ARCH COAL INC
Form 10-K/A
August 06, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

Amendment No. 1

(Mark One)

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

For the fiscal year ended: December 31, 2003

or

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

For the transition period from to

Commission File Number: 1-13105

ARCH COAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	**43-0921172**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
One City Place Drive, Suite 300, St. Louis, MO	**63141**
(Address of principal executive offices)	(Zip Code)

(Registrant s telephone number, including area code): (314) 994-2700

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

Common Stock, $.01 par value	**New York Stock Exchange**
Preferred Share Purchase Rights	**New York Stock Exchange**
5% Perpetual Cumulative Convertible Preferred Stock	**None**
Title of Each Class	Name of Each Exchange On Which Registered

Securities registered pursuant to Section 12(g) of the Act: None

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 x No o

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 registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes x No o

At June 30, 2003, based on the closing price of the registrant s common stock on the New York Stock Exchange on that date, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately $948,857,253. In determining this amount, the registrant has assumed that all of its executive officers and directors, and persons known to it to be the beneficial owners of more than five percent of its common stock, are affiliates. Such assumption shall not be deemed conclusive for any other purpose.

At March 1, 2004, there were 53,950,004 shares of the registrant s common stock outstanding.

Documents incorporated by reference:

1. Portions of the registrant s definitive proxy statement, to be filed with the Securities and Exchange Commission no later than April 1, 2004, are incorporated by reference into Part III of this Form 10-K.

2. Portions of the registrant s Annual Report to Stockholders for the year ended December 31, 2003 are incorporated by reference into Parts I, II and IV of this Form 10-K.

EXPLANATORY NOTE

This Amendment No. 1 to the Company s Annual Report on Form 10-K amends and restates Items 1 and 3 of Part I, Items 7, 7A, 8 and 9A of Part II and Item 15 of Part IV of, and Exhibit 13 to, the Company s Annual Report on Form 10-K for the year ended December 31, 2003, as filed by the Company on March 8, 2004, primarily to provide additional information with respect to the Company s three reportable segments. This Amendment No. 1 does not include any restatement of the Company s previously filed financial statements. No information included in the original report on Form 10-K has been amended by this Form 10-K/A to reflect any information or events subsequent to the filing of the original report on Form 10-K other than as required to reflect the amendment set forth below.

PART I

ITEM 1. BUSINESS

General

Arch Coal, Inc. (Arch Coal or the Company) is one of the largest coal producers in the United States. The Company mines, processes and markets compliance and low-sulfur coal from mines located in both the eastern and western United States, enabling it to ship coal cost-effectively to most of the major domestic coal-fired electric generation facilities. As of December 31, 2003, the Company had 25 operating mines and controlled approximately 2.8 billion tons of proven and probable coal reserves. Arch Coal sold 100.6 million tons of coal in 2003. The Company sells substantially all of its coal to producers of electric power.

The Company owns a 99% membership interest in Arch Western Resources, LLC (Arch Western), a joint venture that was formed in connection with the Company s acquisition of the United States coal operations of Atlantic Richfield Company on June 1, 1998. The principal operating units of Arch Western are Thunder Basin Coal Company, L.L.C., which operates the Black Thunder mine in the Southern Powder River Basin in Wyoming; Mountain Coal Company, L.L.C., which operates the West Elk mine in Colorado; Canyon Fuel Company, LLC (Canyon Fuel), which operates three mines in Utah; and Arch of Wyoming, LLC, which operates two mines in the Hanna Basin of Wyoming. Arch Western owns 100% of the membership interests of Thunder Basin Coal Company, L.L.C., Mountain Coal Company, L.L.C. and Arch of Wyoming, LLC. Arch Western owns a 65% membership interest in Canyon Fuel, with the remaining 35% membership interest owned by ITOCHU Coal International Inc., a subsidiary of ITOCHU Corporation of Japan.

Business Environment

United States Coal Markets. Production of coal in the United States has increased from 434 million tons in 1960 to about 1.1 billion tons in 2003. The following table sets forth demand trends for United States coal by consuming sector through 2025 as compiled, preliminary(p) or forecasted(f) by the United States Department of Energy/Energy Information Agency.

Consumption by Sector	2001	2002	2003(p)	2005(f)	2010(f)	2015(f)	2020(f)	2025(f)	Annual Growth 2002-2025(f)
					(tons in millions)				
Electric Generation	964	978	999	1,032	1,136	1,200	1,301	1,477	1.8%
Industrial	65	61	61	65	65	65	66	67	0.3%
Steel Production	26	24	24	25	23	21	19	17	(1.2%)
Residential/ Commercial	4	4	4	5	5	5	5	5	0.4%
Export	49	40	43	40	35	32	27	23	(2.3%)
Total	1,108	1,107	1,131	1,167	1,264	1,323	1,418	1,589	1.6%

Electricity Generation. Coal has consistently maintained a 49% to 53% market share over competing energy sources to generate electricity during the past ten years because of its relatively low cost and its availability throughout the United States. Coal is the lowest cost fossil-fuel used for base-load electric power generation considerably less expensive than natural gas or oil. Coal-fired generation is also competitive with nuclear power generation, especially on an all-in cost per megawatt-hour basis. Hydroelectric power is inexpensive but is limited by both geography and susceptibility to seasonal and climatic conditions. Non hydropower renewable power generation accounts for only 1.9% of all the electricity generated in the U.S. and is limited by resources and/or technology. Consequently, approximately 87.6% of the coal produced in the United States in 2003 was sold in the domestic market as a fuel to the electric generation segment. The remainder of the tons were sold in 2003 as steam coal for industrial and residential purposes, into the export market, and as metallurgical coal. In addition to the relative competitiveness of coal-fired generation plants, coal consumption patterns are also influenced by the demand for electricity, governmental regulation

impacting coal production and power generation, technological developments and the location, availability and quality of competing sources of coal, as well as other fuels such as natural gas, oil and nuclear and alternative energy sources such as hydroelectric power.

Long-term demand for electric power will depend upon a variety of economic, regulatory, technological and climatic factors beyond our control. Historically, domestic demand for electric power has increased as the United States economy has grown. Two important regulatory initiatives, one designed to increase competition among utilities and lower the cost of electricity for consumers, and another to improve air quality by reducing the level of sulfur emitted from coal-burning power generation plants, have had and are expected to continue to have significant effects on the electric utility industry and its coal suppliers.

According to the Energy Information Agency, coal is expected to remain the primary fuel for electricity generation through 2025. The following table sets forth the source fuel for electricity generation from 2001 through 2025 as compiled, preliminary(p) or forecasted(f) by the Energy Information Agency.

	2001	2002	2003(f)	2005(f)	2010(f)	2015(f)	2020(f)	2025(f)	Annual Growth 2002-2025(f)
					(billion kilowatt hours)				
Coal	1,904	1,928	1,993	2,053	2,255	2,373	2,614	3,029	1.4%
Petroleum	125	88	102	70	75	122	102	97	0.4%
Natural Gas	638	683	656	754	926	1,109	1,288	1,304	2.9%
Nuclear	769	780	762	791	794	812	816	816	0.2%
Hydro/ Renewable/other	299	353	386	431	460	487	516	540	1.9%
Total	3,735	3,832	3,899	4,099	4,510	4,903	5,336	5,786	1.8%

Coal s primary advantage is its relatively low cost compared to other fuels used to generate electricity. The following table sets forth the Energy Information Agency s forecast of delivered fuel prices to electric utilities through 2025 as compiled, preliminary(p) or forecasted(f) by the Energy Information Agency. The table below is derived from the Energy Information Agency s long-term forecast published in December 2003 and is presented in 2002 dollars.

	2001	2002	2003(p)	2005(f)	2010(f)	2015(f)	2020(f)	2025(f)	Annual Growth 2002-2025(f)
					(dollars per million Btus)				
Annual Energy Outlook									
Petrol (Residual)	$4.55	$4.04	$4.65	$3.88	$3.99	$4.14	$4.31	$4.50	(0.5%)
Natural Gas	5.30	3.77	5.62	4.18	4.04	4.78	4.85	4.92	1.2%
Coal	1.25	1.25	1.24	1.23	1.22	1.20	1.17	1.18	(0.3%)

Coal Production. United States coal production was 1.1 billion tons in 2003. The following table, derived from data prepared by the Energy Information Agency, sets forth principal United States production statistics for the periods indicated as compiled or preliminary(p).

	1980	1985	1990	1995	2000	2003(p)
Total Tons (in millions)	830	884	1,029	1,033	1,074	1,076
East	566	554	627	544	508	473
West	264	330	402	489	566	603
Underground	329	349	424	396	374	354
Surface	501	555	605	637	700	722
Percent of Total Tons						
East	68%	63%	61%	53%	47%	44%
West	32	37	39	47	53	56
Underground	40	39	41	38	35	33
Surface	60	61	59	62	65	67
Number of Mines (from RDI)						
Underground	1,875	1,695	1,422	977	707	536
Surface	1,997	1,660	1,285	1,127	746	702
Total	3,872	3,355	2,707	2,104	1,453	1,238
Average Number of Mine Employees (from RDI)						
Underground	150,328	107,357	63,960	44,254	31,825	31,207
Surface	74,610	61,924	43,402	31,777	24,640	25,978
Average Production per Mine (tons in thousands)						
Underground	177	203	297	402	531	662
Surface	249	325	472	568	935	1,026

Sales and Marketing

The Company sells coal both under long-term contracts, the terms of which are greater than 12 months, and on a current market or spot basis. When the Company s coal sales contracts expire or are terminated, it is exposed to the risk of having to sell coal into the spot market, where demand is variable and prices are subject to greater volatility. Historically, the price of coal sold under long-term contracts has exceeded prevailing spot prices for coal. However, in the past several years new contracts have been priced at or near existing spot rates.

The terms of the Company s coal sales contracts result from bidding and extensive negotiations with customers. Consequently, the terms of these contracts typically vary significantly in many respects, including price adjustment features, provisions permitting renegotiation or modification of coal sale prices, coal quality requirements, quantity parameters, flexibility and adjustment mechanisms, permitted sources of supply, treatment of environmental constraints, options to extend, and force majeure, suspension, termination and assignment provisions.

Provisions permitting renegotiation or modification of coal sale prices are present in many of the Company s more recently negotiated long-term contracts and usually occur midway through a contract or every two to three years, depending upon the length of the contract. In some circumstances, customers have the option to terminate the contract if prices have increased by a specified percentage from the price at the commencement of the contract or if the parties cannot agree on a new price. The term of sales contracts has decreased significantly over the last two decades as competition in the coal industry has increased and, more recently, as electricity generators have prepared themselves for federal Clean Air Act requirements and the impending deregulation of their industry.

There are some contract terms that differ between a standard eastern United States contract and a standard western United States contract. In the eastern United States, many customers require that the coal be sampled and weighed at the destination. In the western United States, virtually all samples are taken at the source. More eastern United States coal is purchased on the spot market. The eastern United States market has more recently been a shorter-term market because of the larger number of smaller mining operations in that region. Western United States contracts sometimes stipulate that some production taxes and coal royalties be reimbursed in full by the buyer rather than as a pricing component within the contract. These items comprise a significant portion of western United States coal pricing.

Competition

The coal industry is intensely competitive, primarily as a result of the existence of numerous producers in the coal producing regions in which the Company operates. The Company competes with several major coal producers in the Central Appalachian and Powder River Basin areas. It also competes with a number of smaller producers in those and its other market regions.

Operations

As of December 31, 2003, the Company operated a total of 30 mines, all located in the United States. The Company uses four distinct extraction techniques: continuous mining, longwall mining, truck-and-shovel mining and dragline mining. Coal is transported from the Company s mining complexes to customers by means of railroad cars, river barges or trucks, or a combination of these means of transportation. As is customary in the industry, virtually all the Company s coal sales are made F.O.B. mine or loadout, meaning that customers are responsible for the cost of transporting purchased coal to their facilities.

The Company manages its production sources to supply coal within three of the major low sulfur coal producing basins in the United States the Central Appalachia Basin, Powder River Basin and the Western Bituminous Basin. These geographically distinct areas are characterized by similar geology, coal transportation routes to consumers, regulatory environments and coal quality. These regional similarities have caused market and contract pricing environments to develop by coal basin and form the basis for the Company s segmentation of its operations.

Coal prices are influenced by a number of factors and vary dramatically by region. As a result of these regional characteristics, prices of coal within a given major coal producing basin tend to be relatively consistent. The two principal components of the price of coal within a region are the price of coal at the mine, which is influenced by mine operating costs and coal quality, and transportation costs involved in moving coal from the mine to the point of use. The price of coal at the mine is influenced by geologic characteristics such as seam thickness, overburden ratios and depth of underground reserves. It is generally cheaper to mine coal seams that are thick and located close to the surface than to mine thin underground seams. Underground mining, which is the mining method the Company uses in the Western Bituminous and also a method the Company primarily uses at certain mines in Central Appalachia, is generally more expensive than surface mining, which is the mining method the Company uses in the Powder River Basin and also for certain of its Central Appalachian mines. This is the case because of the higher capital costs, including costs for modern mining equipment and construction of extensive ventilation systems and higher labor costs due to lower productivity that are associated with underground mining.

In addition to the cost of mine operations, the price of coal is also a function of quality characteristics such as heat value, sulfur, ash and moisture content. Higher carbon and lower ash content generally result in higher prices. Coal from the Central Appalachian Basin generally has a sulfur content of 0.7% to 1.5% and a high heat content of between 12,000 and 14,000 Btus per pound. The coal from the Western Bituminous region typically has a lower sulfur content of 0.50% to 1% and a lower heat content of between 10,500 and 12,5000 Btus per pound. Powder River Basin coal generally has the lowest relative sulfur content among the Company s regions, with a sulfur content of between 0.15% and 1.20%, and the lowest relative heat content, which typically is between 7,500 and 10,000 Btus per pound.

The Company s management, including its Chief Executive Officer and Chief Operating Officer, reviews and makes resource allocations based on the goal of maximizing its profits within a coal basin in light of the comparative cost structures of its various operations. Because the Company s customers purchase coal on a regional basis, contracts can generally be sourced from several different locations within a region. Once the Company has a contractual commitment to purchase an amount of coal at a certain price, the Company s central marketing group assigns contract shipments to its various mines which can be used to source the coal in the appropriate region.

The focus of the Company s operating structure is on the reduction of controllable costs. Although revenues are reported at the mine level, the Company s mine management is asked only to manage volume and revenue adjustments due to quality variances for contract shipments assigned to their mines. The Company s mine management is evaluated and compensated on the basis of operating costs per ton at the mine level, as well as on the basis of other non-financial measures such as safety and environmental results.

Based on its management structure, the Company does not utilize mine-by-mine profit as a measure to make decisions. As a result of its management of revenues on a regional basis, the reported profit at any individual mine may not be meaningful and is not indicative of the future economic prospects of the mine.

This is the case because an individual mine s profit is based on the contract shipments that are assigned to it by the central marketing group and the pricing of those contracts, with assignments typically being made on the basis of the availability of coal and the cost of transporting the coal to the customer. Therefore, a mine that is assigned a lower-price contract will have a lower profit margin than a similar mine with similar costs that ships a nearly identical product on a higher-price contract.

The following maps show the locations of the Company s significant mining operations:

Central Appalachia Operations

Powder River Basin and Western Bituminous Operations

The following table provides the location and a summary of information regarding the Company s principal mining complexes and the total sales associated with these operations for the prior three years:

Mining Complex (Location)	Captive Mine(s)(1)	Contract Mine(s)	Mining Equipment(2)	Transportation	Tons Sold 2001	2002	2003
Central Appalachia							
Mingo Logan (WV)	U	U	LW, C	NS	7.2	5.8	5.5
Coal-Mac (WV)	S	U(2)	L	Barge/NS/CSX	3.5	2.1	2.1
Dal-Tex (WV)(3)				CSX			
Hobet 21 (WV) align="bottom" bgcolor="#CCEEFF" style="background:#CCEEFF;padding:0in .7pt 0in .7pt;width:1.62%;">							
32,629	117,251	92,682					

Expenses:				
Selling and operating	37,875	27,963	101,377	82,885
Corporate, general and administration	4,073	3,656	11,980	10,452
Total expenses	41,948	31,619	113,357	93,337
Income (loss) from operations	4,196	1,010	3,894	(655)
Other income	1,028	1,512	3,375	2,639
Income before income taxes and minority interest	5,224	2,522	7,269	1,984
Income tax expense	2,060	977	2,868	784
Minority interest in net (income) loss of consolidated subsidiaries, net of tax	(246)	108	(77)	178
Net income	$ 2,918	$ 1,653	$ 4,324	$ 1,378
Net earnings per share:				
Basic	$ 0.12	$ 0.06	$ 0.17	$ 0.06
Diluted	$ 0.12	$ 0.06	$ 0.17	$ 0.06
Shares used in computing net earnings per share:				
Basic	24,705	26,705	25,000	23,450
Diluted	24,970	26,864	25,222	23,697

See accompanying notes to the interim condensed consolidated financial statements.

GAIAM, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)
(In thousands)

	For the Nine Months Ended September 30, 2007	2006
Operating activities		
Net income	$ 4,324	$ 1,378
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,395	1,593
Amortization	7,215	3,948
Minority interest	77	(178)
Noncash gain from equity investment	(127)	(680)
Noncash loss on disposal of property	265	
Noncash stock-based compensation	832	365
Deferred income tax expense	677	644
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable, net	13,233	14,074
Inventory, net	(3,097)	(4,089)
Deferred advertising costs	(2,256)	(2,436)
Other current assets	(1,757)	(1,111)
Accounts payable	(2,983)	(7,382)
Accrued liabilities	2,297	(5,549)
Income taxes payable	476	
Net cash provided by operating activities	20,571	577
Investing activities		
Purchase of property, equipment and media rights	(5,133)	(1,854)
Proceeds from sale of property and equipment		637
Purchase of acquisitions and investments, net of cash acquired	(10,801)	(6,582)
Proceeds from sale of investments	3,871	
Net cash used in investing activities	(12,063)	(7,799)
Financing activities		
Repurchase of Class A common stock, including related costs	(32,907)	
Proceeds from issuance of common stock, net of related costs	753	96,609
Net cash (used in) provided by financing activities	(32,154)	96,609
Effects of exchange rates on cash and cash equivalents	335	540
Net change in cash and cash equivalents	(23,311)	89,927
Cash and cash equivalents at beginning of period	104,876	15,028
Cash and cash equivalents at end of period	$ 81,565	$ 104,955
Supplemental cash flow information		
Income taxes paid	$ 3,042	$
Common stock issued for acquisitions	$ 491	$ 1,933

See accompanying notes to the interim condensed consolidated financial statements.

Gaiam, Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

September 30, 2007

1. Summary of Significant Accounting Policies

Management believes the following to be critical accounting policies whose application has a material impact on Gaiam Inc. s (Gaiam or the Company) financial presentation, and involve a higher degree of complexity, as they require management to make judgments and estimates about matters that are inherently uncertain.

No changes were made to our significant accounting policies during the three and nine months ended September 30, 2007, except for the adoption of the Financial Accounting Standards Board s (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109* (FIN 48). See Gaiam s significant accounting policy for *Income Taxes* discussed below.

Organization and Nature of Operations

Gaiam is a branded lifestyle media company providing a broad selection of information, media, products and services to customers who value personal development, wellness, ecological lifestyles, responsible media and conscious community. Gaiam was incorporated under the laws of the State of Colorado on July 7, 1988.

The accompanying unaudited interim condensed consolidated financial statements include the accounts of Gaiam and its subsidiaries in which Gaiam s ownership is greater than 50% and the subsidiary is considered to be under Gaiam s control. All material intercompany accounts and transaction balances have been eliminated in consolidation.

The unaudited condensed consolidated financial position, results of operations and cash flows for the interim periods disclosed in this report are not necessarily indicative of future financial results.

Cash and Cash Equivalents

Cash and cash equivalents include demand deposit accounts and highly liquid instruments, with maturities of three months or less at the date of purchase. The fair value of the cash and cash equivalents approximates their carrying value due to their short maturities.

Provisions for Doubtful Accounts and Returns

Gaiam records a provision for doubtful accounts for all receivables not expected to be collected. Gaiam generally does not require collateral. Gaiam evaluates the collectibility of accounts receivable based on a combination of factors. In circumstances in which Gaiam is aware of a specific customer s inability to meet its financial obligations (e.g. bankruptcy filings), Gaiam records a specific reserve for bad debts against amounts due. For all other instances, Gaiam recognizes reserves based on historical experience and review of individual accounts outstanding.

Gaiam records a provision for product returns to be received in future periods at the time the original sale is recognized. The amount of the returns provision is based upon historical experience and future expectations.

Inventory

Inventory consists primarily of finished goods held for sale and is stated at the lower of cost (first-in, first-out method) or market. Gaiam identifies the inventory items to be written down for obsolescence based on the item s current sales status and condition. If the item is discontinued or slow moving, it is written down based on an estimate of the markdown to retail price needed to sell through its current stock level of the item.

Purchase Accounting

Gaiam accounts for the acquisition of a controlling interest in a company using the purchase method prescribed by FASB Statement No. 141, *Business Combinations* (SFAS 141). In determining the estimated fair value of certain acquired assets and liabilities, management makes assumptions based upon historical and other relevant information and, in some cases, independent expert appraisers. Assumptions may be incomplete, and unanticipated events and circumstances may occur that could affect the validity of such assumptions, estimates, or actual results. The estimated fair value of assets and liabilities acquired in accordance with SFAS 141 during the last quarter of 2006 and the first nine months of 2007 are preliminary as of September 30, 2007. We expect to obtain information necessary to finalize the estimated values during the remainder of 2007 and the first half of 2008.

Goodwill and Other Intangibles

Goodwill represents the excess of the purchase consideration over the fair value of assets acquired less liabilities assumed in a business acquisition. Gaiam s other intangibles mainly consist of customer lists. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill is no longer amortized but is reviewed for impairment annually or more frequently if impairment indicators arise, on a reporting unit level. The estimated fair value of a reporting unit is compared with its carrying amount, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired.

If the carrying amount of a reporting unit exceeds its estimated fair value, the goodwill impairment test is performed to measure the amount of impairment loss. Gaiam has allocated goodwill to two reporting units, and uses a market value method for purposes of testing for potential impairment. The annual review requires extensive use of financial judgment and estimates. Application of alternative assumptions and definitions, such as a change in the composition of a reporting unit, could yield significantly different results.

Investments

Investments in limited liability companies in which Gaiam does have the ability to exercise significant influence or control, or in which it holds a five percent or more membership interest, are accounted for under the equity method. Investments in corporations in which Gaiam does have the ability to exercise significant influence or control, or in which it holds a twenty percent or more ownership, are also accounted for under the equity method. Under the equity method, Gaiam records its share of the income or losses of the investment by increasing or decreasing the carrying value of its investment and recording the income or expense through the consolidated statement of operations. Under the cost method of accounting, investments in private companies are carried at cost and are adjusted only for other-than-temporary declines in fair value. Determining whether a decline in value is other-than-temporary requires a high degree of management judgment. Investments under the cost and equity methods are included on the accompanying unaudited Condensed Consolidated Balance Sheets in Notes receivable and other assets.

Media Library

The media library asset represents the estimated fair value of Gaiam s library of produced videos acquired through business combinations, the purchase price of media rights to both video and audio titles, and the capitalized cost to produce media products marketed by Gaiam to retailers and direct-mail and online customers. The acquired and purchased media rights are recorded at estimated fair value and amortized on the basis of their estimated useful lives. Capitalized costs to produce media products are recognized as costs of goods sold on an individual film basis in the ratio that the current year s gross revenues bear to management s estimate of total ultimate remaining gross revenues. Ultimate remaining revenue forecasts, based primarily on historical sales statistics, are continually reviewed by management and revised when warranted by changing conditions. When estimates of total revenues and other events or changes in circumstances indicate that a film has a fair value that is less than its unamortized cost, an impairment loss is recognized in the current period for the amount by which the unamortized cost exceeds the film s estimated fair value.

Contractual Obligations

Gaiam has commitments pursuant to lease agreements, but does not have any outstanding commitments pursuant to long-term debt, capital lease, or purchase obligations. The following table shows Gaiam s commitments to make future payments under operating leases (in thousands):

	Total	**< 1 year**	**1-3 years**	**3-5 years**	**> 5 years**
Operating lease obligations	$4,872	$2,556	$1,845	$319	$152

Off-Balance Sheet Arrangements

Gaiam does not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as special purpose entities (SPEs) or variable interest entities (VIEs), which have been established for the purpose of facilitating off-balance sheet arrangements or other limited purposes. As of September 30, 2007, Gaiam is not involved in any unconsolidated SPEs or VIEs.

Income Taxes

Gaiam provides for income taxes pursuant to the liability method as prescribed in SFAS No. 109, *Accounting for Income Taxes*. The liability method requires recognition of deferred income taxes based on temporary differences between financial reporting and income tax bases of assets and liabilities, using current enacted income tax rates and regulations.

Effective January 1, 2007, Gaiam adopted the provisions of FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes.* Under FIN 48, Gaiam must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the condensed consolidated financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution. The application of income tax law is inherently complex. Laws and regulations in this area are voluminous and are often ambiguous. As such, Gaiam is required to make many subjective assumptions and judgments regarding its income tax exposures. Interpretations of and guidance surrounding income tax law and regulations change over time and may result in changes to the Company s subjective assumptions and judgments which can materially affect amounts recognized in Gaiam s Condensed Consolidated Balance Sheets and Statements of Operations. The Company s reassessment of its tax positions in accordance with FIN 48 did not have a material impact on Gaiam s condensed consolidated financial statements. Gaiam s tax returns for all years after 2002 are subject to future examination by tax authorities.

Use of Estimates

The unaudited interim condensed consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States, which require management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses and disclosure of contingent assets and liabilities in Gaiam s interim condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

New Accounting Pronouncements

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* (SFAS 157 or the Statement). This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. The Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year. Gaiam will adopt the provisions of SFAS 157 in its fiscal year commencing January 1, 2008. Management currently believes that adoption of the provisions of SFAS 157 will not have a material impact on Gaiam s consolidated financial statements.

2. Notes Receivable and Other Assets

Notes receivable and other assets as of September 30, 2007 consisted of $1.0 million of other long-term assets and as of December 31, 2006 was comprised of $1.3 million of investments, $2.4 million in notes and related interest receivable, and $0.6 million of other long-term assets.

Gaiam entered into an agreement with Alps Communications LLC (Alps) and Life Balance Media Holdings LLC (LIME) on January 5, 2006, to sell 19,968 Series A Preferred Units of LIME, an investment previously accounted for using the equity method. The purchase price per unit was equal to the amount Gaiam paid for its investment during 2005. Alps Communications assumed all unpaid Series A Capital Contribution commitments from Gaiam and executed an interest bearing promissory note due February 28, 2009 in the principal amount of $2,250,000. After the closing of this transaction, Gaiam owned 4,876 units, or less than 4%, of LIME. This transaction resulted in a gain of $0.5 million which is included in Other income on the Condensed Consolidated Statements of Operations for the nine months ended September 30, 2006. On February 6, 2007, Gaiam entered into a stock repurchase agreement with Revolution Living LLC (Revolution Living) and Alps. As part of the stock repurchase agreement Alps prepaid its promissory note principal plus accrued interest in the amount of $2.4 million and acquired Gaiam s investment in LIME for $1.4 million in cash.

3. Stockholders Equity

On February 6, 2007, Gaiam entered into a stock repurchase agreement (the Agreement) with Revolution Living and Alps, whereby as part of the Agreement Gaiam purchased 2.5 million shares of its Class A common stock from Revolution Living for $13.14 per share or $32.8 million in cash. The $13.14 per share price agreed to by the parties was the average price over the last 90 days of Gaiam s shares prior to the Agreement s closing. In accordance with the cost method of accounting for treasury stock, Gaiam recorded the treasury stock at $32.9 million including acquisition legal fees. Since Gaiam has not yet decided the ultimate disposition of the re-acquired stock, its cost is reflected in the Condensed Consolidated Balance Sheet at September 30, 2007 as a $32.9 million reduction to Additional paid-in capital. Following this repurchase, Gaiam had approximately 24.8 million Class A and Class B common shares outstanding.

During the nine months ended September 30, 2007, Gaiam issued a total of 4,662 shares of Class A common stock to Gaiam s independent directors, in lieu of cash compensation, for services rendered in 2006 and 2007 and issued 75,980 shares of Class A common stock upon exercise of options granted under Gaiam s 1999 Long-Term Incentive Plan. In addition, on August 1, 2007, Gaiam issued 30,795 shares of Class A common stock as part of the consideration to acquire controlling ownership of Conscious Enlightenment, Inc. See Note 8 Mergers and Acquisitions.

4. Share-Based Payments

Gaiam s share-based compensation program is a long-term retention program that is intended to attract, retain and provide incentives for talented employees, officers, and directors, and to align stockholder and employee interests. Gaiam grants options under its 1999 Long-Term Incentive Plan (the Plan), which provides for the granting of options to purchase up to 3 million shares of Gaiam s common stock and terminates no later than June 1, 2009. Options under the Plan are generally granted with an exercise price equal to the closing market price of Gaiam s stock at the date of the grant and normally vest and become exercisable at 2% per month for the 50 months beginning in the eleventh month after date of grant. Grants typically expire seven years from the date of grant. Gaiam uses the Black-Scholes option pricing model to determine the estimated fair value of stock options and shares issued under the Plan. The determination of fair value stock-based payment awards on the date of grant using the Black-Scholes option-pricing model is affected by Gaiam s stock price as well as assumptions regarding a number of complex and subjective variables. All stock-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally five years for employees and two years for Board members.

During the first nine months of 2007, Gaiam granted 300,000 stock options to employees and directors and 192,200 stock options were cancelled or expired. Total share-based compensation recognized was $0.3 million and $0.2 million for the three months ended September 30, 2007 and 2006, respectively, and $0.8 million and $0.4 million for the nine months ended September 30, 2007 and 2006, respectively, and is shown in Corporate, general, and administration expenses on Gaiam s Condensed Consolidated Statements of Operations.

5. Comprehensive Income

Gaiam s comprehensive income is comprised of net income and foreign currency translation adjustment, net of income taxes. Comprehensive income, net of related tax effects, was as follows (in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2007		2006		2007		2006	
Net income	$	2,918	$	1,653	$	4,324	$	1,378
Foreign currency translation adjustment, net		174		6		258		405
Comprehensive income, net of taxes	$	3,092	$	1,659	$	4,582	$	1,783

6. Earnings Per Share

Basic earnings per share excludes any dilutive effects of options, warrants and dilutive securities. Basic earnings per share is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common and common stock equivalent shares outstanding during the period. Common equivalent shares of 152 thousand and 391 thousand are excluded from the computation of diluted earnings per share for the three and nine months ended September 30, 2007, respectively, because their effect is antidilutive. The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share data):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2007		2006		2007		2006	
Numerator for basic and diluted earnings per share	$	2,918	$	1,653	$	4,324	$	1,378
Denominator:								
Weighted average share for basic earnings per share		24,705		26,705		25,000		23,450
Effect of dilutive securities:								
Weighted average of common stock and stock options		265		159		222		247
Denominators for diluted earnings per share		24,970		26,864		25,222		23,697
Net earnings per share basic	$	0.12	$	0.06	$	0.17	$	0.06
Net earnings per share diluted	$	0.12	$	0.06	$	0.17	$	0.06

7. Segment Information

Gaiam manages its business and aggregates its operational and financial information in accordance with two reportable segments. The direct to consumer segment contains the Internet, catalog, direct response marketing, and subscription community sales channels, while the business segment comprises the retailers, media, and corporate account channels.

Although Gaiam is able to track revenue by sales channel, the management, allocation of resources and analysis and reporting of expenses is solely on a combined basis, at the reportable segment level.

Contribution margin is defined as net sales, less cost of goods sold and direct and allocated expenses. Financial information for Gaiam s segments was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net revenue:				
Direct to consumer	$ 40,239	$ 32,624	$ 104,656	$ 85,741
Business	30,079	19,162	76,481	60,958
Consolidated net revenue	70,318	51,786	181,137	146,699
Contribution margin (loss):				
Direct to consumer	570	587	(2,059)	(723)
Business	3,626	423	5,953	68
Consolidated contribution margin (loss)	4,196	1,010	3,894	(655)
Reconciliation of contribution margin (loss) to net income:				
Other income	1,028	1,512	3,375	2,639
Income tax expense	2,060	977	2,868	784
Minority interest in net (income) loss of consolidated subsidiaries, net of tax	(246)	108	(77)	178
Net income	$ 2,918	$ 1,653	$ 4,324	$ 1,378

8. Mergers and Acquisitions

During the third quarter of 2007, Gaiam acquired varying amounts of controlling ownership interest in four entities for a total cost of approximately $12.4 million, including direct acquisition costs and other liabilities, of which $10.9 million was paid in cash, $0.5 million in Gaiam Class A common stock, and $1.0 million in assumed liabilities. One of the acquisitions calls for additional consideration of $1.7 million in cash contingent upon either the achievement of a certain membership threshold within the next two years or the sale of the acquired business or its assets by Gaiam. Gaiam has not yet recognized the contingent consideration because its amount is not determinable beyond a reasonable doubt.

The four acquired companies include Zaadz, a leading social networking site in the LOHAS space, Lime, a multimedia lifestyle company with multiple platforms focused on leading a healthier, greener, and more balanced lifestyle, Conscious Enlightenment, an on-line and off-line community, and an eco adventure travel company.

Gaiam has preliminarily recognized $5.9 million and $2.9 million of direct to consumer and business segment goodwill, respectively, which are expected to be deductible for tax purposes, $1.7 million of intangibles subject to amortization (with an weighted-average amortization period of 3.8 years), and $0.4 million of indefinite life intangibles for brand and domain names. The amortizable intangibles are media of $1.0 million, amortized over 5 years, and other intangibles of $0.7 million, amortized over 1.5 to 3 years. Gaiam is still in the process of finalizing its assessment of the estimated fair value of the net assets acquired and, thus, the amount of goodwill and other intangibles is subject to refinement.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of Gaiam s financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and related notes included elsewhere in this document.

Adopted New Accounting Policies

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), which became effective for Gaiam January 1, 2007. FIN 48 addressed the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution. The Company s reassessment of its tax positions in accordance with FIN 48 did not have a material impact on the results of operations, financial condition or liquidity. For additional information regarding the adoption of FIN 48, see Note 1 Summary of Significant Accounting Policies - *Income Taxes* to the Interim Condensed Consolidated Financial Statements.

Overview and Outlook

Gaiam is a lifestyle media company providing a broad selection of information, media, products and services to customers who value personal development, wellness, ecological lifestyles, responsible media and conscious community. Gaiam s media brand is built around its ability to develop and offer media content, products, lifestyle solutions and community to consumers in the Lifestyle of Health and Sustainability (LOHAS) and the emerging Media that Matters (MTM) markets.

Gaiam offers its customers the ability to make purchasing decisions and find responsible content based on these values while providing quality offerings at a price comparable to mainstream alternatives. Gaiam markets its media and products through a multi-channel approach including traditional media channels, direct to consumers via the Internet, catalog, direct response marketing, community and subscription clubs, and through national retailers and corporate accounts.

Gaiam s content forms the basis of its proprietary offerings, which then drive demand for parallel product and service offerings. Gaiam s operations are vertically integrated from content creations, through product development and sourcing, to customer service and distribution. Gaiam markets its products and services across two segments, business and direct to consumer. Products are distributed in each of these sales segments from a single fulfillment center or drop-shipped directly to customers.

Through its diverse media reach, the direct to consumer segment provides an opportunity to launch and support new media releases. This direct link to the consumer provides a sounding board for new product testing, promotional opportunities, a growing loyal community, and customer feedback concerning the focus and future of Gaiam and the LOHAS industry as a whole. During 2006, Gaiam completed several acquisitions targeted toward expanding and enhancing its media content and reach. These acquisitions included acquiring the remaining minority interests in Conscious Media, Inc., a multimedia company, and

Newmark Media, Ltd., a retail distributor in the natural grocery and drug channel. Gaiam also acquired an 85% interest in a DVD subscription club that provides inspirational and spiritual family films. During the third quarter of 2007 Gaiam acquired varying ownership interests in four lifestyle companies to further develop its community business.

We believe our growth will be driven by information, media content, products, and community delivered to the consumer via broadcast, catalog, Internet, retailers, international licensing and electronic downloads and subscription systems. Gaiam has increased its focus on media content creation and distribution, which strategically provides increased branding opportunities, significantly higher operating contribution and greater mainstream penetration. Gaiam plans to invest in its community and membership businesses over the next two years to better capitalize on strong relationships with its loyal consumer audience and growing broadband subscription trends. This will allow Gaiam to focus on better leveraging its content through subscription clubs and community.

Factors that Gaiam believes are important to its long-term success include building brand equity, increasing international growth by expanding into new markets primarily through license arrangements, extending product lines into wellness and children s programs, leveraging its Real Goods sustainable living franchise including solar, and enhancing the multimedia platform community through new media opportunities, new club and membership programs, initiatives and acquisitions.

Results of Operations

The following table sets forth certain financial data as a percentage of revenue for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
Net revenue	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	34.4%	37.0%	35.3%	36.8%
Gross profit	65.6%	63.0%	64.7%	63.2%
Expenses:				
Selling and operating	53.9%	54.0%	56.0%	56.5%
Corporate, general and administration	5.8%	7.0%	6.6%	7.1%
Total expenses	59.7%	61.0%	62.6%	63.6%
Income (loss) from operations	5.9%	2.0%	2.1%	(0.4)%
Other income	1.5%	2.9%	1.9%	1.7%
Income tax expense	2.9%	1.9%	1.6%	0.5%
Minority interest in net (income) loss of consolidated subsidiaries, net of tax	(0.4)%	0.2%	(0.0)%	0.1%
Net income	4.1%	3.2%	2.4%	0.9%

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Three Months Ended September 30, 2007 and 2006

Revenue of $70.3 million during the three months ended September 30, 2007 was 35.8% higher than the $51.8 million in revenue generated in the third quarter of 2006. The increase in revenue includes Gaiam s successful entrance into the business segment s international market and the continued success of its web and direct response marketing. Revenue in Gaiam s direct to consumer segment was $40.2 million for the three months ended September 30, 2007, an increase of $7.6 million or 23.3% over 2006 third quarter revenue of $32.6 million. Total revenue generated by Gaiam s business segment was $30.1 million for the quarter ended September 30, 2007 compared to $19.2 million for the three months ended September 30, 2006.

Gross profit, which consists of revenue less cost of goods sold (primarily merchandise cost plus inbound freight and duties), increased to $46.1 million in the third quarter of 2007 from $32.6 million for the three months ended September 30, 2006. As a percentage of revenue, gross profit improved to 65.6% for the quarter ended September 30, 2007 compared to the 63.0% for the same quarter last year.

Selling and operating expenses increased to $37.9 million for the three months ended September 30, 2007 compared to $28.0 million in the same period of 2006, primarily resulting from increased sales and investments made in community, personnel, advertising, and marketing programs. As a percentage of revenue, selling and operating expenses decreased slightly to 53.9% in the third quarter of 2007 from 54.0% during the quarter ended September 30, 2006 reflecting increased leverage on the higher revenue base partially offset by planned investments in our community business.

Corporate, general and administration expenses increased to $4.1 million for the third quarter of 2007 from $3.7 million for the three months ended September 30, 2006 primarily due to Gaiam s investment in personnel and infrastructure to support the growing the revenue base. As a percent of revenue, corporate, general and administration expenses decreased to 5.8% of revenue during the third quarter of 2007 compared to 7.0% of revenue for the same period in 2006.

Income from operations was $4.2 million for the quarter ended September 30, 2007, up from the $1.0 million operating income for the third quarter of 2006, reflecting higher sales, lowered cost of goods sold, and improved selling and operating and corporate, general and administration expenses. As a percent of revenue, income from operations improved to 5.9% during the three months ended September 30, 2007, as compared to a 2.0% of revenue operational income for the third quarter of 2006.

Gaiam recorded other income of $1.0 million during the third quarter of 2007 compared to $1.5 million during the same period in 2006. Other income was mainly comprised of interest earned on cash investments. The decrease in 2007 reflected the use of cash to repurchase 2.5 million shares of Gaiam Class A common stock on February 6, 2007 and acquire businesses during the third quarter of 2007.

Gaiam recorded income tax expense of $2.1 million in the third quarter of 2007 compared to a $1.0 million tax expense in the same period of 2006. Gaiam s consolidated effective tax rate fluctuates based upon the distribution of earnings/losses between its domestic and foreign operations.

As a result of the factors described above, Gaiam improved its 2007 third quarter financial performance over that of the three months ended September 30, 2006. For the quarter ended September 30, 2007, Gaiam produced a net income of $2.9 million, or $0.12 per share, as compared to a net income in the same period of 2006 of $1.7 million, or $0.06 per share.

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Nine Months Ended September 30, 2007 and 2006

Revenue of $181.1 million during the nine months ended September 30, 2007 was 23.5% higher than the $146.7 million in revenue generated in the same period of 2006. The increase in revenue includes Gaiam s successful entrance into the business segment s international market, the continued success of its web and direct response marketing, and revenues from businesses acquired over the last year. Revenue in Gaiam s direct to consumer segment was $104.7 million for the nine months ended September 30, 2007, an increase of $18.9 million or 22.1% over the same period of 2006 revenue of $85.7 million. Total revenue generated by Gaiam s business segment was $76.5 million for the nine months ended September 30, 2007 compared to $61.0 million for the nine months ended September 30, 2006.

Gross profit increased to $117.3 million in the first nine months of 2007 from $92.7 million for the nine months ended September 30, 2006. As a percentage of revenue, gross profit improved 150 basis points to 64.7% for the nine months ended September 30, 2007 compared to the 63.2% for the same period last year.

Selling and operating expenses increased to $101.4 million for the nine months ended September 30, 2007 compared to $82.9 million in the same period of 2006, primarily resulting from increased sales and investments made in community, branding, personnel, advertising, and marketing programs. As a percentage of revenue, selling and operating expenses decreased to 56.0% in the first nine months of 2007 from 56.5% for the nine months ended September 30, 2006 reflecting increased leverage on the higher revenue base.

Corporate, general and administration expenses increased to $12.0 million for the first nine months of 2007 from $10.5 million for the nine months ended September 30, 2006 primarily due to Gaiam s planned investments to support the increased revenue base. As a percent of revenue, corporate general and administration expenses decreased to 6.6% of revenue during the first nine months of 2007 compared to 7.1% of revenue for the same period in 2006.

Income from operations was $3.9 million for the nine months ended September 30, 2007, a substantial improvement over the $0.7 million loss for the same period of 2006, reflecting higher sales, lower cost of goods sold, and improved operating expenses. As a percent of revenue, income from operations improved to 2.1% of revenue during the first nine months of 2007, as compared to a 0.4% of revenue loss for the nine months ended September 30, 2006.

Gaiam recorded other income of $3.4 million during the first nine months of 2007 compared to $2.6 million during the same period in 2006. The increase in 2007 to other income primarily consisted of interest on cash investments. In the first nine months of 2006, Gaiam s other income was mainly comprised of a $0.5 million gain on sale of an investment and interest earned on cash investments.

Gaiam recorded income tax expense of $2.9 million for the nine months ended September 30, 2007 compared to a $0.8 million tax expense in the same period of 2006. Gaiam s consolidated effective tax rate fluctuates based upon the distribution of earnings/losses between its domestic and foreign operations.

As a result of the factors described above, Gaiam improved its first nine months of 2007 financial performance over that of the nine months ended September 30, 2006. For the first nine months of 2007, Gaiam produced net income of $4.3 million, or $0.17 per share, as compared to a net income in the same period of 2006 of $1.4 million or $0.06 per share.

Seasonality

Gaiam s sales are affected by seasonal influences. On an aggregate basis, Gaiam generates its strongest revenues and net income in the latter half of the year due to increased holiday spending.

Liquidity and Capital Resources

Gaiam s capital needs arise from working capital required to fund our operations, capital expenditures related to acquisition and development of media content, development of our Internet platform and new products, acquisitions of new businesses, replacements, expansions and improvements to Gaiam s infrastructure, and future growth. These capital requirements depend on numerous factors, including the rate of market acceptance of Gaiam s product offerings, the ability to expand Gaiam s customer base, the cost of ongoing upgrades to Gaiam s product offerings, the level of expenditures for sales and marketing, the level of investment in distribution systems and facilities and other factors. The timing and amount of these capital requirements are variable and cannot accurately be predicted. Additionally, Gaiam will continue to pursue opportunities to expand its media libraries, evaluate possible investments in businesses, products and technologies, and increase its sales and marketing programs and brand promotions as needed.

Gaiam has a credit agreement with Wells Fargo, which permits borrowings of up to $15 million based upon the collateral value of Gaiam s accounts receivable, inventory, and certain property and equipment. At September 30, 2007, Gaiam had no amounts outstanding under this agreement; however, $2.8 million was reserved for outstanding letters of credit. Gaiam has complied with all of the financial covenants. The credit agreement originally expired on July 31, 2007 and Gaiam obtained extensions of the agreement until October 22, 2007 when Gaiam and Wells Fargo finalized an amendment to the agreement extending the term until October 2009. Under the amended credit agreement, if Gaiam chooses to borrow, outstanding advances would bear interest at the lower of prime rate less 75 basis points or LIBOR plus 275 basis points. Borrowings are secured by a pledge of Gaiam s assets, and the agreement contains various financial covenants, including those requiring compliance with certain financial ratios.

Gaiam s operating activities provided net cash of $20.6 million for the nine months ended September 30, 2007, primarily reflecting cash provided from net income of $4.3 million, noncash adjustments to net income of $10.3 million, and improved accounts receivable collections of $13.2 million, partially offset by the use of funds to increase inventory in preparation for the upcoming holiday season of $3.1 million, to reduce accounts payable by $3.0 million, and to invest $2.2 million in deferred advertising. During the nine months ended September 30, 2006, Gaiam s operating activities provided net cash of $0.6 million, primarily reflecting the use of funds to reduce accounts payable and accrued liabilities by $7.4 million and $5.6 million, respectively, and to increase inventory, advance media production, and acquire media programming and other current assets by $4.1 million, $2.4 million and $1.1 million, respectively. This use of funds was partially offset by cash provided from the decrease in accounts receivable of $14.1 million and noncash charges to net income of $5.7 million.

Gaiam s investing activities for the nine months ended September 30, 2007 used net cash of $12.1 million reflecting the acquisition of businesses for $10.8 million, net of acquired funds, and the purchase of property, equipment and media rights for $5.1 million, partially offset by proceeds from the sale of the LIME investment for $1.4 million and prepayment of the Alps promissory note principal and interest for $2.4 million. Gaiam s investing activities for the nine months ended September 30, 2006 used net cash of $7.8 million to acquire a business for $6.6 million, net, and to acquire property, equipment and media rights for $1.9 million, partially offset by cash provided from the sale of property and equipment of $0.6 million.

Gaiam s financing activities used net cash of $32.1 million for the nine months ended September 30, 2007 primarily to repurchase 2.5 million shares of Gaiam Class A common stock for $32.9 million, which was partially offset by net proceeds of $0.8 million from the exercise of stock options under Gaiam s 1999 Long Term Incentive Plan. For the nine months ended September 30, 2006, Gaiam s financing activities provided net cash of $96.6 million reflecting net cash provided by the common stock offering of $93.0 million and the exercise of stock options during the first nine months of 2006 for $3.5 million.

On April 7, 2006, Gaiam filed a shelf registration statement on Form S-3 with the Securities and Exchange Commission for Class A Common Stock, par value $.0001, with a total offering price not to exceed $100,000,000. During May 2006, Gaiam filed an amended Form S-3 to register 5,000,000 shares of Class A Common Stock, plus additional shares to cover over-allotments, if any. On May 24, 2006, Gaiam sold 5,000,000 shares of Class A Common Stock and on June 13, 2006 sold 690,000 shares of Class A Common Stock in underwritten offerings under the registration statement. The combined stock sales generated gross proceeds of $99.6 million.

Gaiam believes its available cash, cash expected to be generated from operations, borrowing capabilities, and future sales of its securities should be sufficient to fund its operations on both a short-term and long-term basis. However, Gaiam s projected cash needs may change as a result of acquisitions, product development, unforeseen operational difficulties or other factors.

In the normal course of our business, Gaiam investigates, evaluates and discusses acquisition, joint venture, minority investment, strategic relationship and other business combination opportunities in the LOHAS and MTM markets. For any future investment, acquisition or joint venture opportunities, Gaiam may consider using then-available liquidity, issuing equity securities or incurring additional indebtedness.

Risk Factors

There are risks and uncertainties that could cause Gaiam s actual results to be materially different from those indicated by forward-looking statements that it makes from time to time in filings with the Securities and Exchange Commission, news releases, proxy statements, annual reports, registration statements and other written communications, as well as oral forward-looking statements made from time to time by representatives of Gaiam. These risks and uncertainties include, but are not limited to, those listed in Gaiam s Annual Report on Form 10-K for the year ended December 31, 2006. These risks and uncertainties and additional risks and uncertainties not presently known to Gaiam or that are currently deemed immaterial may cause its business, financial condition, operating results and cash flows to be materially adversely affected. Except for the historical information contained herein, the matters discussed in this analysis are forward-looking statements that involve risk and uncertainties, including, but not limited to, general economic and business conditions, competition, pricing, brand reputation, consumer trends, and other factors which are often beyond Gaiam s control. Gaiam does not undertake any obligation to update forward-looking statements except as required by law.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Gaiam is exposed to market risks, which include changes in U.S. interest rates and foreign exchange rates. Gaiam does not engage in financial transactions for trading or speculative purposes.

Any borrowings Gaiam might make under its bank credit facility would bear interest at the lower of prime rate less 75 basis points or LIBOR plus 275 basis points. Gaiam does not have any amounts outstanding under its credit facility, so any change in interest rates would not have a material impact on Gaiam s results from operations or cash flows unless Gaiam makes borrowings in the future.

Gaiam purchases a significant amount of inventory from vendors outside of the U.S. in transactions that are primarily U.S. dollar denominated transactions. Because the percentage of Gaiam s international purchases denominated in currencies other than the U.S. dollar is small, any currency risks related to these transactions are immaterial to Gaiam. A decline in the relative value of the U.S. dollar to other foreign currencies could, however, lead to increased purchasing costs. In order to mitigate this exposure, Gaiam makes virtually all of its purchase commitments in U.S. dollars.

In 2003, Gaiam purchased a 50.1% interest in Gaiam Limited (also known as Leisure Systems International Limited), a U.K. based distributor. Because Gaiam Limited s revenue is primarily denominated in foreign currencies, this investment exposes Gaiam to accounting risk associated with foreign currency exchange rate fluctuations. However, Gaiam has determined that no material market risk exposure to its consolidated financial position, results of operations or cash flows existed as of September 30, 2007.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Gaiam s chief executive officer and chief financial officer conducted an evaluation of the effectiveness of the design and operation of Gaiam s disclosure controls and procedures, as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act. Based upon their evaluation as of September 30, 2007, Gaiam s chief executive officer and chief financial officer have concluded that those disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting

No changes in Gaiam s internal control over financial reporting occurred during the quarter or nine months ended September 30, 2007 that have materially affected, or are reasonably likely to materially affect, Gaiam s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, Gaiam is involved in legal proceedings that it considers to be in the normal course of business. Gaiam does not believe that any of these proceedings will have a material adverse effect on its business.

Item 1A. Risk Factors

No material changes.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

a) Exhibits.

Exhibit No.	Description
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 (filed herewith).
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 (filed herewith).
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).

Signatures

In accordance with the requirements of the Securities and Exchange Act, the registrant caused this report to be signed on its behalf, by the undersigned, thereunto duly authorized.

Gaiam, Inc.
(Registrant)
November 9, 2007

By:	/s/ Jirka Rysavy Jirka Rysavy Chief Executive Officer
By:	/s/ Vilia Valentine Vilia Valentine Chief Financial Officer (principal accounting officer)