ADVANCED ENVIRONMENTAL RECYCLING TECHNOLOGIES INC
Form 10-K
April 07, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

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

For the fiscal year ended December 31, 2007

or

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

Commission file number 1-10367

Advanced Environmental Recycling Technologies, Inc.
(Exact name of Registrant as specified in its charter)

Delaware	**71-0675758**
(State of Incorporation)	*(I.R.S. Employer Identification No.)*
914 N Jefferson Street **Post Office Box 1237** **Springdale, Arkansas**	**72764**
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code:
(479) 756-7400

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

Title of Each Class:	**Name of Each Exchange on Which Registered:**
Class A common stock, $.01 par value	The Nasdaq Stock Market

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. o Yes þ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. o Yes þ No

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. þ Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) 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. þ

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

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the average bid and asked price of such common equity as of the last business day of the registrant s most recently completed second fiscal quarter was $50,453,006 (for the purposes hereof, directors, executive officers and 10% or greater shareholders have been deemed affiliates).

Number of shares of common stock outstanding at March 28, 2008: **Class A 46,314,250; Class B 1,465,530**

DOCUMENTS INCORPORATED BY REFERENCE

Portions of our Definitive Proxy Statement for our 2008 Annual Meeting scheduled to be held June 2008, and expected to be filed within 120 days of our fiscal year end, are incorporated by reference into Part III.

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Disclaimer

Certain of the information contained in this report concerning markets and general economic activity in regard to the remodeling/renovation and housing industry is derived from U.S. government statistics and other publicly available information as well as industry sources. Although we believe this outside information to be reliable, we have not verified the accuracy of this information. We advise you to read the issues discussed in Management s Discussion and Analysis and Liquidity and Capital Resources in conjunction with our consolidated financial statements and the notes to the consolidated financial statements included on this Form 10-K as filed with the United States Securities and Exchange Commission. This report includes Risk Factors that you should consider in connection with any decision to buy or sell our securities.

Item 1. Business.

Summary

Advanced Environmental Recycling Technologies, Inc. (AERT), founded in 1988, develops, manufactures, and markets composite building materials that are used in place of traditional wood or plastic products for exterior applications in building and remodeling homes and for certain other industrial or commercial building purposes. AERT decking products are sold primarily under the trade names ChoiceDek and MoistureShield and offer an attractive wood grain appearance in multiple styles and colors. Our products are made primarily from approximately equal amounts of waste wood fiber, which have been cleaned, sized and reprocessed, and recycled polyethylene plastics which have been cleaned, processed, and reformulated utilizing patented and proprietary technologies developed and commercialized by the Company. Our products have been extensively tested, and are sold by leading national companies such as the Weyerhaeuser Company (Weyerhaeuser), Lowe s Companies, Inc. (Lowe s) and Therma-Tru Corporation. Since inception, we have sold over $537 million of products into the North American marketplace. Our products are primarily used in renovation and remodeling by consumers, homebuilders, and contractors as a low maintenance, exterior green building alternative for decking, railing, and trim products. The majority of our business (72%) is in decking, railing accessories, and trim products through ChoiceDek for the Home Improvement Warehouse (HIW) market. Our door component segment comprises 6% of our business. In 2006, we launched our MoistureShield decking line into the non-HIW market targeted towards professional contractors and large deck builders. In 2007, we expanded MoistureShield distribution via a growing network of regional distributors. As of December 31, 2007 we had 14 distributors covering approximately 70% of the United States and Canada. The ChoiceDek product was carried nationwide by Lowe s Home Improvement warehouses and distributed by Weyerhaeuser as of December 31, 2007. We also began field testing a new line of fencing in 2007.

In the fall of 2007, we retained a national advertising and marketing agency to help us expand sales and distribution and to initiate a nationwide green -building brand awareness campaign for our MoistureShield product line. It is our plan to seek additional sales for our decking products through a combination of increased and expanded distribution throughout North America, conversion of builders and contractors from other products, and international sales via export. In 2007, we initiated our first sales of $18,000 to a new distributor in the Peoples Republic of China and received the Award for Innovation at the Beijing Builder s Show. We plan to increase our green building marketing focus in 2008.

Intellectual Property

As of December 31, 2007 AERT held 14 United States Patents, including U.S. Patent 5759680 on its extruded composite product. The company also sought additional patent protection in 2007, and has additional patents currently pending in regard to its recycled plastics technologies, processes, and procedures. We maintain restricted access to our facilities and require confidentiality and non-disclosure agreements.

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Facilities

We operate two extrusion facilities and a plastics recycling facility in Springdale, Arkansas, and a plastic recycling, warehouse, and reload complex in Lowell, Arkansas. We also maintain a wood processing and back up facility in Junction, Texas. The Texas facility is our oldest and least efficient facility is being prepared for a new product concept in 2008, and is not needed for extrusion production unless and until product demand increases substantially. We recently announced construction of an additional plastics recycling facility in Watts, Oklahoma. Our corporate offices are located at 914 N. Jefferson St, Springdale, Arkansas, 72765, our telephone number is 479-756-7400, and our internet address is www.aert.com.

Market Overview

Our overall sales for 2007 declined primarily due to significant inventory cut backs by our customers combined with a significant reduction in the building materials market during the fourth quarter; however, our HIW decking customers retail sales of our products increased in 2007 over 2006. Our sales of MoistureShield decking increased as we expanded distribution over the year. We also elected to discontinue production of our line of painted window sills at the end of 2007. This market niche has diminished significantly and is primarily tied to companies who sell to builders for new home construction. Our sales of primed/painted components were $1.6 million in 2007.

The Consumer Confidence Index fell to 88.6 in December, down from 110.2 at the beginning of the year. A Harvard University Joint Center for Housing study recently reported expenditures for homeowner remodeling activity totaled approximately $176 billion in 2007, down from $178 billion in 2006.

The primary market for our decking products is renovation and remodeling. Industry estimates show over 4 million decks were built in the U.S. in 2007 with over 80% comprised of wood. It is estimated that over 3.3 billion lineal feet of wood lumber, in excess of approximately $4 billion was sold in 2007 for deck surface and railing products according to industry research by Principle Partners. Residential non-wood decking and railing products were estimated to be around 590 million lineal feet.

Approximately 80% of the lumber used for wood decks and railing is pressure treated with chemicals for decay and insect resistance. The primary species are pine and fir with the balance being redwood and cedar products. Wood products are sold throughout the U.S. by regional suppliers directly to lumberyards and home centers. According to the industry publication Random Lengths the price per MBF (thousand board feet) of pressure treated lumber (southern yellow pine, composite price) has declined from averaging a high of $514 in April of 2006 to $380 in December of 2007.

The non-wood decking segment is divided between 100% plastic products such as polyethylene (PE), fiberglass, polypropylene (PP), or polyvinyl chloride (PVC) and wood-plastic composites which are produced from a combination of wood fibers, polyethylene, polypropylene (with or without thermosets or phenolics), and polyvinyl chloride.

In previous housing or economic downturns, remodeling activity has increased as people tend to upgrade or improve existing homes rather than purchase a new one. As the majority of our business is remodeling oriented, we do not believe the decking business is as affected as the new home construction market. We believe renovation or the addition of decks and railings to existing homes is an increasing trend and reflects an extension of the home with cost effective outdoor living space. We believe we have a unique opportunity to capture additional market share with our expanded line of green decking and railing products in 2008 as consumers are increasingly becoming aware of the benefits of recycling and green building.

A recent Wal-Mart Live Better Index Benchmark survey conducted by Harris Service Bureau showed that:

80% of consumers believe it is important to buy from green companies and a majority say they would spend more on green products. PBS Internet Survey Group, 2007

62% of Americans would buy more eco-friendly products when there is no price difference

68% of Americans feel recycling at home has an impact on the environment

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47% of Americans say they feel like a smart consumer when they buy environmentally friendly products

With near record petrochemical prices, we believe our investments in recycling technology and infrastructure will create a significant raw material cost advantage prior to 2009 compared to several of our virgin resin based competitors while offering a more competitive green building product. A major focus in 2008 is to make green more affordable than the competition.

AERT Mission Statement

Our goal is to be the leader in plastic recycling, wood/plastic extrusion technology, and the building products we make through customer satisfaction, sales growth, associate development, and earnings while building shareholder value.

Green Building Products

We currently sell our ChoiceDek-branded decking products in the HIW market through Weyerhaeuser to Lowe s. This market segment primarily focuses on the do-it-yourself (DIY) market in which homeowners buy, build, and install their own decks. ChoiceDek has been sold in Lowe s exclusively from 2001 until 2007. ChoiceDek is currently stocked in 1500+ Lowe s stores in the U.S. and Canada. The current ChoiceDek product offering for 2008 consists of three colors: grey, woodtone, and redwood with matching trim boards and accessories. In addition two decking products representing a tropical hardwood look, spicewood and driftwood, are also available via special order. ChoiceDek is promoted through in-store displays and an ongoing print and marketing campaign that targets the residential decking market. We maintain a nationwide sales and customer service group consisting of 36 associates. Lowe s also conducts national print and television ads for the products it carries. The loss of Lowe s as a customer of AERT products would have a severe adverse affect on the company.

MoistureShield Decking. In October 2004, we began production of our new MoistureShield brand line of decking products, which consists of four colors and two tropical hardwood colors under our Rainforest Collection with a distinct wood-like embossed surface pattern. MoistureShield decking is currently sold to select primary distributors, who re-sell it to lumber dealers and contractor yards for sale to local deck builders and home builders. MoistureShield decking sales represented about 19% of total Company sales in 2007 up from 9% in 2006, during which we had limited production capacity available to serve that market. The MoistureShield decking line allows us to diversify our customer base. In 2008 we will be presenting additional decking and handrail products to offer a complete line to this customer segment, as we move to expand MoistureShield into nationwide distribution. In addition, the DIY market is also serviced by the Home Depot, as well as several smaller regional chains. Our decking products are is not currently carried in Home Depot and the ChoiceDek brand is exclusive to Lowe s.

Privacy Fencing Systems. In January 2007, we announced our newest product, LifeCycle Fencing. We estimate the privacy fence market to be $5.5 billion annual sales with metal products comprising 63% of the market and wood/other products at 37%. We believe there is a substantial market for an aesthetically pleasing fence product that will serve for twenty years or more, which we expect LifeCycle Fencing to do. In fact, we intend to certify LifeCycle Fencing for use in hurricane-prone regions of the U.S. where its strength and durability could give it a clear competitive advantage over other, less durable, fencing products. We began test marketing LifeCycle Fencing with several large fencing contractors in 2007 and intend to launch this product line in the second half of 2008.

Door Component Products. We sell our MoistureShield industrial products to door manufacturers for use as component parts in products. For example, we manufacture door rails built into doors by Therma-Tru Corporation. In marketing, we emphasize the value-added feature of the MoistureShield composite product, which unlike competing wood products, can be engineered to incorporate certain desired end-product characteristics that save our customers time and expense. Customers also avoid the need for chemical treatments to their final product, which are often otherwise necessary to prevent rot and sustain durability. The durability of our MoistureShield composite components allows our customers to extend the lifetime or warranties of their products while reducing or eliminating warranty claims costs.

Therma-Tru purchases approximately 80% of our industrial products. The loss of this customer would negatively impact sales and earnings. We are unable to predict the future size of the markets for MoistureShield industrial products; however, we believe that the national door and window, commercial and residential trim, and residential decking material markets are large and growing and will allow us to diversify our customer base over time as we add production capacity and focus on additional opportunities.

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Marketing and Sales

General Market Strategy. We have manufactured wood plastic composite products since 1988. Our products are designed for applications where we can add the greatest value and address market needs, i.e. for external applications where wood is prone to rot and/or requires substantial yearly maintenance in the form of staining or water sealing. Though we believe there are many possible applications for our wood/plastic composite technology, we have focused our resources and personnel on outdoor decking and handrail components, door and exterior trim components, and soon outdoor fencing, which in our view represent the most attractive market opportunities at this time. Within our chosen markets, we are constantly working to develop and improve strong customer relationships.

Exterior Trim and Fascia Products. We have marketed an exterior trim and fascia system under the trade names MoistureShield Trim and MoistureShield CornerLoc. Several national homebuilders have been specifying and using the product. We believe this product line has significant growth potential as a Green alternative to PVC and wood trims to be distributed and sold in conjunction with our MoistureShield distributors. This product line is currently being redesigned to be sold as an extruded product, eliminating the additional manufacturing steps of milling and priming, although some limited product quantities are still being sold. The timetable of a full product launch is scheduled for the second part of 2008.

Sales and Customer Service. We provide sales support and customer service through our own marketing department, through outside commissioned representatives with an affiliated entity, through Weyerhaeuser, and through training programs for our customers and their sales associates. We also promote our decking products through interactive displays at national, regional, and local home and lawn and garden shows, as well as through in-store displays. Our in-house sales and customer support team is focused on serving commercial decking contractors and customers and supporting the sales professionals at our regional building products distributor customers as well as Weyerhaeuser and Lowe s. Information and customer service are provided through the websites www.choicedek.com and www.moistureshield.com, and through a national toll-free customer assistance telephone number, 1-800-951-5117. We also use independent, outside sales representatives in some markets to serve door, window, and decking customers.

Cyclical Nature of Building Products Industry. Our products are used primarily in home improvement and new home construction. The home improvement and housing construction industries are subject to significant fluctuations in activity and periodic downturns caused by general economic conditions. High fuel prices, reduced disposable income, and economic uncertainty in particular can lead to reduced home improvement activity, such as has occurred since mid-2006. Reductions in such activity has an adverse effect on the demand for our products. We have focused a large portion of our business on the remodel and repair market segment, which we believe is less cyclical than the new homebuilding market.

Facility Upgrades/Product Innovation. In our constant pursuit to satisfy our customers, and to keep up with changing trends in the marketplace, we routinely analyze the need to develop new products and improve existing products. In 2007 we further upgraded and consolidated our manufacturing and recycling facilities in order to produce a new line of decking and handrail products for 2008. We have invested significantly in plastic recycling technology and infrastructure over the last several years, which is also a strategic initiative designed to help insulate our raw materials purchasing from wide price swings associated with the petrochemical markets. As technology has improved so has the aesthetics of our products, which are overwhelmingly composed of recycled materials.

The composite decking business is continuously evolving. The technology used to manufacture wood/plastic boards has advanced significantly over the last four years and many contemporary products have much improved aesthetics. Going forward, it will be important for AERT to continue to innovate and keep in close touch with consumer trends and focus on regional market trends.

Sales and Innovation

We are committed to becoming the leader in green building products from recycled plastic materials. In addition, we believe plastic recycling technologies could lead to new opportunities in the future.

As manufacturing technology and aesthetics of composite decking improve, market trends are also shifting. Consumers are demanding more variety and selection compared to prior periods as demand for multi-color decks appears to be increasing. Also, the evolution toward a more natural wood look appears to be increasing on the higher end of the market, while decreasing wood prices have widened the price differential on the lower end. Our MoistureShield decking line has been upgraded and reintroduced to address these trends in the market.

The MoistureShield decking introduction is targeted toward the commercial contractor lumberyard, which provides service to large repeat customers. Most of these large customers are regularly purchasing, or have been exposed to, competing brands of composite decking. On this higher end segment, we believe success will require converting customers from competing products to our brands such as MoistureShield or upgrading from wood with ChoiceDek or Basics. Thus, a significant marketing effort was initiated during the fourth quarter of 2006 and continued throughout 2007. The marketing program is focused on green building and converting high volume customers to our products. To help us achieve these goals, the Company has retained the services of a national advertising and marketing agency.

With difficult conditions facing the decking market, AERT is differentiating its products through a combination of green building features, price point, quality, and outstanding customer service. We believe we are in a favorable position to increase market share, but maintaining our low cost model could restrict our ability to grow profit margins over the next year.

From 2001 until earlier this year, Lowe s home improvement stores had carried our Weyerhaeuser ChoiceDek products exclusively in the composite decking category. During 2007, Weyerhaeuser introduced a store special order program, and third color selection into the ChoiceDek set in the Lowe s home improvement warehouses. In addition, 150 new stores opened in 2007 and 140 stores are scheduled to open in 2008, which will also carry Weyerhaeuser ChoiceDek. Two new tropical hardwood products are also available in ChoiceDek for Lowe s. Lowe s started carrying another, though higher priced, decking brand beginning in 2007, which could limit the strong growth that ChoiceDek has enjoyed the last three years. Lowe s is broadening the decking category and adding more accessories as it attempts to broaden its customer base and gain market share. We will continue to work toward more selection combined with innovation and new products in conjunction with our customers.

Advanced Recycling Technologies Mining the Plastic Waste Stream

Over the last two years, we have invested over $3.1 million in plastic recycling technology and infrastructure. The benefits to the investment are just starting to take effect. In addition, we have incorporated a new state of the art plastic analytical laboratory at our Lowell, Arkansas facility. We have also developed and recently filed a patent application on several new technologies, which allow us to analyze and blend mixed plastic waste materials into reformulated, consistent plastic feedstocks. These technologies, combined with recently completed mixing and blending infrastructure, are now coming into commercial fruition.

Over the last year we have developed and installed a new system to blend the various polyethylene films that we recycle in order to deliver a homogenous feedstock to our extrusion plants. This blending system became operational late in the third quarter 2007, and we expect it to have a positive impact on throughput and yields at our extrusion plants. We also continue to upgrade the equipment at our Lowell plastic recycling facility in order to increase throughput, lower operating costs, and maximize the return on our investment. This should also have a positive effect on our cost structure.

Because of competition from overseas, prevailing prices of easy to access recyclable plastics have risen to the point that we must increase our efficiencies and find new, lower cost sources of raw materials. Initial permitting for the new Oklahoma recycling facility has been cleared and we have recently obtained financing and broken ground on this new facility. The new facility is designed to allow us to use the less desirable, but low cost, forms of waste polyethylene and additional sources of waste wood fiber, which should greatly assist us in regaining a competitive advantage and maintaining a low cost structure. The initial phase of the Oklahoma project is currently estimated to cost $15 million and take one year to build.

As worldwide demand increases for oil and petrochemicals, prices of those products continue to rise. In conjunction with these price increases, prices for consistent, easier to recycle plastics also increase. Thus, in response to continued price escalation of plastic raw materials, we initiated a program focused on recovering and recycling polyethylene packaging films from a segment of the United States waste stream. These films are recycled at a rate of less than 3%, according to recent United States Environmental Protection Agency statistics. We believe these materials can be obtained in large quantities for minimal handling and freight charges. Preliminary laboratory analysis completed within the last year on samples of these materials shows the quality to be acceptable for our blending technologies and systems. Thus, it is our intent to acquire up to 40% of our plastic raw materials from these types of sources, and recycle 70% of our plastics internally.

The project involves retrofitting a large agriculture hog feedout and finishing facility and its confinement buildings into a state of the art plastic recycling and washing facility. We successfully completed a joint development project involving polyethylene film recovery with the Dow Chemical Company earlier in our history. Based on that project, we intend to build a model, state of the art plastic recycling and waste management facility at the Watts, Oklahoma location. Once operational, we believe that further refinement of this technology could lead to additional revenue opportunities beyond composite decking and building materials. With petrochemical prices near all time highs, the future sales opportunities for plastic resin recycled substitutes could be substantial. We successfully completed a $13.5 million funding for this initial phase during the fourth quarter of 2007, and our goal is to have the first phase operational by the fourth quarter of 2008.

Our new Springdale South plant is now operating efficiently, and the installation of the next three lines will be relatively fast, as most of the infrastructure is in place for four lines, and we should be able to increase production capacity relatively quickly as demand picks up or new markets are opened. However, financing will have to be obtained for any further expansion.

Raw Materials

Wood Fiber. The wood fiber we use is waste byproduct generated by hardwood furniture, cabinet, and flooring manufacturers. Until recently, the cost of acquiring the waste wood has primarily been the handling and transportation costs involved in getting the material to our facilities. Costs vary with transportation costs in general, which are related to petroleum prices and the supply and demand for over-the-road trucking services. Our cost of sourcing waste wood fiber has increased over the last three years due to transportation costs, but remains a small proportion of our total costs. The housing slowdown starting in mid-2006 reduced the demand for hardwood building products and has caused some of our suppliers to temporarily close facilities, which has forced us to pay higher costs to source wood elsewhere. In addition, we now increasingly see competition for scrap wood fiber for use as a fuel to replace natural gas or oil burners for both residential and industrial applications.

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One of our waste wood fiber suppliers accounted for approximately 45% of our wood fiber purchases by weight and another accounted for approximately 20%. Based on our discussions with other waste wood fiber suppliers, we believe that if the arrangements with one or both of these suppliers were terminated we would be able to obtain adequate supplies of waste wood fiber at an acceptable price from new suppliers. We are currently evaluating the feasibility of establishing an in-house wood fiber reclamation and cleaning system in northwest Arkansas or at our Watts, Oklahoma facility.

Cedar Fiber. We are currently sourcing heartwood cedar from ranches surrounding our Texas facility in Junction, Texas. Earlier in our history our initial products utilized heartwood cedar fiber sourced from cedar oil mills in the area. Several mills subsequently ceased operations and supplies diminished. Additional equipment for wood processing has been installed in our Texas facility in order to process logs, trees, and brush that is currently being cleared from the ranches. This initiative is designed to work with a Federal farm program designed to eradicate brush from ranch land and improve surface water supplies. The initial plan is to process raw cedar and transfer it to Springdale, Arkansas to reintroduce the natural cedar product line.

Recycled Plastics. We use the following classes of industrial and consumer waste polyethylene:

- Low density polyethylene (LDPE) poly coatings or linings from recycled bleached food-board, which are generated from the hydro-pulping process;
- High density polyethylene (HDPE) and linear low density polyethylene (LLDPE) mixed plastic grocery bags from supermarket and store collection programs;
- HDPE ground container material;
- LLDPE stretch film from warehouses and packing waste;
- Virgin HDPE and LDPE pellets; and
- Mixed PE films from industrial and municipal sources.

The largest portion of the materials we use is contaminated with paper and other non-plastic materials, which lessen its value to other plastic recyclers. Our proprietary recycling process does not require the purity, extensive cleaning, additional washing, and melt filtration required for conventional plastics manufacturing, and can be conducted faster and more economically. By primarily sourcing these contaminated waste plastics prior to processing, we produce a usable but lower cost feedstock for our composite extrusion lines. We also purchase plastic raw materials from outside sources, including virgin resin producers. These materials are more expensive and more sensitive to price swings related to the petrochemical industry. We also are subject to various quality and consistency problems when dealing with third party scrap suppliers, which increases our costs.

One supplier accounted for about 48% of our 2007 polyethylene scrap purchases by weight. No other of our more than 100 polyethylene suppliers accounted for more than 10% of our purchases by weight.

Over the last several years, we believe three factors have caused an increase in the demand for scrap polyethylene and, consequently, the cost to us of acquiring raw materials for our manufacturing process.

- As global political and economic factors have caused an increase in the price of petroleum, there was a related rise in the price of virgin plastic, which is a petroleum and natural gas derivative. This in turn increased the demand for scrap plastics since scrap can be substituted for virgin plastics in many manufacturing applications. We thus began competing with scrap plastic consumers that had not previously been in the market.

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The relative decline in the value of the dollar versus major Asian currencies has made it economical for Asian manufactures to source scrap plastic in the U.S. for use in their countries. We have thus encountered significant competition for scrap plastics from foreign consumers that had not previously been a factor in the market. Demand for petrochemical products from China, India and other rapidly expanding economies is expected to increase.

As annual sales of wood composite decking products have grown, we and other composite decking manufacturers have become relatively large consumers of scrap plastics, which has created increasing competition for raw materials and driven up prices.

On the other hand, we believe that the economics of recycling are now such that more private and public entities will find it attractive to undertake removing plastic scrap from the waste stream and make it available to consumers like us.

Supply Contracts. We purchase raw materials under both supply contracts and purchase orders. In 2007, we purchased 45% of our polyethylene scrap and all of our waste wood via purchase orders. Purchase order acquisitions are one-time transactions that involve no long-term obligation. We also have both polyethylene and wood supply contracts, with terms that range from one to three years, which obligate us to purchase materials. The prices under these contracts are renegotiated semi-annually or annually. In the past three years, the amounts we have been obligated to purchase under the supply contracts have been significantly less than the amounts of these materials we have needed for production.

Competition for Raw Materials. As the wood/plastic composites industry grows, we sometimes compete for raw materials with other plastic recyclers or plastic resin producers. We believe that our ability to use highly contaminated polyethylene limits the number of competitors because most recycling processes require cleaner waste plastic sources. Nonetheless, we expect to continue to encounter new entrants into the plastics reclamation business. These new entrants may have greater financial and other resources than we do, and may include domestic and foreign beverage bottlers, manufacturers, distributors and retailers, forestry product producers, petrochemical and other companies. We increased our capacity for processing waste plastic in recent years, which reduced our dependence on outside suppliers and reduces our overall costs but it is still not to our desired levels. There is no assurance that we will be able to control the effect that increasing waste plastic costs has on our profitability. (see Item 7. Management s Discussion and Analysis Liquidity and Capital Resources.)

Patented and Proprietary Technology

Our composite manufacturing process and our development efforts in connection with waste plastics reclamation technologies involve patents and many trade secrets that we consider to be proprietary. We have also developed certain methods, processes, and equipment designs for which we have sought additional patent protection. We have taken measures to safeguard our trade secrets by, among other things, entering into confidentiality and nondisclosure agreements, and restricting access to our facilities. We also have installed advanced security systems, including limited access and cameras, at all facilities including on-site security personnel. Should our trade secrets be disclosed notwithstanding these efforts, our business and prospects could be materially and adversely affected.

We have filed nineteen patent applications and have received issuance from the United States Patent and Trademark Office for fourteen patents, five of which relate to our composite materials manufacturing operations and product, and nine of which relate to waste plastics reclamation technologies. The patents cover our composite product, extrusion process and apparatus, our continuous down-stream cooling and forming conveyor system and our plastic reclamation process and equipment. The cost of patent protection and, in particular, patent litigation is extremely high. It can also strain resources and inhibit growth.

Industry Standards

Local building codes often require that building materials meet strength and safety standards developed by the International Code Commission and that, in order to qualify, the materials be evaluated by an independent testing organization. Our decking, handrails and stair applications are covered in a National Evaluation Report (NER) under NER-596, which provides local building inspectors and code officials with independent testing and installation information regarding our products. We believe that the NER listing has helped to increase sales and market acceptance of our decking products. We have renewed our building code listing during the end of 2007 and are currently in the process of upgrading and increasing the number of products covered for additional building code approval in this expanded listing application.

Regulation

AERT is subject to federal, state, and local environmental regulations. Environmental discharges and impacts from our manufacturing facilities, including air, solid waste, and wastewater discharges, must meet the standards set by environmental regulatory authorities in Arkansas, Texas and Oklahoma. Compliance with environmental laws has not had a material effect on our operating results or financial condition.

Our operations are also subject to workplace safety regulation by the U.S. Occupational Safety and Health Administration and the states of Arkansas, Texas, and Oklahoma. We provide safety awareness and training programs for all associates who work in a manufacturing environment.

Competition

Competition for Sales. Our products compete with high-grade western pine, cedar and other premium woods, aluminum, high-performance plastics, and an increasing number of composites and other construction materials. We believe that our products have superior physical characteristics, which make them a better value for the consumer; however, they are more expensive initially than traditional wood products. Manufacturers of some competing products, however, have long-established ties to the building and construction industry and have well-accepted products. Many of our competitors are larger and have research and development budgets, marketing staffs, and financial and other resources that surpass our resources.

Sales of non-wood decking products to date represent a small portion of the decking market. According to an independent research report from Principal Partners, the wood-alternative market share was 19% in 2006. Pressure treated pine, cedar, redwood and other traditional woods constitute the vast majority of annual decking sales. We thus view wood decking as our principal competitor. The wood decking industry is highly segmented with many small to medium sized manufacturers. Wood decking is principally a commodity that competes as the low-priced product, whereas the more expensive non-wood products must compete on features and performance.

Among manufacturers of alternative decking materials, we view Trex Company, TimberTech Ltd., Tamko Building Products and Fiber Composites LLC as our primary competitors. Louisiana Pacific exited the business and sold its Weather best grand and one of its plants to Fiberon during 2007. Certainteed also announced exiting the business in 2007.

The market for door products is highly segmented, with many competitors. We believe that our MoistureShield industrial products have superior characteristics and are competitively priced. We emphasize durability, which means that manufacturers and homebuilders using our products should see reduced warranty callbacks and higher customer satisfaction. Our product competes on durability and the ability of the customer to order a product that is custom manufactured to its specifications.

Employees

On December 31, 2007, we employed 662 people on a full-time basis. We reduced associates at the Texas facility to 17. The Arkansas facilities, including our corporate office and field sales team, employed 645 full-time associates, of

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which 4 were executives, 125 were sales or office personnel and 516 were full-time factory personnel. From time-to-time, we hire part-time employees to supplement our workforce.

Available Information

We make available free of charge on our website (www.aert.com) our periodic reports filed with the SEC on Forms 10-K, 10-Q, and 8-K and amendments to these reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

Item 1A. Risk Factors.

Our business is subject to a number of risks, including but not limited to the following:

Risks Related to Operating Our Business

The demand for our products is influenced by general economic conditions and may be adversely affected by general economic downturns or declines in construction activity.

Our products are sold in the home improvement and new home construction markets. These markets are subject to significant fluctuations in activity and periodic downturns caused by general economic conditions, as has been the case since mid-2006, which contributed substantially to the decline in our revenues from $98 million in 2006 to $82 million in 2007 and to the resulting net losses we experienced. Slowdowns in the economy or construction activity may result in a reduction of the demand for our products and adversely affect our profitability. A worsening of the current economic climate, including further deterioration of the credit markets and/or consumer confidence, will negatively impact the Company s sales and profitability.

The loss of one or more of our key customers could cause a substantial reduction in our revenues and profits.

We could be materially adversely affected if we were to lose one or more of our large existing customers. Our principal customer for our decking material is Weyerhaeuser, which accounted for 75% and 81% of our sales in 2007 and 2006, respectively. A few large door and window construction companies have historically purchased substantially all of our industrial component products. A loss of any one of our large customers would adversely affect our sales and profitability.

We may be unable to secure an adequate quantity of quality raw materials at economical prices.

Our products are constructed primarily from scrap wood fiber and scrap polyethylene. The markets for such scrap materials are dynamic. The global demand for these materials has increased significantly and we expect demand to continue to increase. The largest component of our raw material costs is scrap polyethylene. The price that we must pay for these materials is related to the market prices of natural gas and petroleum, which have been rising and volatile in recent years. Our future profitability is contingent on us being able to manage raw material costs under these circumstances.

Weather

Sales of decking and accessories are subject to weather and seasonality trends associated with outdoor construction. Our current product mix is sold year round but experiences significant higher retail sales during the second and third quarters which run from April through September. Thus, adverse or bad weather during the first or fourth quarters could result in a negative impact on sales.

High fuel prices

Near record gasoline and diesel prices may reduce consumers disposable income unless driving is curtailed, substitutions are made, or fuel prices retreat. This may substantially reduce funds available for home improvement or remodeling.

We are highly leveraged and if we are unable to comply with certain debt covenants, our financial position and operations could be adversely affected.

Our $24.7 million outstanding bond agreements, including our 2003 bonds and our $13.5 million of new bond indebtedness incurred in December 2007 for the development of a new facility in Oklahoma, contain certain financial covenants. The 2003 bonds included the following covenants at December 31, 2007: (1) a current ratio of not less than 1.00 to 1.00, (2) that not more than 10% of accounts payable be in excess of 75 days past the invoice date, (3) that not more than 20% of accounts receivable be in excess of 90 days past the invoice or billing date (unless contested in good faith or written off), (4) a requirement that we maintain a long-term debt service coverage ratio for the preceding four quarters of at least 2.00 to 1.00 and (5) a debt-to-equity ratio of not more than 3.00 to 1.00 as of any year-end. Our 2007 bonds have substantially the same covenants as our 2003 bonds, except that the accounts payable percentage is 20% and the debt service coverage ratio requirement is 1.5 to 1 through December 31, 2008, and moves to 2 to 1 beginning with the quarter ended March 31, 2009. We were not in compliance with the accounts payable and debt service coverage ratio covenants at December 31, 2007; however, the debt service coverage covenant was waived by the bondholder as of December 31, 2007 through, and including, March 31, 2008, and the accounts payable covenant was waived by the bondholder as of December 31, 2007 through, and including, December 31, 2008.

In September 2007, the Company renewed its $15.0 million bank line of credit through June 2008. The revolving credit facility includes covenants substantially similar to those under our 2003 bond agreements and customary restrictions on dividends and the incurrence of additional debt or liens, among other matters. The bank has waived any past noncompliance with those covenants in connection with the September 2007 renewal through June 2008.

There is no assurance that we will be able to comply with these debt covenants in the future, or that the bondholder or bank lender will waive or modify the covenants in the future. If we are unable to comply with any of the covenants or obtain a waiver or modification of the covenants in the future, except the debt service coverage covenant, then the bond debt, in the amount of $24.7 million at December 31, 2007, or bank loan, in the amount of $12.3 million at December 31, 2007, could immediately become due and payable, the bondholder or bank lender could foreclose on the property used to secure the debt, which consists of substantially all of our material operating assets, and the bondholder could claim our revenues pledged as part of the bond agreement. If we are unable to comply with the debt service covenant, then we could be required to retain a consultant to make recommendations to increase the debt service coverage ratio to required levels, and to follow those recommendations.

If we do not effectively manage our growth, our business resources may become strained and our results of operations may be adversely affected.

Though our sales decreased $15.6 million in 2007, we increased our sales by $10.5 million in 2006, $23.7 million in 2005 and $20.1 million in 2004. Our products have seen significant growth, and our customers have significant established expansion plans. We expect significant future growth. This growth may provide challenges to our organization and may strain our management and operations. We expect to expand our manufacturing capabilities and to automate while we continue to become more efficient with our facilities. Our ability to effectively manage growth depends on our success in attracting and retaining highly qualified personnel and our ability to finance and implement additional production equipment and manufacturing facilities. We may be unable to accurately predict the amount of time or resources that will be required to effectively manage any anticipated or unanticipated growth in our business. We may not be able to attract, hire and retain sufficient personnel or acquire and implement sufficient manufacturing capacity to meet our needs. If we cannot scale our business appropriately, maintain control over expenses, or otherwise adapt to anticipated and unanticipated growth, our business resources may become strained, we may not be able to deliver products in a timely manner and our results of operations may be adversely affected.

Our growth is limited by the availability of human capital resources.

Future profitable growth will require us to recruit and retain qualified associates. We have recently hired a new President and named a new V.P. of Operations, both of whom have significant prior industry experience; however, we compete with many larger companies in the labor market, many of whom offer more attractive compensation packages than we are able to

economically provide. Though we have adopted equity compensation plans to aid in our efforts to recruit and retain qualified associates, our compensation offerings may not be as attractive as our competitors and the accounting treatment for such equity plans results in a reduction in our earnings.

We have recently been sued by plaintiffs alleging defects in our decking products

We have recently been sued by two separate groups seeking class action status and alleging defects in our decking products that make them susceptible to mold or mildew growth. Although the Company denies the allegations and intends to vigorously defend itself, the costs of litigation is always high and can strain the resources of and an unfavorable litigation outcome could have a material adverse affect on the Company. *See Item 103 Legal Proceedings.*

Fire disruptions may adversely affect our ability to operate our business.

Our raw materials and manufacturing processes involve a greater than average risk of fire loss or disruption. Through the Company s history, we have experienced several fires, some of which severely disrupted our manufacturing operations. There was an accidental fire at our Junction, Texas facility in March 2003, which caused substantial damage and temporarily shut down plant operations. Although we have increased security and increased fire protection equipment at our facilities, another major fire could occur and materially adversely affect our operations.

Our strategy of using recycled plastic and waste wood to create a competitive cost advantage involves significant risks, the occurrence of which may materially adversely affect our profitability.

Our business strategy is to provide an environmentally friendly product at a competitive price. To achieve our business objectives we must recycle plastic and process waste wood on a cost-effective basis and efficiently convert these materials into high-quality finished goods. This strategy involves significant risks, including the risks that:

Our profitability may be materially diminished. The intrinsic variability of our raw material sources can result in considerable reduction in our operating rates and yields, which may more than offset any savings we realize from the purchase price of the materials.

We may not produce a sustainable return on investment. Because our production model requires backward integration in plastic recycling operations, as well as customized solutions for material preparation, compounding and extrusion, our model is significantly more capital intensive on a per-unit-basis than the models of our typical competitors. Our plants must convert our raw materials at high rates and net yields to generate the profit margins and cash flows necessary to sustain our business.

We may be limited in the markets in which we can effectively compete. Successfully expanding our business beyond decking would require applying our formulation and process technology to increasingly more challenging applications, such as high-end railing systems and fencing. The greater complexity and tighter design tolerances of such profiles require a level of process control that is more stringent than the level involved in deck board production. Our raw materials and process technology may not permit us to develop new applications on a cost-effective basis.

Environmental regulation exposes us to potential liability for response costs and damages to natural resources.

We are subject to federal, state, and local environmental laws and regulations. The environmental laws and regulations applicable to our operations establish air quality standards for emissions from our manufacturing operations, govern the disposal of solid waste, and regulate wastewater and storm water discharge. As is the case with manufacturers in general, we may be held liable for response costs and damages to natural resources if a release or threat of release of hazardous materials occurs on or from our properties or any associated offsite disposal location, or if contamination from prior activities is discovered at any properties we own or operate.

Identification of certain weaknesses in our internal controls.

Our management identified three material weaknesses in our internal control over financial reporting as of December 31, 2007, two of which were also cited weaknesses in our internal controls as of December 31, 2006. Management concluded that the Company did not have an adequate process in place to assess potential impairment of fixed assets, that the Company s inventory costing system was not adequately documented nor were there adequate procedures for an independent review of the costing analysis to ensure completeness and accuracy of

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the calculated costs, all of which were rated as weaknesses last year and which we have been in the process of remediating. Additionally, at the entity level, the Company has not properly allocated resources to ensure that necessary internal controls are implemented and followed throughout the Company. We are in the process of remediating the weaknesses in our internal controls; however, there can be no assurance at this time that our remediation plans and the actions we take will effectively remediate the material weaknesses.

Maintaining product innovation at competitive costs

With ever increasing competition and with an increasing number of new products entering the marketplace, we must maintain the quality and performance of our products while constantly addressing the needs of our customers in the marketplace. This involves offering a broader selection of high quality products on a routine basis, while being able to maintain acceptable manufacturing rates and yields at competitive costs. If we can not maintain acceptable manufacturing costs in producing new products in a timely manner, our costs may be higher. This could impede our introduction of new products and negatively affect our profitability.

Maintaining product quality and performance at acceptable costs

Our ability to grow and continue to gain market share is dependent on our ability to maintain the quality and performance of our products at reasonable costs. We have invested heavily in technology and infrastructure since inception to process and reformulate recycled materials in to high quality building products. However, if we should experience any negative problems or perceptions with product quality, it could have a negative impact on net sales. We were recently sued in federal district court in Washington in regard to an alleged surface cleaning defect with one of our product lines. *See Item 103 Legal Proceedings.*

Lack of Product Diversification

Our current product lines are based exclusively on our wood/plastic composite formulas and manufacturing process for AERT composite products. With an increasing number of PVC and other non wood alternatives entering the marketplace, any market shift away from wood/plastic composites in general could have a reduced or negative impact on our sales growth.

Risks Related to Financing Our Business

Our indebtedness could adversely affect our ability to compete and produce net income

As of December 31, 2007 we had $49 million of total indebtedness. This will require a substantial portion of our cash flow to be used for interest and debt repayment. If we cannot attain substantial improvements in operating efficiencies and cost reductions, our ability to generate net income will be greatly impaired.

We may have insufficient working capital to achieve our growth objectives.

At December 31, 2007, we had a working capital surplus of $2,226,615 and at December 31, 2006, we had a working capital deficit of $3,466,130. The prior year s working capital deficit was the result of losses from operations, our decision to finance capital projects with cash generated from operations, and our need to fund rapid growth in sales. Our current positive working capital is attributable to new preferred equity and bond financings we completed in the fourth quarter of 2007, aggregating $23.5 million. There is no assurance that we will be able to maintain a working capital surplus.

We will likely need to raise additional capital in the future. If we need additional funding, but fail to obtain it, we may not be able to adequately develop and commercialize our products or improve or expand our operations.

We may need to raise additional outside financial resources in the future to effectively compete in the composite building materials marketplace, finance increased inventories, execute our current and future business plans and/or further develop and commercialize our current and future product offerings. Inability to raise sufficient outside capital would likely materially adversely impact our business, operations and profitability.

Our failure to maintain Nasdaq listing requirements could cause our common stock to be delisted.

On December 21, 2007, our Class A common stock closed at $0.78 and at that date had closed below $1.00 per share for thirty consecutive trading days resulting in a notice to us on that day that we had failed to satisfy the Nasdaq minimum closing bid price of $1.00 per share and could be subject to Nasdaq delisting procedures if such noncompliance

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is not rectified on or before June 18, 2008. If the stock price does not increase to $1.00 or more for at least 10 consecutive trading days to re-establish compliance with Nasdaq s listing requirement, the Company intends to present a plan to NASDAQ for additional time to regain compliance and/or seek stockholder approval for a reverse stock split to re-establish compliance.

The loss of our Nasdaq listing would likely reduce trading activity in our common stock and make it more difficult for stockholders to sell their shares, and the threat of such a result could have a negative or dampening effect on our trading activity until such matter is resolved. Any decreased trading activity and added difficulty in trading our stock could have a negative impact on our stock price. In addition, failure to maintain our Nasdaq listing, or to then be listed on the OTC Bulletin Board, would also result in the Series D preferred stockholders having an option to require us to redeem all of the outstanding Series D preferred stock at a price equal to 120% of its stated value plus accrued dividends. The redemption amount is payable at our option in either Class A common stock (valued at the lower of the then applicable conversion price or an average price based upon the 30 trading days preceding the redemption) or cash.

We currently have a significant number of derivative equity securities outstanding, the conversion of which could adversely impact the market price of our Class A common stock and our ability to obtain additional needed outside capital.

The conversion of a significant number of our outstanding derivative securities into Class A common stock could adversely affect the market price of the stock. At December 31, 2007, there were warrants outstanding for 3,787,880 shares of Class A common stock at an exercise price of $1.38, shares of Series D convertible preferred stock convertible into 7,575,760 shares of Class A common stock (disregarding contractual restrictions that prevent any one of the holders of such warrants and convertible preferred stock from acquiring more than 4.99% of the outstanding equity except upon at least 61 days prior notice, and disregarding additional shares of common stock that may be issued as paid-in-kind dividends on the Series D preferred stock), options outstanding for 1,521,500 shares of Class A common stock at an average exercise price of $1.59, and 502,633 restricted stock awards subject to issuance without additional consideration upon satisfaction of vesting conditions. The issuance, exercise or conversion of a material amount of such securities will result in a dilution in interest for our other security holders. The convertible securities, whether converted into stock or not, could impair our ability to obtain additional capital because of the potential for dilution. Also, the holders of such securities may be expected to exercise their rights at a time when we would in all likelihood be able to obtain needed capital through a new offering of our securities on terms more favorable than those provided by the outstanding securities.

If we raise additional funding, the terms of such transactions may cause dilution to existing shareholders or contain terms that are not favorable to us.

We may seek to raise additional funding through private placements or public offerings of our equity or debt securities. We cannot be certain that additional funding will be available on acceptable terms, or at all. To the extent that we raise additional funds by issuing equity securities, our shareholders may experience significant dilution. Any debt financing, if available, may involve restrictive covenants, such as limitations on our ability to incur additional indebtedness and operating restrictions that could adversely impact our ability to conduct our business. Furthermore, any new equity or debt securities may have rights, preferences and privileges senior to those of our existing equity holders.

Covenants in our bond agreements could restrict our ability to borrow, which could impair our ability to execute our business plan.

Certain covenants in our bond agreements restrict the types and amounts of additional indebtedness that we may incur, including a requirement that, with certain exceptions, we may only incur additional indebtedness to the extent it would satisfy a debt incurrence coverage ratio of 250% of income before interest, taxes, depreciation and amortization to debt service. Those restrictions could inhibit our ability to execute our business plan, including the improvement and expansion of our operations and facilities. Additionally, our ability to secure adequate working capital to support our day-to-day operations as we grow could be limited by the covenants in our bond agreements.

Management may be in a position to control the Company.

Directors and officers of the Company currently own approximately 36% of the outstanding Class A common stock and stock representing approximately 43% of the combined voting power of the Class A and Class B common stock, including approximately 32% of the Class A common stock and 40% of the combined voting power which are owned by members of the Brooks family.

Risks Related to Our Intellectual Property

Our proprietary rights may not adequately protect our technologies or products.

Our commercial success will depend, in part, on our ability to obtain patents and maintain adequate protection for our technologies and products. We will be able to protect our proprietary rights from unauthorized use by third parties only to the extent that our proprietary technologies and products are covered by valid and enforceable patents or are effectively maintained as unpatented proprietary technology. If we do not adequately protect our intellectual property, competitors may be able to use our technologies and erode or negate any competitive advantage we may have, which could harm our business and ability to achieve profitability. Our ability to maintain and solidify our proprietary position for our products will depend on our success in obtaining effective claims and enforcing those claims once granted.

We also rely on trade secrets to protect some of our technology, especially where we do not believe patent protection is appropriate or obtainable. However, trade secrets are difficult to maintain. While we use reasonable efforts to protect our trade secrets, our employees, consultants, contractors or other advisors may unintentionally or willfully disclose our proprietary information to competitors. Enforcement of claims that a third party has illegally obtained and is using trade secrets is expensive, time consuming and uncertain. In addition, non-U.S. courts are sometimes less willing than U.S. courts to protect trade secrets. If our competitors independently develop equivalent knowledge, methods and know-how, we would not be able to assert our trade secrets against them and our business could be harmed.

Item 1B. Unresolved Staff Comments.

We received a comment letter from the Securities and Exchange Commission dated December 21, 2007 as a result of our filing an S-3 registration statement, certain of which comments were addressed to our most recent 10K and 10Q filings. We responded to those comments on February 6, 2008, indicating to the Commission staff how we propose to respond to each such comment, and received additional comments from the SEC on February 21, 2008 including with respect to the appropriate accounting treatment of the Series D preferred stock and warrants issued in an October 2007 private placement transaction. Though we have not yet responded to the most recent comment letter, because with the passage of time it had become necessary to complete our 2007 audit before continuing with the registration statement, we believe that we have in this 10-K responded to the staff s prior comments in a manner consistent with our prior discussions with the staff as to such matters other than their comments as to (i) whether the existence of financial covenants defaults required a classification of our bond debt to short-term, and (ii) the appropriate accounting treatment for the preferred stock and warrants and, as to the latter two items, we believe the existence of waivers that we have obtained from such bondholder as well as its concurrent actions during the fourth quarter 2007 in extending substantial additional bond financing to us resulted in the continuing long term classification of such debt being appropriate, and we have in this 10-K responded to and accounted for such preferred stock and warrants in a manner that we believe to be consistent with the guidance and accounting principles to which the Commission staff was directing us, subject to our further discussion with the Commission staff.

Item 2. Properties.

We operate the following manufacturing and recycling facilities:

We manufacture our MoistureShield and Weyerhaeuser ChoiceDek brand lines of decking products at our two Springdale, Arkansas extrusion plants, Springdale North and Springdale South. The Springdale North facility also produces door and housing trim components. Springdale North had four extrusion lines and a plastic recycling facility throughout 2007. The Springdale North plant consists of a 103,000 square feet facility located on ten-acres with a rail siding in the Springdale industrial district.

We lease an office, storage building, and parking lot adjacent to the Springdale facility. The lease is renewable yearly. The office and storage facility is comprised of 10,000 square feet on 2.36 acres and houses our corporate offices.

Until the fourth quarter of 2007, our Junction, Texas facility manufactured primarily Weyerhaeuser ChoiceDek and Basics decking products; however, we suspended extrusion operations at the facility in October 2007. The raw materials department at the facility is being prepared for a new product concept for 2008. The Junction plant consists of a 49,000 square foot manufacturing and storage facility on a seven-acre site.

We operate a 45,000 square foot facility at Lowell, Arkansas, which is used for plastic recycling, blending, and

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storage, and includes a railroad loading/unloading spur, truck scale, receiving station, and finished goods storage.

We operate two 100,000 square foot warehouses in Lowell, Arkansas that are connected by rail spurs and are used for raw materials storage. We also operate a 125,000 square foot warehouse in the same complex, which is used for finished goods processing and distribution. We have signed a lease for a 150,000 square foot warehouse, also in the Lowell complex, which will be used for both raw material and finished goods handling. We also lease ten acres of land adjacent to our Lowell plastic plant for storage and load-out of finished goods; this operation is designed to load up to five railcars and ten trucks at a time.

In December 2007, the Company entered into a related party lease for the use of 60 acres in Watts, Oklahoma where we plan to build an additional plastic recycling facility.

Item 3. Legal Proceedings.

Class Action Lawsuits

On February 26, 2008, plaintiffs filed a purported class action lawsuit seeking to recover on behalf of the purchasers of ChoiceDek composite decking for damages allegedly caused by mold and mildew. (Pelletz v. Weyerhaeuser Company, Advanced Environmental Recycling Technologies, Inc. and Lowe s Companies, Inc. pending in US District Court, Western District of Washington at Seattle.) The plaintiffs filing suit on behalf of the purported class, have sued AERT, Weyerhaeuser Company, and Lowe s Companies, Inc., asserting causes of action for violation of the Washington Consumer Protection Act, unfair competition or unfair and deceptive trade practices in various states, breach of implied warranty of merchantability, breach of express warranty, and violation of the Magnuson-Moss Warranty Act. By agreement, the deadline for AERT to answer or otherwise respond to plaintiffs complaint is April 18, 2008. Weyerhaeuser has requested a defense and indemnification from AERT. AERT denies the allegations in this lawsuit and intends to vigorously defend itself.

On March 10, 2008, additional plaintiffs filed a purported class action lawsuit seeking to recover on behalf of the purchasers of ChoiceDek composite decking for damages allegedly caused by mold and mildew. (Joseph Jamruk et al vs. Advanced Environmental Recycling Technologies, Inc. and Weyerhaeuser Company in U.S. District Court, Western District of Washington.) Plaintiffs filing suit on behalf of the purported class have sued AERT and Weyerhaeuser Company, asserting causes of action for misrepresentation, violation of the Washington Consumer Protection Act, unjust enrichment, and breach of express warranty. By agreement, the deadline for AERT to answer or otherwise respond to plaintiffs complaint is April 18, 2008. Weyerhaeuser has requested a defense and indemnification from AERT. AERT denies the allegations in this lawsuit and intends to vigorously defend itself.

Energy Unlimited, Inc. vs. AERT, Inc.

This case originally started as a suit on account by Energy Unlimited Inc against AERT to collect the balance it asserts to be owed on work performed on the Springdale South facility material handling and drying systems. The claim was in the original amount of $196,868.60. AERT contends that the design and installation by Energy Unlimited Inc. was faulty resulting in a series of explosions and the subsequent need to undertake refabrication of the material handling and drying system. AERT has filed a counter claim for its out of pocket loss relating to an explosion occurring on April 2, 2007 and for the cost to fix and complete the material handling and drying systems properly in the amount of $1.2 million. This matter is in the early phase of discovery. AERT intends to vigorously defend the initial claim and pursue its counter claim based on the faulty design, improper installation, and serious safety defects of the material handling and drying systems by Energy Unlimited, Inc.

Other Matters

AERT may be involved from time to time in other litigation arising from the normal course of business. In management s opinion, this litigation is not expected to materially impact the Company s results of operations or financial condition.

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

There were no matters submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2007.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our Class A common stock is traded on the NASDAQ Capital Market System under the symbol ***AERT***. As of March 31, 2008, there were approximately 1,500 holders of record of Class A common stock and 11 holders of record of Class B common stock. The price of our common stock was $0.73 on December 31, 2007. We have not previously paid cash dividends on the common stock and there are currently restrictions under various debt obligations and our Series D preferred stock designation that would prevent the payment of such dividends for the foreseeable future. The following table sets forth the range of high and low quarterly sales prices (as reported by NASDAQ) of our Class A common stock for the years ended December 31, 2007 and 2006.

Sales price range of Class A common stock	**High**	**Low**
Fiscal 2006		
First Quarter	$2.56	$1.58
Second Quarter	3.71	1.95
Third Quarter	3.32	2.10
Fourth Quarter	2.37	1.48
Fiscal 2007		
First Quarter	2.07	1.38
Second Quarter	1.82	1.31
Third Quarter	1.72	1.27
Fourth Quarter	1.34	.70

No repurchases of common stock took place during 2007.