

AeroGrow International, Inc.
Form 10KSB
June 29, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549**

FORM 10-KSB

(MARK ONE)

x

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended March 31, 2007**

OR

o

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____**

Commission file number: **000-50888**

AEROGROW INTERANATIONAL, INC.
(Name of small business issuer in its charter)

Nevada

(State or other jurisdiction of
incorporation or organization)

46-0510685

(IRS Employer
Identification No.)

6075 Longbow Dr., Suite 200 Boulder, Colorado

(Address of principal executive offices)

80301

(Zip Code)

(303) 444-7755

(Issuer's telephone number)

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

Title of each class

Name of each exchange on which
registered

Common Stock, \$0.0001 Par Value

Over the Counter

Securities registered under Section 12(b) of the Exchange Act:

Common Stock, \$.01 par value

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Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act ☐

Check whether the Registrant: (1) filed all reports required to be filed by Sections 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for past 90 days. Yes ☒ No ☐

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. ☐

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

Issuer's revenues for its most recent fiscal year \$13,144,037.

The aggregate market value of the common equity stock held by non-affiliates, computed by reference to the average bid and asked prices of such stock as of May 31, 2007, was approximately \$66,476,272.

The number of shares outstanding of the issuer's common equity as of May 31, 2007 was 11,065,609.

Documents incorporated by reference: None

Table of Contents**TABLE OF CONTENTS**

	<u>PAGE</u>
PART I.	
Item 1.	<u>Description of Business</u> 1
Item 2.	<u>Description of Property</u> 15
Item 3.	<u>Legal Proceedings</u> 15
Item 4.	<u>Submission of Matters to a Vote of Security Holders</u> 15
PART II.	
Item 5.	<u>Market for Common Equity and Related Stockholder Matters and Small Business Issuer Purchases of Equity Securities</u> 15
Item 6.	<u>Management's Discussion and Analysis or Plan of Operation</u> 16
Item 7.	<u>Financial Statements</u> 28
Item 8.	<u>Changes In and Disagreements With Accountants on Accounting and Financial Disclosure</u> 28
Item 8A.	<u>Controls and Procedures</u> 28
Item 8B.	<u>Other Information</u> 28
PART III.	
Item 9.	<u>Directors, Executive Officers, Promoters, Control Persons and Corporate Governance; Compliance with Section 16(a) of the Exchange Act</u> 29
Item 10.	<u>Executive Compensation</u> 32
Item 11.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> 36
Item 12.	<u>Certain Relationships and Related Transactions, and Director Independence</u> 41
Item 13.	<u>Exhibits and Reports</u> 42
Item 14.	<u>Principal Accountant Fees and Services</u> 42
	<u>Signatures</u> 43
	<u>Financial Statements</u> F-1
	<u>Exhibit Index</u> I-1

In addition to historical information, this Annual Report on Form 10-KSB ("Annual Report") for AeroGrow International Inc. ("AeroGrow" the "Company," "we," "our" or "us") contains "forward-looking" statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), including statements that include the words "may," "will," "believes," "expects," "anticipates" or similar expressions. These forward looking statements may include, among others, statements concerning our expectations regarding our business, growth prospects, revenue trends, operating costs, working capital requirements, competition, results of operations and other statements of expectations, beliefs, future plans and strategies, anticipated events or trends, and similar expressions concerning matters that are not historical facts. The forward-looking statements in this Annual Report involve known and unknown risks, uncertainties and other factors that could cause our actual results, performance or achievements to differ materially from those expressed or implied by the forward-looking statements contained herein.

Each forward-looking statement should be read in context with, and with an understanding of, the various disclosures concerning our business made elsewhere in this Annual Report, as well as other public reports filed by us with the United States Securities and Exchange Commission. Investors should not place undue reliance on any forward-looking statement as a prediction of actual results of developments. Except as required by applicable law or regulation, we undertake no obligation to update or revise any forward-looking statement contained in this Annual Report.

Table of Contents

PART I

ITEM 1. DESCRIPTION OF BUSINESS

Corporate History

AeroGrow International Inc. (“AeroGrow”) was formed as a Nevada corporation on March 25, 2002. Wentworth I, Inc., a Delaware corporation (“Wentworth”) organized under the laws of the State of Delaware on March 6, 2001, entered into an Agreement and Plan of Merger with us (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”). Our certificate of incorporation and by-laws 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.

Our Business

Our principal business is developing, marketing, distributing, and selling advanced indoor aeroponic garden systems designed and priced to appeal to the gardening, cooking and small kitchen appliance, healthy eating, and home and office décor markets worldwide. Our principal activities since our formation through March 2006 consisted of product research and development, market research, business planning, and raising the capital necessary to fund these activities. We have been issued seven trademarks, one of which has been registered (AeroGarden®), and have an additional 28 trademark applications pending (25 in the United States and 3 internationally). We have 19 patent applications pending in the United States. To date, we have completed the development of multiple proprietary growing systems and 22 proprietary seed kits. These development activities have in the past, and continue to include, an iterative process of experimentation, consumer testing, and adjustment in consultation with scientists familiar with the technology. Often, these tests are combined with in-home use of our systems by sample consumers picked from our employees and investors. User feedback from these tests is frequently incorporated in next generation products and development.

During 2005 we completed development of our initial kitchen garden systems and related “bio-grow” seed pods. We contracted with a third-party manufacturer who commenced production activities in December 2005 and a second manufacturer who began production in the first quarter of calendar 2007. In March 2006, we began sales activities. As of March 31, 2007, we had manufactured and taken delivery of over 140,000 AeroGarden® kitchen garden units from its two manufacturers. We commenced 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 that allow consumers, with or without gardening experience, the ability to grow cherry tomatoes, cilantro, chives, basil, dill, oregano, mint, flowers, chili peppers, salad greens, vegetables and more 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. This conclusion was reached on the basis of standard market research, including focus groups and potential customer interview techniques, review of potentially competitive products offered at all ranges of functionality and price, and testing of products that may be considered competitive in function although not necessarily competitive in market orientation.

We believe that our 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 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 systems currently on the market retail at approximately \$149 to \$169 with 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 company and we did not generate any revenues. Through March 1, 2006, we funded our operations primarily through private sales 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. 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") No. 7, Accounting and Reporting by Development Stage Enterprises.

Table of Contents

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 a nutrient solution. AeroGrow believes that the aeroponic technology used in our 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, we 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 AeroGrow. Persons found our website through referrals, web searches, or as a result of our fund raising and hiring activities. The research consisted of face-to-face and internet interviews/surveys with potential consumers and standard focus groups. From some of the contacts, we obtained a ten-page questionnaire, and in other instances we taped the responses for later review. Persons from approximately 35 states responded to the surveys and participated in 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, and the initial results of our subsequent product launch, we believe that there is a potential, sizeable national market for our countertop soil-less kitchen garden systems for use indoors in homes and offices. Until the development of our 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 indoors in the absence of adequate natural light;
- Consumers are unable 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 are unable to deal with the problem of nutrient spoilage; and
- Federally-mandated water quality reports show that the water in many large cities is not suitable for hydroponic or aeroponic growing and requires chemical treatments. Consumers generally are unaware of how to adjust the water for healthy plant growth.

We believe that these complexities have been accepted in existing hydroponic market channels because our 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. These users are motivated to gain the specialized knowledge, equipment and experience currently required to successfully grow plants with these products. Our research has indicated that the hydroponic growing equipment currently available in these markets is bulky, expensive and comprised of many parts

We believe 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. We further believe that our trade secrets, patent-pending inventions and companion technologies have simplified and improved hydroponic and aeroponic technologies have enabled us to create the first indoor aeroponic gardening system appropriate for the mass consumer market.

Table of Contents

Our Proprietary Technology

We have spent over four years innovating, simplifying, combining and integrating numerous proprietary technologies and inventions into a family of “plug and grow” aeroponic kitchen garden systems and related seed kits specifically designed and priced for the mass consumer market. We have filed 19 patent applications in the United States to protect our inventions. Following is a description of our proprietary technologies and inventions that are used in our 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 - Our intellectual property and proprietary rights give us only limited protection and can be expensive to defend.”

Rainforest Nutrient Delivery System. Our “rainforest” nutrient delivery system combines our 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.

Our 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. Our 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. We designed our seed pods for use in our kitchen garden systems. We believe consumers may use seeds purchased from other sources in our kitchen garden system, although we do not provide any assurances on germination and growth in such cases.

We selected the seeds to pre-implant in our 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 our greenhouse and grow laboratories, and
- testing the taste and appearance of our grown vegetables, herbs and flowers with consumers.

We implant our selected seeds in a bio-sponge growing medium that, based upon our research, facilitates rapid germination and enhanced root growth in comparison to other mediums tested, as well as supports plant roots from germination through maturity and harvest. Our 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.

Our proprietary bio-grow seed pods are a vital component of our kitchen garden system. Our bio-grow seed pods are packaged along with nutrients in our proprietary seed kits for use in our 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, we also allow consumers to purchase unseeded pods in our Master Gardner Kit, to give them the opportunity to grow their own seeds in our kitchen garden systems. Not all plants, however, are appropriate to grow in the kitchen garden system.

Table of Contents

Microprocessor-Based Control Panel and Nutrient Cycle Delivery System. We believe 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 for healthy growth.

To assist consumers, especially inexperienced gardeners, we have 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.

We have developed multiple kitchen garden systems, which are described below at "Our Kitchen Garden Systems," with different control systems. Variations of our microprocessor-based control panel are included as a standard feature on our current 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. In addition, with our microprocessor-based 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 our 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.

We believe 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, we

have developed 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 (usually once every two weeks) by the microprocessor-based nutrient cycle delivery system. 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.

Table of Contents

Automatic Water Adjustment. Tap water 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.

We believe 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 to the use of hydroponic gardening by the general public. We have 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 our 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 our entire kitchen garden system.

Our kitchen garden systems include built-in adjustable grow lights with ballast, reflector hood, lights and an electronic timer. Our 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, our lighting system is fully automated and controlled by our microprocessor-based control panel described above. Improvements continue to be made in our proprietary light bulbs to facilitate better growing characteristics at lower manufacturing costs.

Adaptive Growth Software. Through research and testing in our grow laboratory, we 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. We have developed a proprietary software technology entitled "adaptive growth technology" which automatically analyzes and adjusts the nutrient delivery schedules based on plant maturity. We have introduced this technology into an upgraded kitchen garden system, which was introduced in the second calendar quarter of 2007.

New Technologies in Development. We continue to improve on our initial development of a methodology to cultivate and ship "live starter plants" in the grow pod mediums that will be able to grow in our kitchen garden systems. We have started market testing this process with strawberries during the first quarter of calendar 2007. We plan to expand our efforts in this area and are developing a portable greenhouse that we believe enables us to scale this methodology both geographically as well as increasing the varieties of plants offered as "live starter plants." We have also begun development of a new aeroponic based technology that utilizes a new form of proprietary seed pod that will facilitate transfer of water using materials that transfer moisture to the seeds without the need of the pump system. This new technology is anticipated to reduce manufacturing costs with no loss of efficacy. We plan to test market a smaller version of our kitchen garden system in the fourth calendar quarter of 2007 using this new technology with a targeted retail price of \$99-\$129 based on the channel of distribution in which it is sold and the accessory components included with the unit.

Table of Contents

AeroGrow's Kitchen Garden Systems

AeroGrow's Kitchen Garden Systems. We have begun, and in some cases completed, development for multiple kitchen garden systems and have commenced marketing two of these models. Both marketed models feature the rainforest nutrient delivery system and an integrated lighting system (including the microprocessor-based control panel), and a microprocessor-based nutrient cycle delivery system. The initial/standard model of our 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. In April 2007 we launched the AeroGarden Pro100 which features a stainless steel accented finish as well as our adaptive growth technology (described above) and retails at approximately \$169 with variations based on the channel of distribution in which it is sold and the accessory components included with the unit.

AeroGrow's Seed Kits. We have developed and are producing 22 seed kits for use in our kitchen garden systems. These seed kits include pre-seeded bio-grow seed pods and a three-to-six-month supply of nutrients, including our formula for adjusting water quality. Our seed kits retail at prices ranging from \$14.99 to \$29.99. Currently developed seed kits include:

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

Our seed kits, time-release nutrient tablets, and replacement light bulbs are also sold to consumers for use with our kitchen garden system. Additionally, with our Master Gardner Kit, seed pods are available for use by consumers who wish to try to grow their own seeds, but we do not give assurance that all varieties of plants will grow with this kit in our kitchen garden system.

Table of Contents

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

Additional Future Products. In addition to our kitchen garden systems, we are developing and plan 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 us. Our 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.

Children’s Garden. Our children’s garden is designed for simplicity and ease of use. We anticipate introducing this garden system in the toy market.

Decorator Office Garden. We are 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 gardening enthusiasts who want to grow large quantities of vegetables, herbs and flowers.

Future Seed Kits. We plan to continue development of additional seed kits on an ongoing basis including new varieties for international markets.

Markets

Based on our informal market research consisting of individual consumer interviews, focus groups and Internet survey responses, as well as our “sales to date” experience, we believe that our kitchen garden systems will appeal to a broad spectrum of consumers in the United States and internationally, including Europe and Japan. We believe that our products will appeal to at least four major market segments:

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

Further, based on our discussions with potential distributors, we believe that our kitchen garden systems present opportunities in the specialized toy, educational, gift and hydroponic hobbyist markets.

Table of Contents

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

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

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

Table of Contents

Kitchen Products and Small Appliances Market. We believe 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 our 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.

We believe that our 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. Our kitchen garden systems enable colorful and fragrant flowers to be easily grown indoors year-round. Flowers grown with our 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.

Specialty Markets. We believe that several specialized markets potentially exist for our 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,
- hydroponic enthusiast market, and
- international markets, particularly in large cities with limited outdoor garden space.

Marketing and Sales Strategy

We began launching our 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, we agreed to feature Sur La Table and Frontgate in the Company's public relations efforts. In addition, we paid Sur La Table a \$30,000 fee for full page advertisement in Sur La Table's catalogue distributed to over one million consumers. We 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