LUXOTTICA GROUP SPA
Form 6-K
April 30, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 6-K

REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13a-16 OR 15d-16 UNDER
THE SECURITIES EXCHANGE ACT OF 1934

April 29, 2008

COMMISSION FILE NO. 1 - 10421

LUXOTTICA GROUP S.p.A.

VIA C. CANTÙ 2, MILAN, 20123 ITALY
(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F. Form 20-F x Form 40-F o

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): o

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): o

Indicate by check mark whether by furnishing the information contained in this Form, the registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934. Yes o No x

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-

Set forth below is the text of a press release issued on April 24, 2008.

Luxottica sees strong growth in 1Q08 net sales:

+17% at constant exchange rates, +8% at current exchange rates

Milan, Italy April 24, 2008 The Board of Directors of **Luxottica Group S.p.A. (NYSE: LUX; MTA: LUX),** a global leader in the design, manufacturing and distribution of premium fashion and luxury eyewear, convened today in Milan by chairman Leonardo Del Vecchio, approved results as of and for the three-month period ended March 31, 2008(1).

Financial highlights for the period in accordance with U.S. GAAP are set forth below. A detailed balance sheet, income statements and other financial tables are attached to this press release.

First quarter of 2008(1)

millions of euro	**1Q08**	**Change at current exchange rates**	**Change at constant exchange rates**
Consolidated sales			
Group	1,398.7	+7.6%	+16.6%
Wholesale third parties	619.6	+32.9%	+37.6%
Retail	779.1	6.5%	+4.8%
Comp. Sales Retail(2)			3.0%
		Change	
Operating margin		vs. Pro forma(4)	
Group	14.8%	80 bps	
Wholesale	24.3%	+100 bps	
Retail	8.6%	320 bps	
EBITDA(3)	19.7%	70 bps	
		Change at current exchange rates	Change in US$
EPS (in Euro)	0.23	19.6%	8.1%

- Before trademark amortization(3)	0.26	15.3%	3.2%

Andrea Guerra, chief executive officer of Luxottica Group, commented: *We are pleased with our overall performance for the first three months of the current year. The Group grew significantly: +17% at constant exchange rates, due to the first effects of the integration of Oakley s business and to the organic growth of the Group all across the world. In the U.S., we posted a positive quarter also including Oakley s results for the* *first quarter on a pro forma basis, which is an encouraging indicator for the remainder of the year.*

This quarter was characterized by a continued weakness of the U.S. currency, by the slowdown of the North American market and by the activities necessary to obtain great synergies from the new journey with Oakley. In these circumstances and despite these factors, Group profitability performed well. Earnings per share before trademark amortization in US dollars was just 3% lower than the first quarter of 2007, a great quarter. That confirms an outstanding resilience of the Group to face more complicated macroeconomic trends.

We expect that for the remainder of the year, especially in the second half, our business will have an opportunity to reap to an even greater degree the benefits of its leadership in the market, exploiting Oakley s seasonality and the new wholesale/retail mix resulting from the integration. We have already implemented several business-specific as well as Group-wide initiatives to further improve our ability to capture and maximize opportunities for growth while further increasing cost controls, confirming a 5% of net sales investment plan for our future.

In the first quarter of 2008, the Group also grew in North America. Net sales for the retail and wholesale segments combined, including Oakley pro forma, grew in US$ by 3% compared to the first quarter of 2007, due to a diversified strategy and a balanced brand portfolio for the retail and wholesale segments. While there is clearly a market slowdown, the severe market fluctuations appear to have been stabilized. We have been able to plan and react to these new conditions. We have been engaged in an important cost-control plan, the purpose of which is to enhance efficiency. This plan allows us to view our prospects for future quarters positively.

Our manufacturing and wholesale segment s best brands performed very well across all regions. The different positioning of our brand portfolio, the strengths of each brand and our deeply rooted global presence allowed us to post a strong overall growth: +36% at constant exchange rates.

Integration projects with Oakley are moving very quickly, exceeding our expectations. Europe and emerging markets are the regions where we have done the most integration work so far and where we are already reaping the initial results of such work.

These results allow us to confirm our previously announced guidance for FY 2008.

In the first quarter of 2008, our two most important house brands, Ray-Ban and Oakley, posted strong results, as did the first collection of our licensed brand, Tiffany, which was successfully launched first in North America and then in other markets. The launch of 30 new colors of Wayfarer completed the restyling campaign, started last year, for this iconic Ray-Ban model and was well-received by the market. This quarter, Oakley posted double digit sales growth in the U.S. and in other markets. This is the year of the Olympic games and great product launches which are being well-received by male and female audiences.

Luxottica Group s consolidated net outstanding debt on March 31, 2008, was 2,729 million, reflecting a consolidated net debt to pro forma EBITDA ratio(3) of 2.38x.

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The officer responsible for preparing the company s financial reports, Enrico Cavatorta, declares, pursuant to paragraph 2 of Article 154-bis of the Consolidated Law on Finance, that the accounting information contained in this press release corresponds to the document results, books and accounting records.

Luxottica Group S.p.A.

Luxottica Group is a global leader in eyewear, with over 6,000 optical and sun retail stores in North America, Asia-Pacific, China, South Africa and Europe and a strong brand portfolio that includes our key house brand, Ray-Ban, the best selling sun and prescription eyewear brand in the world, as well as, among others, license brands Bvlgari, Burberry, Chanel, Dolce & Gabbana, Donna Karan, Polo Ralph Lauren, Prada, Salvatore Ferragamo, Tiffany and Versace, and other key house brands Oakley, Oliver Peoples, Vogue, Persol, Arnette and REVO. In addition to a global wholesale network that touches 130 countries, the Group manages leading retail brands such as LensCrafters and Pearle Vision in North America, OPSM and Laubman & Pank in Asia-Pacific, and Sunglass Hut globally. The Group s products are designed and manufactured in six Italy-based high-quality manufacturing plants, in the only two China-based plants wholly-owned by a premium eyewear manufacturer, and in manufacturing facilities in the United States acquired as part of the Oakley acquisition. For fiscal year 2007, Luxottica Group (NYSE: LUX; MTA: LUX) posted consolidated net sales of 5 billion. Additional information on the Group is available at www.luxottica.com.

Safe Harbor Statement

Certain statements in this press release may constitute forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Such statements involve risks, uncertainties and other factors that could cause actual results to differ materially from those which are anticipated. Such risks and uncertainties include, but are not limited to, the ability to successfully integrate Oakley s operations, the ability to realize expected synergies from the merger with Oakley, the ability to successfully introduce and market new products, the ability to maintain an efficient distribution network, the ability to predict future economic conditions and changes in consumer preferences, the ability to achieve and manage growth, the ability to negotiate and maintain favorable license arrangements, the availability of correction alternatives to prescription eyeglasses, fluctuations in exchange rates, the ability to effectively integrate other recently acquired businesses, as well as other political, economic and technological factors and other risks and uncertainties described in our filings with the U.S. Securities and Exchange Commission. These forward-looking statements are made as of the date hereof, and we do not assume any obligation to update them.

Media and investor relations contacts		
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(1) All comparisons, including percentage changes, are between the three-month periods ended March 31, 2008 and 2007.

(2) Comparable store sales reflects the change in sales from one period to another that, for comparison purposes, includes in the calculation only stores open in the more recent period that also were open during the comparable prior period, and applies to both periods the average exchange rate for the prior period and the same geographic area.

(3) EBITDA, pro forma EBITDA, the ratio of net debt to pro forma EBITDA and EPS before trademark amortization are non-U.S. GAAP measures. For additional disclosure regarding such measures, please refer to the tables attached or to the tables accompanying

the 1Q08 results conference call that the Group s management will hold this afternoon (presentation available on www.luxottica.com)

(4) Pro forma data reflects the inclusion of Oakley, Inc., a subsidiary that was acquired in November 2007, as if it was acquired on January 1, 2007.

APPENDIX

Non-U.S. GAAP Measures

Earnings per share before trademark amortization:

Earnings per share (EPS) before trademark amortization means earnings per share before trademark and other similar intangible asset amortization expense, net of taxes, per share. The Company believes that EPS before trademark amortization is useful to both management and investors in evaluating the Company s operating performance and prospects compared to that of other companies in its industry. Our calculation of EPS before trademark amortization allows us to compare our earnings per share with those of other companies without giving effect to the accounting effects of the amortization of the Company s trademarks and other similar intangible assets, which may vary for different companies for reasons unrelated to the overall operating performance of a company s business.

EPS before trademark amortization is not a measure of performance under accounting principles generally accepted in the United States (U.S .GAAP). We include it in this presentation in order to:

- improve transparency for investors;

- assist investors in their assessment of the Company s operating performance;

- ensure that these measures are fully understood in light of how the Company evaluates its operating results;

- properly define the metrics used and confirm their calculation; and

- share these measures with all investors at the same time.

EPS before trademark amortization is not meant to be considered in isolation or as a substitute for items appearing on our financial statements prepared in accordance with U.S. GAAP. Rather, these non-GAAP measures should be used as a supplement to U.S. GAAP results to assist the reader in better understanding operational performance of the Company. The Company cautions that these measures are not defined terms under U.S. GAAP and their definitions should be carefully reviewed and understood by investors. Investors should be aware that Luxottica Group s method of calculating EPS before trademark amortization may differ from methods used by other companies. The Company recognizes that the usefulness of EPS before trademark amortization as an evaluative tool may have certain limitations, including:

- EPS before trademark amortization does not include the effects of amortization of the Company s trademarks and other intangible assets. Because trademarks and other intangible assets are important to our business and to our ability to generate sales, we consider trademark amortization expense as an element of our costs. Therefore, any measure that excludes trademark amortization expense may have material limitations.

- We compensate for these limitations by using EPS before trademark amortization as one of several comparative tools, together with U.S. GAAP measurements, to assist in the evaluation of our operating performance.

- See the table on the following page for a reconciliation of EPS before trademark amortization to EPS for the quarters ending March 31, 2007 and March 31, 2008, respectively which are the most directly comparable U.S.GAAP financial measure for 1Q07 and 1Q08.

Non-U.S. GAAP Measures: EPS before Trademark Amortization

(Millions of Euro, unless otherwise noted)

		1Q07	1Q08
Trademark amortization and other similar intangible assets	(+)	15	21
Taxes on trademark amortization and other similar intangible assets	( )	(6)	(8)
Trademark amortization and other similar intangible assets, net of taxes	(=)	9	13
Average number of shares outstanding as of March 31 (in thousands)	(/)	453,990	456,361
Trademark amortization and other similar intangible assets, net of taxes, per share	**(=)**	**0.02**	**0.03**
EPS	**(+)**	**0.28**	**0.23**
EPS before trademark amortization and other similar intangible assets, net of taxes	**(=)**	**0.30**	**0.26**

- TABLES TO FOLLOW -

LUXOTTICA GROUP

CONSOLIDATED FINANCIAL HIGHLIGHTS

FOR THE THREE-MONTH PERIODS ENDED

MARCH 31, 2008 AND MARCH 31, 2007

KEY FIGURES IN THOUSANDS OF EURO (3)

	2008	2007	% Change
NET SALES	**1,398,703**	**1,299,825**	**7.6%**
NET INCOME	**103,705**	**128,257**	**19.1%**
BASIC EARNINGS PER SHARE (ADS) (2):	**0.23**	**0.28**	**19.6%**
EPS BEFORE TRADEMARK AMORTIZATION (4):	**0.26**	**0.30**	**15.5%**

Selling and operating	27,963	13,682	82,885	35,307
Corporate, general and administration	3,656	2,153	10,452	5,818
Total expenses	31,619	15,835	93,337	41,125
Earnings (loss) from operations	1,010	878	(655)	(106)
Other income (expense)	65	(1)	617	37
Interest income	1,447	202	2,022	272
Total other income	1,512	201	2,639	309
Earnings before income taxes and minority interest	2,522	1,079	1,984	203
Income tax expense	977	406	784	4
Minority interest in net (income) loss of consolidated subsidiaries, net of tax	108	(168)	178	(344)
Net income (loss)	$ 1,653	$ 505	$ 1,378	$ (145)
Net earnings (loss) per share:				
Basic	$ 0.06	$ 0.03	$ 0.06	$ (0.01)
Diluted	$ 0.06	$ 0.03	$ 0.06	$ (0.01)
Shares used in computing net earnings (loss) per share:				
Basic	26,705	18,592	23,450	16,091
Diluted	26,864	18,892	23,697	16,091

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, 2006	2005
Operating activities		
Net income (loss)	$ 1,378	$ (145)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	1,593	1,666
Amortization	3,948	1,280
Minority interest in consolidated subsidiaries	(178)	343
Noncash gain from equity investment	(680)	
Noncash stock-based compensation	365	
Deferred income tax expense	644	(469)
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	14,074	2,333
Inventory	(4,089)	1,451
Deferred advertising costs	(2,436)	(1,676)
Prepaid and other assets	(1,111)	(3,732)
Accounts payable	(7,382)	(1,290)
Accrued liabilities	(5,549)	1,512
Net cash provided by operating activities	577	1,273
Investing activities		
Purchase of property, equipment and media rights	(1,854)	(928)
Proceeds from sale of property and equipment	637	
Purchase of acquisitions and investments	(6,582)	(38,739)
Net cash used in investing activities	(7,799)	(39,667)
Financing activities		
Proceeds from issuance of common stock, net	96,609	38,468
Net cash provided by financing activities	96,609	38,468
Effects of exchange rates on cash and cash equivalents	540	(266)
Net change in cash and cash equivalents	89,927	(192)
Cash and cash equivalents at beginning of period	15,028	10,439
Cash and cash equivalents at end of period	$ 104,955	$ 10,247
Supplemental cash flow information		
Interest paid	$	$
Income taxes paid	$	$ 743
Common stock issued for acquisitions	$ 1,933	$ 390

See accompanying notes to the interim condensed consolidated financial statements

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Gaiam, Inc.
Notes to Interim Condensed Consolidated Financial Statements
(Unaudited)
September 30, 2006

1. Interim Condensed Consolidated Financial Statements

Organization and Nature of Operations

Gaiam, Inc. (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, and responsible media. Gaiam was incorporated under the laws of the State of Colorado on July 7, 1988.

The accompanying 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.

Preparation of Interim Condensed Consolidated Financial Statements

The interim condensed consolidated financial statements included herein have been prepared by the management of Gaiam pursuant to the rules and regulations of the United States Securities and Exchange Commission, and, in the opinion of management, contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly Gaiam s consolidated financial position as of September 30, 2006, the interim results of operations for the three and nine months ended September 30, 2006 and 2005, and cash flows for the nine months ended September 30, 2006 and 2005. These interim statements have not been audited. The balance sheet as of December 31, 2005 was derived from Gaiam s audited consolidated financial statements included in Gaiam s annual report on Form 10-K.

The 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 amounts reported in Gaiam s consolidated financial statements and accompanying notes. The interim condensed consolidated financial statements contained herein should be read in conjunction with Gaiam s audited financial statements, including the notes thereto, for the year ended December 31, 2005. No changes were made to our significant policies during the three and nine months ended September 30, 2006, except for the adoption of Financial Accounting Standards Board s (FASB) Statement No. 123 revised 2004 (SFAS 123R), *Share-Based Payment*. See Summary of Significant Accounting Policies discussed below.

The 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.

Summary of Significant Accounting Policies

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

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.

Goodwill

Goodwill represents the excess of the purchase consideration over the fair value of assets acquired less liabilities assumed in a business acquisition. 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 fair value of a reporting unit is compared with its carrying amount, including goodwill. If the 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 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 the 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. Investments under the cost and equity methods are included on the accompanying consolidated balance sheet in Notes receivable and other assets .

Capitalized Production Costs and Media Library

Capitalized production costs include costs incurred to produce media products marketed by Gaiam to retailers and direct-mail and online customers. These costs are deferred for financial reporting purposes until the media is released, then amortized over succeeding periods on the basis of estimated sales. Historical sales statistics are the principal factor used in estimating the amortization rate. Gaiam s media library consists of titles and content purchased or acquired. At acquisition, the fair market value of the library is established and is amortized over succeeding periods on the basis of its estimated useful life.

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Stock-Based Compensation

Prior to January 1, 2006, Gaiam accounted for its stock option program under the recognition and measurement provisions of APB Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees*, and related Interpretations, as permitted by FASB Statement No. 123 (SFAS 123), *Accounting for Stock-Based Compensation*. No stock-based compensation cost was recognized in the Statement of Operations for the quarter or nine months ended September 30, 2005, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant.

During the first quarter of fiscal 2006, Gaiam adopted the provisions of and accounted for stock-based compensation in accordance with SFAS 123R, which replaced SFAS 123 and supersedes APB 25. Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period. Gaiam elected the modified-prospective method, under which prior periods are not revised for comparative purposes. The valuation provisions of SFAS 123R apply to new grants and to grants that were outstanding as of the effective date and are subsequently modified. Estimated compensation for grants that were outstanding as of the effective date will be recognized over the remaining service periods using the compensation cost estimated for the SFAS 123 pro forma disclosures.

The adoption of SFAS 123R did not have a material impact on Gaiam s consolidated financial position, results of operations and cash flows. See Note 4 for further information regarding stock-based compensation assumptions and expenses, including pro forma disclosures for the three and nine months ended September 30, 2005 as if Gaiam had recorded stock-based compensation expense.

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	$ 4,950	$ 2,962	$ 1,522	$ 314	$ 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, 2006, Gaiam is not involved in any unconsolidated SPEs or VIEs.

Use of Estimates

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

New Accounting Pronouncements

During the quarter ended September 30, 2006, the Financial Accounting Standards Board (Board) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109* (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.* The Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This Interpretation is effective for fiscal years beginning after December 15, 2006. Earlier application of the provisions of this Interpretation is encouraged if the enterprise has not yet issued financial statements, including interim financial statement, in the period this Interpretation is adopted. Consequently, Gaiam will adopt the provisions of FIN 48 for its fiscal year beginning on January 1, 2007. Management believes that FIN 48 is applicable to Gaiam, but can not yet reasonably estimate the impact of the Interpretation.

In September 2006, the Board issued Statement No. 157, Fair Value Measurements (SFAS 157). This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements, the Board 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, 2006 consisted of $1.3 million of investments, $2.3 million in notes and related interest receivable, and $0.6 million of other long-term assets. On January 5, 2006, Gaiam entered into an agreement with Alps Communications LLC and Life Balance Media Holdings LLC (LIME), 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 owns 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. Notes receivable and other assets as of December 31, 2005 consisted of $6.8 million of investments and $0.4 million of other assets.

On June 23, 2006, Gaiam purchased, for $3.5 million, an approximate 34% ownership interest in Cinema Circle, Inc. (CCI), the parent company of Spiritual Cinema Circle, a subscription-based DVD film club. This investment was accounted for under the equity method and the excess of the cost of the investment over the underlying equity in the net assets of CCI, $2.3 million, was recognized as goodwill. Subsequent to June 30, 2006, Gaiam purchased an additional 29% interest in CCI for $3.4 million. With the purchase of the additional interest, Gaiam s ownership was approximately 63% and, therefore, commencing with the effective dates of the additional share purchases, CCI met the accounting criteria to be considered a business combination as outlined in SFAS No. 141, *Business Combinations* and Gaiam began consolidating CCI s results of operations effective July 31, 2006.

On September 30, 2006, as part of a Share Exchange Agreement, Gaiam sold 76% of its CCI ownership interest directly to CCI in return for 85% ownership in a new entity, Spiritual Cinema, Inc. (SCI), consisting primarily of CCI s formerly owned subscription based DVD club segment, thereby reducing Gaiam s ownership interest in the remaining CCI film production segment to 15%. As a result of this reduction in the CCI investment, Gaiam changed its accounting for its investment in CCI from the consolidation to cost method. SCI is consolidated into Gaiam s balance sheet effective September 30, 2006. See Note 8 Mergers and Acquisitions.

3. Stockholders Equity

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. The combined stock sales generated gross proceeds of $99.6 million. During the first nine months of 2006, Gaiam issued a total of 7,692 shares of Class A common stock to Gaiam s independent directors, in lieu of cash compensation, for services rendered in 2005 and 2006. In addition, for the nine months ended September 30, 2006, Gaiam issued 609,294 shares of Class A common stock upon exercise of options granted under Gaiam s 1999 Long-Term Incentive Plan. Furthermore, on September 29, 2006, Gaiam issued 149,698 shares of Class A common stock to acquire additional ownership of Conscious Media, Inc. See Note 8 Mergers and Acquisitions.

4. Stock-Based Compensation

Gaiam s stock option 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. Both incentive stock options and nonqualified stock options may be issued under the provisions of the Plan. Employees of Gaiam and its affiliates, members of the Board of Directors, consultants and certain key advisors are eligible to participate in the plan, which terminates no later than June 1, 2009. Options granted under the Plan generally vest and become exercisable at 2% per month for the 50 months beginning in the eleventh month after date of grant. Grants generally expire seven years from the date of grant.

Gaiam uses the Black-Scholes option pricing model to determine the 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 an option-pricing model is affected by Gaiam s stock price as well as assumptions regarding a number of complex and subjective variables. These variables include Gaiam s expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behavior, risk-free interest rate and expected dividends.

Expected volatilities are based on historical realized volatility of Gaiam s stock. Gaiam s use of historical realized volatility is based upon the expectation that future volatility over the expected term is not likely to differ from historical results. The risk-free interest rate used in the option valuation model is based on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term on the options. Gaiam does not anticipate paying any cash dividends in the foreseeable future and therefore an expected dividend yield of zero is used in the option valuation model. In accordance with SFAS No. 123R, Gaiam is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. Historical data is used to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. All stock-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods.

Total stock-based compensation recognized was $0.2 million and $0.4 million and are shown in corporate, general, and administration expenses on Gaiam s condensed consolidated financial statements for the three and nine months ended September 30, 2006, respectively.

The following table sets forth the pro forma amounts of net income and net income per share, for the three and nine months ended September 30, 2005, that would have resulted if Gaiam had accounted for its stock-based compensation plan under the fair value recognition provisions of SFAS No. 123 (in thousands, except per share data).

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net income (loss) as reported	$ 505	$ (145)
Deduct: Total stock-basedcompensationexpenses determined under fair value basedmethod for all awards	(37)	(182)
Pro forma	$ 468	$ (327)
Net earnings (loss) per common share		
As reported	$ 0.03	$ (0.01)
Pro forma	$ 0.03	$ (0.02)
Fully diluted net earnings (loss) per common share		
As reported	$ 0.03	$ (0.01)
Pro forma	$ 0.03	$ (0.02)

5. Comprehensive Income (Loss)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Net income (loss)	$ 1,653	$ 505	$ 1,378	$ (145)
Foreign currency translation adjustment, net	6	(80)	405	(408)
Comprehensive income (loss), net of taxes	$ 1,659	$ 425	$ 1,783	$ (553)

6. Earnings (Loss) Per Share

Basic earnings (loss) per share excludes any dilutive effects of options, warrants and dilutive securities. Basic earnings (loss) per share is computed using the weighted average number of common shares outstanding during the period. Diluted loss per share is computed using the weighted average number of common and common stock equivalent shares outstanding during the period. Common equivalent shares of 172 are excluded from the computation of diluted loss per share for the nine months ended September 30, 2005, because their effect is antidilutive.

The following table sets forth the computation of basic and diluted earnings (loss) per share (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Numerator for basic and diluted earnings (loss) per share	$ 1,653	$ 505	$ 1,378	$ (145)
Denominator:				
Weighted average share for basic earnings (loss) per share	26,705	18,592	23,450	16,091
Effect of dilutive securities:				
Weighted average of common stock, stock options and warrants	159	300	247	
Denominators for diluted earnings (loss) per share	26,864	18,892	23,697	16,091
Net earnings (loss) per share – basic	$ 0.06	$ 0.03	$ 0.06	$ (0.01)
Net earnings (loss) per share – diluted	$ 0.06	$ 0.03	$ 0.06	$ (0.01)

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7. Segment Information

Gaiam manages its business and aggregates its operational and financial information in accordance with two reportable segments. The business segment comprises sales to businesses, retailers, corporate accounts, and media outlets, while the direct to consumer segment includes catalog, print advertising, direct response television (DRTV), subscription, and e-commerce channels.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
Net revenue:				
Direct to consumer	$ 32,624	$ 16,248	$ 85,741	$ 41,520
Business	19,162	13,891	60,958	36,649
Consolidated net revenue	51,786	30,139	146,699	78,169
Contribution margin (loss):				
Direct to consumer	587	211	(723)	(41)
Business	423	667	68	(65)
Consolidated contribution margin (loss)	1,010	878	(655)	(106)
Reconciliation of contribution margin (loss) to net income (loss):				
Other income	1,512	201	2,639	309
Income tax expense	977	406	784	4
Minority interest in net (income) loss of consolidated subsidiaries, net of tax	108	(168)	178	(344)
Net income (loss)	$ 1,653	$ 505	$ 1,378	$ (145)

8. Mergers and Acquisitions

On September 29, 2006, Gaiam increased its ownership percentage in Conscious Media, Inc. (CMI), a multimedia company, from 51% to 86% for an additional investment of $1.9 million. Gaiam acquired stock directly from certain CMI minority interest shareholders by issuing 149,698 shares of Gaiam Class A common stock. Also on September 29, 2006, CMI reacquired and retired 14.5 million of its outstanding Class A common stock from another minority shareholder in exchange for 100% of the common stock of a wholly-owned subsidiary of CMI. As a result of these two transactions, Gaiam re-valued the net tangible assets of CMI, adjusted the portion assignable to minority interest and recorded a $1.4 million increase to goodwill. Gaiam is in the process obtaining valuations for certain tangible and intangible assets and, thus, the allocation of the purchase price is subject to refinement. Management believes that CMI s expertise in media programming, development and post production will complement Gaiam s current businesses and future growth, at a cost less than Gaiam could develop on its own. Subsequent to September 30, 2006, CMI reacquired and retired 1.0 million of its outstanding Class A common stock from a minority shareholder in exchange for the forgiveness of $1.0 million worth of a note receivable from that shareholder. As a result of this exchange and an additional Gaiam Class A common stock investment of approximately $3.0 million, of which 85,526 shares were issued to two board directors of Gaiam, Gaiam owns substantially all of CMI s outstanding stock as of November 8, 2006.

Cinema Circle, Inc. (CCI) had two business segments, direct (primarily subscription clubs) and film production. On September 30, 2006, Gaiam, CCI, and Spiritual Cinema, Inc. (SCI), a newly formed wholly-owned subsidiary of Gaiam, entered into a Share Exchange Agreement (Agreement). Under the Agreement, 100% of the equity and net assets of CCI s direct segment were acquired by SCI from CCI in exchange for 76% of Gaiam s interest in CCI and 15% of its SCI ownership. Of the $6.9 million determined cost of its 85% ownership in SCI, Gaiam allocated $6.1 million to goodwill and the remainder to net tangible assets and minority interest. The purchase price allocation is preliminary

pending identification and valuation of potentially separable intangibles, such as customer relationships, trademarks, and media rights. SCI s results of operations will be included in Gaiam s consolidated statement of operations commencing October 1, 2006. Gaiam plans to invest in its online business over the next two years to better capitalize on growing broadband subscription trends as well as to establish stronger relationships with its loyal consumer audience. This will be accomplished through the direct-to-consumer business as Gaiam continues to focus on better leveraging its content through subscription clubs and community. The investment in SCI provides immediate content that can be offered to Gaiam s existing customer base. The films distributed to SCI s members are meaningful inspirational and spiritual family films that compliment Gaiam s product offerings.

In September 2005, Gaiam acquired the majority of the net assets held by GoodTimes Entertainment and certain of its affiliates. As of December 31, 2005, the purchase price of $35.0 million was initially allocated $29.1M to media library, $13.2 million to tangible assets, and $7.3 million to assumed liabilities. During September 2006, Gaiam reduced the aggregate purchase price to $34.8 million due to unrealized estimated acquisition costs and adjusted the estimated fair values by allocating $32.4 million to the media library, $9.6 million to tangible assets, and $7.2 million to assumed liabilities. The adjustments were primarily based on additional facts about benefits and obligations as of the purchase date which were identified during the allocation period after the acquisition date. As a result of the adjustment to the media library, Gaiam recorded in September 2006 additional amortization expense of $0.3 million.

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

Forward-Looking Statements

This report may contain forward-looking statements that involve risks and uncertainties. When used in this discussion, the words anticipate, believe, plan, estimate, expect, strive, future, intend and similar expressions as they relate to Gaiam or its manag intended to identify such forward-looking statements. Gaiam s actual results could differ materially from the results anticipated in these forward-looking statements as a result of certain factors set forth under Management s Discussion and Analysis of Financial Condition and Results of Operations, Quantitative and Qualitative Disclosures about Market Risk and elsewhere in this report. Risks and uncertainties that could cause actual results to differ include, without limitation, general economic conditions, competition, loss of key personnel, pricing, brand reputation, consumer trends, acquisitions, new initiatives undertaken by Gaiam, security and information systems, legal liability for website content, merchandise supply problems, failure of third parties to provide adequate service, our reliance on centralized customer service, overstocks and merchandise returns, our reliance on a centralized fulfillment center, increases in postage and shipping costs, E-commerce trends, future Internet related taxes, control of Gaiam by its founder, fluctuations in quarterly operating results, customer interest in our products, the effect of government regulation and other risks and uncertainties included in Gaiam s filings with the Securities and Exchange Commission. We caution you that no forward-looking statement is a guarantee of future performance, and you should not place undue reliance on these forward-looking statements which reflect our management s view only as of the date of this report. We undertake no obligation to update any forward-looking information.

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

Overview and Outlook

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 and responsible media. Gaiam s media brand is built around its ability to develop and offer media content, products and lifestyle solutions 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 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, DRTV, subscription clubs, catalog, and through national retailers and corporate accounts. As of September 30, 2006, Gaiam s media was carried by over 65,000 retail stores in the United States alone, and it had approximately 7 million direct buyers.

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Gaiam offers its customers the ability to make purchasing decisions based on these values while providing quality c

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.

On September 13, 2005, Gaiam acquired substantially all of the assets of GoodTimes Entertainment and certain of its affiliates. GoodTimes Entertainment s assets included entertainment programming and home video products distributed through various channels, including television, theatres, retailers and the Internet. GoodTimes Entertainment s library contained wellness franchises such as The Firm and Tae Bo, children classics and theatrical releases.

During 2006, Gaiam expanded and strengthened its management team. Jane Pemberton joined Gaiam as President of Worldwide Distribution, having previously served in senior management roles at The Walt Disney Company, 20th Century FOX Home Entertainment and CEO of Mommy & Me. Vilia Valentine joined Gaiam from VERIO Inc. as the Chief Financial Officer. Ms. Valentine replaced Janet Mathews as CFO. Ms. Mathews assumed the position of Chief Administrative Officer. Rob Sussman joined Gaiam as President of New Media. Mr. Sussman was a founding member of the Sundance Channel and its Executive Vice President and Chief Financial Officer. John Jackson joined Gaiam as Vice President of Corporate Development and will take over acquisitions and legal affairs when Ms. Mathews leaves Gaiam at the end of November. Mr. Jackson has extensive experience in M&A transactions, business and legal affairs, including service as a partner at a national law firm and as the general counsel and an executive at two public companies. Gaiam feels that the expertise and experience of these new team members increases the depth and capabilities of an already strong leadership group.

During the three months ended September 30, 2006, both reportable segments experienced significant revenue growth over the third quarter of 2005, with the business segment generating revenue of $19.2 million, and the direct-to-consumer segment generating revenue of $32.6 million. For the nine months ended September 30, 2006, the business and direct-to-consumer segments generated revenue of $61.0 million and $85.7 million, respectively. Gaiam expects to generate over $200 million in annual revenues in 2006.

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,**			
	2006		**2005**		**2006**		**2005**	
Net revenue	100.0	%	100.0	%	100.0	%	100.0	%
Cost of goods sold	37.0	%	44.5	%	36.8	%	47.5	%
Gross profit	63.0	%	55.5	%	63.2	%	52.5	%
Expenses:								
Selling and operating:	54.0	%	45.4	%	56.5	%	45.2	%
Corporate, general and administration	7.0	%	7.2	%	7.1	%	7.4	%
Total expenses	61.0	%	52.6	%	63.6	%	52.6	%
Income (loss) from operations	2.0	%	2.9	%	(0.4	)%	(0.1	)%
Other income	2.9	%	0.7	%	1.7	%	0.3	%
Income tax expense	1.9	%	1.3	%	0.5	%	0.0	%
Minority interest in net (income) loss of consolidated subsidiaries, net of tax	0.2	%	(0.6	)%	0.1	%	(0.4	)%
Net income (loss)	3.2	%	1.7	%	0.9	%	(0.2	)%

Three Months Ended September 30, 2006 Compared to September 30, 2005

For the three months ended September 30, 2006 revenues increased 71.8% to $51.8 million from $30.1 million for the three months ended September 30, 2005. Gaiam s increase in revenue was derived from the direct to consumer segment, in which revenue increased to $32.6 million, and the business segment, in which revenue increased to $19.2 million. The revenue increase reflects the sales of media titles acquired from GoodTimes Entertainment, coupled with strong performance in our direct marketing programs, continued penetration into existing retail stores, and the addition of new retail distribution outlets. During the quarter, Gaiam added distribution to over 4,000 new retail doors, bringing the total number of doors in the United States to 65,000.

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Gross profit, which consists of revenue less cost of sales (primarily merchandise acquisition costs and in-bound freight), increased to $32.6 million for the third quarter of 2006 from $16.7 million during the same period in 2005. As a percentage of revenue, gross profit for the third quarter of 2006 increased 750 basis points to 63.0% in 2006 from 55.5% in the third quarter of 2005 which in turn was an 880 basis point increase from 46.7% in the third quarter of 2004. The increase was primarily due to strong sales of media and direct marketing products which carry higher margins, but also carry higher selling and operating expenses. The increased media sales have allowed Gaiam to leverage its purchasing volume to receive improved buying discounts. Gaiam also continued to benefit from the elimination of fees previously paid for third party distribution following the GoodTimes transaction.

Selling and operating expenses (which consist primarily of sales and marketing costs, commission and fulfillment expenses) increased to $28.0 million for the three months ended September 30, 2006 as compared to $13.7 million in the same period of 2005, primarily resulting from the GoodTimes transaction. As a percentage of revenue, selling and operating expenses increased to 54.0% in 2006 from 45.4% in 2005 reflecting additional amortization expense associated with GoodTimes media library, and a change in revenue mix toward increased media and direct marketing products which carry higher selling and operating expenses, such as merchandising fees and advertising costs.

Corporate, general and administration expenses increased to $3.7 million for the third quarter of 2006 compared to $2.2 million for the same 2005 period, primarily due to Gaiam s planned investments in its business to support the increased revenue base. As a percentage of revenue, corporate, general and administration expenses decreased to 7.0% in the third quarter of 2006 from 7.2% in the comparable 2005 period, as economies of scale are achieved on the increased revenue base.

Operating income was $1.0 million for the three months ended September 30, 2006 compared to $0.9 million for the three months ended September 30, 2005, primarily reflecting higher selling and operating expenses associated with media and direct marketing products, as well as redundant system and operating costs as a result of the GoodTimes acquisition, partially offset by increased gross profit margins.

Gaiam recorded $1.5 million in other income for the three months ended September 30, 2006 compared to $0.2 million for the third quarter of 2005. The increase in other income in 2006 primarily consisted of interest earned on the investment of the stock offering net proceeds. The share of net loss associated with minority interest was $0.1 million during the third quarter of 2006, compared to the share of net income of $0.02 million for the same 2005 period.

Gaiam recorded an income tax expense of $1.0 million for the three months ended September 30, 2006 compared to $0.4 million for the three months ended September 30, 2005. 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 s net income was $1.7 million, or $0.06 per share, for the three months ended September 30, 2006, as compared to a net income of $0.5 million, or $0.03 per share, for the three months ended September 30, 2005.

Nine Months Ended September 30, 2006 Compared to September 30, 2005

For the nine months ended September 30, 2006 revenues increased 87.7% to $146.7 million from $78.2 million for the nine months ended September 30, 2005. Gaiam s increase in revenue was derived from the direct to consumer segment, in which revenue increased to $85.7 million, and the business segment, in which revenue increased to $61.0 million. The combination of strong internal revenue growth in both segments coupled with sales of media titles acquired from GoodTimes Entertainment primarily accounted for the increase in revenues.

Gross profit increased to $92.7 million for the first nine months of 2006 from $41.0 million during the same period in 2005. As a percentage of revenue, gross profit for the first nine months of 2006 increased to 63.2% in 2006 from 52.5% in the first nine months of 2005. The increase was primarily due to strong sales of media and direct marketing products, which carry higher margins, but also carry higher selling and operating expenses. Also favorably impacting the gross margin were increased purchasing discounts associated with higher DVD sales volume and the elimination of fees previously paid for third party distribution.

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Selling and operating expenses increased to $82.9 million for the nine months ended September 30, 2006 as compared to $35.3 million in the same period of 2005, primarily resulting from the GoodTimes transaction. As a percentage of revenue, selling and operating expenses increased to 56.5% in 2006 from 45.2% in 2005 reflecting GoodTimes transition costs, distribution, management, systems, and additional amortization expense associated with its media library, and a change in revenue mix toward increased media and direct marketing products which carry higher selling and operating expenses, such as merchandising fees and advertising costs.

Corporate, general and administration expenses increased to $10.5 million for the first nine months of 2006 compared to $5.8 million for the same 2005 period, primarily due to the Gaiam s planned investments in its business to support the increased revenue base. As a percentage of revenue, corporate, general and administration expenses decreased to 7.1% in the first nine months of 2006 from 7.4% in the comparable 2005 period, as economies of scale are achieved on the increased revenue base.

Operating loss was $0.7 million for the nine months ended September 30, 2006 compared to an operating loss of $0.1 million for the nine months ended September 30, 2005, primarily reflecting higher selling and operating expenses including costs associated with the GoodTimes transition and integration, partially offset by increased gross profit margins.

Gaiam recorded $2.6 million and $0.3 million in other income for the nine months ended September 30, 2006 and 2005, respectively. The increase in 2006 primarily consisted of the $0.5 million gain from the LIME transaction, and interest earned on the investment of the stock offering net proceeds of $1.7 million. The share of net loss associated with minority interest was $0.2 million during the first nine months of 2006, compared to the share of net income of $0.3 million for the same 2005 period.

Gaiam recorded income tax expense of $0.8 million for the nine months ended September 30, 2006 compared to $4,000 for the nine months ended September 30, 2005. 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 s net income was $1.4 million, or $0.06 per share, for the nine months ended September 30, 2006, as compared to a loss of $0.1 million, or $0.01 per share, for the nine months ended September 30, 2005.

Seasonality

Gaiam s sales are affected by seasonal influences. On an aggregate basis, Gaiam generates its strongest revenues and net income in the fourth quarter 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, 2006, Gaiam had no amounts outstanding under this agreement and complied with all of the financial covenants. The credit agreement expires on July 31, 2007. Should Gaiam choose to borrow under the credit agreement, outstanding advances would bear interest at the lower of prime rate less 50 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 covenants prohibiting the payment of cash dividends to Gaiam shareholders and requiring compliance with certain financial ratios.

Gaiam s operating activities provided net cash of $0.6 million for the nine months ended September 30, 2006, 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, advanced media production, and acquired 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

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to net income of $5.7 million. During the nine months ended September 30, 2005, Gaiam s operating activities generated net cash of $1.3 million, primarily attributable to decreases in accounts receivable, inventory, and accrued liabilities of $2.3 million, $1.5 million, and $2.0 million, respectively, and noncash charges to net income of $2.8 million. These sources of funds were partially offset by an increase in prepaid expense for transition services provided by GoodTimes Entertainment of $2.6 million, holiday catalog production costs of $1.7 million, and reductions in accounts payable of $1.3 million.

Gaiam s investing activities for the nine months ended September 30, 2006 used net cash of $7.8 million to purchase an interest in CCI 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 for $0.6 million. During the nine months ended September 30, 2005, Gaiam s investing activities used cash of $0.9 million for the purchase of property, equipment, and media rights and $38.7 million to acquire assets from GoodTimes Entertainment and to fund its investment in LIME Media.

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 s financing activities provided net cash of $96.6 million for the nine months ended September 30, 2006 reflecting net cash provided by the common stock offering of $93.0 million and the exercise of stock options for $3.5 million.

For the nine months ended September 30, 2005, Gaiam s financing activities provided net cash of $38.5 million. On July 7, 2005, Gaiam issued and sold 2,821,317 shares of unregistered Class A common stock for an aggregate purchase price of approximately $18.7 million to certain funds advised by Prentice Capital Management, LP. On August 22, 2005, Gaiam issued and sold 2,500,000 shares of unregistered Class A common stock for an aggregate purchase price of $20.0 million to Revolution Living, LLC.

Gaiam believes its available cash, cash expected to be generated from operations, cash generated by the sale of Class A common stock, and borrowing capabilities 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, 2005. 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.

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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 50 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 Leisure Systems International Limited, a U.K. based distributor. Because Leisure Systems 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, 2006.

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 Rules 13a-15(e) and Rule 15d-15(e) under the Exchange Act. Based upon their evaluation as of September 30, 2006, 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 first nine months ended September 30, 2006 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. Sales of Unregistered Securities and Use of Proceeds

During the third quarter, Gaiam, Inc. issued 149,698 shares of Class A common stock to shareholders of Conscious Media, Inc. to purchase shares of Conscious Media. On November 8, 2006, Gaiam, Inc. issued 220,026 shares of Class A common stock to shareholders of Conscious Media, Inc. to purchase shares of Conscious Media. These shares were issued pursuant to an exemption from registration under Section 4(2) of the Securities Act of 1933 for sales not involving a public offering.

PART II. OTHER INFORMATION

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, 2006

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