commensurate with the policies and programs adopted by AeroGrow for its senior executives. Further, the agreement provides for Mr. Robertson to receive a grant of 125,000 options to purchase AeroGrow's common stock under AeroGrow's 2005 Plan at an exercise price of not greater than \$5.00. The options

shall: (i) vest 50% twelve months from the anniversary date hereof and an additional 12.5% per each three month period thereafter until fully vested; (ii) not expire in less than five years from the date of grant; and (iii) be subject to other standard terms and conditions under the 2005 Plan. Mr. Robertson has agreed to regular confidentiality and inventions assignment provisions and agreed not to compete with AeroGrow for a period equal to the term employed after the termination of employment. In addition, in the event of a change in control of AeroGrow, including a change in chief executive officer, Mr. Robertson shall be entitled to receive severance for one year. On November 15, 2006, Mr. Robertson's annual salary was increased to \$165,000 per year and he received a cash bonus of \$10