



Edgar Filing: AeroGrow International, Inc. - Form 10-K

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

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

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

---

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

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

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

The aggregate market value of the voting common stock held by non-affiliates of the registrant as of September 30, 2015 was \$5,251,794, the last day of our most recent second quarter. For the purpose of the foregoing calculation only, all directors and executive officers of the registrant and owners of more than 5% of the registrant's common stock are assumed to be affiliates of the registrant. This determination of affiliate status is not necessarily conclusive for any other purpose.

The number of shares of the registrant's common stock outstanding as of June 6, 2016 is 7,696,010.

DOCUMENTS INCORPORATED BY REFERENCE

None

---

AeroGrow International, Inc.  
Annual Report on Form 10-K  
Year Ended March 31, 2016

	Page
PART I	
Item 1. <u>Business</u>	1
Item 1A. <u>Risk Factors</u>	8
Item 1B. <u>Unresolved Staff Comments</u>	12
Item 2. <u>Description of Property</u>	12
Item 3. <u>Legal Proceedings</u>	13
Item 4. <u>Mine Safety Disclosures</u>	13
PART II	
Item 5. <u>Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	14
Item 6. <u>Selected Financial Data</u>	15
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	14
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	27
Item 8. <u>Financial Statements</u>	28
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	28
Item 9A. <u>Controls and Procedures</u>	28
Item 9B. <u>Other Information</u>	29
PART III	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	30
Item 11. <u>Executive Compensation</u>	34
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	40
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	42
Item 14. <u>Principal Accountant Fees and Services</u>	43
PART IV	
Item 15. <u>Exhibits, Financial Statement Schedules</u>	46
<u>Signatures</u>	

NOTE REGARDING FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K (“Annual Report”) for AeroGrow International, Inc. (“AeroGrow,” the “Company,” “we,” “our” or “us”), including the “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” contains forward-looking statements regarding future events and our future results that are based on current expectations, estimates, forecasts, and projections about the industry in which we operate and the beliefs and assumptions of our management. Words such as “expects,” “anticipates,” “targets,” “goals,” “projects,” “may,” “will,” “would,” “intends,” “plans,” “believes,” “seeks,” and “estimates,” as well as variations of such words and similar expressions, are intended to identify such forward-looking statements. These forward looking statements may include, among others, statements concerning our expectations regarding our business, growth prospects, revenue trends, operating costs, working capital requirements, access to funding, competition, results of operations and other statements of expectations, beliefs, future plans and strategies, anticipated events or trends, and similar expressions concerning matters that are not historical facts. These forward-looking statements are subject to risks, uncertainties, and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from expectations expressed or implied in forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed under the section entitled “Risk Factors” in Part I Item 1A of and elsewhere in this Annual Report, and in other reports we file with the SEC, including the most recent quarterly reports on Form 10-Q and current reports on Form 8-K. While forward-looking statements are based on reasonable expectations of our management at the time that they are made, you should not rely on them. We undertake no obligation to revise or

update publicly any forward-looking statements for any reason.

---

Table of Contents

PART I

ITEM 1. BUSINESS

Corporate History

AeroGrow International, Inc. (“AeroGrow,” the “Company,” “we,” “us” and “our”) was formed as a Nevada corporation in March, 2002. After more than three years of initial research and product development, we began sales activities in 2006. Our principal executive offices are located at 6075 Longbow Drive, Suite 200, Boulder, Colorado 80301 and our main telephone number is (303) 444-7755.

Our Business

AeroGrow is a developer, marketer, direct-seller, and wholesaler of advanced indoor garden systems designed for consumer use and priced to appeal to the gardening, cooking, healthy eating, and home and office decor markets. We offer multiple lines of proprietary indoor gardens, grow lights, a patented nutrient formula, more than 40 corresponding proprietary seed pod kits, and various cooking, gardening and decor accessories, primarily in the United States and Canada, as well as selected countries in Europe, Asia and Australia. As of March 31, 2016, we have manufactured and shipped approximately 1.4 million AeroGarden® units and approximately 3.2 million seed pod kits to consumers and retailers worldwide, through two sales channels:

Retail Sales Channel, consisting of approximately 1,050 retail outlets (both online and storefront) in North America, and in five countries internationally; and

Direct-to-Consumer Sales Channel, which includes web sales and a direct mail catalogue business, with approximately 574,000 catalogues mailed in the fiscal year ended March 31, 2016 (“Fiscal Year 2016”). In Fiscal 2016, we utilized 30, 60 and 120 second television commercials. In prior years, we have also utilized direct television sales, including infomercials and 60 and 120 second television commercials, mall kiosks, and print and radio advertisements.

After more than three years of initial research and product development, we commenced initial marketing and distribution of our products in March 2006 with an emphasis on our retail sales channel, which typically generates lower margins and requires much higher investments in inventory than our direct sales channel. As a result of the downturn in the economy in 2009 and the corresponding lack of funding, we shifted our sales and marketing efforts away from retail distribution. During the four-year period ending on March 31, 2013, we emphasized our higher margin “direct-to-consumer” sales channels, primarily our own in-house direct mail catalogue, e-mail marketing, and internet marketing, and continued to sell to a limited number of international customers.

Beginning in April 2013, we re-entered the retail channel sales due to the improving economic conditions and our strategic alliance with a subsidiary of The Scotts Miracle-Gro Company (“Scotts Miracle-Gro”), which has strong retail presence and a globally recognized and highly trusted Miracle-Gro brand name. In July 2015, Scotts Miracle-Gro provided us with up to \$6.0 million of working capital payable in specified installments through a Term Loan. Interest was charged at the stated rate of 10% per annum, and was paid in May 2016 in the form of 196,044 shares of AeroGrow common stock, valued at a price per share equal to the conversion price of the Series B Preferred Conversion Price on the due date the Term Loan. We believe that the strategic alliance also gives Scotts Miracle-Gro an entry into the burgeoning indoor gardening market, while providing AeroGrow a broad base of support in marketing, distribution, supply chain logistics, R&D, and sourcing. See “April 2013 Scotts Miracle-Gro Strategic Alliance” below.

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

Our indoor gardens are designed to be simple, consistently successful, and affordable. We believe that our products enable almost anyone, from consumers who have no gardening experience to professional gardeners, to produce year-round harvests of a variety of herbs, vegetables, and flowers, regardless of season, weather, or availability of natural light. We believe that our indoor gardening products’ unique and attractive designs make them appropriate for use in almost any location, including kitchens, living areas, and offices.

Our indoor gardening units are sold through different channels designed to match customer needs and interests with the appropriate garden unit features and benefits at retail list prices ranging from approximately \$90 to \$380, depending on size, design elements, light intensity and other automated features. As is customary in the direct-to-consumer channels and select retail channels, we sometimes offer temporary discounts and targeted promotions that are designed to generate higher sales volume.

## Table of Contents

### April 2013 Scotts Miracle-Gro Strategic Alliance

In April 2013 (the first month of Fiscal 2014), we entered into a Securities Purchase Agreement and strategic alliance with a wholly owned subsidiary of Scotts Miracle-Gro. In conjunction with this transaction, we entered into several other agreements, including: (i) an Intellectual Property Sale Agreement; (ii) a Technology Licensing Agreement; (iii) a Brand Licensing Agreement; and (iv) a Supply Chain Management Agreement. For further information on the strategic alliance with Scotts Miracle-Gro, please see Note 3 “Scotts Miracle-Gro Transactions – Convertible Preferred Stock, Warrants and Other Transactions” to our financial statements.

**Intellectual Property Sale Agreement.** Pursuant to the Intellectual Property Sale Agreement, we agreed to sell all intellectual property associated with our hydroponic products (the “Hydroponic IP”), other than the AeroGrow and AeroGarden trademarks, free and clear of all encumbrances, to Scotts Miracle-Gro for \$500,000; we also agreed to pay 2% of our revenue to Scotts Miracle-Gro for a defined period. Scotts Miracle-Gro has the right to use the AeroGrow and AeroGarden trademarks in connection with the sale of products incorporating the Hydroponic IP.

**Technology Licensing Agreement.** Under the Technology Licensing Agreement, Scotts Miracle-Gro granted us an exclusive license to use the Hydroponic IP in North America and certain European Countries (collectively, the “AeroGrow Markets”) in return for a royalty of 2% of annual net sales, as determined at the end of each fiscal year and will be paid in common stock for the first four years. The initial term of the Technology Licensing Agreement is five years, and we may renew the Technology License for additional five-year terms by providing notice to Scotts Miracle-Gro at least six months in advance of the expiration of each five-year term.

**Brand Licensing Agreement.** Under the Brand Licensing Agreement, we may use certain of Scotts Miracle-Gro trade names, trademarks and/or service marks to rebrand the AeroGarden, and, with written consent of Scotts Miracle-Gro, other products in the AeroGrow Markets in exchange for our payment to Scotts Miracle-Gro of an amount equal to 5% of incremental growth in net sales, as compared to net sales during the fiscal year ended March 31, 2013. The initial term of the Brand Licensing Agreement is five years, and we may renew the Brand Licensing Agreement for additional five-year terms by providing notice to Scotts Miracle-Gro at least six months in advance of the expiration of each five-year term.

**Supply Chain Services Agreement.** Under the Supply Chain Services Agreement, Scotts Miracle-Gro will pay AeroGrow an annual fee equal to 7% of the cost of goods of all products and services requested by Scotts Miracle-Gro during the term of the Technology Licensing Agreement (referenced above), thereby assisting AeroGrow in exploiting the Hydroponic IP internationally (outside of the AeroGrow Markets).

### Hydroponics and Aeroponics Industry - Background

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

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



Until the development of our indoor gardening products, certain barriers prevented hydroponic or aeroponic technology from being incorporated into mainstream, mass-marketed consumer products, including:

Consumers generally lack the specialized knowledge required to select, set up, operate, and maintain the various components for a typical hydroponic or aeroponic system, including growing trays, irrigation channels, growing media, nutrient reservoirs, and nutrient delivery systems consisting of electronic timers, pumps, motors, tubing, and nozzles;

In the absence of adequate natural light, consumers generally do not possess the specific knowledge required to select, set up, operate, and maintain the varied indoor lighting systems that are necessary to grow plants indoors;

Consumers are often unable to properly mix and measure complex hydroponic nutrient formulas, which change depending on the plant variety and the stage of plant growth;

2

---

## Table of Contents

·Consumers are unable to deal with the problem of nutrient spoilage; and

Federally mandated water quality reports show that the water in many large cities is not suitable for hydroponic or aeroponic growing and requires treatments in order to sustain growth.

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

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

## Proprietary Technology and Intellectual Property

Since our inception in 2002, we have been innovating, simplifying, and integrating proprietary technologies and inventions into a family of “plug and grow” indoor gardening products and related seed pod kits specifically designed and priced for the mass consumer market. We have used this technology platform to develop seven different models of indoor gardens, each with different features and technology groupings, with list prices ranging from approximately \$90 to \$380. Multiple patent applications have been filed in the United States and internationally to protect the inventions that are exclusively used in our indoor garden system and seed pod kits, and seven patents have been issued (four in the United States and three internationally). We have also obtained access to, both domestically and internationally, trademarks and certain domain names, including AeroGrow.com, AeroGarden.com, AeroGarden.net, AeroGarden.tv, AeroGarden.biz, and Getthegarden.com, among others.

Our success and ability to compete are substantially dependent upon our exclusive access to technology and expertise. While we rely on patent, copyright, trade secret, and trademark law to protect the use of such technology, we also believe that factors such as the technological and creative skills of our personnel, new product developments, product enhancements, and reliable product maintenance are essential to establishing and maintaining a technology leadership position. There can be no assurance, however, that others will not develop technologies that are similar or superior to our technologies. Each of our employees, independent contractors, interns, and consultants has executed assignment of rights to intellectual property agreements and nondisclosure agreements. The assignment of application rights to intellectual property agreements grant us the right to own inventions and related patents which may be granted in the United States and throughout the world. The nondisclosure agreements generally provide that these people will not disclose our confidential information to any other person without our prior written consent.

Following is a description of the proprietary technologies, all of which were sold to Scott Miracle-Gro, and inventions that are exclusively used in our indoor garden system and seed pod kits.

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

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

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

3

---

## Table of Contents

Microprocessor-Based Control Panel and Nutrient Cycle Delivery System. The microprocessor-based controls include automated grow lights to ensure that plants receive the proper amount of lighting, and feature nutrient and water reminder systems that alert consumers to add water and nutrients when needed. In addition, some systems allow consumers to select from multiple plant types (for example, lettuce, herbs, tomatoes, or flowers) and the system then automatically adjusts the nutrient, water and lighting cycles to optimize growth. In addition, some systems take into account stage of growth of the specific plants when optimizing these factors. Our most recent ULTRA gardens include a display screen that walks consumers step-by-step through planting, tending and harvest, and allows for complete customization of all aspects of the grow cycle, including photo period, pump cycle and nutrient cycle.

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

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

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

## Markets

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

Gardener Market. A recent study conducted by the National Gardening Association states that gardening is America’s number one hobby with more than 81 million households active in gardening. Based upon this survey, there were estimated to be 36 million households participating in food gardening and 13 million households participating in fresh herb gardening. We believe that our indoor gardening products and related products offer both expert and novice gardeners several major benefits not readily available through traditional gardening methods, including:

the ability to grow fresh herbs, lettuces, vegetables, tomatoes, and flowers year-round, regardless of indoor light levels or seasonal weather conditions;

the ability to easily start plants indoors during colder months and then transplant them outdoors at the onset of the outdoor growing season;

· the ability to use stem cuttings to propagate multiple reproductions of the desired plants in our indoor gardening products; and

· the ease of growing in our indoor gardens, in contrast to the toil associated with traditional gardening, including preparing the soil, planting, thinning, weeding, watering, and removing pests.

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

· gardening requires an ongoing time commitment;

· apartment, high-rise, and condominium dwellers often lack the land needed for a traditional garden;

4

---

### Table of Contents

- gardening requires physical work, which can be a significant barrier to people with limited mobility or health issues;
- buying the necessary equipment to garden can be expensive; and
- gardening requires knowledge and expertise.

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

Cooking and Healthy Eating Market. Many customers enjoy cooking as a hobby, including those who:

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

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

Home and Office Decor Market. Flowers are frequently used to brighten homes and offices worldwide. It is difficult to readily grow flowers indoors due to a lack of sufficient light and growing knowledge. As a result, people often use cut flowers, which are expensive, short-lived, and require ongoing maintenance. Our indoor gardening products enable colorful and fragrant flowers to be easily grown indoors year round and at a lower cost. Flowers grown with our indoor gardening products will last for months with minimal care and maintenance. Flowers can be grown in a wide variety of indoor locations, including kitchen and bathroom countertops, living rooms, bedrooms, family rooms, offices, work stations, waiting rooms, and lobbies.

### Products

AeroGarden Indoor Gardens. We currently offer nine different indoor garden models with list prices ranging from approximately \$90 to \$380 and differentiated based on size, design, light intensity, degree of automation, inclusion of Adaptive Growth Technology or Advanced Growing Systems, height potential of light hoods, and inclusion of plant support systems.

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

AeroGarden Sprout Series – The AeroGarden Sprout series features the Advanced Growing System, grow lights, a smaller footprint, and an attractive, slim, elegant design that makes it suitable for use as a decorative feature throughout the home or office. AeroGarden Sprouts fit easily on kitchen counters, night stands, and end tables. Some models include upgraded trim and designs such as the red and blue garden targeted at all-family usage. List prices start at \$89.95.

AeroGarden 6 Series – The AeroGarden 6 series has a compact, triangular shape that is a perfect fit for kitchen counter-top corners with energy efficient LED lighting. It has a smaller footprint than the AeroGarden 7 and as a result features six pods for planting. The list price is \$159.95.

AeroGarden Harvest Series – The AeroGarden Harvest series has a compact, beautiful design that has a smaller footprint and is perfect fit for a kitchen counter-top with energy efficient LED lighting. It has a smaller footprint than the AeroGarden 7 and as a result features six pods for planting. It features a variety of trim and touch screen control panels. The starting list price is \$149.95.

AeroGarden 7 Series – Includes our original products which feature the rainforest nutrient delivery system, automated LED lights, and reminder systems. The list price is \$199.95.

5

---

## Table of Contents

AeroGarden Extra Series – A seven pod garden with extended lamp arms and greater light output for growing larger vegetables. Some models also include stainless steel trim. This garden offers a model with an LED light that delivers faster growth with higher yields but uses less energy. List prices start at \$219.95.

AeroGarden ULTRA Series - The ULTRA features the new MyGarden control panel – an automated garden “brain” that makes gardening easier than ever for beginners and offers complete customization for experts. It also includes a redesigned lighting system featuring new MaxGrow Grow Lights and aluminum reflectors, the widest, easiest range of Grow Light adjustment from small to tall, an improved trellis system, a 20% larger reservoir, and a “QuickPlant” button that walks users step-by-step through the planting process. This garden comes with an LED light that delivers faster growth with higher yields but uses less energy. List prices start at \$279.95.

AeroGarden Bounty Series – A nine pod garden, the biggest garden to date, with a more powerful LED lighting system to deliver higher yields and the ability to grow more plants. This garden includes an interactive LCD display panel that utilizes screen prompts to walk users through the planting process. Some models also include stainless steel trim. List prices start at \$349.95.

In fiscal year 2015, the Company has introduced a series of LED grow light systems that enhance plant growth and were generally well-received in the market. The LED lighting systems were available on the AeroGarden 7, the AeroGarden Extra and the AeroGarden ULTRA. In Fiscal 2016, the Company released additional LED grow light systems and AeroGardens with different control panel options and colors.

AeroGarden Seed Pod Kits. We currently offer more than 40 seed pod kits for use in our indoor gardening products. These seed pod kits include pre-seeded bio-grow seed pods and a three-to-six-month supply of nutrients, including our patented formula for adjusting water quality. Our seed pod kits have list prices ranging from \$13 to \$30, and include:

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

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

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

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

Future Products. The core technology platform can be leveraged by bundling different components into new products with a wide variety of features and price points that then can be sold through a variety of direct and retail channels for use in different settings around the home or office. Examples include significantly larger, modular gardens, and less expensive, more decorative gardens.



### Integrated Marketing and Sales Channel Strategy

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

6

---

## Table of Contents

**Shift in Channel Strategy.** For the three fiscal years ending March 31, 2013, we reduced our presence in the retail channel due to the downturn in the economy, capital shortages, and the high cost of maintaining inventory levels sufficient for retail customers. During this time period, we decreased the number of storefronts offering our products from 575 in Fiscal 2011 to approximately 72 as of March 31, 2013. However, beginning with the April 2013 strategic alliance with Scotts Miracle-Gro, we have once again increased our retail presence. As of March 31, 2016, our products were offered in approximately 1,050 storefronts in North America, as well as through select online retailers such as Amazon.com, Costco.com, and Home Depot.com. We believe we will continue to expand and revise our retail presence during the coming fiscal year as our trials with specific retailers and brick and mortar stores are revised and examined. For further information on the strategic alliance with Scotts Miracle-Gro, please see Note 3 “Scotts Miracle-Gro Transactions – Convertible Preferred Stock, Warrants and Other Transactions” to our financial statements.

**Direct-to-Consumer Sales.** In 2007, we produced and began mailing our own in-house, direct mail product catalogue, which tested successfully with a mailing of approximately 60,000 catalogues. In Fiscal 2016, we mailed approximately 574,000 catalogues. With our catalogue sales we focus on remarketing to current customers and also prospecting for new customers using database marketing techniques.

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

A key focus of our web and catalogue marketing is to maximize the lifetime value of AeroGrow customers through repeat sales of our seed pod kits, light bulbs and accessories. During Fiscal 2016, direct-to-consumer sales represented 34.2% of our total net sales.

**Retail Sales.** Initial shipments to retailers commenced in March 2006. Over the next several years, we rapidly grew our retail distribution and as of March 31, 2009 our products were being sold through approximately 7,500 stores in North America. We then began to reduce our sales to retailers (as discussed above) and as of March 31, 2013 our products were being sold through approximately 72 stores in North America. Since March 31, 2013, we have renewed our focus in the retail markets and dramatically increased our visibility in stores and were being sold in approximately 1,050 stores and sales to retailers represented 65.4% of our total net sales.

During Fiscal 2016, approximately 76.6% of our total sales to retailers represented sales to Amazon.com, Inc. Moreover, sales to Amazon.com represented approximately 50.1% of our total sales in Fiscal 2016. As we continue our expansion of our retail sales efforts during the coming fiscal year, we expect to continue our sales with strong retailers as a result of our strategic alliance with Scotts Miracle-Gro.

**International Sales.** We began testing international sales opportunities in the UK and Japan in late 2007 and eventually expanded into Australia, South Korea, Mexico, France and several other countries. In Fiscal 2016, international sales were conducted through third-party distributors and we began to focus efforts on new retailers such as Amazon.co.uk. During Fiscal 2016, international sales represented less than 1% of our total net sales, as we began to expand into Europe, including the United Kingdom, starting in January of 2016.

## Competition

Aeroponic and hydroponic technologies have historically been limited to ardent hobbyists and commercial growing facilities. We believe that we are the first company to develop and offer a simple dirt-free indoor growing system for the mass consumer market.

Typical hydroponic manufacturers offer a range of equipment and accessories through distributors or small independent “hydro-shops” in a trade-oriented manner similar to plumbing or electrical suppliers. Purchasers typically mix and match equipment from various suppliers in an “a la carte” fashion to individually customize a large system that they then assemble on their premises. We believe that these products are substantially more expensive than our products.

We believe that our simplified and complete indoor gardening products and current and planned methods of distribution offer significant benefits from these traditional hydroponic industry practices. To date, we have discovered a few kitchen design firms that have tried to introduce an indoor growing system into the market, but we do not believe they have a significant presence in the market. In our laboratory tests, these systems have performed at levels far below our own systems in terms of germination success, longevity, speed-of-growth and overall yields. However, we recognize that there are other companies that are better funded and have greater experience in producing hydroponic products in commercial markets, or that have been more successful in manufacturing or selling consumer products or soil-based gardening products.

## Table of Contents

### Manufacturing and Operations

We source our AeroGarden products and accessory items from contract manufacturing companies that manufacture products using tooling we own, in accordance with our specifications, and subject to our intellectual property rights provided by the Technology Licensing Agreement with Scotts Miracle-Gro. We have four Chinese manufacturers of our garden products. Several are capable of manufacturing multiple garden models. We believe the existing production capacity of these manufacturers is more than sufficient to meet our garden requirements for the short-to-medium term. In addition, capacity expansion is available in a reasonable period of time with a nominal tooling investment. We also try to have multiple, dual-sourced manufacturers of our many component parts and accessories. Indoor gardening products are shipped from China to the third-party fulfillment center in Missouri, as well as to third-party distribution facilities in countries outside North America.

### Product Returns and Warranties

To date, product returns have been within our expectations for both retail and direct-to-consumer sales. At retail, we generally use a “destroy in field” methodology as the cost of shipping a used product back to us often does not justify the value of the recovered unit. We record warranty liabilities at the time of sale for the estimated costs that may be incurred under our basic warranty program. The specific warranty terms and conditions vary depending upon the product sold, but generally include technical support, repair parts, and labor for periods up to one year. Factors that affect our warranty liability include the number of installed units currently under warranty, historical and anticipated rates of warranty claims on those units, and cost per claim to satisfy our warranty obligation.

### Governmental Regulation and Certification

We believe that we are in compliance with regulations in the United States and Canada concerning the shipping and labeling of seeds and nutrients. Currently, the components for the indoor garden system are ETL certified. These certifications confirm that the products have been tested and conform to a recognized level of fire and other safety standards for consumers. Such independent third-party certification is required for sales of products through many major retailers.

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

### Personnel

As of March 31, 2016, AeroGrow employed 30 full-time employees. In addition, we contract the services of part-time and project consultants on an “as needed” basis. We believe that our employee relations are good. Historically, our outsourced business also included manufacturing, telemarketing, infomercial production, fulfillment and shipping. Additional employees and/or consultants may be hired in the future as our operations merit.

## ITEM 1A. RISK FACTORS

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

### Risks Related to our Business, Products and Markets

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

Since we commenced operations in 2002, and through March 31, 2016, we incurred substantial losses, including a net loss of \$553,000 for the twelve month period ended March 31, 2016. As of March 31, 2016, our losses have resulted in an accumulated deficit of \$84.3 million. The future success of our business will depend in part on our ability to use the Scotts Miracle-Gro partnership to: (i) profitably expand sales of our AeroGarden indoor garden systems, seed pod kits and accessory products; (ii) develop new product extensions and applications; and (iii) efficiently spend marketing dollars to gain customer acceptance.

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

Our ability to borrow funds or raise additional equity may be limited by our financial condition. In addition, a failure to obtain additional funding to support our working capital and operating requirements could prevent us from making expenditures that are needed to allow us to grow our operations. In the event we cannot raise additional funding to fulfill working capital needs, we will have to scale back on our operating plans for the current and future fiscal years. There can be no assurance that we will be able to secure the additional capital in an amount and in time to support all of our operating plans.

## Table of Contents

As we grow our sales into the retail channel and increase sales through individual retailers, the loss or significant reductions in orders from our top retail customers could have a material adverse impact on our business.

In Fiscal 2016, our net sales to one retail customer, Amazon.com, Inc., totaled 76.6% of our total net sales to retailers and 50.1% of our total net sales. The loss of this significant customer, or a significant decline in orders could materially affect our sales of indoor garden systems, seed pod kits and accessories, and could therefore have a material adverse effect on our business, prospects, results of operations, and financial condition.

We do not have long-term sales agreements with, or other contractual assurances as to future sales to, any of our current or planned major retail customers. In addition, our business may be negatively affected by changes in the policies of our retailers, such as payment terms, shelf space limitations, price demands and other conditions.

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

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

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

To maintain our business position, we will need to attract, retain, and motivate highly skilled design, development, management, accounting, sales, merchandising, marketing, and customer service personnel. Competition for many of these types of personnel can be intense, depending on general economic conditions, alternative employment options, and job location. As a result, we may be unable to successfully attract or retain qualified personnel. Additionally, any of our officers or employees can terminate their employment with us at any time. The loss of any key employee, or our inability to attract or retain other qualified employees, could have a material adverse effect on our business, prospects, results of operations, and financial condition.

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

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

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

For the fiscal year ended March 31, 2016, approximately 70.9% of our total net sales occurred during four consecutive calendar months (October through January). We must therefore estimate sales in advance of the anticipated peak

months and operate our business during the balance of the year in such a way as to insure that we can meet the demand for our products during the peak months. This requires us to incur significant operating, marketing, and overhead expenses, and to utilize cash and other capital resources to invest in inventory in advance of having certainty as to the ultimate level of demand for our product during the peak months. Shortfalls in the supply of our products could result in a significant loss of revenue due to lack of adequate product inventory. For example, the cobranding of our product with the “Miracle-Gro AeroGarden” trade name caused a delay in available inventory during the first six months of Fiscal 2014. Additionally, during the third and fourth quarters of Fiscal 2013, a labor strike in the ports of Los Angeles and Long Beach delayed the delivery of AeroGarden inventory during the critical pre-Christmas season and caused a decline in sales during that time period. Alternatively, a shortfall in actual demand for our products, relative to forecast, during peak months could cause us to liquidate excess inventory at a loss or at substantially lower margins. In any of these cases, we may not generate enough revenue to cover expenses incurred throughout the balance of the year. Our business prospects, results of operations and financial condition would be materially and adversely affected.

## Table of Contents

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

We currently depend on four contract manufacturers in China to produce our indoor garden systems. These manufacturers could fail to produce the indoor garden system to our specifications or in a workmanlike manner and may not deliver the systems on a timely basis. Our manufacturers must also obtain inventories of the necessary parts and tools for production. Although we own the tools and dies used by our manufacturers, our manufacturers operate in China. As a result, our manufacturers may be subject to business risks that fall outside our control, including but not limited to, political, currency, regulatory and shipping/transportation risks, each of which may affect the manufacturer's ability to fulfill our orders for indoor garden systems. As discussed in the preceding risk factor, the December 2012 labor strike in the ports of Los Angeles and Long Beach (delayed the delivery of AeroGarden inventory during the critical pre-Christmas season and caused a decline in sales during the third and fourth quarters of Fiscal 2013. In addition, port congestion in October 2014 backed up deliveries and delayed ground transportation during the third quarter of Fiscal 2015. Weather or natural disasters in China could disrupt our supply of product. Any change in manufacturers could disrupt or delay our ability to fulfill orders for indoor garden systems while we search for alternative supply sources, provide specifications, and test initial production. Our business prospects, results of operations and financial condition would be materially and adversely affected.

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

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

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

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

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

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

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

We believe that our complete indoor garden systems offer significant benefits over traditional hydroponic industry products. However, there are companies in a variety of related markets, including but not limited to, consumer



electronics, commercial hydroponics, gardening wholesale, and soil-based gardening that are larger, better funded, and have experience in our channels of distribution. These companies may decide to develop products to compete with our products. These companies could use hydroponic technologies, and could achieve better consumer acceptance. The success of any competing products may have a material adverse effect on our business prospects, results of operations and financial condition.

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

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

### Table of Contents

If our indoor garden systems fail to perform properly, our business could incur increased warranty-related costs and reduced income.

From our inception through March 31, 2016, we have sold approximately 1.4 million AeroGardens and have provided a limited warranty with each garden sold. In addition, our indoor garden systems are “guaranteed to grow.” We therefore may be required to replace or repair products or refund the purchase price to consumers. Failure of our products to meet expectations could damage our reputation, decrease sales, increase costs related to returns and repairs, delay market acceptance of our products, result in unpaid accounts receivable, and divert our resources to remedy the malfunctions. The occurrence of any of these events would have a material adverse effect on our business prospects, results of operations and financial condition.

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

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

Cyber-attacks targeting systems and infrastructure used by our Company may adversely impact our operations.

Our business has become increasingly dependent on digital technologies to conduct certain development, operating and sales activities. We depend on digital technology to communicate with our employees, third-party manufacturers, partners and customers. We have been the subject of cyber-attacks on our internal systems and through those of third parties, but these incidents did not have a material adverse impact on our results of operations. Nevertheless, unauthorized access to our proprietary or commercially sensitive information could lead to leaks of customer-sensitive information, data corruption, communication interruption, or other disruptions in our sales, product development, production or planned business transactions, any of which could have a material adverse impact on our results of operations. Further, as cyber-attacks continue to evolve, we may be required to expend significant additional resources to continue to modify or enhance our protective measures or to investigate and remediate any vulnerabilities to cyber-attacks.

### Risks Related to the Market for our Securities

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

Our common stock, like that of many emerging growth companies, is typically subject to price and volume volatility. Trading in our common stock is limited, and the price per share is likely to be influenced by the price at which and the amount of shares that selling security holders are attempting to sell at any time. If a large stockholder, including Scotts Miracle-Gro and its affiliates, decided to sell its shares, the price of our common stock would decline. Our common stock may also be subject to the activities of persons engaged in short selling securities, which generally has the effect of driving the price down. The price of our common stock has fluctuated, and may continue to fluctuate, widely. A full and stable trading market for our common stock may never develop and, as a result, stockholders may not be able to sell their shares at the time they elect, if at all.

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

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

## Table of Contents

For example, in April 2013 (during the first quarter of fiscal year 2014), we entered into a Securities Purchase Agreement with SMG, a wholly owned subsidiary of Scotts Miracle-Gro. Pursuant to the Securities Purchase Agreement, SMG acquired 2,649,007 shares of the Company's Series B Convertible Stock, par value \$0.001 per share (the "Series B Preferred Stock"), and (ii) a warrant to purchase shares of the Company's common stock (the "Warrant"). The Series B Preferred Stock is convertible into 2,649,007 shares of common stock (\$4.0 million divided by a conversion price of \$1.51 per share). The Warrant entitles, but does not obligate, Scotts Miracle-Gro to purchase a number of shares of common stock that, on a "fully diluted basis," constitute 80% of the Company's outstanding capital stock (when added to all other shares owned), as calculated as of the date or dates of exercise. The Warrant can be exercised at any time and from time to time for a period of five years between April 22, 2016 and April 22, 2021. In June 2016, representatives of Scotts Miracle-Gro informed our management team and our Board of Directors of its intent to exercise some or all of the Warrant prior to December 31, 2016.

Under the Securities Purchase Agreement, our Board of Directors is required to consist of five members. While the Warrant is outstanding, SMG is entitled to elect one director and have one additional Board observer. As a result of this transaction, your rights as a common stockholder could be adversely affected. Because the holder of Series B Preferred Stock is entitled to vote on an "as-converted" basis with the common stock, SMG controls approximately 40% of the voting power of our outstanding equity. If SMG exercises the Warrant, its voting power will increase. Please see Note 3 "Scotts Miracle-Gro Transactions – Convertible Preferred Stock, Warrants and Other Transactions" to our financial statements for more detailed disclosure regarding the strategic relationship with Scotts Miracle-Gro and the terms of the Series B Convertible Preferred Stock, the Warrant and other transactions. In addition, we entered into a \$6.0 million Term Loan Agreement with Scotts Miracle-Gro in July 2015. Interest was charged at the stated rate of 10% per annum, and was paid in May 2016 in the form of 196,044 shares of AeroGrow common stock, valued at a price per share equal to the conversion price of the Series B Preferred Conversion Price on the date the Term Loan.

As a result, SMG may be deemed to have effective control over all matters requiring action by our stockholders, including the election of our entire Board. It is unlikely that a change of control of our company could be effected without SMG's approval.

Our outstanding warrants, options and any additional future obligations to issue our securities to various parties may dilute the value of an investment in AeroGrow. In addition, the terms and conditions of these securities could significantly impact the price of our common shares, and could adversely impact our ability to raise additional equity capital.

As of March 31, 2016, we had reserved for issuance up to approximately 3.7 million additional shares of common stock under the terms of warrants, options, convertible preferred stock, and other arrangements, including the conversion of Series B Convertible Preferred and exercise of Warrants issued to Scotts Miracle-Gro. In June 2016, representatives of Scotts Miracle-Gro informed our management team and our Board of Directors of its intent to exercise some or all of the Warrant prior to December 31, 2016. Scotts Miracle-Gro's exercise of the Warrant may result in immediate and substantial dilution of the number of shares of AeroGrow common stock outstanding.

For the length of time the warrants, options and Series B Convertible Preferred Stock are outstanding, the holders will have an opportunity to profit from a rise in the market price of our common stock without assuming all the risks of common share ownership. This may adversely affect the terms upon which we can obtain additional capital and may be dilutive to the interests of common stockholders. In this regard, interest on the Term Loan with Scotts Miracle-Gro was charged at the stated rate of 10% per annum, and was paid in May 2016 in the form of 196,044 shares of AeroGrow common stock, valued at a price per share equal to the conversion price of the Series B Preferred Conversion Price on the date the Term Loan. The holders of such derivative securities would likely exercise or convert them at a time that could be lower than our common stock is trading.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. DESCRIPTION OF PROPERTY

We lease a 9,868 square foot office space in, Boulder, Colorado, with a current monthly rent of \$10,000, which is subject to annual increases of 3.5%. We also pay our proportionate share of building taxes, insurance and operating expenses. The lease term continued until September 30, 2014, unless modified under specified circumstances. As of April 14, 2014 the lease term was extended to September 30, 2016. The agreement contains other standard office lease provisions.

12

---

Table of Contents

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

ITEM 3. LEGAL PROCEEDINGS

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

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

13

---

Table of Contents

## PART II

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

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

## Price Range of Common Stock

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

	Fiscal Year		Fiscal Year	
	Ended		Ended	
	3/31/16		3/31/15	
	High	Low	High	Low
1st Quarter - Ended June 30	\$3.30	\$2.60	\$7.25	\$4.45
2nd Quarter - Ended Sept 30	\$2.70	\$1.02	\$6.75	\$3.93
3rd Quarter - Ended Dec 31	\$1.39	\$0.92	\$4.95	\$2.75
4th Quarter - Ended Mar 31	\$2.47	\$0.93	\$4.70	\$2.75

## Holders

As of June 6, 2016, we had approximately 508 holders of record of our common stock. A substantially greater number of stockholders are "street name" or beneficial holders, whose shares are held of record by banks, brokers and other financial institutions. See "Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters," for additional information about holders of our common stock.

## Dividends

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

## Equity Compensation Plan Information

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

## Issuer Purchases of Equity Securities

We did not repurchase any shares of our common stock during the year ended March 31, 2016.

Table of Contents

## ITEM 6. SELECTED FINANCIAL DATA

## Statements of Operations Data

(in thousands, except per share data)	Fiscal Years ended	
	March 31,	
	2016	2015
Revenues	\$19,612	\$17,912
Cost of revenue	12,618	12,367
Gross profit	6,994	5,545
Operating Expenses		
Research and development	588	389
Sales and marketing	5,302	3,895
General and administrative	2,403	2,088
Total operating expenses	8,293	6,372
Loss from operations	(1,299 )	(827 )
Other income (expense)	746	636
Net loss	\$(553 )	\$(191 )
Less: Preferred stock dividend	(675 )	(1,355 )
Net income (loss) attributable to common shareholders	\$(1,228 )	\$(1,546 )
Net loss per share, basic and diluted	\$(0.18 )	\$(0.26 )
Weighted average number of common shares outstanding, basic and diluted	6,666	5,847

## Balance Sheet Data

(in thousands)	2016	2015
Cash and cash equivalents	\$1,401	\$1,015
Total assets	\$7,348	\$5,974
Total liabilities	\$5,147	\$4,591
Total stockholders' equity	\$2,201	\$1,383

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

This Annual Report on Form 10-K ("Annual Report"), including the "Management's Discussion and Analysis of Financial Condition and Results of Operations," contains forward-looking statements regarding future events and our future results that are based on current expectations, estimates, forecasts, and projections about the industry in which we operate and the beliefs and assumptions of our management. Words such as "expects," "anticipates," "targets," "goals," "projects," "may," "will," "would," "could," "intends," "plans," "believes," "seeks," "estimates," variations of such words, and expressions are intended to identify such forward-looking statements. These forward looking statements may include, among others, statements concerning our expectations regarding our business, growth prospects, revenue trends, operating costs, results of operations, working capital requirements, access to funding, competition and other statements of expectations, beliefs, future plans and strategies, anticipated events or trends, and similar expressions concerning matters that are not historical facts. These forward-looking statements are subject to risks, uncertainties, and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from expectations expressed or implied in forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in this Report under the section entitled "Risk Factors" in Item 1A of Part I and elsewhere, and in other reports we file with the SEC, specifically the most recent reports on Form 10-Q. While forward-looking statements are based on reasonable expectations of our management at the time that they are made, you should not rely on them. We undertake no obligation to revise or update publicly any



forward-looking statements for any reason.

15

---

Table of Contents

Executive Overview

We are in the business of developing, marketing, and distributing advanced indoor aeroponic and hydroponic garden systems. After several years of initial research and product development, we began sales activities in March 2006. Since that time we have expanded our operations and currently offer nine different indoor garden models, more than 40 seed pod kits, and various gardening and kitchen accessories. Although our business is focused on the United States and Canada, our products are available in other countries and we have begun to expand our market into Europe, including the United Kingdom.

Background – Fiscal Years 2014-2016

As disclosed above under the caption “Item 1. Business,” we entered into a Securities Purchase Agreement and strategic alliance in April 2013 with a wholly owned subsidiary of Scotts Miracle-Gro. Pursuant to the Securities Purchase Agreement, we issued (i) 2,649,007 shares of Series B Convertible Preferred Stock, par value \$0.001 per share (the “Series B Preferred Stock”); and (ii) a warrant to purchase shares of our common stock for an aggregate purchase price of \$4.0 million. In addition, as part of the strategic alliance, we entered into several other agreements with Scotts Miracle-Gro, including: (i) an Intellectual Property Sale Agreement in which we agreed to sell all intellectual property associated with our hydroponic products, other than the AeroGrow and AeroGarden trademarks, free and clear of all encumbrances, to Scotts Miracle-Gro for \$500,000; (ii) a Technology Licensing Agreement; (iii) a Brand License Agreement; and (iv) a Supply Chain Management Agreement.

In addition to the working capital infusion of approximately \$4.5 million from the Securities Purchase Agreement and Intellectual Property Sale Agreement, the strategic alliance affords us the use of the globally recognized and highly trusted Miracle-Gro brand name. In July 2015, we also entered into a \$6.0 million Term Loan Agreement with Scotts Miracle-Gro in order to provide working capital in advance of our peak selling season. Interest was charged at the stated rate of 10% per annum, and was paid in May 2016 in the form of 196,044 shares of AeroGrow common stock, valued at a price per share equal to the conversion price of the Series B Preferred Conversion Price on the date the Term Loan. We believe that the strategic alliance also gives Scotts Miracle-Gro an entry into the burgeoning indoor gardening market, while providing AeroGrow a broad base of support in marketing, distribution, supply chain logistics, R&D, and sourcing. We have used the opportunities provided by our strategic alliance with Scotts Miracle-Gro to re-establish our presence in the retail sales channels. During the first six months of Fiscal 2014, we cobranded our products with the Miracle-Gro AeroGarden trade name. We have since renewed our focus in retail markets as we grow awareness of our newly cobranded product. As of March 31, 2015 our products had been offered in approximately 2,750 stores in North America. During Fiscal 2016, we strategically reduced the number of stores our product was offered in to approximately 1,050 and we also enhanced the depth and breadth of our direct sales distribution channels by distributing approximately 574,000 direct mail catalogues, significantly increasing our web-selling presence and developing a robust e-mail marketing program. In Fiscal 2016, approximately 34.2% of our total sales were to direct customers and approximately 65.8% of our total sales were to retail customers. Amazon.com, Inc., our largest retailer customer, comprised approximately 76.6% of our sales to retailers and 50.1% of our total sales during Fiscal 2016.

Based on the efforts during Fiscal 2016 and our growing product awareness, we believe we can meet our cash requirements for the next twelve months based on current cash on hand plus financing from Scotts Miracle-Gro similar to the last few years. We may need to seek additional capital, however, to provide a cash reserve against contingencies, address the seasonal nature of our working capital needs, and to enable us to invest further in trying to increase the scale of our business. There can be no assurance we will be able to raise this additional capital, that we will be able to increase the scale of our business, or that our existing resources will be sufficient to meet all of our cash requirements. In such an event, we would reduce the scale of our operations and take such actions as are available to us to reduce our cash requirements. However, there can be no assurance that such actions would be successful.

## Our Critical Accounting Policies

Inventory

Inventories are valued at the lower of cost, as determined by standard pricing which approximates the first-in, first-out method, or net realizable value. When the Company is the manufacturer, raw materials, labor and manufacturing overhead are included in inventory costs. We record the raw materials at delivered cost. Standard labor and manufacturing overhead costs are applied to the finished goods based on normal production capacity. A majority of our products are manufactured overseas and are recorded at cost.

	March	March
	31,	31,
	2016	2015
(in thousands)		
Finished goods	\$2,372	\$1,919
Raw materials	777	684
	\$3,149	\$2,603

Table of Contents

The Company determines an inventory obsolescence reserve based on management’s historical experience and establishes reserves against inventory according to the product lifecycle. As of March 31, 2016 and 2015, the Company had reserved \$285,000 and \$267,000, respectively, for inventory obsolescence. The increase in the inventory obsolescence is attributable to further examining aged inventory and recording additional reserves.

Revenue Recognition

The Company recognizes revenue from product sales, net of estimated returns, when persuasive evidence of a sale exists, including the following: (i) a product is shipped under an agreement with a customer; (ii) risk of loss and title has passed to the customer; (iii) the fee is fixed or determinable; and (iv) collection of the resulting receivable is reasonably assured.

The Company records estimated reductions to revenue for customer and distributor programs and incentive offerings, including promotions and other volume-based incentives. Certain incentive programs require the Company to estimate based on industry experience the number of customers who will actually redeem the incentive. As of March 31, 2016 and March 31, 2015, the Company had accrued \$151,000 and \$110,000 respectively, as its estimate for the foregoing deductions and allowances.

Warranty and Return Reserves

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 and labor for periods up to one year. Factors that affect our warranty liability include the number of installed units currently under warranty, historical and anticipated rates of warranty claims on those units, and cost per claim to satisfy our warranty obligation. Based upon the foregoing, the Company has recorded a provision for potential future warranty costs of \$117,000 and \$58,000, as of March 31, 2016 and March 31, 2015, respectively.

The Company reserves for known and potential returns and associated refunds or credits related to such returns based upon historical experience. In certain cases, customers are provided a fixed allowance, usually in the 1% to 2% range, to cover returned goods. This allowance is deducted from payments made to us by such retailers. As of March 31, 2016 and March 31, 2015, the Company has recorded a reserve for customer returns of \$197,000 and \$119,000, respectively.

Shipping and Handling Costs

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

Stock Based Compensation

The Company accounts for share-based payments in accordance with FASB Accounting Standards Codification (“ASC”) 718-10-55 Share-Based Payment. The Company uses the Black-Scholes option valuation model to estimate the fair value of stock option awards issued. For the years ended March 31, 2016, and 2015, equity compensation in the form of stock options and grants of restricted stock that vested totaled \$276,000 and \$302,000, respectively, and is included in the accompanying statements of operations in the following categories:

	Fiscal Years Ended March 31, 2016 2015	
(in thousands)		
General and administrative	\$90	\$158

Edgar Filing: AeroGrow International, Inc. - Form 10-K

Sales and marketing	186	144
Total	\$276	\$302

Advertising and Production Costs

The Company expenses all production costs related to advertising, including, print, television, and radio advertisements when the advertisement has been broadcast or otherwise distributed. In contrast, we record media and marketing costs related to our direct-to-consumer advertisements, inclusive of postage and printing costs incurred in conjunction with mailings of direct response catalogues, and related direct response advertising costs, in accordance with ASC 340-20-25 Reporting on Advertising Costs. As prescribed by ASC 340-20-25, direct response advertising costs incurred are reported as assets and should be amortized over the estimated period of the benefits, based on the proportion of current period revenue from the advertisement to probable future revenue.

As the Company has re-entered the retail distribution channel, it has expanded advertising into online gateway and portal advertising, as well as placement in third party catalogues.

Table of Contents

Advertising expenses for the years ended March 31, 2016 and March 31, 2015, were as follows:

	Fiscal Year Ended March 31, (in thousands)	
	2016	2015
Direct-to-consumer	\$708	\$890
Retail	1,598	871
General	721	40
Total advertising expense	\$3,027	\$1,801

As of March 31, 2016 and March 31, 2015, the Company had deferred \$24,000 and \$48,000, respectively, related to such media and advertising costs which include the catalogue cost described above and commercial production costs. The costs are included in the prepaid expenses and other line of the condensed balance sheets.

Research and Development

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

Fair Value Measurements

In evaluating the fair value of derivative financial instruments, there are numerous assumptions which management must make that may influence the valuation of the derivatives in the financial statements. We revalue our financial instruments at fair value on a case by case basis and recognize the change in the fair value of the instrument at each reporting period.

Intellectual Property Sale Agreement

Under the Intellectual Property Sale Agreement with Scotts Miracle-Gro, we received \$500,000 cash in April 2013 and agreed to pay a specified percentage of our revenue to Scotts Miracle-Gro for a defined period. Because AeroGrow has significant involvement in the generation of its revenue, the excess paid over net book value is classified as debt and is being amortized under the effective interest method.

New Accounting Pronouncements

In February 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-02, “Leases.” The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The adoption of this ASU is expected to result in all operating leases being capitalized in the Company’s financial statements.

In November 2015, the FASB issued ASU 2015-17, “Balance Sheet Classification of Deferred Taxes,” which requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position to simplify the presentation of deferred income taxes. The standard is effective prospectively for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with early adoption permitted. The Company does not expect the adoption of this update to have a material impact on its financial statements. The Company has early adopted this ASU and had no material impact on our financial statements.

In August 2015, the FASB issued ASU 2015-14 which updated (to defer the effective date by one year) previously issued ASU 2014-09, "Revenue from Contracts with Customers," which amended revenue recognition guidance to clarify the principles for recognizing revenue from contracts with customers. The guidance requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. The guidance also requires expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This accounting guidance is effective for the Company beginning in the first quarter of fiscal year 2018 using one of two prescribed retrospective methods. Early adoption is not permitted. We have not yet selected a transition method, nor have we determined the effect of the standard on our ongoing financial reporting.

Table of Contents

In July 2015, the FASB issued ASU 2015-11, “Simplifying the Measurement of Inventory.” Under this ASU, inventory will be measured at the “lower of cost and net realizable value” and options that currently exist for “market value” will be eliminated. The ASU defines net realizable value as the “estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation.” No other changes were made to the current guidance on inventory measurement. ASU 2015-11 is effective for interim and annual periods beginning after December 15, 2016. Early application is permitted and should be applied prospectively. Management has early adopted ASU 2015-11 and notes no material impact on the Company's financial position or results of operations.

In August 2014, the FASB issued ASU 2014-15, “Presentation of Financial Statements – Going Concern: Disclosures of Uncertainties about an Entity’s Ability to Continue as a Going Concern,” which requires management to evaluate whether there are conditions and events that raise substantial doubt about the entity’s ability to continue as a going concern within one year after the financial statements are issued. This ASU is effective for annual periods ending after December 15, 2016 and interim periods within annual periods beginning after December 15, 2016. The adoption of this ASU is not expected to have a material impact on the Company’s financial statements.

**Inflation, Seasonality and Currency Fluctuations**

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

**Results of Operations**

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

	Fiscal Years	
	Ended March 31,	
	2016	2015
Net revenue		
Direct-to-consumer	34.2 %	37.4 %
Retail	65.4 %	62.3 %
International	0.4 %	0.3 %
Total net revenue	100.0 %	100.0 %
Cost of revenue	64.3 %	69.0 %
Gross profit	35.7 %	31.0 %
Operating expenses		
Research and development	3.0 %	2.2 %
Sales and marketing	27.0 %	21.7 %
General and administrative	12.3 %	11.7 %
Total operating expenses	42.3 %	35.6 %
Loss from operations	(6.6 %)	(4.6 %)



Edgar Filing: AeroGrow International, Inc. - Form 10-K

Total other income/(expense), net	3.8	%	3.5	%
Net loss	(2.8	%)	(1.1	%)

Table of Contents

Fiscal Years Ended March 31, 2016 and March 31, 2015

Summary Overview

Our net revenue in Fiscal 2016 totaled \$19.6 million, an increase of 9.5% from Fiscal 2015 revenues. This increase was primarily due to our increased focus on selling through web/internet channels (Amazon.com, Costco.com, etc.) and tests in the housewares channel (namely QVC, Bed Bath & Beyond, and Sur La Table). Our success in selling to these retailers more than offset the revenue that was not repeated this year with tests at mass retail stores (namely Home Depot, Walmart and Sam's Club) in the previous year. In addition, we believe an increased level of general advertising drove sales increases in all of our channels.

Our sales to retailer customers increased by 15.1% to \$12.8 million during Fiscal 2016. Retailer sales encompass sales to both traditional "in-store" and on-line retailers. The increase in sales to retailers reflected sales to the existing Amazon.com and Costco.com accounts, as well as newly acquired retail accounts such as Bed Bath & Beyond. We spent \$1.6 million in advertising dollars in the retail distribution channel, primarily to promote general brand awareness which included a broad-based campaign involving 30, 60 and 120 second television commercials and third party catalogues.

Direct-to-consumer sales during Fiscal 2016 remained steady at \$6.7 million, despite dramatically increased competition from our on-line retailers (primarily Amazon.com) and a decrease in our direct-to-consumer advertising spend by sending fewer catalogues, partially offset by increased visibility in the retail channel, and from new product offerings and generally higher pricing.

For the years ended March 31, 2016, sales of AeroGarden garden units increased by \$1.8 million or 11.5% from the prior year period due to the increase in retail sales. This percentage increase was attributable to the introduction of new higher-end products and increased retail distribution, especially during the high demand holiday season. Seed pod kit and accessory sales increased by \$676,000 or 17.4% over the prior year period, as our established base of AeroGardeners continues to grow. As our established base of AeroGarden users continue to grow we expect our seed pod kit and accessory gross sales to grow and in Fiscal 2016 seed pod kit and accessories increased as a percentage of total revenue year-over-year.

For Fiscal 2016, we incurred \$3.0 million in advertising expenditures, a 68.1% year-over-year increase compared to the Fiscal Year ended 2015, which includes \$636,000 in general television, YouTube, Facebook and other media advertising. The Company views this investment as a long term commitment to increasing awareness of the AeroGarden brand and to support the growth in our direct-to-consumer and retail channels. Overall advertising efficiency (measured as total revenue per dollar of advertising expense) decreased from \$9.95 to \$6.48 for the years ended March 31, 2015 and March 31, 2016, respectively due to an increased focus on general advertising and brand awareness. These expenditures included:

Direct-to-consumer advertising declined 20.4% to \$708,000 from \$890,000 for the year ended March 31, 2016 and March 31, 2015, respectively. This decrease reflects a reallocation of our advertising spending away from catalogues and toward television and retail-specific campaigns. Efficiency, as measured by dollars of direct-to-consumer sales per dollar of related advertising expense, increased to \$9.47, or 25.6%, for the fiscal year ended March 31, 2016, as compared to \$7.54 for Fiscal 2015. Catalogue advertising expenses decreased during the year as we spent more on other direct-to-consumer measurable media which helped drive the efficiency of advertising expenses.

Retail advertising increased to \$1.6 million from \$871,000 for the year ended March 31, 2016 and March 31, 2015, respectively, as the Company focused on driving product awareness on behalf of our retail partners. We anticipate that as we advertise more in the retail channel that the increased awareness will also help drive direct-to-consumer sales.

Finally, in support of driving increased levels of category and brand awareness during the year ended March 31, 2016, we spent over \$636,000 in general television, YouTube, Facebook and other media advertising. The Company views this investment as a long term commitment to increasing awareness of the AeroGarden brand.

The combination of all of the factors cited above helped drive a year-over-year increase in total net revenues of 9.5% to \$19.6 million in Fiscal 2016.

Our gross margin for Fiscal 2016 was 35.7%, up from 31.0% in the prior fiscal year. This increase was achieved through:

- Lower product costs throughout our supply chain;
  - Revised product pricing resulting in higher selling costs; and
- A focus on selling to retail partners with distribution models that allowed us to achieve higher margins. Long term, we also believe that creating increased brand awareness through advertising will help us maintain higher prices and deliver better margins.

Table of Contents

Operating expenses for Fiscal 2016 totaled \$8.3 million, an increase of 30.2% or \$1.9 million over the prior fiscal year to support a large scale general advertising campaign to increase brand awareness and achieve long term awareness, increased retail advertising, along with increases in depreciation expense related to new tooling on new products. Even with the increases in spending noted above, operating expenses as a percentage of total revenue only increased 6.7% year-over-year, which is primarily due to the increase in advertising. Gross spending increased in the following areas:

- \$1.2 million increase in advertising, primarily with our larger retailers and general advertising and media;
- \$213,000 increase in sales and marketing personnel in an effort to promote the retail sales channel and support customer service efforts, as our established base of AeroGardens grows;
- \$132,000 increase in spending on commissions to sales representatives as part of our expanded retail distribution initiatives;
- \$108,000 increase in legal expenses primarily due to cyber-attacks;
- \$108,000 increase in depreciation as our new product introductions required new tooling; and
- \$110,000 increase in general personnel expense to support the growing business, including the addition of a full-time IT employee and increased travel and other related expenses due to the expanded retail distribution.

General and administrative expense totaled \$2.4 million during Fiscal 2016, an increase of 15.1%, or \$315,000 from Fiscal 2015, principally due to hiring an IT employee which replaced a consultant, additional depreciation expense for the fixed assets at our new manufacturers and legal fees associated with cyber-attacks.

Research and development costs also increased 23.3% year-over-year, or \$91,000 in Fiscal 2016, primarily reflecting development of the AeroGarden Harvest and Bounty models, additional product testing and certifications, and enhanced market research required to develop new products.

Our loss from operations totaled \$1.3 million for Fiscal 2016, as compared to a loss of \$827,000 in the prior year. The increased loss primarily reflected the \$1.2 million increase in brand-building advertising as discussed above, partially offset by increased margins and higher sales during Fiscal 2016.

Other income for Fiscal 2016 totaled \$746,000, as compared to other income of \$636,000 in the prior year. The net other income in the current year period included a non-cash gain of \$1.0 million to reflect the change in fair value of the Scotts Miracle-Gro warrant and \$293,000 of interest expense related to the loan with Scotts Miracle-Gro. The net other income in the prior year included a non-cash gain of \$842,000 to reflect the change in fair value of the Scotts Miracle-Gro warrant valuation and \$207,000 of interest expense related to the loan with Scotts Miracle-Gro.

Our net loss for Fiscal 2016 totaled \$553,000, a \$362,000 increase over the net loss of \$191,000 in Fiscal 2015, primarily due to increases in advertising and other operating expenses partially offset by higher sales volumes and an increase in operating margins as we continue to refine our selling strategy.

Revenue

The table set forth below shows quarterly revenues by sales channel for the fiscal years ended March 31, 2016, and March 31, 2015:

Fiscal 2016 (in thousands)	Quarters ended				Year ended
	30-Jun-15	30-Sep-15	31-Dec-15	31-Mar-16	31-Mar-16
Sales – direct-to-consumer	\$962	\$ 564	\$ 2,990	\$ 2,184	\$ 6,700
Sales – retail	607	527	8,902	2,805	12,841
Sales – international	-	-	-	71	71
	\$1,569	\$ 1,091	\$ 11,892	\$ 5,060	\$ 19,612

Fiscal 2015 (in thousands)	Quarters ended				Year ended
	30-Jun-14	30-Sep-14	31-Dec-14	31-Mar-15	31-Mar-15
Sales – direct-to-consumer	\$1,043	\$ 764	\$ 2,664	\$ 2,237	\$ 6,708
Sales – retail	630	930	8,316	1,276	11,152
Sales – international	10	13	-	29	52
	\$1,683	\$ 1,707	\$ 10,980	\$ 3,542	\$ 17,912

21

---

Table of Contents

In Fiscal 2016, revenue totaled \$19.6 million, an increase of \$1.7 million, or 9.5%, from Fiscal 2015. Sales to retailer customers for Fiscal 2016 totaled \$12.8 million, up \$1.7 million, or 15.1%, from the same period a year earlier, principally reflecting sales to newly acquired retail accounts such as Bed Bath & Beyond, and Sur La Table as well as increased sales to existing retail customers (primarily Amazon.com and Costco.com). The increase in retail distribution channels is the result of increased advertising and growth of the product category in the marketplace. Direct-to-consumer revenue totaled \$6.7 million in Fiscal 2016 as compared to \$6.7 million from the same period a year earlier, principally reflecting our focus on the retail environment, increased competition from other on-line retailers like Amazon.com, a decreased advertising budget for the channel, offset by a larger customer based of existing AeroGarderners. Direct-to-consumer revenues per dollar of advertising expense increased to \$9.47 in Fiscal 2016 from \$7.54 in the prior year period.

The following table presents our quarterly sales by product category, in U.S. dollars and as a percent of total net revenue, for Fiscal 2016 and Fiscal 2015.

Fiscal 2016 (in thousands)	Quarters ended				Year ended
	30-Jun-15	30-Sep-15	31-Dec-15	31-Mar-16	31-Mar-16
<b>Product Revenue</b>					
AeroGardens	\$1,032	\$ 542	\$ 11,896	\$ 3,701	\$ 17,171
Seed pod kits and accessories	547	611	1,728	1,672	4,558
Discounts, allowances and other	(10 )	(62 )	(1,732 )	(313 )	(2,117 )
<b>Total</b>	<b>\$1,569</b>	<b>\$ 1,091</b>	<b>\$ 11,892</b>	<b>\$ 5,060</b>	<b>\$ 19,612</b>
<b>% of Revenue</b>					
AeroGardens	65.8 %	49.7 %	100.0 %	73.1 %	87.6 %
Seed pod kits and accessories	34.8 %	56.0 %	14.5 %	33.1 %	23.2 %
Discounts, allowances and other	(0.6 )%	(5.7 )%	(14.5 )%	(6.2 )%	(10.8 )%
<b>Total</b>	<b>100.0%</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>100.0 %</b>

  

Fiscal 2015 (in thousands)	Quarters ended				Year ended
	30-Jun-14	30-Sep-14	31-Dec-14	31-Mar-15	31-Mar-15
<b>Product Revenue</b>					
AeroGardens	\$1,013	\$ 1,207	\$ 10,889	\$ 2,290	\$ 15,399
Seed pod kits and accessories	622	511	1,203	1,547	3,883
Discounts, allowances and other	48	(11 )	(1,112 )	(295 )	(1,370 )
<b>Total</b>	<b>\$1,683</b>	<b>\$ 1,707</b>	<b>\$ 10,980</b>	<b>\$ 3,542</b>	<b>\$ 17,912</b>
<b>% of Revenue</b>					
AeroGardens	60.2 %	70.7 %	99.1 %	64.6 %	86.0 %
Seed pod kits and accessories	37.0 %	29.9 %	11.0 %	43.7 %	21.7 %
Discounts, allowances and other	2.8 %	(0.6 )%	(10.1 )%	(8.3 )%	(7.7 )%
<b>Total</b>	<b>100.0%</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>100.0 %</b>

AeroGarden garden unit revenue totaled \$17.2 million in Fiscal 2016, up \$1.8 million or 11.5%, from the year earlier, principally due to: (i) the increase in retail channel sales, (ii) the increase in general brand awareness, and (iii) the launch of the new AeroGarden Harvest and Bounty models. Sales of seed pod kits and accessories increased by \$676,000, or 17.4%, an overall increase in brand awareness and the growth of the existing customer base. In Fiscal 2016, sales of seed pod kits and accessories represented 23.2% of our total net revenue, an increase from 21.7% in the prior fiscal year, reflecting the follow-on sales due to the increase in AeroGarden sales in the prior year. The increase in seed pod kit and accessories is impressive as it contains a 25.5% decrease in compact fluorescent light bulb sales as we incorporate more LED lighting technology into our gardens. Other revenue (expense), which is comprised of

items that are not specifically identifiable to a product, such as grow club revenue, shipping revenue, accruals and deductions, increased as a percentage of total revenue from (7.7)% in Fiscal 2015 to (10.8)% in Fiscal 2016 due to increases in revenue deductions for sales allowances and discounts for retail accounts as we test the in-store retail market.

Table of Contents

## Cost of Revenue

Cost of revenue for Fiscal 2016 totaled \$12.6 million, a 2.0% increase from the prior fiscal year. Cost of revenue includes product costs for purchased and manufactured products, freight costs for inbound freight from manufacturers and outbound freight to customers, costs related to warehousing, credit card processing fees for direct sales, and duties and customs applicable to imported products. The dollar amount of cost of revenue increased because of the 9.5% increase in total sales, as well as fees associated with our strategic alliance with Scotts Miracle-Gro. As a percent of total revenue, cost of revenue totaled 64.3% in Fiscal 2016, as compared to 69.0% in the year earlier period. The decrease in costs as a percent of revenue resulted from:

- Reducing product and other costs in the supply chain;
- New products and revised product pricing resulting in higher selling prices;
- A focus on selling to retail partners with a distribution model that allowed us to achieve higher margins; and
- The reduction of aggressive discounting to drive sales.

## Gross Margin

Our gross margin varies based upon the factors affecting net revenue and cost of revenue as discussed above, as well as the mix of our revenue that comes from the retail and direct-to-consumer channels, all of which have very different base gross margins. In a direct-to-consumer sale, we recognize as revenue the full consumer purchase price for the product. In retail and international sales, by comparison, we recognize as revenue the wholesale price for the product which we charge to the retailer or international distributor. Media costs associated with direct sales are included in sales and marketing costs. Overall, the gross margin for Fiscal 2016 was 35.7% as compared to 31.0% in the prior year. The increase in our gross margin was primarily attributable to the focus on reducing product costs and supply chain efficiencies, general brand advertising instead of aggressive pricing with in-store retailers, higher pricing for new AeroGarden products and maintaining a larger online presence as compared to the larger in-store presence in the prior year.

## Sales and Marketing

Sales and marketing costs for Fiscal 2016 totaled \$5.4 million, an increase of \$1.5 million, or 38.9%, from the prior fiscal year. Sales and marketing costs include all costs associated with the marketing, sales, operations, customer support, and sales order processing for our products. The following table breaks down the components of our sales and marketing costs for Fiscal 2016 and Fiscal 2015:

	Fiscal Years Ended March 31,	
	2016	2015
(in thousands)		
Advertising	\$3,027	\$1,801
Salaries and related expenses	1,646	1,433
Sales commissions	172	40
Trade shows	24	7
Travel	120	81
Media production and promotional products	102	341
Quality control and processing fees	120	100
Other	199	92
Total	\$5,410	\$3,895

Advertising is principally composed of the costs of developing and airing our infomercials, the costs of development, production, printing, and postage for our catalogues, and mailing and web media costs for search and affiliate web marketing programs and retail support placement. Each of these are key components of our integrated marketing



strategy because they generate direct-to-consumer sales and help build awareness of, and consumer demand for, our products in all our channels of distribution. Advertising expense totaled \$3.0 million for Fiscal 2016, a year-over-year increase of 68.1%, or \$1.2 million, primarily because of our increased focus on retail advertising and the introduction of general television, YouTube, Facebook and other general media advertising, partially offset by lower catalogue mailing expenses during the current year period.

Sales and marketing personnel costs include salaries, payroll taxes, employee benefits and other payroll costs for our sales, operations, customer service, graphics and marketing departments. Personnel costs for sales and marketing in Fiscal 2016 were \$1.6 million, up 14.8% from Fiscal 2015 to support our revenue growth and our expanded distribution channels.

Sales commissions, generally 3-7% of cash collections from some of our retailer customers, are paid to third-party sales representatives that assist us in developing and maintaining relationships with certain retailers. Sales commission expense totaled \$172,000 for the fiscal year ended March 31, 2016, an increase of 332.6% from the prior fiscal year as a result of an increase in sales to customers represented by third-party sales representatives. Additionally, sales made directly by our internal customer service telephone sales agents qualify for a small commission, however, commission expenses for these sales agents are declining as a smaller percentage of orders come in over the telephone.

Table of Contents

Other marketing expenses decreased \$72,000, or 11.7%, year-over-year as a result of fewer public relations programs and in-store retailer displays, partially offset with increases in a variety of other marketing initiatives, sales travel and order processing costs.

General and Administrative

General and administrative expense for the fiscal year ended March 31, 2016 totaled \$2.4 million, up \$315,000, or 15.1% from the prior fiscal year. The increase is attributable to expenses associated with the addition of an IT employee which replaced a consultant, additional depreciation expense for the fixed assets at our new manufacturers, legal fees associated with cyber-attacks, and expenses related to a Company-wide bonus.

Research and Development

Research and development costs totaled \$480,000 for Fiscal 2016, an increase of \$91,000, or 23.3%, from the prior fiscal year. Research and development costs are comprised of payroll, travel and other costs associated with (i) development of new AeroGarden models and technologies; (ii) our plant laboratories that research new plant varieties and growing technologies; and (iii) new technologies, such as improved lighting and nutrient formulation; and (iv) costs to enhance the performance of our products. The increase in research and development expenses reflects the support of new product development activities, including the ongoing certification and testing on all of our AeroGarden garden units, as required by our retail partners, and design and consulting service expenses for testing for new retail customers.

Operating Loss

The loss from operations totaled \$1.3 million in Fiscal 2016, an increase of \$472,000, or 57.1%, over the prior year, primarily as a result of an increase in general television, YouTube, Facebook and other general media advertising.

As a non-U.S. GAAP measure of our operating performance, we track earnings before interest, taxes, depreciation and amortization (“EBITDA”) as an indicator of our ability to generate cash, which we define as operating income or loss excluding the non-cash depreciation, amortization, Scott’s Miracle-Gro IP royalty and branding, common stock warrant expense and stock based compensation expense incurred during the period (“Adjusted EBITDA”). As calculated in the table below, our Adjusted EBITDA for Fiscal 2016 totaled \$304,000, which was \$305,000 less than the \$609,000 Adjusted EBITDA in the prior fiscal year due to our investment in advertising. The year-over-year decrease in Adjusted EBITDA was generated primarily by the increase in advertising expenditures to drive short and long term brand and category awareness, partially offset by the increase in sales and gross margin.

	Fiscal Years Ended March 31,	
	2016	2015
(in thousands)		
Loss from operations	\$(1,299)	\$(827)
Add back non-cash items:		
Depreciation	368	260
Amortization	-	-
Stock based compensation	276	302
Common stock warrant expense	-	37
Scott’s Miracle-Gro IP royalty and branding license	959	837
Total non-cash Items	1,603	1,436
Adjusted EBITDA	\$304	\$609

The U.S. GAAP measure most directly comparable to Adjusted EBITDA is income (loss) from operations. The non-U.S. GAAP financial measure of Adjusted EBITDA should not be considered as an alternative to net earnings. Adjusted EBITDA is not a presentation made in accordance with U.S. GAAP and has important limitations as an analytical tool. Adjusted EBITDA should not be considered in isolation or as a substitute for analysis of our results as reported under U.S. GAAP. Because Adjusted EBITDA excludes some, but not all, items that affect net earnings and is defined differently by different companies, our definition of Adjusted EBITDA may not be comparable to similarly titled measures of other companies.

#### Other Income and Expense

Other income for Fiscal 2016 totaled \$746,000, as compared to other income of \$636,000 in the prior year. The net other income in the current year period included non-cash income of \$1.0 million related to the change in the fair value of the Scotts Miracle-Gro warrant, partially offset by \$293,000 of interest expense related to the loan with Scotts Miracle-Gro. Net other income for Fiscal 2015 included a non-cash income of \$842,000 related to the change in the fair value of the Scotts Miracle-Gro warrant, offset partially by \$207,000 of interest expense related to the loan with Scotts Miracle-Gro.

Table of Contents

Net Loss

Our net loss for Fiscal 2016 was \$553,000, a \$362,000 increase over our net loss of \$191,000 in Fiscal 2015. This increase in our net loss was primarily attributable to general television, YouTube, Facebook and other general media advertising to drive short and long term brand and category awareness, offset by higher sales volumes and higher operating margins associated with sales.

Liquidity and Capital Resources

After adjusting the net loss for non-cash items and changes in operating assets and liabilities, net cash used by operating activities totaled \$152,000 in Fiscal 2016, as compared to net cash used by operating activities of \$258,000 in the prior fiscal year.

Non-cash items, consisting of depreciation, amortization, bad debt (recoveries) allowances, issuances of common stock and options, and adjustments to the fair value of Scotts Miracle-Gro warrant liability totaled a net loss of \$515,000 in Fiscal 2016, as compared to a net loss of \$550,000 in the prior fiscal year.

Changes in current assets used cash of \$897,000 during Fiscal 2016, primarily due to increases in accounts receivable, inventory, and other current assets. In Fiscal 2015, changes in these assets used \$1.9 million, reflecting increases in accounts receivable and inventory, partially offset by a decrease in other current assets. As of March 31, 2016, the inventory balance was \$3.1 million, representing approximately 91 days of sales activity during Fiscal 2016. Net accounts receivable totaled \$1.6 million as of March 31, 2016, representing approximately 45 days of net retail sales activity at the average daily rate of sales recognized during Fiscal 2016. The days of sales in receivables and inventory calculations can fluctuate, and are greatly impacted by our seasonality and the timing of sales and inventory receipts during the period.

Current operating liabilities increased \$783,000 during Fiscal 2016, principally because of a \$783,000 increase in accounts payable, accrued liabilities, including accrued interest, and customer deposits. In the prior year period, current operating liabilities increased \$1.3 million primarily due to increases in accounts payable and accrued liabilities, including accrued interest. Accounts payable as of March 31, 2016 totaled \$1.7 million, representing approximately 30 days of daily expense activity at the average daily rate of expenses incurred during Fiscal 2016.

Net investment activity used \$462,000 of cash, primarily due to purchases of equipment for use with our new manufacturers and products, as compared to cash used of \$487,000 in the prior year. Net financing activity, including the borrowing and repayment of debt, provided cash of \$1.0 million during Fiscal 2016, as compared to cash provided of \$53,000 in the prior fiscal year.

As of March 31, 2016, we had a cash balance of \$1.4 million, of which \$15,000 was restricted as collateral for our various corporate obligations. This compares to a cash balance of \$1.0 million as of March 31, 2015, of which \$15,000 was restricted.

As of March 31, 2016 and March 31, 2015, the outstanding balance of our note payable and debt, including accrued interest, is as follows:

	For the Fiscal Years Ended March 31, 2016    2015	
(in thousands)		
Notes payable-related party	\$ 1,293	\$ 207
Derivative warrant liability (see Note 3)	644	1,688

Edgar Filing: AeroGrow International, Inc. - Form 10-K

Sale of intellectual property liability (see Note 3)	160	208
Total debt	2,097	2,103
Less current portion	2,097	2,103
Long term debt	\$-	\$-

As of March 31, 2016, we have \$1.0 million of debt requiring cash payments which was repaid in April 2016. The remaining debt in the current liability is related to the Scotts Miracle-Gro transaction, for further information see Note 3 to our financial statements.

We use, or have used, a variety of debt funding sources to meet our liquidity requirements, including the following:

25

---

## Table of Contents

### Series B Convertible Preferred Stock and Warrant

In April 2013, the Company entered into a Securities Purchase Agreement with SMG Growing Media, Inc. (the “Investor”), a wholly owned subsidiary of Scotts Miracle-Gro (NYSE: “SMG”), a worldwide marketer of branded consumer lawn and garden products. Pursuant to the Securities Purchase Agreement, Scotts Miracle-Gro acquired 2,649,007 shares of the Company’s Series B Convertible Preferred Stock, par value \$0.001 per share (the “Series B Preferred Stock”), and (ii) a warrant to purchase shares of the Company’s common stock (the “Warrant,” as described in greater detail below) for an aggregate purchase price of \$4.0 million. After deducting offering expenses, including commissions and expenses paid to the Company’s advisor, net cash proceeds to the Company totaled to \$3.8 million. The Company used \$950,000 of the net proceeds to repay “in full” (with concessions) a promissory note payable to one of our principal suppliers (Main Power) and then used the remaining net proceeds for working capital and general corporate purposes.

The Warrant entitles, but does not obligate, Scotts Miracle-Gro to purchase a number of shares of common stock that, on a fully diluted basis, constitute 80% of the Company’s outstanding common stock (when added to all other shares owned by Scotts Miracle-Gro). For additional information about the Series B Preferred Stock, the Warrant, and related transactions with Scotts Miracle-Gro, see Note 3 “Scotts Miracle-Gro Transactions – Convertible Preferred Stock Warrants and Other Transaction” to our financial statements.

### Cash Requirements

We generally require cash to:

- fund our operations and working capital requirements,
- develop and execute our product development and market introduction plans,
- execute our sales and marketing plans,
- fund research and development efforts, and
- pay debt obligations as they come due.

At this time, we do not expect to enter into additional capital leases to finance major purchases. In addition, we do not currently have any binding commitments with third parties to obtain any material amount of equity or debt financing other than the financing arrangements described in this report.

### Assessment of Future Liquidity and Results of Operations

#### Liquidity

To assess our ability to fund ongoing operating requirements, we developed assumptions regarding operating cash flow. Critical sources of funding, and key assumptions and areas of uncertainty include:

- our cash of \$1.4 million (\$15,000 of which is restricted as collateral for our various corporate obligations) as of March 31, 2016;
- our cash of \$700,000, (\$15,000 of which is restricted as collateral for our various corporate obligations) as of June 2, 2016;
- continued support of, and extensions of credit by, our suppliers and previous lenders, including Scotts Miracle-Gro;
- our historical pattern of increased sales between September and March, and lower sales volume from April through August;
- the level of spending necessary to support our planned initiatives; and
- our sales to consumers, retailers, and international distributors, and the resulting cash flow from operations, which will depend in great measure on acceptance of our products by retail distribution customers and the success of planned direct-to-consumer sales initiatives.

During Fiscal 2016 we took a number of actions to address our liquidity needs. Most importantly, we concentrated on improving our margins in an effort to support our marketing efforts which will allow us to continue to increase our sales. Specifically, we focused our efforts on generating general brand awareness and expanding our retail operations with key strategic retailers and better enhancing our relationships with those retailers to sell our products at the margins we believe are capable of generating growth. During Fiscal 2016, our retail expansion continued and we have strategically limited the number of major retailers that carry our products in order to focus on those retailers that have proven to be the best and most profitable business partners. During Fiscal 2016, sales to Amazon represented 76.6% of our total net sales to retailers and approximately 50.1% of our total net sales.

As disclosed in greater detail in Note 3 “Scotts Miracle-Gro Transactions – Convertible Preferred Stock Warrants and Other Transaction” to our financial statements, we raised: (i) \$4.0 million from Scotts Miracle-Gro during the first quarter of 2014 through the issuance of our Series B Convertible Preferred Stock and a Warrant; and (ii) an additional \$500,000 from the sale of all intellectual property associated with our Hydroponic IP, other than the AeroGrow and AeroGarden trademarks.

Table of Contents

In second quarter of Fiscal 2016, the Company entered into a Term Loan Agreement in the principal amount of up to \$6.0 million with Scotts Miracle-Gro with a maturity date of April 15, 2016, and the principal amount was repaid in full on April 12, 2016. The Term Loan Agreement was secured by a lien on the assets of the Company. Interest was charged at the stated rate of 10% per annum, and was paid on May 9, 2016 in the form of 196,044 shares of AeroGrow common stock, valued at a price per share equal to the conversion price of the Series B Preferred Conversion Price on the date the Term Loan. The funding provided general working capital and was used for the purpose of acquiring inventory to support our expansion into retail and its direct-to-consumer sales channels in advance of our peak selling season.

Based on these facts and assumptions, we believe our existing cash and cash equivalents, along with the cash generated by our anticipated results from operations, will be sufficient to meet our needs for the next twelve months from the filing date of this report based on current cash on hand plus financing from Scotts Miracle-Gro similar to the last few years. However, we may need to seek additional debt or equity capital to provide a cash reserve against contingencies, address the seasonal nature of our working capital needs, and to purchase inventory and incur other expenses in an attempt to increase the scale of our business. There can be no assurance we will be able to raise this additional capital.

Results of Operations

There are several factors that could affect our future results of operations. These factors include, but are not limited to, the following:

- the effectiveness of our consumer marketing efforts in generating both direct-to-consumer sales, and sales to consumers by our retailer customers,
- uncertainty regarding the impact of macroeconomic conditions on consumer spending,
- uncertainty regarding the capital markets and our access to sufficient capital to support our current and projected scale of operations,
- the seasonality of our business, in which we have historically experienced higher sales volume during the fall and winter months (September through March),
- a continued, uninterrupted supply of product from our third-party manufacturing suppliers in China, and
- the success of the Scotts Miracle-Gro relationship.

Off-Balance Sheet Arrangements

We do not have current commitments under capital leases and have not entered into any contracts for financial derivative such as futures, swaps, and options other than those disclosed in this Annual Report.

Obligations and Commitments

As part of our ongoing operations, we enter into arrangements that obligate us to make future payments under contracts, such as leases and the timing and effect that such commitments are expected to have on our liquidity and cash flow in future periods. The following is a summary of these obligations as of March 31, 2016.

	Less than 1 year	1 -3 years	More than 3 years	Total
(in thousands)				
Operating leases	\$ 197	\$ -	\$ -	\$ 197
Notes payable and long-term debt	2,097	-	-	2,097



Totals: \$2,294 \$ - \$ - \$2,294

See Note 2, Note 3 and Note 7 to our financial statements for additional information related to our notes payable and long term debt and operating leases, respectively.

#### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

##### Interest Rate Risk

Our interest income is most sensitive to fluctuations in the general level of U.S. interest rates. As such, changes in U.S. interest rates affect the interest earned on our cash, cash equivalents, and the value of those. Due to the short-term nature of our cash equivalents, we have concluded that a change in interest rates does not pose a material market risk to us with respect to our interest income. However, as discussed above, if we acquire additional debt changes in the general level of market interest rates could impact our interest expense during the terms of future debt arrangements. In this regard, interest on our Term Loan with Scotts Miracle-Gro was charged at the stated rate of 10% per annum, and was paid in May 2016 in the form of 196,044 shares of AeroGrow common stock, valued at a price per share equal to the conversion price of the Series B Preferred Conversion Price on the date the Term Loan.

27

---

Table of Contents

Foreign Currency Exchange Risk

We transact business primarily in U.S. currency. Although we purchase our products in U.S. dollars, the prices charged by our suppliers in Asia are predicated upon their cost for components, labor and overhead. Therefore, changes in the valuation of the U.S. dollar in relation to the Asian currencies may cause our manufacturers to raise prices of our products which could reduce our profit margins.

In future periods, it is possible that we could be exposed to fluctuations in foreign currency exchange rates on accounts receivable from sales and net monetary assets denominated in foreign currencies and liabilities. To date, however, virtually all of our transactions have been denominated in U.S. dollars.

ITEM 8. FINANCIAL STATEMENTS

Our financial statements appear in a separate section at the end of this Annual Report. Such information is incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

We conducted an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Senior Vice President, Finance and Accounting, of the effectiveness of the design and operation of our disclosure controls and procedures. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures also include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based on our assessment, management has concluded that, as of March 31, 2016, our disclosure controls and procedures were effective.

Management’s Report on Internal Control Over Financial Reporting

Management assessed the effectiveness of our internal control over financial reporting as of March 31, 2016. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations (“COSO”) of the Treadway Commission’s Internal Control-Integrated Framework (2013).

Based on our assessment, management has concluded that, as of March 31, 2016, our internal control over financial reporting was effective based on those criteria.

Management is responsible for establishing and maintaining adequate internal controls over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) and 15d-15(f), promulgated under the Securities Exchange Act of 1934, as a process designed by, or under the supervision of, our principal executive and principal financial officers and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for

external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect transactions and dispositions of the assets;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of our management and directors; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Table of Contents

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failure. Internal control over financial reporting can also be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Attestation Report of the Independent Registered Public Accounting Firm

This Annual Report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our independent registered public accounting firm pursuant to rules of the SEC that permit us to provide only management's report in this Annual Report.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting during the fourth quarter of fiscal year ended March 31, 2016 that have or are reasonably likely to materially affect our internal control over financial reporting identified in connection with the previously mentioned evaluation.

ITEM 9B. OTHER INFORMATION

None.

29

---

Table of Contents

## PART III

## ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

## Executive Officers

The following sets forth certain information with respect to our executive officers and significant employees, as of the filing date of this report. The executive officers have employment contracts with the Company as discussed in Item 11 below. All other employees are considered at-will.

Name	Age	Position with AeroGrow
J. Michael Wolfe	57	President, Chief Executive Officer and Director
Grey H. Gibbs	49	SVP – Finance and Accounting
John K. Thompson	55	EVP, Sales & Marketing and Secretary

J. Michael Wolfe, age 57, has been a director since February 2011. Mr. Wolfe became our Chief Operating Officer in January 2010, our President on February 9, 2011, and our Chief Executive Officer on March 31, 2011. He previously served as Vice President of Operations since April 2006. Prior to joining AeroGrow, Mr. Wolfe was an independent consultant. From 1992 to 2002, he was President and Chief Operating Officer of Concepts Direct and was its Chief Executive Officer from 2000 to 2001. At Concepts Direct, Mr. Wolfe oversaw the development, launch and operations of seven independent catalogues. From 1987 to 1992, Mr. Wolfe served as Vice President of Wiland Services, Inc., a database management company where he oversaw the redesign of the company's product line, its sales and investor relations. The Board believes that Mr. Wolfe's leadership experience, combined with his extensive direct-to-consumer marketing background, his executive experience at a variety of direct-to-consumer companies, and his knowledge of AeroGrow's history and business, qualifies him to serve as a director.

Grey H. Gibbs, age 49, has been employed by AeroGrow since November of 2007. He has served as Senior Vice President – Finance and Accounting since May 2015 and previously served as: (i) Vice President of Finance and Accounting from June 2014 to May 2015; (ii) Vice President of Accounting from February 2011 to June 2014; and (iii) Controller from November 2007 to June 2011. Before joining AeroGrow, Mr. Gibbs was employed by Swift Company, an animal protein processor, as Director of Sarbanes-Oxley Compliance from 2006 to 2007 and Assistant Corporate Controller from 2004 to 2006. From 2003 to 2004, Mr. Gibbs was the Chief Financial Officer of JCIT International, an educational and consulting firm in lean manufacturing. From 1994 to 2002, Mr. Gibbs served in a range of strategic and financial roles for Agilent Technologies and Hewlett Packard, including New Product Introduction Program Manager, Outsourcing Program Manager, Site Finance Manager, Planning and Reporting Analyst and Senior Internal Auditor. Mr. Gibbs was also an Audit Supervising Senior for KPMG LLP from 1991 to 1994.

John K. Thompson, age 55, became Executive Vice President of Sales and Marketing in April 2014. Mr. Thompson joined AeroGrow in 2002 and has served in a variety of senior management positions at AeroGrow, including his position as Vice President of Marketing from October 2009 to April 2014. Mr. Thompson also served as the Company's International Division General Manager and Vice President of Investor Relations, and was instrumental in the research activities leading to the development and launch of the Company's AeroGarden product line. Prior to joining AeroGrow, Mr. Thompson was Director of Marketing for Productivity Point International, a direct marketing and direct sales company, and Sales and Marketing Manager for CareerTrack, a direct marketing company that sold personal and professional growth products to the consumer and commercial markets.

## Board of Directors

Our Board of Directors oversees the management of AeroGrow on your behalf. Among other things, the Board reviews our long-term strategic plans and exercises direct decision-making authority on key issues, including the appointment of our executive officers and setting the scope of their authority in managing AeroGrow's day-to-day operations. Our Board is currently comprised of Jack J. Walker (Chairman), Michael S. Barish, Wayne E. Harding III, Chris Hagedorn and J. Michael Wolfe. Biographical information about Mr. Wolfe is contained above under the caption heading "Executive Officers." Biographical information for Messrs. Barish, Hagedorn, Harding and Walker is presented below.

Table of Contents

Jack J. Walker, age 81, has been a director since February 2006, and became Chairman of the Board in July 2008. Mr. Walker served as President from January 2010 until February 9, 2011 and as our Chief Executive Officer from January 2010 until March 31, 2011. Mr. Walker has been the Managing Member of Walker Enterprises LLLP, and its predecessors, a real estate investment and development company, since 1980. During that time he has developed in excess of \$500 million of commercial real estate in California, Colorado, Arizona and Texas. He serves on the Board of Pathogen Systems, Inc. and is an advisor to several start-up companies. Mr. Walker is an English Solicitor and began his career in 1956 in London, England. In 1968, Mr. Walker founded English & Continental Property Company, and served as Joint Managing Director of this commercial property development company, which operated in Europe with over 200 staff, until its sale to the Post Office Pension Fund in 1973. From 1973, Mr. Walker controlled several English listed companies, including Charles Spreckly Industries, Town & Commercial Properties and Associated Development Holdings, with worldwide interests and over 3,500 employees. Mr. Walker served as a director of supermarket group Megafoods Stores, Inc. from 1987 to 1993, and was Chief Financial Officer for part of that time. Mr. Walker serves as a director of and advisor to various civic and charitable organizations. The Board believes that Mr. Walker's extensive executive leadership experience, combined with his international and entrepreneurial business background and broad range of knowledge of AeroGrow's history and business, among other factors, qualifies him to serve as a Director and Chairman of the Board.

Michael S. Barish, age 76, has been a director since July 2009. Mr. Barish co-founded Lazarus Investment Partners LLLP, a private investment partnership focused on microcap stocks, in 2003, and served as the fund's Chief Investment Officer until his retirement in June 2009. In 1973, Mr. Barish founded Cambiar Investors and grew the firm's assets from less than \$1 million in 1973 to over \$2.3 billion upon his retirement in 2001. The Board believes that Mr. Barish's experience as a chief investment officer, particularly his specialized focus on microcap stocks, qualifies him to serve as a director.

Chris J. Hagedorn, age 31, has been a director since April 2013. Mr. Hagedorn was appointed the General Manager of The Hawthorne Gardening Company in October 2014 and was previously appointed Director of Indoor Gardening at Scotts Miracle-Gro in May of 2013. From 2011 to 2013, Mr. Hagedorn served as a Marketing Manager for the North Region at Scotts Miracle-Gro. Between 2007 and 2010, Mr. Hagedorn served as a Copywriter at ML Rogers Agency after graduation with a bachelor's degree from Bowdoin College. Mr. Hagedorn was appointed to the Board by Scotts Miracle-Gro pursuant to a condition to the Securities Purchase Agreement between AeroGrow and Scotts Miracle-Gro which allows Scotts Miracle-Gro, as holder of the Series B Preferred Convertible Stock, to appoint one member to the Board of Directors for so long as the Warrant remains outstanding. For more details regarding the Securities Purchase Agreement, the Series B Preferred Stock, the Warrant, and related agreements, refer to Note 3. "Scotts Miracle-Gro Transactions – Convertible Preferred Stock, Warrants and Other Transactions" to our financial statements. The Board believes that Mr. Hagedorn's business experience and ties to Scotts Miracle-Gro, particularly in light of AeroGrow's strategic alliance with Scotts Miracle-Gro, qualifies him to serve as a director. Mr. Hagedorn is the son of James Hagedorn, the Chief Executive Officer and Chairman of the Board of The Scotts Miracle-Gro Company (NYSE: "SMG").

Wayne E. Harding III, age 61, has been the Chief Financial Officer of Two Rivers Water & Farming Company ("Two Rivers"), a publicly traded company (OTC QB: TURV) that acquires and develops high yield irrigated farmland and the associated water rights in the western United States, since September 2009, and previously served as the controller of Two Rivers, beginning in July 2008. Prior to joining Two Rivers, Mr. Harding served as vice president business development of Rivet Software since December 2004. Mr. Harding was the principal of Wayne Harding & Company P.C., a financial consulting organization, from August 2000 to December 2004 and also served from 2000 until August 2002 as the director-business development of CPA2Biz. Mr. Harding also served on the Board, and was chair of the Governance, Compensation and Nominating Committee and the Audit Committee, for AeroGrow from 2005 – 2007. Mr. Harding holds an active CPA license in Colorado and a CGMA (Charter Global Management Accountant) designation. He received his BS and MBA degrees from the University of Denver. He previously served on the American Institute of CPAs (AICPA) Council, is a past-President of the Colorado Society of CPAs, and was the

recipient of the prestigious AICPA Special Recognition Award for his early involvement in developing the AICPA XBRL project. The Board believes that Mr. Harding's experience as a Chief Financial Officer of a public company, as a CPA, and as a former Board member of AeroGrow qualifies him to serve as a director.

#### Board Committees and Meetings

We have established two standing committees so that certain 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. The two committees each operate under a written charter.



### Table of Contents

Audit Committee. The current members of our Audit Committee are Mr. Harding (chairman), Mr. Barish, Mr. Hagedorn and Mr. Walker. The members were elected to the committee, and the chairman was appointed by the Board. The Board has determined that Messrs. Harding and Barish are considered “audit committee financial experts,” as defined by Item 407(d)(5)(ii) of Regulation S-K, due to their extensive financial background and experience (as summarized in the biographical information for Messrs. Harding and Barish disclosed above). The Board has affirmatively determined that Mr. Harding is an independent director as defined by applicable securities law and NASDAQ corporate governance guidelines. Due to their positions as significant stockholders of AeroGrow, Messrs. Hagedorn and Walker are not independent directors. The Audit 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, our compliance with legal and regulatory requirements, our 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. Walker (chairman), Mr. Barish and Mr. Hagedorn. The members were elected to the committee, and the chairman was appointed, by the Board. The Governance, Compensation and Nominating 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 officers; and
- administer the equity-based performance compensation plans of AeroGrow.

The Governance, Compensation and Nominating Committee does not have a formal policy concerning stockholder recommendations to the Board of Directors and we did not receive any recommendations from stockholders requesting that the Board consider a candidate for inclusion as a nominee. The Committee has determined that it is appropriate to not have such a policy given the infrequency of such recommendations. The absence of such a policy does not mean, however, that a recommendation would not have been considered had one been received. The Committee would consider any candidate proposed in good faith by a stockholder on the same basis as a candidate proposed directly by the Board. To do so, a stockholder should send the candidate’s name, credentials, contact information, and the candidate’s consent to be considered to the Governance, Compensation and Nominating Committee, c/o Corporate Secretary, AeroGrow International, Inc., 6075 Longbow Drive, Boulder, Colorado, 80301. The proposal should be received by the due date for a stockholder proposal, as set forth below under the caption heading “Submission of Stockholder Proposals,” in order to be considered timely for consideration by the Committee prior to the Annual Meeting of Stockholders or, in lieu of an annual meeting, for an action by written consent of the stockholders. The proposing stockholder should also include his or her contact information and a statement of his or her share ownership (how many shares owned and for how long).

In evaluating director nominees, the Governance, Compensation and Nominating Committee considers the appropriate skills and personal characteristics needed in light of the makeup of the current Board, including considerations of character, background, professional experience, education, skill, qualifications for committee membership, independence, race, gender, national origin, differences in viewpoint, and other individual qualities and attributes. Other than the foregoing, there are no stated minimum criteria for director nominees, although the Committee may

also consider such other factors as it may deem are in the best interests of the AeroGrow and its stockholders. The Committee does, however, believe it is appropriate for a member or members of AeroGrow's management to participate as members of the Committee.

The Governance, Compensation and Nominating Committee identify nominees by first evaluating the current members of the Board willing to continue in service. Current members of the Board with skills and experience that are relevant to our business and who are willing to continue in service are considered for re-nomination. If any member of the Board does not wish to continue in service or if the Board decides not to re-nominate a member for re-election, the Committee then identifies the desired skills and experience of a new nominee in light of the criteria above. Current members of the Board would be polled for suggestions as to individuals meeting the criteria described above. The Committee may also engage in research to identify qualified individuals. To date, we have not engaged third parties to identify or evaluate or assist in identifying potential nominees, although we reserve the right in the future to retain a third-party search firm, if appropriate.

## Table of Contents

Meetings. During the fiscal year ended March 31, 2016 the Board held nine meetings. A quorum of directors attended all of the meetings held by the Board during the period that he served as a director of AeroGrow. Also during the fiscal year ended March 31, 2016, the Audit Committee held four meetings and the Governance, Compensation and Nominating Committee held two meetings. Only one meeting did not include all the members of the Board otherwise each committee member attended all of the committee meetings held during the period that he served as a committee member.

The Company encourages all incumbent directors, as well as all nominees for election as director, to attend the annual stockholder meetings, but they are not required to do so. We did not hold an annual meeting last year.

## Code of Ethics

The Board of Directors has adopted a Code of Ethics to provide guidance to all of our directors, officers and employees, including our principal executive officer, principal financial and accounting officers, and persons performing similar functions. The Code of Ethics is posted on our website at [www.aerogrow.com](http://www.aerogrow.com), and may be found by linking to “Investors” and then “Code of Ethics.” We intend to satisfy the disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or waiver from, a provision of this code of ethics by posting such information on our website.

## Board Structure and Risk Oversight

Jack J. Walker serves as the Chairman of the Board and J. Michael Wolfe serves as President, Chief Executive Officer and a director. Mr. Walker is one of the largest investors in AeroGrow and his financial support was instrumental in allowing AeroGrow to persevere through a very difficult economic period. He is involved in setting the strategic direction for the Company. Mr. Wolfe has responsibility for our day-to-day operations, as well as for helping set our strategic directions.

Our Board has overall responsibility for risk oversight. Throughout the year, the Board dedicates a portion of their meetings to review and discuss specific risk topics in greater detail. Strategic and operational risks are presented and discussed in the context of the President’s report on operations to the Board at regularly scheduled board meetings and at presentations to the Board by our other employees and consultants. The Board’s risk oversight process builds upon management’s risk assessment and mitigation processes. The small size of AeroGrow allows our Board to develop in-depth knowledge of different facets of the business. This in-depth knowledge, coupled with exposure to and frequent communication with our management, assists the Board in performing its oversight responsibilities, including risk management, in an effective manner.

## Communications with the Board of Directors

Stockholders and other interested parties may communicate with the Board or any individual director, by writing to:

AeroGrow International, Inc.  
Attention: Board of Directors  
c/o Corporate Secretary  
6075 Longbow Drive, Suite 200  
Boulder, Colorado 80301

If the letter is from a stockholder, the letter should state that the sender is a stockholder. Under a process approved by the Board, depending on the subject matter, management will:

·forward the letter to the director or directors to whom it is addressed; or

- attempt to handle the matter directly (as where information about our business or our stock is requested); or
- not forward the letter if it is primarily commercial in nature or relates to an improper or irrelevant topic.

A summary of all relevant communications that are received after the last meeting of the full Board and which are not forwarded will be presented at each Board meeting along with any specific communication requested by a director.

All communications will be handled in a confidential manner, to the degree the law allows. Communications may be made on an anonymous basis; however, in these cases the reporting individual must provide sufficient details for the matter to be reviewed and resolved. The Company will not tolerate any retaliation against an employee who makes a good faith report.

Table of Contents

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 (the “Exchange Act”) requires our executive officers and directors, and persons who own more than 10% of our common stock (herein collectively, our “Section 16 insiders”) to file with the SEC certain forms reporting their ownership and changes in beneficial ownership of our common stock and other equity with the SEC, and to furnish us with copies of these filings.

To our knowledge, based solely upon a review of the copies of such forms furnished to us and written representations that no other reports were required, we believe that, during the fiscal year ended March 31, 2016, all such filings required to be made by our Section 16 insiders were timely filed in accordance with the requirements of the Exchange Act except for the following: (i) a report filed by SMG Growing Media, Inc. on July 14, 2015, relating to a dividend, royalty and brand license fee paid in common stock, was filed one-day late on July 17, 2016; (ii) the reports filed on behalf of Messrs. Barish, Gibbs, Harding, Thompson, Walker and Wolfe, relating to the annual grant of stock options on August 20, 2015, were filed late on June 10, 2016; and (iii) a report filed on behalf of Mr. Barish, relating to a common stock purchase on September 11, 2015, was filed late on June 10, 2016.

ITEM 11. EXECUTIVE COMPENSATION

Compensation Philosophy

The Governance, Compensation and Nominating Committee of our Board is responsible for guiding and overseeing the formulation and application of the compensation and benefit programs for our executive officers and our directors. A description of compensation for our non-employee directors is included below under the caption “Director Compensation.” The Committee acts pursuant to a charter that has been approved by our Board.

The Governance, Compensation and Nominating Committee believes that the most effective compensation program is one that is designed to reward the achievement of specific annual, long-term, and strategic goals by AeroGrow, and which aligns executives’ interests with those of the stockholders by rewarding performance above established goals, with the ultimate objective of increasing stockholder value. The Governance, Compensation and Nominating Committee evaluates both performance and compensation to ensure that AeroGrow maintains its ability to attract and retain superior employees in key positions and that compensation provided to key employees remains competitive relative to the compensation paid to similarly situated executives of our peer companies. Accordingly, the Governance, Compensation and Nominating Committee believes executive compensation packages provided by AeroGrow to its executives, including the executive officers, should include salary compensation, annual cash incentives based on the Company’s ability to pay and fundamental measures of financial performance, and longer-term stock-based compensation.

We compensate our executives through a mix of base salary, bonus, and equity compensation designed to be competitive with comparable employers and to align management’s incentives with the long-term interests of our stockholders. In making compensation decisions, the Governance, Compensation and Nominating Committee, may compare certain elements of total compensation against other comparable publicly traded and privately held companies that compete in our markets. A significant percentage of total compensation is allocated to incentive compensation as a result of the philosophy mentioned above. There is no pre-established policy or target for the allocation between either cash and non-cash or short-term and long-term incentive compensation. Rather, the Governance, Compensation and Nominating Committee reviews information such as that referenced above with respect to our peers and our major shareholder, SMG, Scotts Miracle-Gro, to determine the appropriate level and mix of incentive compensation. Income from such incentive compensation is realized as a result of the performance of AeroGrow or the individual, depending on the type of award.

Compensation Process

Generally, base salaries and annual incentive awards will be reviewed at the end of each fiscal year with changes made to the base salaries effective April 1 of the following fiscal year. Whether an individual's salary and incentive awards are increased or decreased depends on the individual's performance as well as the overall performance of AeroGrow.

Stock options and other stock grants are reviewed and approved at meetings of the Governance, Compensation and Nominating Committee and the full Board. By establishing the meeting schedule and agenda for these grants in advance, AeroGrow diminishes any opportunity for manipulation of exercise prices on option grants to the extent any recipients are in possession of non-public information at the time of the meetings. Approval of grants for any newly hired or promoted executives during the course of the year generally occurs at the Governance, Compensation and Nominating Committee's meeting immediately following the hiring or promotion.

## Table of Contents

### Role of Executive Officers in Compensation Decisions

The Governance, Compensation and Nominating Committee make all compensation decisions for the executive officers and approve recommendations regarding equity awards to all elected officers. The Chief Executive Officer annually reviews the performance of each Named Executive Officer (other than the Chief Executive Officer, whose performance is reviewed by disinterested members of the Governance, Compensation and Nominating Committee). As a “smaller reporting company,” our “Named Executive Officers” include our (i) Chief Executive Officer; and (ii) other two most highly compensated executive officers based on SEC regulations. Compensation ranges for our Named Executive Officers are based on the individual’s experience and prior performance, as well as AeroGrow’s operating performance. The conclusions reached and recommendations based on these reviews, including with respect to salary adjustments and annual award amounts, are presented to the Governance, Compensation and Nominating Committee. The Governance, Compensation and Nominating Committee can exercise its discretion in modifying any recommended adjustments or awards to executives.

### Components of Total Compensation

In Fiscal 2016, the principal components of compensation for executive officers were:

- base salary;
- stock options; and
- benefits and other perquisites.

Each component is designed to achieve a specific purpose and to contribute to a total package that is competitive, appropriately performance-based, and valued by AeroGrow’s executives.

### Base Salaries

We provide executive officers and other employees with base salary to compensate them for services rendered during the fiscal year. Base salary ranges for executive officers are determined for each executive based on his or her position and responsibility. During its review of base salaries for executives, the Governance, Compensation and Nominating Committee primarily considers:

- individual scope of responsibility;
- years of experience;
- market data, such as that obtained from a review of other similarly situated companies;
- internal review of the executive’s compensation, both individually and relative to other officers; and
- individual performance of the executive.

Salary levels are typically considered annually as part of our performance review process as well as upon a promotion or other change in job responsibility.

### Performance-Based Annual Incentive Compensation

Though markets dictate that base salaries must be competitive, we are moving toward basing a greater proportion of our executive compensation on the achievement of measurable individual and company results through the award of annual incentive bonuses. These bonuses are often tied to performance against AeroGrow's EBITDA objectives. By increasing variable pay as a percentage of total compensation, the Governance, Compensation and Nominating Committee believes that executive compensation will be more aligned with value delivered to our stockholders. This limits fixed costs and also results in higher pay occurring only in years when merited by high performance. Due to company-wide improvements on sales and operations, we paid an aggregate of \$21,000 in discretionary cash bonuses to our Named Executive Officers in Fiscal 2016. We accrued \$50,000 in performance-based bonuses during Fiscal 2016 for payments that are to be paid to our Named Executive Officers during Fiscal 2017.



Table of Contents

Long Term Stock-Based Compensation

This category of awards covers options granted to executives out of our 2005 Equity Compensation Plan (the “2005 Plan”), and that vest over time, at different rates for different executives. Because these awards vest over time and become more valuable to the recipient only as our stock price increases, the Governance, Compensation and Nominating Committee believes these are a useful form of long-term incentive compensation, with the potential to directly align the interests of shareholders and management. During Fiscal 2016, we granted options to purchase 122,042 shares of common stock under the 2005 Plan. For more details about outstanding stock options held by our Named Executive Officers, please refer to the table below entitled “Outstanding Equity Awards at Fiscal Year End.”

At March 31, 2016, options to purchase 141,000 shares of our common stock were unvested. These options will result in up to \$152,000 of compensation expense as they vest over the next 16 months.

Executives and Employment Arrangements

The following discussion and table relate to compensation arrangements on behalf of, and compensation paid by us during Fiscal 2016, to our Named Executive Officers who were employed by AeroGrow as of March 31, 2016.

Employment Contracts

We have employment agreements with J. Michael Wolfe and John K. Thompson.

J. Michael Wolfe

Effective as of March 4, 2012, AeroGrow and J. Michael Wolfe entered into an employment agreement (the “Wolfe Agreement”) that provides that he will be employed as the Chief Executive Officer and must devote substantially all of his working time and efforts to our business. The Wolfe Agreement superseded and replaced a previous agreement between the parties dated as of February 9, 2009. The Wolfe Agreement has an initial one year term, with automatic one year renewals unless advance notice is given by either party. Pursuant to the Wolfe Agreement, Mr. Wolfe’s annual base salary was set at \$200,000 until September 2, 2012, at which time his annual base salary increased to \$226,923. Beginning on April 1, 2013, and each April 1 thereafter, Mr. Wolfe’s annual base salary will be increased by 3%, or such higher percentage as may be determined by our Board of Directors. In addition, Mr. Wolfe will receive an automobile allowance of \$750 per month during the term of the Wolfe Agreement. Mr. Wolfe is eligible to participate in our annual cash incentive compensation plan for senior managers, and in our 2005 Equity Compensation Plan, each as determined by the Board of Directors from time to time. The Wolfe Agreement also provides for medical, vacation, and other benefits commensurate with the policies and programs adopted by the Board of Directors for our senior executives. In the event that we terminate the employment of Mr. Wolfe without cause (as determined under the Wolfe Agreement), Mr. Wolfe will be entitled to receive his base salary for 12 months following the date of termination, plus a prorated portion of his annual cash bonus. In the event that we breach any term of the Wolfe Agreement and such breach is not cured within thirty days of notice being given, then Mr. Wolfe can terminate his employment and be entitled to receive his base salary for 12 months following the date of termination, plus a prorated portion of his annual cash bonus. The Wolfe Agreement also requires Mr. Wolfe to comply with certain restrictive covenants including but not limited to a covenant not to compete during the term of the Wolfe Agreement and for a period of twelve months following the termination of the Wolfe Agreement.

John K. Thompson

Effective as of March 4, 2012, AeroGrow and John K. Thompson entered into an employment agreement (the “Thompson Agreement”) that provides that he will be employed as the Senior Vice President, Sales and Marketing and must devote substantially all of his working time and efforts to our business. The Thompson Agreement superseded

and replaced a previous agreement between the parties dated as of January 26, 2009. The Thompson Agreement has an initial one year term, with automatic one year renewals unless advance notice is given by either party. Pursuant to the Thompson Agreement, Mr. Thompson's annual base salary was set at \$150,000 until September 2, 2012, at which time his annual base salary increased to \$167,307. Beginning on April 1, 2013, and each April 1 thereafter, Mr. Thompson's annual base salary will be increased by 3%, or such higher percentage as may be determined by our Board of Directors. Mr. Thompson is eligible to participate in our annual cash incentive compensation plan for senior managers, and in our 2005 Equity Compensation Plan, each as determined by the Board of Directors from time to time. The Thompson Agreement also provides for medical, vacation, and other benefits commensurate with the policies and programs adopted by the Board of Directors for our senior executives. In the event that we terminate the employment of Mr. Thompson without cause (as determined under the Thompson Agreement), then Mr. Thompson will be entitled to receive his base salary for 12 months following the date of termination, plus a prorated portion of his annual cash bonus. In the event that we breach any term of the Thompson Agreement and such breach is not cured within thirty days of notice being given, then Mr. Thompson can terminate his employment and be entitled to receive his base salary for 12 months following the date of termination, plus a prorated portion of his annual cash bonus. The Thompson Agreement also requires Mr. Thompson to comply with certain restrictive covenants including but not limited to a covenant not to compete during the term of the Thompson Agreement and for a period of twelve months following the termination of the Thompson Agreement.

Table of Contents

Other Company officers who do not qualify as Named Executive Officers are employed on an “at will” basis, subject to varying lengths of employment agreements and severance agreements.

## Summary Compensation Table

The following table sets forth information regarding all forms of compensation received by the Named Executive Officers during Fiscal 2016 and Fiscal 2015:

Name and Principal Position	Fiscal Year	Salary Paid	Bonus	Stock Awards	Option Awards (1)	All Other Compensation	Total
J. Michael Wolfe, Director, President and CEO (2)	2016	\$248,076 (3)	\$12,191	\$ -	\$56,953 (5)	\$ 9,000 (4)	\$326,220
	2015	\$240,743 (3)	\$102	\$ -	\$112,860 (6)	\$ 9,000 (4)	\$362,705
John K. Thompson, EVP, Sales and Marketing	2016	\$182,616 (3)	\$9,092	\$ -	\$34,172 (7)	\$ -	\$225,880
	2015	\$177,496 (3)	\$146	\$ -	\$58,140 (8)	\$ -	\$235,782
Grey H. Gibbs, SVP of Finance and Accounting	2016	\$147,857 (3)	\$5,229	\$ -	\$11,390 (9)	\$ -	\$164,476
	2015	\$139,327 (3)	\$146	\$ -	\$25,650 (10)	\$ -	\$165,123

(1) Represents the aggregate grant date fair value of stock option awards, as computed in accordance with FASB ASC Topic 718.

(2) Mr. Wolfe did not receive compensation for his service on the Board of Directors.

(3) Salaries are computed and disclosed on a cash basis. The executive officers did receive a pay increase in Fiscal 2016 (as determined by the employment agreements with respect to Messrs. Wolfe and Thompson).

(4) Beginning in March 2012, Mr. Wolfe was paid \$750 per month in accordance with his employment agreement.

(5) On August 20, 2015, Mr. Wolfe was granted options to purchase 67,801 shares of our common stock at an exercise price of \$1.55 per share. These options vest quarterly over a two year period and have a five-year term.

(6) On August 7, 2014, Mr. Wolfe was granted options to purchase 33,000 shares of our common stock at an exercise price of \$5.31 per share. These options vest quarterly over a two year period and have a five-year term.

(7) On August 20 2015, Mr. Thompson was granted options to purchase 40,681 shares of our common stock at an exercise price of \$1.55 per share. These options vest quarterly over a two year period and have a five-year term.

(8) On August 7 2014, Mr. Thompson was granted options to purchase 17,000 shares of our common stock at an exercise price of \$5.31 per share. These options vest quarterly over a two year period and have a five-year term.

(9) On August 20, 2015, Mr. Gibbs was granted options to purchase 13,560 shares of our common stock at an exercise price of \$1.55 per share. These options vest quarterly over a two year period and have a five-year term.

(10) On August 7, 2014, Mr. Gibbs was granted options to purchase 7,500 shares of our common stock at an exercise price of \$5.31 per share. These options vest quarterly over a two year period and have a five-year term.



Table of Contents

The following table provides information with respect to the Named Executive Officers concerning unexercised stock options held by them at March 31, 2016. During the year ended March 31, 2016, some options granted to the Named Executive Officers were exercised.

Outstanding Equity Awards at Fiscal Year End

Name	Number of Securities Underlying Unexercised Options (Exercisable)	Number of Securities Underlying Unexercised Options (Unexercisable)	Exercise Price per Share	Expiration Date
J. Michael Wolfe	175	-	\$ 2.20	31-Oct-2018
J. Michael Wolfe	50	-	\$ 2.20	31-Oct-2018
J. Michael Wolfe	100	-	\$ 2.20	31-Oct-2018
J. Michael Wolfe	2,500	-	\$ 2.20	31-Oct-2018
J. Michael Wolfe	32,307	-	\$ 1.01	8-Feb-2018
J. Michael Wolfe	66,158	-	\$ 2.20	9-Oct-2018
J. Michael Wolfe	27,500	5,500	(1) \$ 5.31	7-Aug-2019
J. Michael Wolfe	22,060	45,201	(2) \$ 1.55	20-Aug-2020
John K. Thompson	39,049	-	\$ 1.01	8-Feb-2018
John K. Thompson	46,000	-	\$ 2.20	9-Oct-2018
John K. Thompson	14,164	2,836	(1) \$ 5.31	7-Aug-2019
John K. Thompson	13,560	27,121	(2) \$ 1.55	20-Aug-2020
Grey H. Gibbs	7,383	-	\$ 1.01	8-Feb-2018
Grey H. Gibbs	8,750	-	\$ 2.20	9-Oct-2018
Grey H. Gibbs	6,252	1,248	(1) \$ 5.31	7-Aug-2019
Grey H. Gibbs	4,520	9,040	(2) \$ 1.55	20-Aug-2020

(1) Stock options granted on August 7, 2014 have an exercise price of \$5.31 per share and vest quarterly over a two year period.

(2) Stock options granted on August 20, 2015 have an exercise price of \$1.55 per share and vest quarterly over a two year period.

Compensation Committee Interlocks and Insider Participation

Disclosure under this section is not required for a “smaller reporting company.”

Report of the Compensation Committee

Disclosure under this section is not required for a “smaller reporting company.”

Director Compensation

The following table provides information on AeroGrow’s compensation practices during the fiscal year ended March 31, 2016 for non-employee directors:

Non-Employee Director Meeting Fee and Retainer Information

Annual retainer for all non-employee directors \$5,000

Edgar Filing: AeroGrow International, Inc. - Form 10-K

Additional annual retainer for Board Chairman	\$ 10,000
Additional annual retainer for Audit Committee Chairman	\$ 5,000
Additional annual retainer for Governance, Compensation, and Nominating Committee Chairman	\$ 5,000
Stock options granted for annual service on the Board by non-employee directors (1)	40,680
Stock options granted for annual service on the Audit Committee (1)	-
Stock options granted for annual service on the Governance, Compensation, and Nominating Committee (1)	-
Additional stock options granted for annual service as Board Chairman (1)	-
Reimbursement for expenses attendant to Board membership	Yes
Payment for Board meetings attended in person or held telephonically	\$ 1,000
Payment for Board meetings attended in person or held telephonically by the Board Chairman	\$ 2,000

The options vest pro-rata monthly (one-twelfth per month) on the last day of each month throughout the term of (1) service. If a director is unable to finish his or her term of service by reason of death or disability, the director options vest immediately.

Table of Contents

Only Messrs. Barish, Harding, and Walker received non-employee director compensation during the fiscal year ended March 31, 2016. J. Michael Wolfe served as an employee during the fiscal year ended March 31, 2016 and therefore, was not eligible to receive cash and equity compensation as non-employee directors. Chris J. Hagedorn, a full-time employee of The Scotts Miracle-Gro Company, was appointed to the Board and to both committees of the Board in April 2013. Under the terms of the Scotts Miracle-Gro transaction, Mr. Hagedorn is not entitled to receive non-employee Board compensation. We maintain \$10 million of director and officer liability insurance and we have entered into indemnification agreements with each director.

Summary of Board and Committee Composition

Current Directors	Board	Audit	Governance, Compensation, and Nominating
Jack J. Walker, Chairman and Director	X	X	X
Michael S. Barish, Director	X	X	X
Chris J. Hagedorn (1)	X	X	X
Wayne E. Harding III, Director	X	X	
J. Michael Wolfe, Director	X		

(1) Chris J. Hagedorn was appointed to the Board and to both committees of the Board in April 2013.

Director Compensation Table during Fiscal 2016

The following table sets forth information regarding all forms of compensation received by members of our Board of Directors during Fiscal 2016:

Director	Director Fees					All Other Compensation	Total
	Earned or Paid in Cash	Stock Awards	Option Awards (1)	Warrant Awards			
Jack J. Walker, Chairman	\$33,000	\$ -	\$15,187	\$ -	\$ -	\$ -	\$48,187
Michael S. Barish, Director	\$14,000	\$ -	\$9,492	\$ -	\$ -	\$ -	\$23,492
Wayne E. Harding, III, Director (2)	\$18,000	\$ -	\$9,492	\$ -	\$ -	\$ -	\$27,492
J. Michael Wolfe, President, CEO and Director (3)	\$-	\$ -	\$-	\$ -	\$ -	\$ -	\$-
Chris J. Hagedorn (4)	\$-	\$ -	\$-	\$ -	\$ -	\$ -	\$-

(1) Represents the aggregate grant date fair value of stock option awards, as computed in accordance with FASB ASC Topic 718.

(2) Wayne E. Harding, III was appointed to the Board of Directors and named the Audit Committee Chairman on December 9, 2011.

(3) As an employee of the Company, Messr. Wolfe did not receive compensation for his service on the Board of Directors. Their compensation as officers of AeroGrow is included in the Executive Compensation Table.

(4) As an employee of The Scotts Miracle-Gro Company, Mr. Hagedorn did not receive compensation for his service on the Board of Directors.

Table of Contents

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

## Stock Ownership

The following table sets forth certain information as of June 6, 2016 regarding our common stock owned of record or known by the Company to be owned beneficially by: (i) each director, (ii) each executive officer named in the Summary Compensation Table (the “Named Executive Officers”), (iii) all those known by the Company to beneficially own more than 5% of the Company’s common stock, and (iv) all directors and Named Executive Officers as a group.

In general, a person is deemed to be a “beneficial owner” of a security under SEC Rule 13d-3 if that person has or shares the power to vote or direct the voting of such security, or the power to dispose or to direct the disposition of such security. A person is also deemed to be a beneficial owner of any securities of which the person has the right to acquire beneficial ownership within 60 days. To the best of our knowledge, subject to community and marital property laws, all persons named have sole voting and investment power with respect to such shares except as otherwise noted. For purposes of calculating percent of class ownership, the table below assumes a total of 7,696,010 shares of common stock outstanding. However, shares of our common stock subject to convertible preferred stock, warrants and stock options that are convertible or exercisable within 60 days of June 6, 2016 are deemed outstanding for purposes of computing the percentage ownership of the person holding such convertible preferred stock, warrants and stock options, but are not deemed outstanding for computing the percentage of any other person.

Name of Beneficial Owner	Number of Common Shares Beneficially Owned (1)	Number of Common Shares Acquirable Within 60 Days (2)	Percent Beneficial Ownership	
<b>5% Stockholders</b>				
The Peierls Foundation, Inc. and Related Parties (3)	930,408	-	12.09	%
Jack J. Walker (4), (5)	986,619	3,013	12.42	%
SMG Growing Media, Inc. (6), (9)	1,522,584	23,848,314	80.00	%
<b>Directors and Named Executive Officers</b>				
Jack J. Walker (4), (5)	986,619	3,013	12.42	%
Michael S. Barish (5), (7)	365,444	1,883	4.72	%
Chris J. Hagedorn (8)	-	-	*	
Wayne E. Harding III (5)	26,067	1,883	*	
J. Michael Wolfe (5)	202,290	8,400	2.67	%
Grey H. Gibbs	28,659	1,754	*	
John K. Thompson (5)	119,249	4,808	1.59	%
All AeroGrow Named Executive Officers and Directors as a Group (6 Persons)	1,728,328	21,741	22.39	%



Table of Contents

\* Represents less than 1% of our outstanding common stock as of June 6, 2016.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission, which include holding voting and investment power with respect to the securities. Shares of common stock that are acquirable within 60 days, though conversion of preferred stock or exercise of options or warrants, are deemed outstanding for computing the percentage of the total number of shares beneficially owned by the designated (1) person, but are not deemed outstanding for computing the percentage for any other person. Beneficial ownership is based on holdings known to the Company and may not include all shares of common stock beneficially owned but held in street name or reflect recent sales or purchases of securities that have not been made known to the Company.

The number of shares acquirable within 60 days includes any shares issuable upon conversion of convertible (2) preferred stock or upon exercise of options or warrants that are currently exercisable or exercisable within the next 60 days. This number is included in the number of shares beneficially owned.

Beneficial ownership is based on holdings known to the Company and includes information provided in a (3) Schedule 13G filed with the SEC on April 23, 2012 and Form 4s filed on March 11, 2014. The Peierls Foundation, Inc. and Related Parties address is c/o US Trust Company of N.Y. 114 W. 47th Street, New York, NY 10036. The beneficial ownership includes common stock and warrants held by Brian Eliot Peierls, E. Jeffrey Peierls, The Peierls By-Pass Trust, The Peierls Foundation, Inc., UD E.F. Peierls for B.E. Peierls, UD E.F. Peierls for E.J. Peierls, UD E.S. Peierls for E.F. Peierls Et al, UD Ethel F. Peierls Charitable Lead Trust, UD J.N. Peierls for B.E. Peierls, UD J.N. Peierls for E.J. Peierls, UW E.S. Peierls for BEP Art VI-Accum, UW E.S. Peierls for EJP Art VI-Accum, UW J.N. Peierls E.J. Peierls, UW J.N. Peierls for B.E. Peierls.

Mr. Walker's beneficial ownership includes 88,890 shares of common stock and 39,501 warrants to (4) purchase common stock that are held of record by M&J Walker Charitable Remainder Trust, of which Mr. Walker is a controlling person. In addition, Mr. Walker's beneficial ownership includes 70,031 shares of common stock held of record by his spouse.

(5) The address of the beneficial owner is 6075 Longbow Dr., Suite 200, Boulder, CO 80301.

Beneficial ownership is based on holdings known to the Company and includes information provided in a (6) Schedule 13D filed with the SEC on May 2, 2013, Form 4 filed on August 7, 2014, Schedule 13D filed on April 27, 2015, and Schedule 13D filed on May 9, 2016. SMG Growing Media, Inc. is a wholly-owned subsidiary of The Scotts Miracle-Gro. The address of SMG Growing Media, Inc. and The Scotts Miracle-Gro is 14111 Scottslawn Road, Marysville, Ohio 43041. The shares beneficially owned by SMG Growing Media, Inc. include shares of common stock issuable upon conversion of Series B Convertible Preferred Stock issued on April 22, 2013. The ownership does not include the number of shares issuable upon exercise of the warrant as the number of shares are unknown and the warrant is not exercisable until the third anniversary date of the agreement which at the earliest is April 22, 2016. In June 2016, representatives of Scotts Miracle-Gro informed the Company's management team and Board of Directors of its intent to exercise some or all of the Warrant prior to December 31, 2016. For further information refer to Note 3, "Scotts Miracle-Gro Transactions – Convertible Preferred Stock, Warrants and Other Transactions" to our financial statements.

(7) Mr. Barish's beneficial ownership includes 4,334 common shares held by his wife Joyce F. Barish, and 2,501 shares held by Joyce F. Barish Irrevocable Children's trust, of which Mr. Barish is a controlling person.

(8) Mr. Hagedorn was elected to the Board by representative of SMG Growing Media, Inc. Mr. Hagedorn does not hold voting or investment power over the shares owned by SMG Growing Media, Inc. and therefore disclaims beneficial ownership over such shares.

(9) The number referenced as acquirable within 60 days assumes the warrant was exercised as of June 6, 2016.

41

---

Table of Contents

Equity Compensation Plan Information

The following table summarizes information about our equity compensation plans as of March 31, 2016.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average price of outstanding options, warrants and rights	Number of securities remaining available for future issuance
Equity compensation plans	655,995	\$ 2.13	12,849,005
Equity compensation plans not approved by security holders	-	\$ -	-
Total	655,995	\$ 2.13	12,849,005

At March 31, 2016 the Company has granted options for 141,000 shares of the Company’s common stock that are unvested that will result in \$152,000 of compensation expense if and when they vest over the next 16 months.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Certain Relationships and Related Transactions

Review, Approval or Ratification of Transactions with Related Parties

Since April 1, 2015, the beginning of Fiscal 2016, our Board of Directors reviewed and did not object to any of the related party transactions reported in this Annual Report on Form 10-K. Our Board recognizes that related party transactions present a heightened risk of conflicts of interest and/or improper valuation (or the perception thereof) and therefore follows the procedures as described below to address such risks.

Our Board of Directors is required to review all related party transactions. AeroGrow is prohibited from entering or continuing a material related party transaction that has not been reviewed and approved or ratified by the Board. Additionally, in transactions where an executive officer is considered to be a related party of any provider of our goods or services, the board of directors must approve the transaction. In reviewing a related party transaction, the board of directors considers all of the relevant factors surrounding the transaction including:

- whether there is a valid business reason for us to enter into the related party transaction consistent with the best interests of AeroGrow and its stockholders;

- whether the transaction is negotiated on an arm’s length basis on terms comparable to those provided to unrelated third parties or on terms comparable to those provided to employees generally;

- whether the board of directors determines that it has been duly apprised of all significant conflicts that may exist or may otherwise arise on account of the transaction, and it believes, nonetheless, that we are warranted in entering into the related party transaction and have developed an appropriate plan to manage the potential conflicts of interest;

- whether the rates or charges involved in the transaction are determined by competitive bids, or the transaction involves rates or charges fixed in conformity with law or governmental authority; and/or

whether the interest of the related party or that of a member of the immediate family of the related party arises solely from the ownership of our class of equity securities and all holders of our equity securities received the same benefit on a pro-rata basis.

During the fiscal year ended March 31, 2016, subsequent to year end, and in prior years, we relied upon a variety of debt funding sources to meet our liquidity requirements, including transactions that: (i) involved members of our Board, management team and certain stockholders that beneficially own more than five percent of our outstanding voting securities and (ii) are required to be disclosed pursuant to Item 404 of Regulation S-K. In each case, these related parties received the same terms and conditions as other third-party investors. These transactions are disclosed above under the heading “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operation– Liquidity and Capital Resources” and in Note 2, “Notes Payable and Long Term Debt,” Note 6 “Related Party Transactions,” and Note 8 “Stockholders’ Equity,” to our financial statements.

Table of Contents

## Board Independence

Our common stock trades on the OTCQB market tier and we are considered to be a “smaller reporting company” under applicable SEC rules. As such, we are not currently subject to corporate governance standards of other listed companies, which require, among other things, that the majority of the board of directors be independent. Because we are not currently subject to corporate governance standards defining the independence of our directors, we have chosen to define an “independent” director in accordance with the NASDAQ Global Market’s requirements for independent directors. Under the NASDAQ definition, an independent director is a person who is not an executive officer or employee of the Company and who does not have a relationship with the Company that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. Our Board has determined that Mr. Harding is the only independent member of our Board of Directors during Fiscal 2016. Mr. Harding currently serves as the Chairman of the Audit Committee.

Chris J. Hagedorn was appointed to the Board by Scotts Miracle-Gro pursuant to a condition to the Securities Purchase Agreement between AeroGrow and Scotts Miracle-Gro which allows Scotts Miracle-Gro, as holder of the Series B Preferred Stock, to appoint one member to the Board of Directors for so long as the Warrant remains outstanding. For more details regarding the Securities Purchase Agreement, the Series B Preferred Stock, the Warrant, and related agreements, refer to Note 3, “Scotts Miracle-Gro Transactions – Convertible Preferred Stock, Warrants and Other Transactions” to our financial statements.

## ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

## Fees of the Independent Registered Public Accountants

Aggregate fees billed by EKS&H LLLP for the fiscal years ended March 31, 2016 and 2015 are as follows:

	For the Fiscal Years Ended March 31, 2016 2015	
(in thousands)		
EKS&H		
Audit Fees	99	95
Audit Related Fees	1	2
Tax Fees	-	-
All Other Fees	-	-
Total EKS&H	100	97
Grand Total	\$100	\$97

**Audit Fees:** This category includes the audit of our annual financial statements included in our Annual Report on Form 10-K, review of quarterly financial statements included in our Quarterly Reports on Form 10-Q, and if and when required or requested, the audit of the effectiveness of our internal controls.

**Audit-related fees:** This category consists of assurance and related services provided by the independent registered public accounting firm that are reasonably related to the performance of the audit or review of our financial statements and are not reported above under “Audit Fees.”

Tax fees: This category consists of professional services rendered primarily in connection with our tax planning and compliance activities, including the preparation of tax returns. Although we did incur \$12,000 and \$11,000 in tax fees during Fiscal 2016 and 2015, respectively, we did not engage EKS&H for any tax services.

All other fees: This category consists of fees for other corporate services, primarily the review of SEC reports other than annual and quarterly reports.

#### Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services

The primary purpose of the Audit Committee is to assist the Board in monitoring (i) the integrity of our financial statements and disclosures, including oversight of the accounting and financial reporting processes and the audits of our financial statements, (ii) compliance with our legal, ethical, and regulatory requirements, and (iii) the independence and performance of our independent registered public accounting firm.

Table of Contents

The Audit Committee's policy is to pre-approve all audit and non-audit services, other than de minimis non-audit services, provided by the independent registered public accounting firm. In this regard, all fees incurred in Fiscal 2015 and Fiscal 2016, as disclosed above under the caption "Fees of the Independent Registered Public Accountants," were pre-approved by the Audit Committee. These services may include, among others, audit services, audit-related services, tax services, and other services. Pre-approval is generally provided for up to one year and any pre-approval is detailed as to particular services or categories of services and is generally subject to a specific budget. The independent registered public accounting firm and management are required to periodically report to the full Board regarding the extent of services provided by the independent registered public accounting firm in accordance with this pre-approval, and the fees for the services performed to date.

The Audit Committee considers the provision of non-audit services by our independent registered public accounting firm compatible with its independence. The Audit Committee will continue to approve all audit and permissible non-audit services provided by our independent registered public accounting firm.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**AEROGROW INTERNATIONAL,  
INC.,  
A NEVADA CORPORATION**

Date: June 15, 2016 By: /s/ J. Michael Wolfe  
J. Michael Wolfe  
Title  
President and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below does hereby constitute and appoint either of J. Michael Wolfe or Grey H. Gibbs, with full power of substitution and full power, to act as his or her true and lawful attorney-in-fact and agent with full power and authority to do and perform all and every act and thing whatsoever requisite and necessary to be done in and about the premises as fully, to all intents and purposes, as he or she might or could do if personally present at the doing thereof, hereby ratifying and confirming all that said attorney-in-fact and agent may or shall lawfully do, or cause to be done, in connection with the proposed filing by AeroGrow International, Inc. with the Securities and Exchange Commission, under the provisions of the Securities Exchange Act of 1934, as amended, of an Annual Report on Form 10-K for the fiscal year ended March 31, 2016 (the "Annual Report"), including but not limited to, such full power and authority to do the following: (i) execute and file such Annual Report; (ii) execute and file any amendment or amendments thereto; (iii) receive and respond to comments from the Securities and Exchange Commission related in any way to such Annual Report or any amendment or amendments thereto; and (iv) execute and deliver any and all certificates, instruments or other documents related to the matters enumerated above, as the attorney-in-fact in her sole discretion deems appropriate.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on the 15th day of June 2016.

Signature	Title	Date
/s/ JACK J. WALKER Jack J. Walker	Chairman of the Board	JUNE 15, 2016
/s/ J. MICHAEL WOLFE J. Michael Wolfe	President and Chief Executive Officer	JUNE 15, 2016
/s/ GREY H. GIBBS Grey H. Gibbs	Senior Vice- President – Finance and Accounting (Principal Accounting Officer)	JUNE 15, 2016
/s/ MICHAEL S. BARISH Michael S. Barish	Director	JUNE 15, 2016
/s/ WAYNE E. HARDING III	Director	JUNE 15, 2016



Wayne E. Harding III

45

---

Table of Contents

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Audit Committee, Board of Directors and Stockholders  
AeroGrow International, Inc.  
Boulder, Colorado

We have audited the accompanying balance sheets of AeroGrow International, Inc. (the “Company”) as of March 31, 2016 and 2015, and the related statements of operations, changes in stockholders’ equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of AeroGrow International, Inc. as of March 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ EKS&H LLLP

June 15, 2016  
Denver, Colorado

Table of ContentsAEROGROW INTERNATIONAL, INC.  
BALANCE SHEETS

	March 31, 2016	March 31, 2015
(in thousands, except share and per share data)		
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$1,401	\$1,015
Restricted cash	15	15
Accounts receivable, net of allowance for doubtful accounts of \$14 and \$10 at March 31, 2016 and 2015, respectively	1,577	1,300
Other receivables	232	214
Inventory, net	3,149	2,603
Prepaid expenses and other	196	144
Total current assets	6,570	5,291
Property and equipment, net of accumulated depreciation of \$3,652 and \$3,284 at March 31, 2016 and 2015, respectively	620	525
Intangible assets, net	2	2
Deposits	156	156
Total assets	\$7,348	\$5,974
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable	\$1,733	\$1,641
Accrued expenses	964	816
Customer deposits	352	30
Deferred rent	1	1
Notes payable – related party	1,293	207
Derivative warrant liability	644	1,688
Debt associated with sale of IP	160	208
Total current liabilities	5,147	4,591
Commitments and contingencies (Note 7)		
Stockholders' equity		
Preferred stock, \$.001 par value, 20,000,000 shares authorized, 2,649,007 issued and outstanding at March 31, 2016 and 2015	3	3
Common stock, \$.001 par value, 750,000,000 shares authorized, 7,499,966 and 6,563,518 shares issued and outstanding at March 31, 2016 and 2015, respectively	7	6
Additional paid-in capital	84,129	82,101
Stock dividend to be distributed	2,391	1,715
Accumulated deficit	(84,329)	(82,442)
Total stockholders' equity	2,201	1,383
Total liabilities and stockholders' equity	\$7,348	\$5,974

See accompanying notes to the financial statements



Table of ContentsAEROGROW INTERNATIONAL, INC.  
STATEMENTS OF OPERATIONS

	Years ended March 31,	
	2016	2015
(in thousands, except per share data)		
Net revenue	\$19,612	\$17,912
Cost of revenue	12,618	12,367
Gross profit	6,994	5,545
Operating expenses		
Research and development	480	389
Sales and marketing	5,410	3,895
General and administrative	2,403	2,088
Total operating expenses	8,293	6,372
Loss from operations	(1,299)	(827)
Other income (expense), net		
Fair value changes in derivative warrant liability	1,044	842
Interest expense – related party	(293)	(207)
Other (expense) income, net	(5)	1
Total other income (expense), net	746	636
Net loss	\$(553)	\$(191)
Change in fair value of stock to be distributed for Scotts Miracle-Gro transactions	(675)	(1,355)
Net loss attributable to common shareholders	\$(1,228)	\$(1,546)
Net loss per common share, basic and diluted	\$(0.18)	\$(0.26)
Weighted average number of common shares outstanding, basic and diluted	6,666	5,847

See accompanying notes to the financial statements

Table of ContentsAEROGROW INTERNATIONAL, INC.  
STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(in thousands, except share data)	Preferred Stock		Common Stock		Additional	Stock	Accumulated	Total
	Shares	Amount	Shares	Amount	Paid-in Capital	to be distributed	(Deficit)	Stockholders Equity
Balances, March 31, 2014	2,649,007	\$ 3	6,129,326	\$ 6	\$ 79,563	\$ 1,456	\$ (80,134 )	\$ 894
Common stock dividend distribution issued in connection with Scotts Miracle-Gro agreement	-	-	390,092	-	1,383	(1,095 )	-	288
Warrants issued to consultants	-	-	-	-	37	-	-	37
Exercise of stock options	-	-	44,100	-	53	-	-	53
Stock options issued under equity compensation plans	-	-	-	-	302	-	-	302
Stock dividend to be distributed	-	-	-	-	763	1,354	(2,117 )	-
Net (loss)	-	-	-	-	-	-	-	-